

time to get active?



Simon Wood, Investment Director in the SWIP Multi-Manager Team and co-manager of the SWIP Multi-Manager Diversity Fund, makes the case for active management.



for financial advisers only

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The argument on active and passive fund management is a long-standing one (see Graham Bentley's article 'active on passive' article from March 2009 Informer). Historically, those in the passive camp claim that the majority of active managers fail to beat their benchmark indices and investors would be better off putting their money into index-tracking funds. By their very nature these funds are inextricably linked to market movements, with the added attraction of comparatively low management fees.

However, the volatility of equity markets in recent times has underlined the danger of relying too heavily on market performance, lending weight to the argument for active management. This is because active funds are in a position to take advantage of tactical investment opportunities such as purchasing under-valued stocks, shifting to more stable defensive-market sectors or increasing allocations to cash. Tracker funds don't possess this flexibility, leaving investors fully exposed to any market downturn.

risk of under-diversification

In the current environment, many investors are understandably trying to minimise risk and diversify their holdings. The stock composition of the majority of benchmarks and the funds that track them, however, may not help this process. Most major indices are heavily influenced by the performance of a handful of huge companies, with the phenomenon particularly pronounced in the UK. At the end of December 2008, for instance, just ten companies made up 53% of the FTSE 100 index.

Typically, some of these stocks are likely to be large companies within the energy and pharmaceutical sectors, preventing investors in tracker funds from achieving a broad spectrum of risk. A fund manager running a portfolio with the objective of tracking the FTSE must hold substantial amounts of these stocks – even if he or she doesn't believe that any of them will perform especially well.

As a result, it has become much less appealing for investors to pay for direct

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exposure to this level of risk via a tracker fund, when instead they could choose to invest in an actively managed fund which has the ability (through stock selection) to avoid such pitfalls.

adding value

Of course, these arguments aren't restricted to the management of equity funds. Active management can add value and help preserve investors' capital across a range of investments, and in the current environment many investors are choosing to diversify their holdings across as broad a range as possible.

As managers of the SWIP Multi-Manager Diversity Fund, we look for the best managers across bonds, commercial property, funds of hedge funds and commodities. By investing in a wide selection of assets and engaging in active asset allocation, it is possible to take advantage of the low correlation that many of these asset classes have with each other. This helps to smooth returns, reduce volatility and lessen the effects of the market's peaks and troughs. Our emphasis on absolute returns and capital preservation means we have a corresponding lack of interest in relative returns and peer group comparisons.

good from the bad

There are of course good, bad and indifferent managers in all these asset

classes. Multi-managers research the thousands of funds available and pick the most appropriate funds from the best investment houses. Depending on market conditions, it is possible to blend these funds in a way that will create strong, consistent returns.

We aim to choose the managers that, over a significant period of time, will have added substantially to what could have been achieved through buying an indexed fund. We believe that at the top end of fund management past performance does, in fact, persist. We prefer managers who aim to beat their benchmark without using it as a guideline for managing their own fund's holdings; if, for example, an equity fund manager doesn't like banks, they wouldn't hold any regardless of the benchmark.

sound philosophy

Active management of a diverse portfolio is a very sound investment philosophy to adopt, particularly in current market conditions. Managers with the conviction to move away from the benchmark when they feel it is appropriate, for example moving into cash to preserve capital, are the best placed to withstand the type of vicious market sell-offs we have seen recently. Of course, great skill is required to take advantage of such market movements, and this is where a multi-manager's thorough research and

knowledge of the best managers in the market proves vital.

In particular, it is important to look at the experience of fund managers during different market cycles. By amassing substantial background data and assessing how funds have performed in different conditions in the past, we can then make a judgement on the funds that are in the best position to make a positive return against any market backdrop.

There is still a place for tracker funds, for example in combination with actively managed funds as part of a balanced portfolio. But for those investors that want the best chance of achieving consistently strong returns regardless of prevailing market conditions, a diverse, actively managed fund of funds run by managers with the expertise to find the most appropriate funds in the market could be their best option. The dual attractions of true diversification and the ability to target consistent, positive returns make an actively managed, diverse multi-manager fund a highly attractive proposition. ●

The SWIP Absolute Return Bond and SWIP Multi Manager Diversity Funds are now available through Skandia's Selestia Investment Solutions platform and Life and Pensions fund ranges.

The Skandia fund will not mirror the performance of the underlying fund because of Skandia fund charges, taxation adjustments (if appropriate) and the Skandia investment process.

actively managing diverse portfolios

It is important to have an experienced team with the expertise and resources to actively research the market and locate the managers who consistently add value year in, year out. Our five-strong multi-manager team has 0041 29-0487 been working together for six years, utilising a proven and robust investment process for selecting funds.

The best multi-managers should be able to design portfolios to achieve target

returns while keeping risk to a minimum. It is not just about picking the top performing fund in each sector, but about combining the right funds with complementary characteristics. By doing so, it is possible to achieve desired returns in a consistent, risk-efficient manner.

Multi-managers who actively scour the market for the best funds can often gain access to funds that may not be marketing themselves to the average retail investor.

These are often run by investment companies able to pursue an investment style unhindered by centralised asset allocation or investment processes. Access to these funds, which are sometimes highly specialised in nature, can prove very beneficial – particularly in times of extreme volatility. Exposure to these funds can further aid diversification, and if they are skilfully selected they can improve investors' prospects of achieving consistent, positive returns.

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