momentum

Press release

Passive investments take off as RDR begins to bite – but investors still need to do their homework

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A new report released today reveals the growth of passively managed funds in portfolios – but argues investors are too often lulled into a false sense of security with passive funds.

The report by Momentum Global Investment Management in conjunction with Scorpio Partnership revealed that in the last three years over 50% of wealth advisors had introduced a passive solution for their clients' portfolios.

The results of the survey of 40 wealth managers and independent wealth advisors comes as RDR begins to squeeze IFAs margins, which has in turn caused the low fees associated with passive solutions to become increasingly attractive.

The report argues that while going passive funds can be very useful, if passive investing is to be a core part of a portfolio investors need to fully understand what they are buying. The report argues in niche areas, like credit and commodities, passive solutions differ widely and also are sometimes no cheaper than active management.

By contrast the authors still find a few areas of the investing world where, contrary to popular opinion, active management continues to yield sustainable outperformance to a majority of active fund managers. These tend to less efficient asset classes such as the small cap area.

Commenting on their view, Christopher Mahon, Head of Investment Strategy at Momentum GIM said, "Too often the active vs. passive debate is dominated by active and passive fund managers on opposing sides. They can hardly be blamed for a bias towards their own style of management but we hope with this report to give investors a more rounded opinion on the issue"

The report suggests a number of key principles in the active vs. passive debate

- Appropriate asset allocation is still required with both active and passive solutions. Whether asset allocation decisions are done implicitly through choice of benchmarks or explicitly through active asset class positioning, such decisions will often dominate performance. As such investors, even in passive solutions, need to think carefully about constructing an appropriate asset allocation strategy. This also needs to reflect the state of the markets (valuation and economics) as well as the investor's requirements.

- In order to find asset classes that can yield sustainable outperformance for active management, investors should consider the efficiency of any particular asset class.

- Efficiency is the speed at which information is reflected in prices and the ability to consistently gain from thorough and detailed research.

- Active management tends to be more likely to deliver outperformance in less efficient asset classes such as the small cap equity space. By contrast sustainable outperformance is more difficult to achieve in more efficient asset classes such as government bonds.

- Passive solutions work better in mainstream asset classes. In more niche areas passive solutions can be expensive or come with hidden drawbacks. For example in mainstream asset classes such as government bonds the index can be replicated easily without structural issues. Passive investing is more problematic in areas like credit or commodities. In these areas investors need to do extensive due diligence before selecting a passive solution.

- Passive solutions vary widely, and investors should not be led into thinking they are all the same. On issues such as fees, tax, liquidity and risk, passive offers differ enormously.

Mr. Mahon concludes "Going passive is not the simple solution many investors hope it might be. While passive funds can be a very effective way to fulfil specific needs investors still need to do their homework and think through their investing decisions fully."

A copy of the full research findings can be viewed at www.momentumgim.com.

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Notes to editors

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