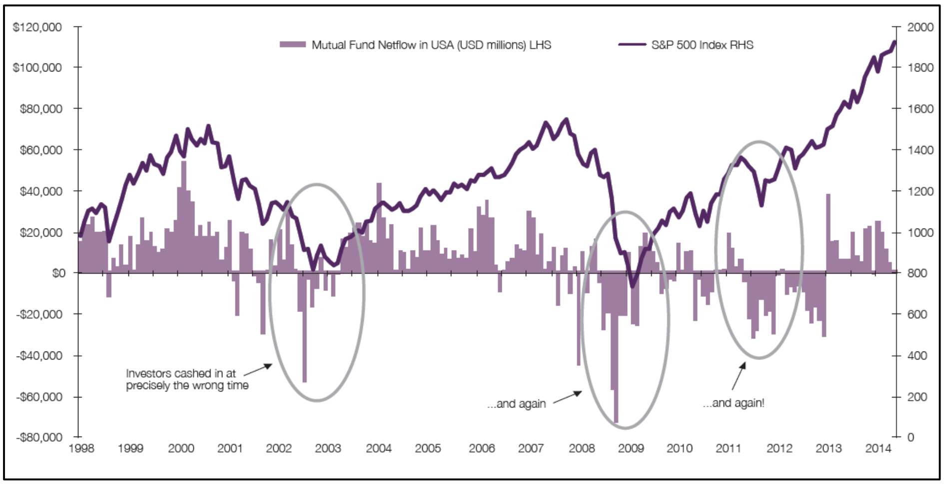
TIME-IN VERSUS TIMING
THE CASE FOR ACTIVE MANAGEMENT

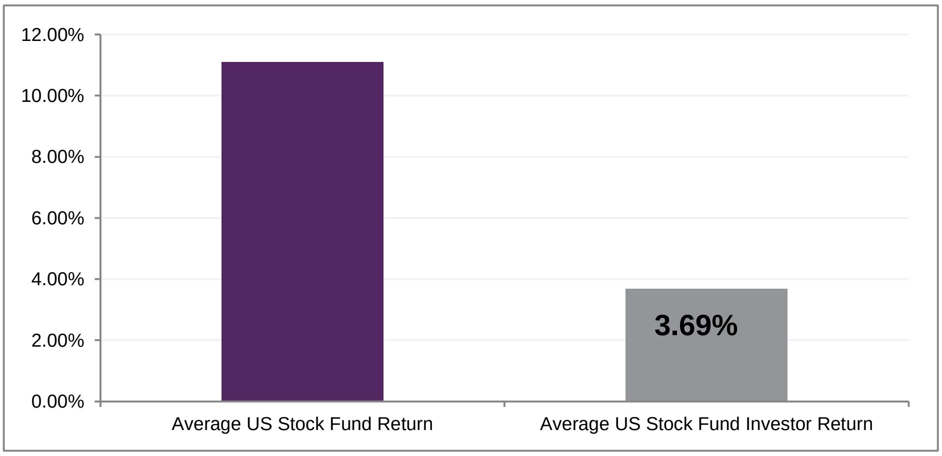
It's around this time of the market cycle that the passive-investment zealots emerge armed with historic reasons as to how active management fails to deliver. However, it is exactly this time of the market cycle when volatility increases, that active managers earn their fees – exploiting investment inefficiencies whilst individual investor emotions and the weight of money create mis-pricings.



Source: Bloomberg and ICI as at 31 May 2014

The debate about the merits of active versus passive investment management has been inflamed following the Global Financial Crisis (GFC) and the failings of outdated portfolio construction theories to preserve client wealth. The increased volatility in financial markets that followed the GFC crisis exposed the frailties of many investment approaches which failed to preserve investor wealth, and in many cases, amplified portfolio risks. The euphoria of the pre-GFC environment, coupled with inadequate research, excessive borrowing, and a poor understanding of the financial instruments being promoted were also contributing factors impacting upon investor's expectations in active investing.

Whilst the reaction of many investors to the turmoil in financial markets and innovation, to flee to the perceived safe-haven of passive investing to fulfill their various investment objectives was appropriate, they have mistaken that 'passive' investment approaches would have been effective in avoiding the mayhem. Unfortunately the findings of studies commissioned to consider the case for an active versus a passive approach have been muddied by the use of skewed statistics, questionable association of



Average US Fund Return vs Investor Return (1984-2013)
Source: Dalbar (2014)

outcomes and causes, and disingenuous extrapolation of past events. The inability of passive-enthusiasts to effectively argue against market inefficiencies, has forced them to focus on the price benefits of passive investments. The adoption of passive discussions by the advisory community, demonstrates a systemic issue of an industry that has difficulty in defining its value proposition. The end result is that intermediation soon becomes irrelevant to the consumer, if the main differentiator is price.

Whilst a passive approach may be appropriate for the circumstances of some, there is a strong case for most investors to employ a proven active approach in pursuance of their investment objectives. The concept of 'market efficiency' is erroneous, with passive investments failing to 'neutralize' risk, and introducing significant 'concentration risk' and benchmark risk (and, in relation to exchange-traded funds, counterparty risk) to investors. Active management allows 'risk' to be managed appropriately in the context of investors' specific objectives