Less is More

There is a growing school of thought, supported by academic research mainly from the USA, that many of the traditional activities of the fund management industry actually achieve nothing, other than making the funds more expensive, to the detriment of investors. A certain "fund management company" is now marketing its funds here, only through fee-based financial planners, on the basis that by not actively "managing" the investments within its funds, it will achieve superior returns.

Their stance is based upon a few claimed "home truths" about investment, apparently supported by persuasive academic research. These can be briefly summarised as:

- The vast majority (over 90%) of variation in investment returns attributable to investment decisions are attributable to the asset-allocation decisions, rather than stock-selection, market-timing, manager-selection, vehicle, geography etc. By "asset-allocation" we mean whether to be in property, fixed interest, cash, or shares etc.; not which ones, or when to buy & sell them.
- "Investment Managers" fall into the "active" and "passive" management camps. "Index-Trackers" are a sub-set of passive managers, but do have to trade to match their index.
- "Active managers" buy and sell, select stock and timing etc. and cost more than passives.
- "Passive managers" buy and hold the asset class without trading much, and cost less.
- Most Active Managers (over ¾) tend to underperform the market index which they aim to beat. The incidence of those who beat it can be attributed mainly to chance.
- Some of the core activities of "Active Managers" can be shown to be worthless. It is claimed that one can show that:
    - Stock selection adds no value in the long term over holding the whole market
    - Market timing doesn't work. It's unpredictable.
    - Interest rate movements and currency exchange rates are unpredictable

  (It may come as an unwelcome shock to some to find that large sectors of the fund management industry throughout the World are allegedly useless. One might expect resistance to these claims from those with a vested interest.)

- Consequently, it is claimed that one cannot justify the extra costs, or indeed the existence of "Active Managers" - so funds should therefore be held in ultra low-cost "Passive" funds.
- These needn't be "Index Trackers", which still have to trade stocks, so do incur dealing commissions, and also omit dividends, which can be a large part of returns, especially here. They can simply buy and hold most/all of a market to give asset class exposure.

In addition, research allegedly firmly establishes that:

- Equities tend to outperform fixed interest, inflation and cash, medium to long term
- Commercial Property lags closely behind Equities in this regard, though is not correlated, and shows less volatility.
- Small Capitalisation stocks tend to out-perform Large Capitalisation stocks
- "Value" investment styles out-perform "Growth" styles.
- Emerging Markets show higher risk/return characteristics than established markets
- Short-dated Gilts show lower volatility, though similar returns to Long Dated Gilts
- As they return less than Equities, and timing is unpredictable, the only reason for holding Gilts is to reduce volatility (and return).

On the basis of these findings, a range of "Passive Funds" exists with nil commission, minimal charges, and no active management, to buy and hold certain markets at minimal cost (with some specific investment exclusions). Exchange Traded Funds (ETFs) also have a part to play in this investment philosophy, with even lower costs. Having *less* management may give you *more* gain.

Action: The convert to "asset-class investing" may be interested in seeking advice about their suitability and identity. My contact details are enclosed.