Active Vs 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 an index. As the fund is not actively managed, the charges are lower. By contrast, the active investment manager will seek to justify higher charges by hopefully adding value through out-performance of the index.

At Forrester-Hyde Ltd we do not see conflict but instead, believe both methods can have their uses.

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 to out-perform both the benchmark index 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 significantly 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.
- 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 incur higher transactional costs as the manager is likely to make more trades than a passive fund manager.
- Research demonstrates that developed equity markets can be highly efficient and more difficult to out-perform. For an active strategy to work the manager must consistently beat the 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 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 mispriced stock, nor do they seek to time the market.

Advantages

- Low charging structure.
- 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. E.G. 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 might be forced to sell shares perhaps at their cheapest when dropping out of the index, or buy shares at their most expensive when they are admitted to the index.

Key Features

	Active	Passive
Objective	• To outperform a selected market	• To track a selected market
Technique	• Stock pick stronger performing companies • Market timing • Optimise asset allocation • React to macroeconomics	• Replicate market
Benefit	• Chance of outperformance • Active manager is monitoring your investment	• Low cost

At Forrester-Hyde, our objective is to combine investments which complement each other with the intention to deliver consistent performance over the long term, without exposure to unnecessary risk. We provide a range of Model Portfolios which vary in their mix between Active and Passive investment strategies and that cover the risk/ reward spectrum. There is a place for both types of strategy and fundamentally whether Active or Passive is correct for an investor is dependent on individual circumstance, requirements and objectives. Please contact your adviser for further information on investing and the strategies which we offer.

This Report is designed as a tool to help Clients understand the Markets and support their decision making. It represents the views of Forrester-Hyde Limited based on research at the date of this document and this is subject to subsequent change. This document has been produced for information only and as such the views contained herein are not to be taken on a sole basis for advice or recommendation to buy or sell any investment. The information provided should be used in conjunction with other information provided to substantiate a recommendation. The results of the research are based on data provided by third parties and not Forrester-Hyde Limited. The forecasts, figures and opinions and statements of financial market strategies are considered to be reliable at the time of writing but not necessarily all inclusive and are not guaranteed as to accuracy. Both past performance and yield may not be a reliable guide to future performance and you should be aware that the value of real assets and subsequent yield arising from them may fluctuate in accordance with market conditions. There are no guarantees that the forecast made here will come true and are merely a reasoned judgement made by the Forrester-Hyde's Investment Team based on their research. Forrester-Hyde are authorised and regulated by the Financial Conduct Authority. Registered in England No: 6455894. FCA number 476495.