Active vs. Passive

Russell Investments

Room for both?

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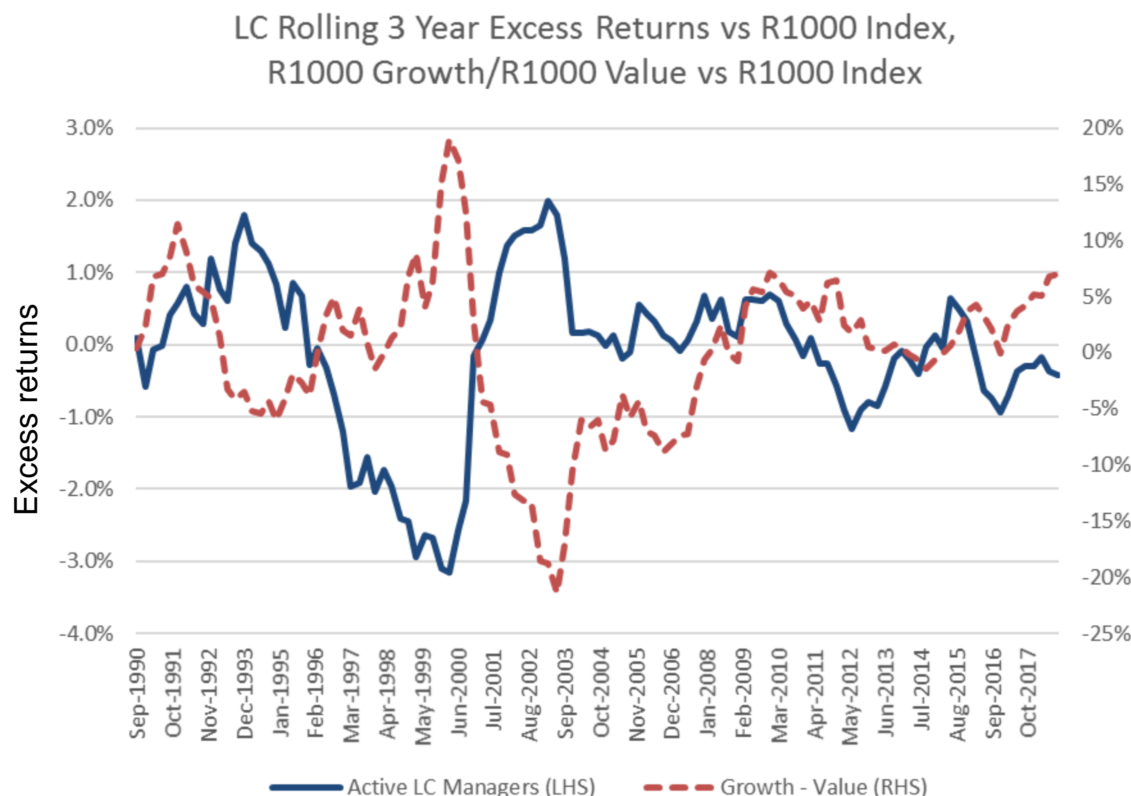
What are the decision points?

1. Philosophy
2. Market environment - is the ground fertile?
3. Factor and mean reversion beliefs
4. Cost of active and passive
5. Performance of passive
6. Asset class availability
7. Frequency of trading
8. What is the fee budget and where is it best to spend it?
9. Desire for excess return versus risk aversion

The active management cycle

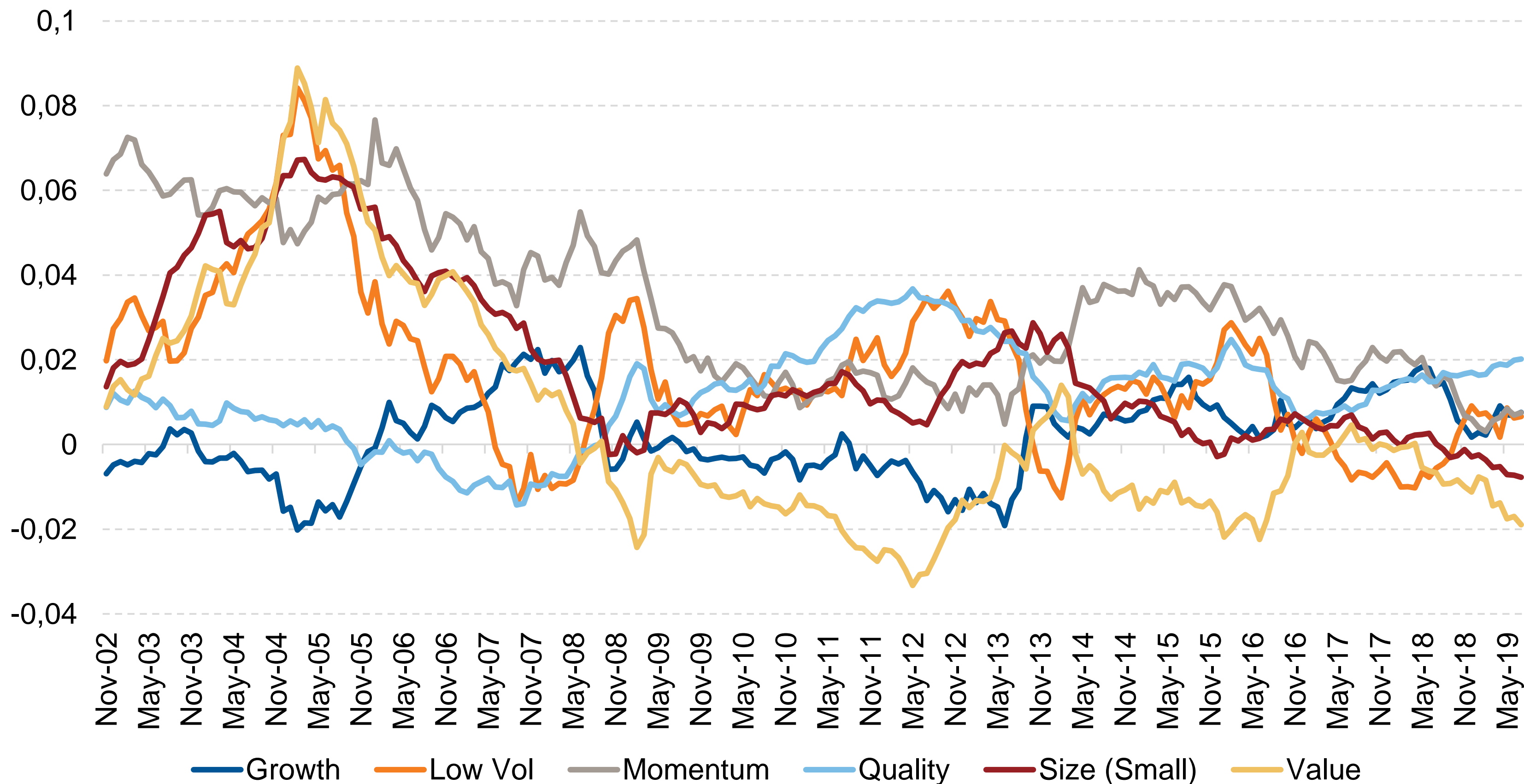
Fundamentals don't always matter



- Active managers' excess returns tend to be inversely correlated with performance of growth stocks.
- The majority of active managers select stocks on a combination of fundamentals (e.g. balance sheet strength, earnings growth) and valuation, less so on trends and momentum.
- Periods of growth leadership can be extended, however periods where fundamental stock selection is rewarded are similarly durable.

Source: Russell Investments active management universes (equal weighted combination of market, price and earnings), gross of fees.

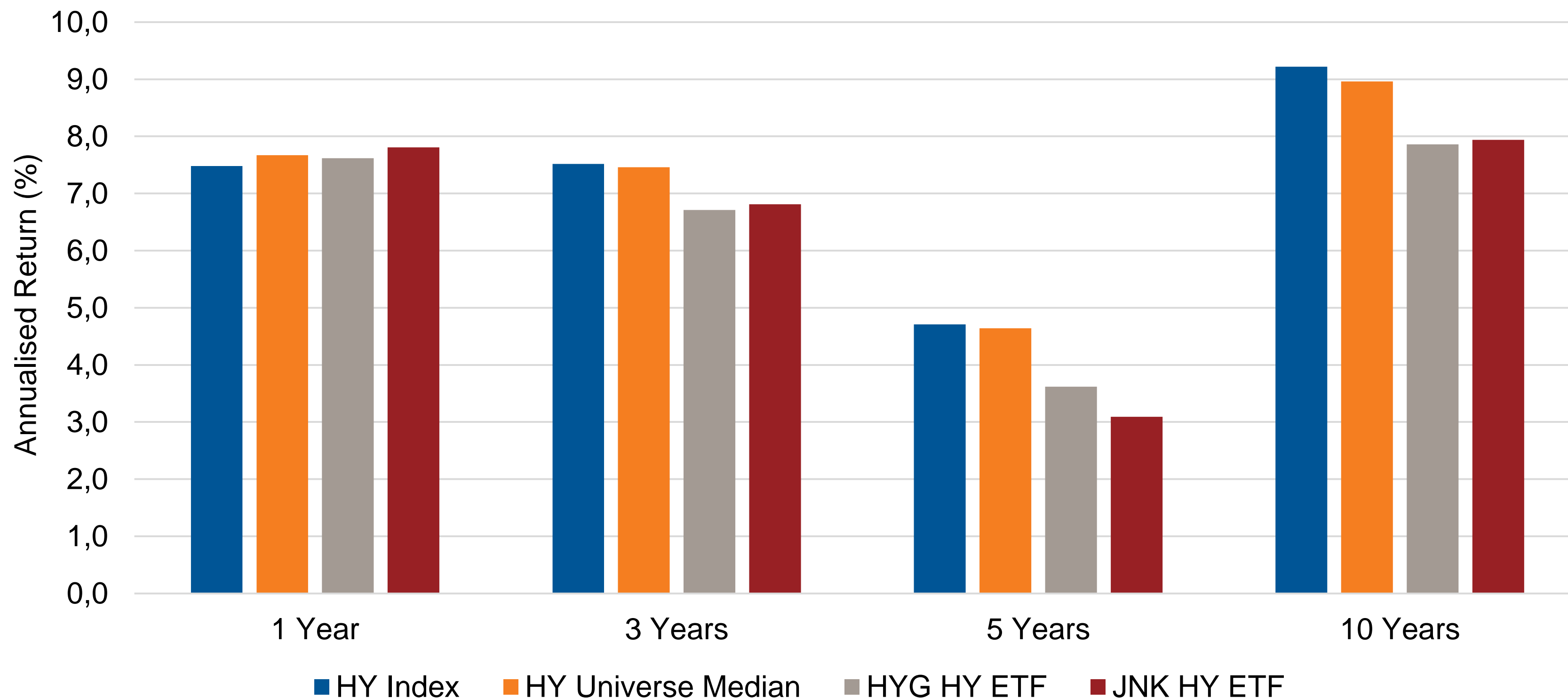
A third way



Source: Russell Investments, data as at 31 July 2019.

A different debate for a different asset class

High yield bonds



Source: Russell Investments, data as at 30 June 2019.

Not all passive is created equal

Futures vs. ETF's

Jun-Sep Roll Cost			Average Historical Roll Cost		
Index Name	Region	Average	1 yr avg	2 yr avg	3 yr avg
MSCI ACWI*	Global	0.05%	0.08%	0.20%	0.22%
MSCI EM**	Global	-0.41%	0.07%	0.32%	0.44%
MSCI EAFE**	Global	0.03%	-0.15%	-0.03%	0.10%
S&P 500	Americas	0.17%	0.13%	0.27%	0.27%
Russell 2000	Americas	-0.03%	-0.08%	-0.01%	-0.07%
S&P Midcap 400	Americas	0.13%	0.07%	0.23%	0.23%
S&P/TSX60	Americas	-0.27%	-0.31%	-0.24%	-0.17%
Euro Stoxx 50	Europe	0.04%	0.20%	0.12%	0.16%
FTSE 100	Europe	0.27%	0.12%	0.13%	0.22%
CAC 40	Europe	-0.01%	-0.04%	-0.02%	0.06%
DAX	Europe	-0.11%	0.17%	0.10%	0.14%
Topix	Asia	-0.24%	-0.27%	-0.20%	-0.17%
S&P ASX200	Asia	0.40%	0.08%	0.20%	0.22%

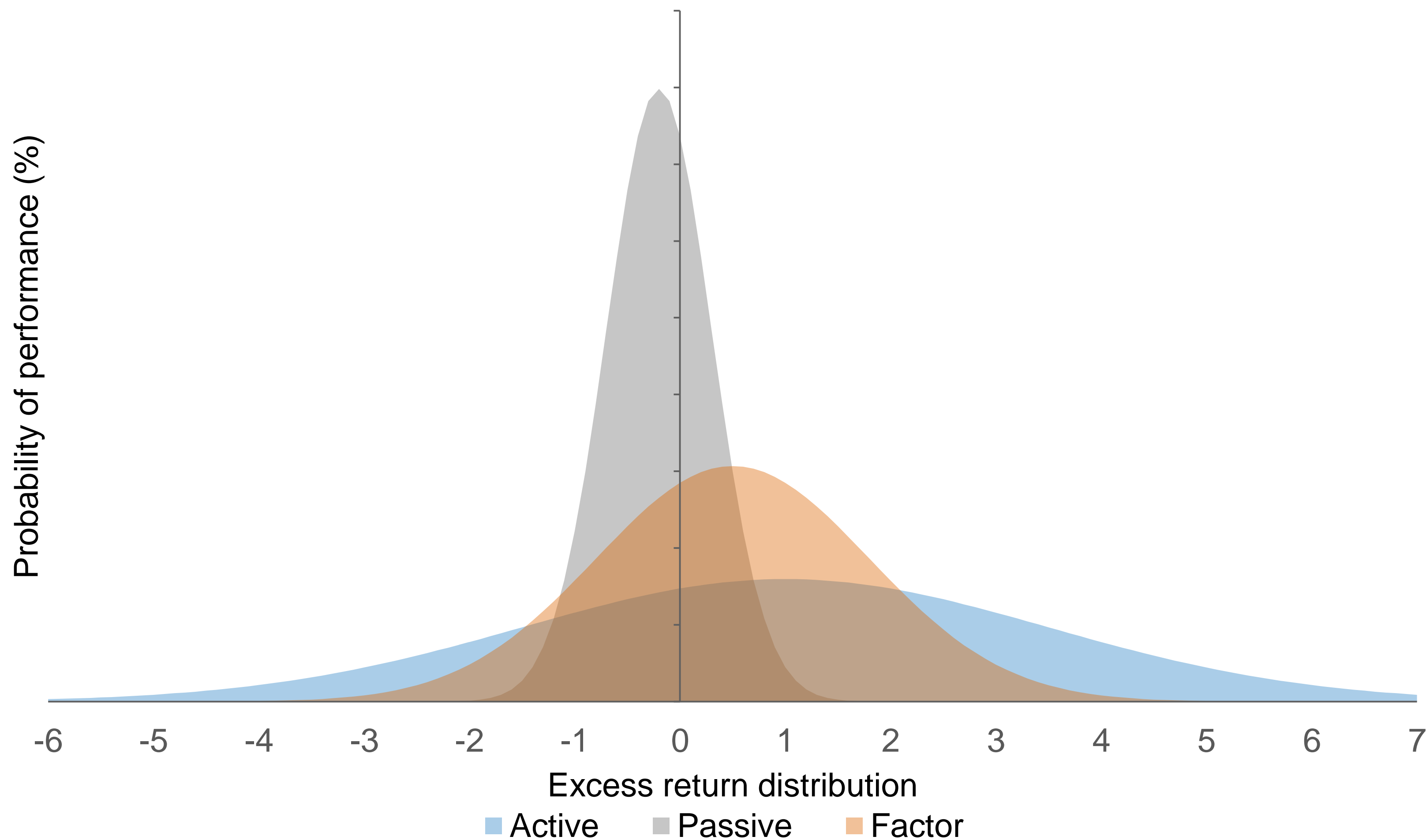
Source: Bloomberg, all mispricing values are annualised and calculated using forecasted gross dividends except for MSCI EM and EAFE which use estimated net dividends (i.e. estimated gross dividends less foreign tax withheld). A negative number indicates discount to fair value, a positive number indicates premium to fair value.

* MSCI ACWI roll cost is calculated using a proxy nine contract global futures basket where roll cost data is available.

**MSCI EM and EAFE historical roll costs prior to the June 2019 roll are based on net dividend assumptions provided by BAML.

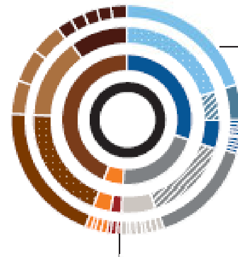
Fee budgeting and risk aversion

Understanding the trade-offs



Source: For illustrative purposes only.

Hybrid balanced model strategy



Three investment approaches

- 40% Active investing to help increase return potential
- 20% Multifactor investing to help target specific factor exposures
- 40% Passive investing to help capture market return with low costs

4 Asset Classes

30% U.S. Equity			21% International Equity		5% Alternatives		44% Fixed Income		
10 Funds									
PASSIVE	MULTIFACTOR	ACTIVE	MULTIFACTOR	ACTIVE	ACTIVE		PASSIVE	ACTIVE	
20% iShares® Core S&P 500 ETF	5% Multifactor U.S. Equity	5% U.S. Small Cap Equity	15% Multifactor International Equity	6% Emerging Markets	2% Commodity Strategies	3% Global Real Estate Securities	20% iShares Core U.S. Aggregate Bond ETF	14% Investment Grade Bond	10% Opportunistic Credit[6]
33 Manager Strategies									
BlackRock®	RIM†	Ancora[1]	RIM†	AllianceBernstein[1]	Mellon Capital	Cohen & Steers[1,3]	BlackRock	MIM[8]	Barings[7]
		Boston Partners[1]		Consillium[1]	PIMCO	Morgan Stanley[1,4]		Schroder	DDJ
		Calamos[1,2]		Neuberger Berman[1]	RIM†	RREEF America[1,5]		RIM†	DuPont
		Copeland[1]		Numeric		RIM†			Voya
		Falcon Point[1]		Oaktree[1]					RIM†
		Jacobs Levy		Westwood					
		RIM†		RIM†					

WHAT IS A 'FACTOR'?

Factors are simply specific, single attributes of investable securities, such as security's size, value, momentum, quality, low volatility. Understanding and actively managing these factors can both potentially drive returns and manage risk within a portfolio. RIM multifactor funds, Multifactor U.S. Equity Fund and Multifactor International Equity Fund, emphasize dynamic management of multiple factors.

*Effective 1 March 2019, the Global Opportunistic Credit Fund was renamed to the Opportunistic Credit Fund.

Source: Russell Investments, data as at 30 June 2019.

Base the conclusions in research

A Model for Building a Lower-Cost Portfolio Using Active, Passive, and Smart Beta Products

by Sam Pittman, Ph.D. Head of Retail Solutions, Global Client Strategy and Research

Published in the Journal of Financial Planning - June 2017

Thank you.

Any questions?

Important information

For professional clients only

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