

## FORRESTER-HYDE LTD

### ACTIVE V PASSIVE INVESTMENT MANAGEMENT

#### Introduction

The debate about the relative merits of Active versus Passive Investment Management is ongoing and widely reported in the financial press. The argument for Passive Management is that a tracker fund will, as the name indicates track a sector up and down. Because the fund is not actively managed, the charges are lower. The Active Investment Manager will seek to justify higher charges claiming they add value.

At Forrester-Hyde Ltd we do not see conflict but instead see the two methods complementing each other and both are incorporated in the portfolios that we design, install and manage for our investment clients. The Passive Fund is the blunt instrument delivering a core strategy at a lower AMC, complemented by Actively Managed Funds, which focus on specific markets and investment strategies. The additional level of expertise required warrants a higher AMC, but there is a place for both strategies in a diversified portfolio.

Looking at each in turn.

- **Active Fund Management**

Active Fund managers believe there is a degree of market inefficiency and a combination of experience, in depth research and skill will enable them out-perform both the benchmark and their rivals. Out-performance is achieved by a combination of stock selection, sector weighting and market timing.

#### Advantages

- The best Active Funds have out-performed the market index hugely over the long term.
- Active Funds are not tied to the stock or sector weightings of an index.
- An Active Investor can choose from many management styles and strategies to best suit their investment goals and attitude to risk.
- Active managers can take a broader perspective when investing looking at key trends that may affect companies' prospects.
- They are able to target specific aims such as income, growth or fundamental value.
- Can react quickly to specific company risk such as the recent collapse in BP share price.
- Some managers have demonstrated they have the skill to seek out strong Companies and preserve value for unit holders compared to market benchmark.
- These funds do not have to subscribe strictly to a mandate and have the ability to change strategy in variable market conditions.
- The Fixed Income sector is more sensitive to economic change and pricing can be more subjective.

#### Disadvantages

- Actively managed funds attract higher Annual Management Charges.
- They may also incur higher transactional costs as the manager is likely to make more trades than a Passive Fund manager.
- Research demonstrates that developed Equity markets are highly efficient and more difficult to out-perform. For an active strategy to work the manager must consistently beat the benchmark. Over ten years approximately 49% of Active Fund managers produce total returns in excess of the market benchmark.

- **Passive Fund Management**

The manager of a Passive Fund subscribes to the theory that markets are efficient, which is to say that all information is available to all participants and is priced in accordingly. Passive or "index" investing is a strategy that aims simply to match the returns from the stock market, as measured by an index such as the FTSE 100. The Passive manager does not, therefore, seek to gain an advantage by actively selecting mis-priced stock, nor does he seek to time the market. Perhaps the main attraction of Passive Funds is that charges tend to be lower.

### Advantages

- Lower charges, the total expense ratio of Passive funds can be as low as 0.27%.
- Timing risks will not affect performance and Passive funds are unlikely to under-perform the market index by a significant margin.
- You know what stocks will be in your fund.
- Performance will not be disrupted by a change in management.

### Disadvantages

- You are restricted to investing in a near replication of a market index and hence only have potential to earn the average rate of return.
- There is little or no potential for a Passive Fund to out-perform the market.
- Lack of diversification can have a negative impact. In April 2008 40% of the FTSE 100 comprised just two sectors, Oils and Financials. If either sector performed badly this would have had a negative impact on the Fund.
- A Passive Fund manager is required to rebalance in line with the index and maybe forced to sell shares which may be at their cheapest when dropping out of the index and buy shares at their most expensive when they are admitted to the index.

### Summary

At Forrester-Hyde Limited we follow a four step approach to advising, installing and maintaining an actively managed portfolio for our investors, see:-

[www.forrester-hyde.co.uk/static\\_content/bespoke/4827/Guide%20to%20Making%20Investment%20Decisions.pdf](http://www.forrester-hyde.co.uk/static_content/bespoke/4827/Guide%20to%20Making%20Investment%20Decisions.pdf)

Our fee model is designed to treat our customers fairly and is entirely transparent with our Firm rebating commission to investors in exchange for fees that are either fund based or time cost. This avoids any criticism of commission bias and means that investments are purchased on wholesale terms. Further, we register investment on an electronic back office platform to facilitate online trading which reduces time out the market and speeds transactions. We design, install and maintain portfolios to match an investor's appetite for risk and volatility.

Our portfolios include Passively Managed Funds where appropriate and these serve to lower the average Annual Management Charge. Actively Managed Funds are appropriate when investing in markets that are not efficient, such as Emerging Economies, Smaller Companies and in Fixed Interest Securities, where there is opportunity for specialists with market knowledge to secure returns above the benchmark.

In conclusion, we believe that Active and Passively Managed Funds complement each other and there is a place for both in a diversified portfolio. Forrester-Hyde Limited Investment Committee meets at least monthly and more frequently when circumstance dictates. The group is chaired by Rob Marek, Investment Manager and the Committee embrace both Active and Passively Managed Funds, believing there is a place for both strategies in the portfolios we maintain for our clients.

#### **IMPORTANT NOTICE**

This is the view of Forrester-Hyde Ltd's Investment Committee as at the date of publication. Investment markets and conditions can change rapidly and as such the views expressed should not be taken as a statement of fact, nor should reliance be placed on these views when making investment decisions. Past performance is not a reliable indicator of future results. Virtually any investment other than Cash on deposit in a Bank or Building Society can fall as well as rise in value and you may get back less than you originally invest.

#### **Forrester-Hyde Ltd**

Authorised and Regulated by the Financial Services Authority  
19 Clifftown Road, Southend-on-Sea, Essex SS1 1AB  
Tel: 01702 432532 – Fax: 01702 431466  
Email: [Postmaster@forrester-hyde.co.uk](mailto:Postmaster@forrester-hyde.co.uk)  
Web: [www.forrester-hyde.co.uk](http://www.forrester-hyde.co.uk)