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# Active investment: The certainty of uncertainty.

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Head of Investment Sales, New Ireland Assurance.



***In 2014 Buffett outlined some terms  
he included in his own Will...***

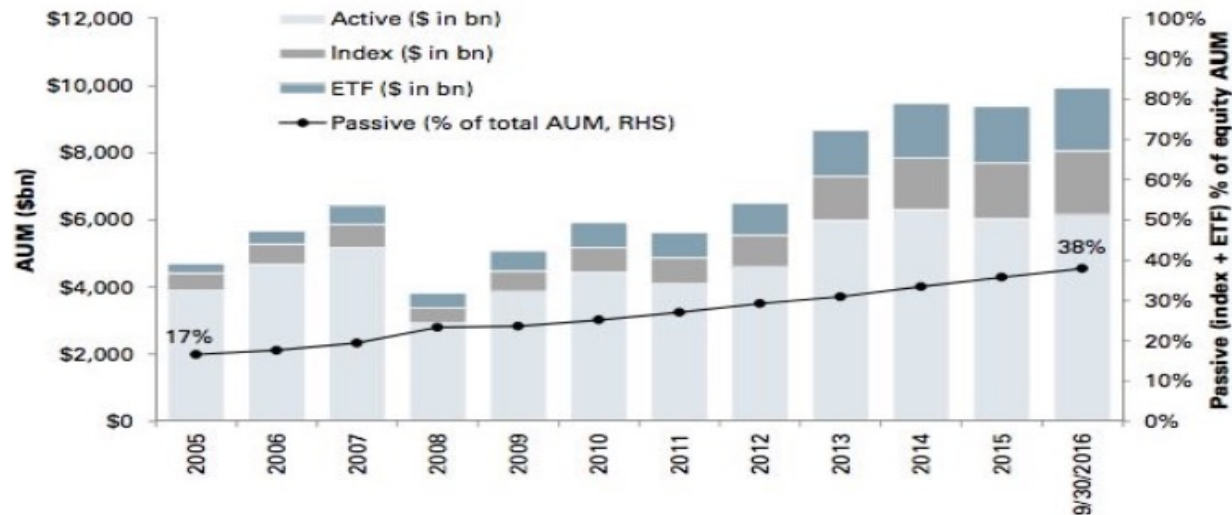
*"My advice to the trustee could not be more simple:*

*Put 10% of the cash in short-term government bonds  
and 90% in a passive fund tracking the S&P 500...*

*I believe the trust's long-term results from this policy  
will be superior to those attained by most investors"*

# It seems like many investors are listening!

**Exhibit 1: Passive investing accounts for nearly 40% of total US equity AUM, more than twice the level in 2005**  
AUM of US-domiciled equity mutual funds, index funds and ETFs; passive share of total AUM



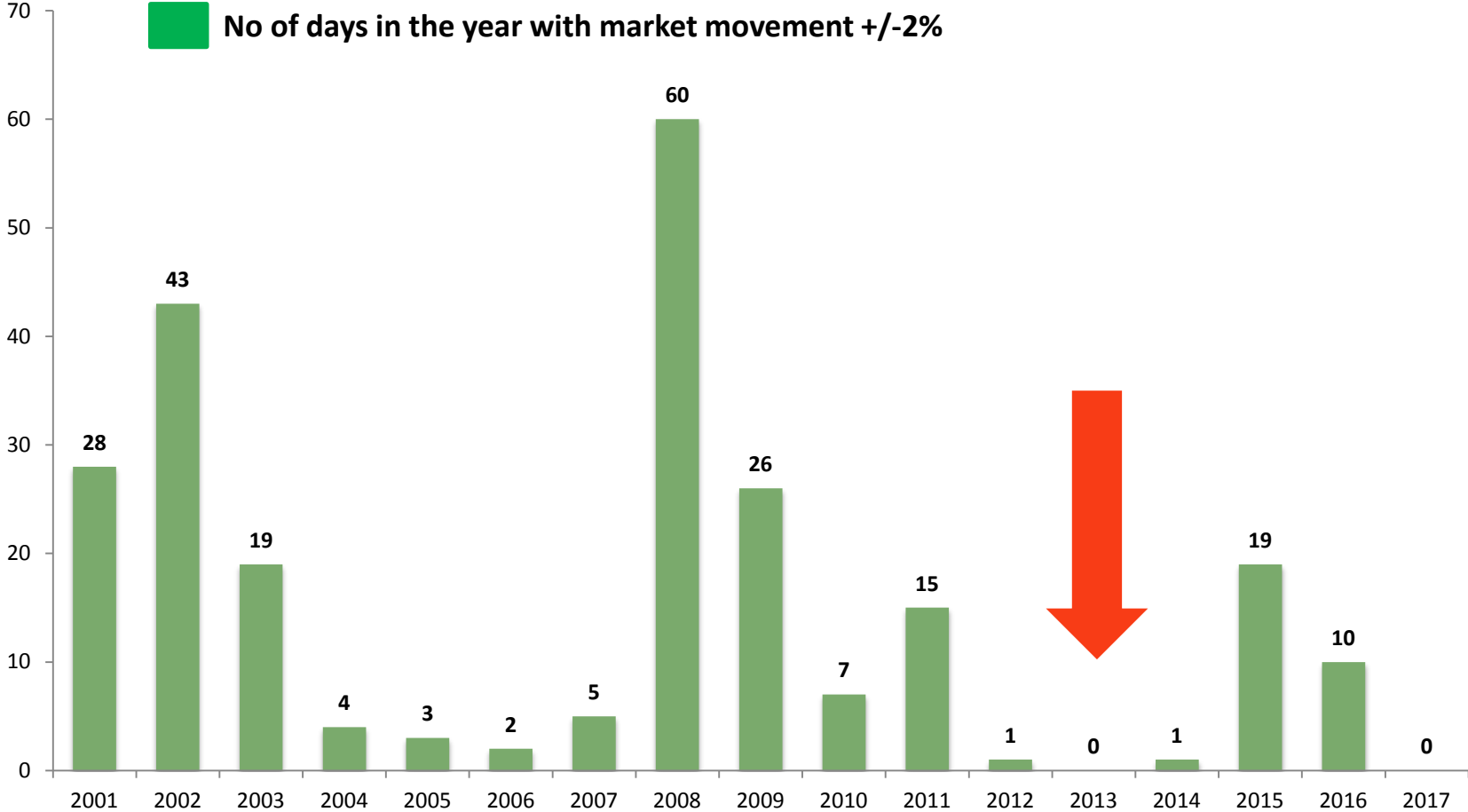
Source: Strategic Insight, Goldman Sachs Global Investment Research.

# The core principles of Active Management.

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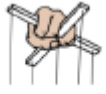
- Fund managers aim to produce returns *greater than* an underlying market index such S&P 500 **Equity** index or IBOX **Bond** index.
- Believes it's possible to profit from '***mispriced***' securities. (*Markets are inefficient?*)
- Not always compelled to follow a **benchmark**, active managers have greater flexibility to try to *manage risk*. (*Active share important here!*)
- Can benchmark **Absolute** rather than **relative** returns. (Relative when positive, Absolute when negative!)
- Success depends on the **skills** of the underlying fund manager.

# A calm number of years for equity investors!

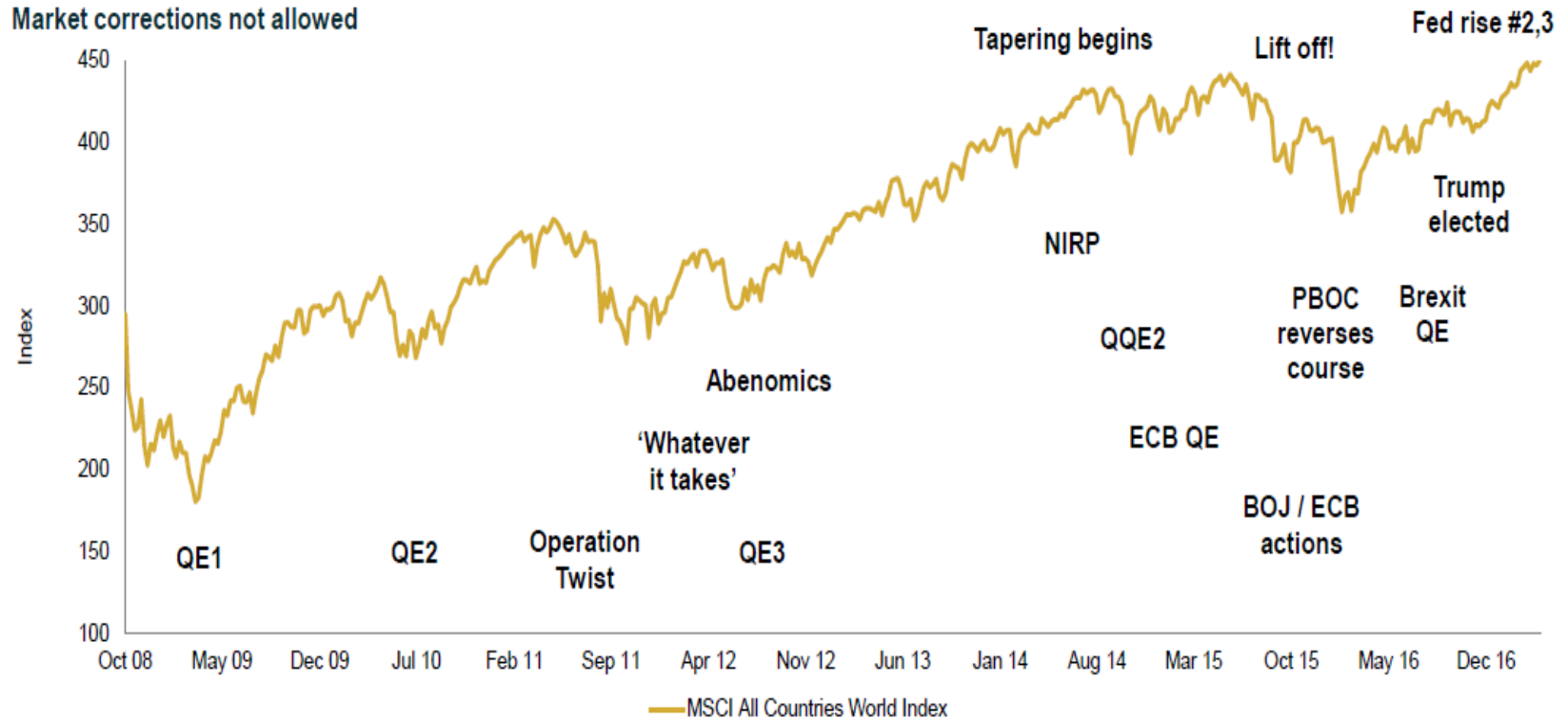


Source: SSGA. Developed Market Equity returns 22/02/17

# Setting policy to suit markets, is this 'normal'?



State intervention



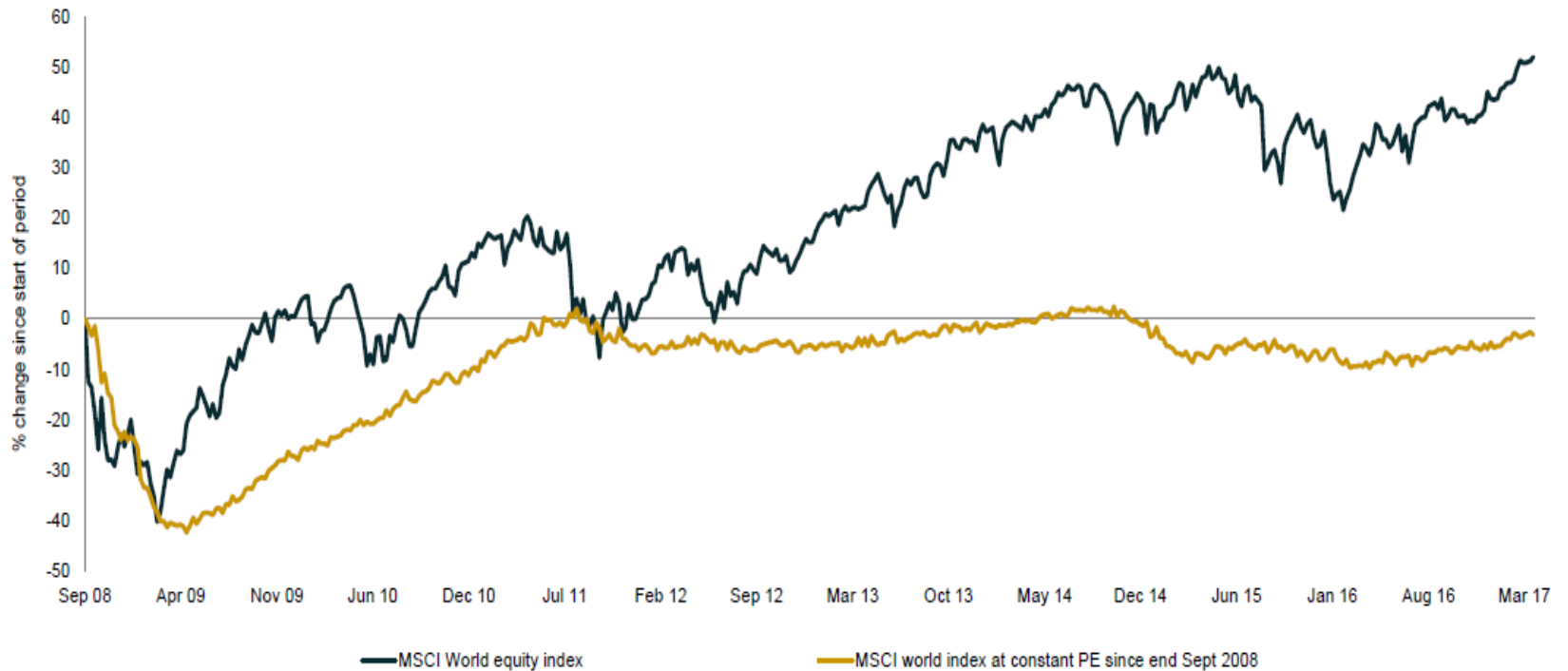
Source: Datastream, Newton, 29 March 2017.

Free markets, so long as the direction is up?

# Capital gains run ahead of earnings



Equity prices rise without earnings growth



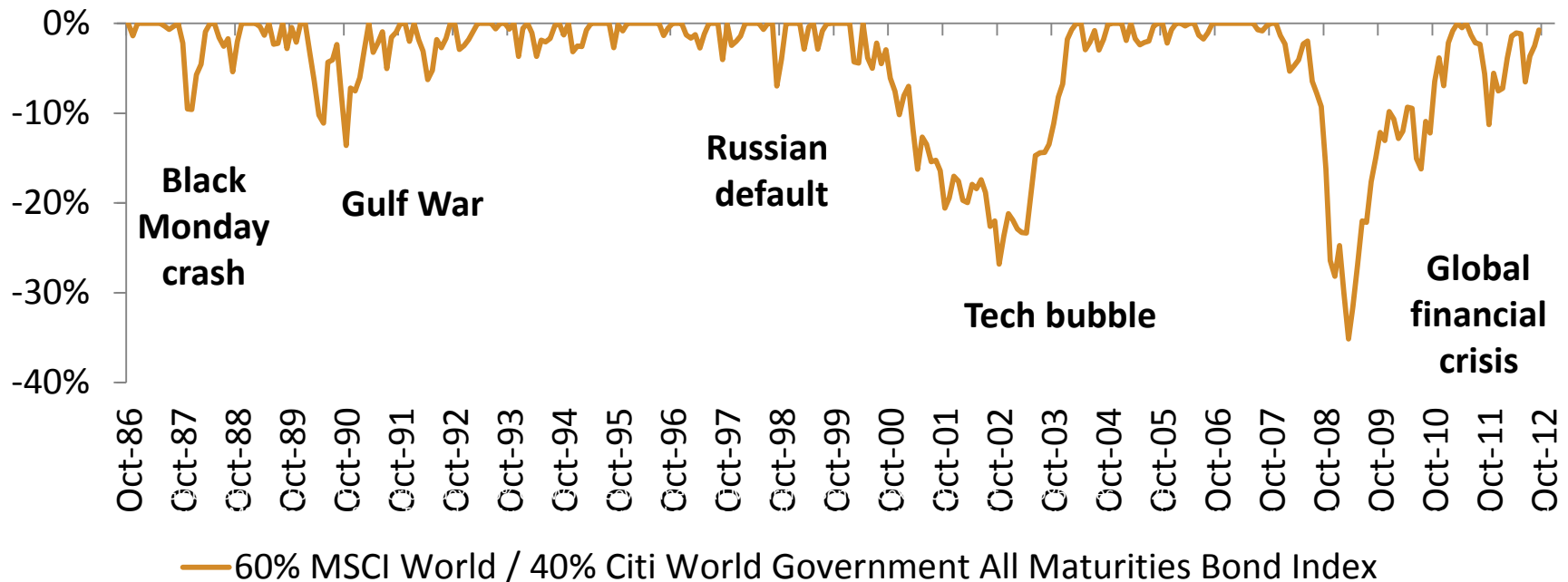
Source: Newton, Datastream, MSCI AC World, 21 March 2017.

A significant re-rating of risk assets



# Importance of managing downside risk?

Managing drawdowns is key to achieving a strong risk/return mix in the long run

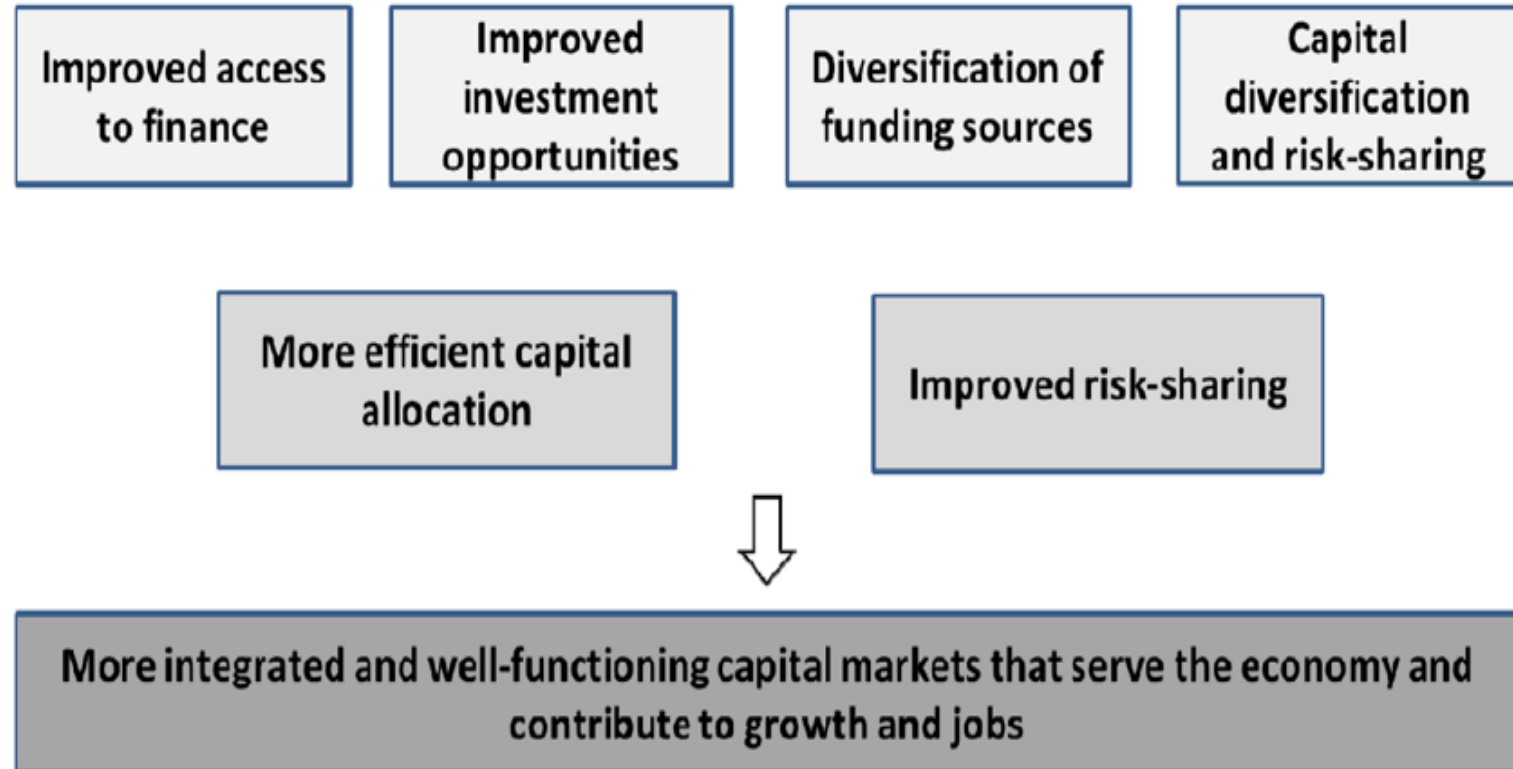


World Government All Maturities Bond Index in USD (Oct. 1, 1986 – Dec. 31, 2012)

Source: MSCI, Barclays, SSGA. The index returns are unmanaged and do not reflect the deduction of any fees or expenses. The index returns reflect all items of income, gain and loss and the reinvestment of dividends and other income. See Disclosure pages for further information. Past performance is not a guarantee of future results.

# Economic benefits of *integrated* and *well functioning* capital markets.

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# Without *Active Managers*, who will invest in new companies?

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# Where does valuation come into the passive decision?

GRAB  
9 <GO> to Save Defaults

MXUS Index    Display    Output    Alert    Member Weightings

MSCI USA Price Return USD Index    617 Members    Currency LCL

1) Members    2) Historical Summary

3) Stats    Group by None    4 Fields    As of 10/31/2016

Ticker	Name	Weight (%)*	Shares	Price
11) AAPL	Uw Apple Inc	3.229741	5,477,425,000	113.5400
12) MSFT	Uw Microsoft Corp	2.323733	7,467,443,513	59.9200
13) XOM	UN Exxon Mobil Corp	1.794259	4,146,611,352	83.3200
14) JNJ	UN Johnson & Johnson	1.656904	2,750,644,288	115.9900
15) AMZN	Uw Amazon.com Inc	1.645027	401,053,700	789.8200
16) FB	Uw Facebook Inc	1.572690	2,311,865,096	130.9900
17) GE	UN General Electric Co	1.389691	9,195,657,000	29.1000
18) JPM	UN JPMorgan Chase & Co	1.315253	3,656,658,925	69.2600
19) GOOG	Uw Alphabet Inc	1.259362	309,095,708	784.5400
20) GOOGL	Uw Alphabet Inc	1.235211	293,675,151	809.9000
21) T	UN AT&T Inc	1.176260	6,156,461,998	36.7900
22) PG	UN Procter & Gamble Co/The	1.152585	2,556,882,660	86.8000
23) WFC	UN wells Fargo & Co	1.152470	4,823,195,268	46.0100
24) CVX	UN Chevron Corp	1.025272	1,884,702,387	104.7500
25) VZ	UN Verizon Communications Inc	1.018245	4,076,288,055	48.1000
26) PFE	UN Pfizer Inc	0.998754	6,064,849,361	31.7100
27) KO	UN Coca-Cola Co/The	0.904979	4,109,888,787	42.4000
28) BRK/B	UN Berkshire Hathaway Inc	0.893888	1,192,818,815	144.3000
29) BAC	UN Bank of America Corp	0.880193	10,271,915,653	16.5000
30) INTC	Uw Intel Corp	0.855107	4,722,000,000	34.8700
31) MRK	UN Merck & Co Inc	0.844109	2,768,025,348	58.7200

5 Analyze List    \*Index Weight (%) Calculated by Bloomberg

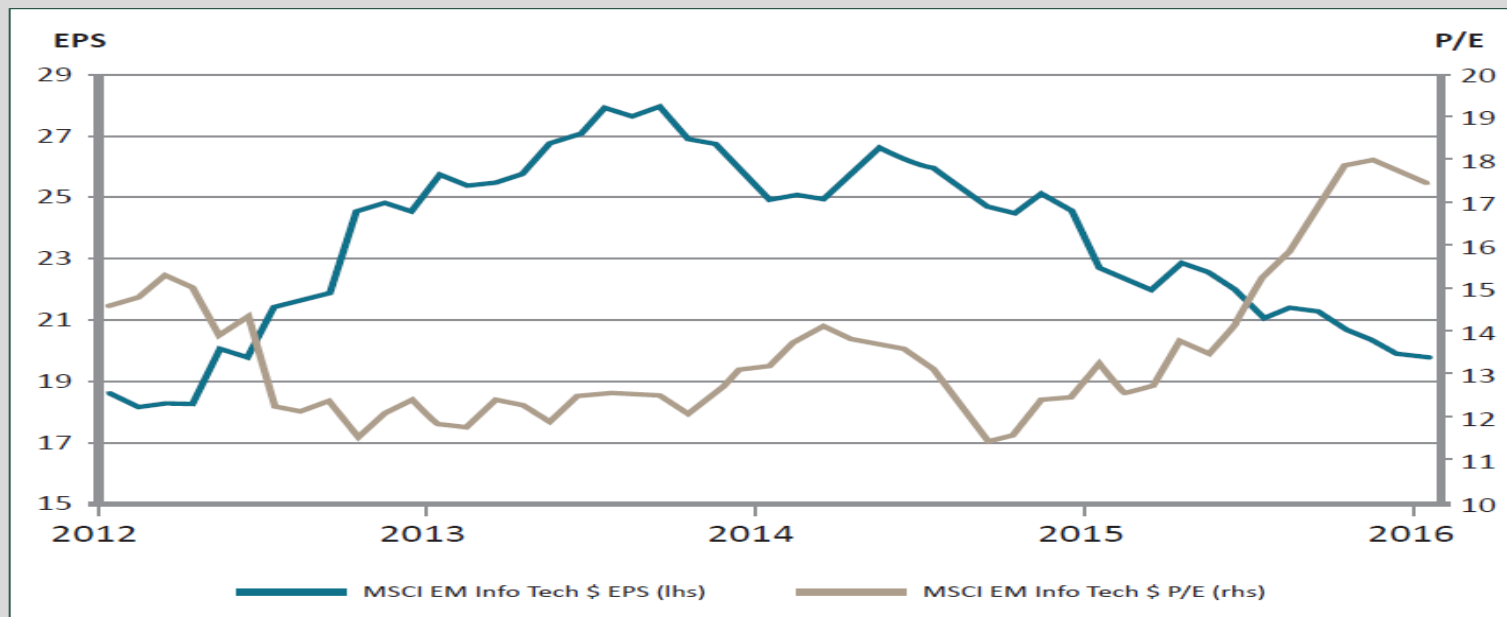
Australia 61 2 9777 8600 Brazil 5511 2395 9000 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000  
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2017 Bloomberg Finance L.P.  
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P/E's as of 23/4/17

# Emerging Markets also seem to be ignoring market fundamentals!

Chart 2. MSCI EM Information Technology - EPS v PE



Source: Datastream, Thomson Reuters & MSCI

Unsurprisingly, this pattern is also strongly evident in the big 5 technology names of Samsung Electronics, Tencent Holdings, Alibaba Group, Naspers and Baidu referenced earlier. All have posted strong outperformance, a significant increase in their PE multiple, while all except Baidu have experienced a fall in EPS. In Graham terms, for this crucial group the short-term voting machine is clearly dominating the long-term weighing machine.

Source: Datastream, Thomson Reuters & MSCI

# Every new indexed \$ Dollar goes the same place as the previous!.....what about *valuation, supply and demand?*

**Table 2. Top 10 MCSI EM Holdings 31.12.2016**

Name	Weight	Industry	Country
1 Samsung Electronics	3.8	Technology Hardware & Equipment	Korea
2 Tencent Holdings	3.5	Software & Services	China
3 Taiwan Semicon. Mnfg.	3.5	Semiconductors	Taiwan
4 Alibaba Group Hldg.Spnr.Adr. 1:1	2.5	Software & Services	China
5 China Mobile	1.7	Telecommunication Services	China
6 China Con.Bank 'H'	1.6	Banks	China
7 Naspers	1.6	Media	Sth. Africa
8 Baidu 'A' Adr 10:1	1.1	Software & Services	China
9 Indl. & Coml. Bk. of China 'H'	1.1	Banks	China
10 Hon Hai Precn. Ind.	1.0	Technology Hardware & Equipment	Taiwan

Almost ¼ of your exposure  
in 10 stocks!

**21.5**

Source: Datastream, Thomson Reuters & MSCI

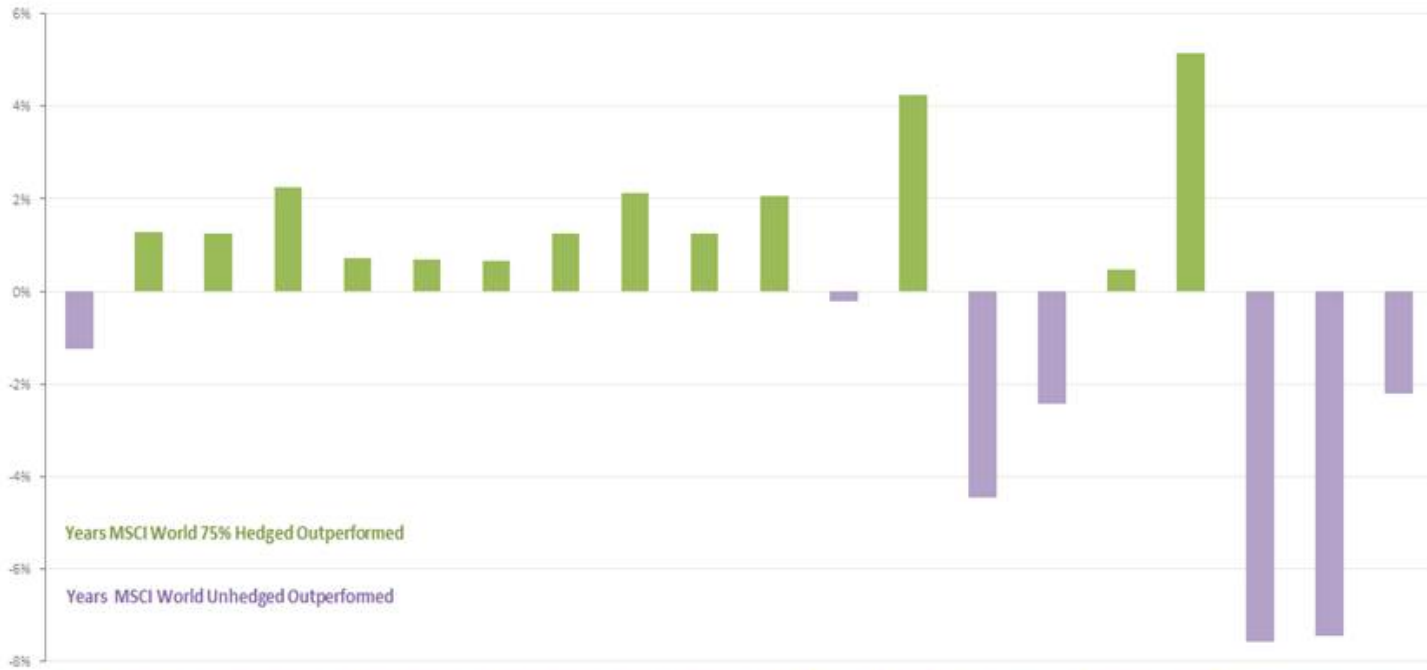
# What about valuations, time to stock pick?

Table 4. Current Price/Earnings of Big 5 Tech Names

Stock Name	Current P/E Q1 2017
Samsung Electronics	12.9
Tencent Holdings	45.2
Alibaba Adr	53.7
Naspers	106.3
Baidu Adr	13.0
<b>Average</b>	<b>46.2</b>

Source: Datastream, Thomson Reuters & MSCI

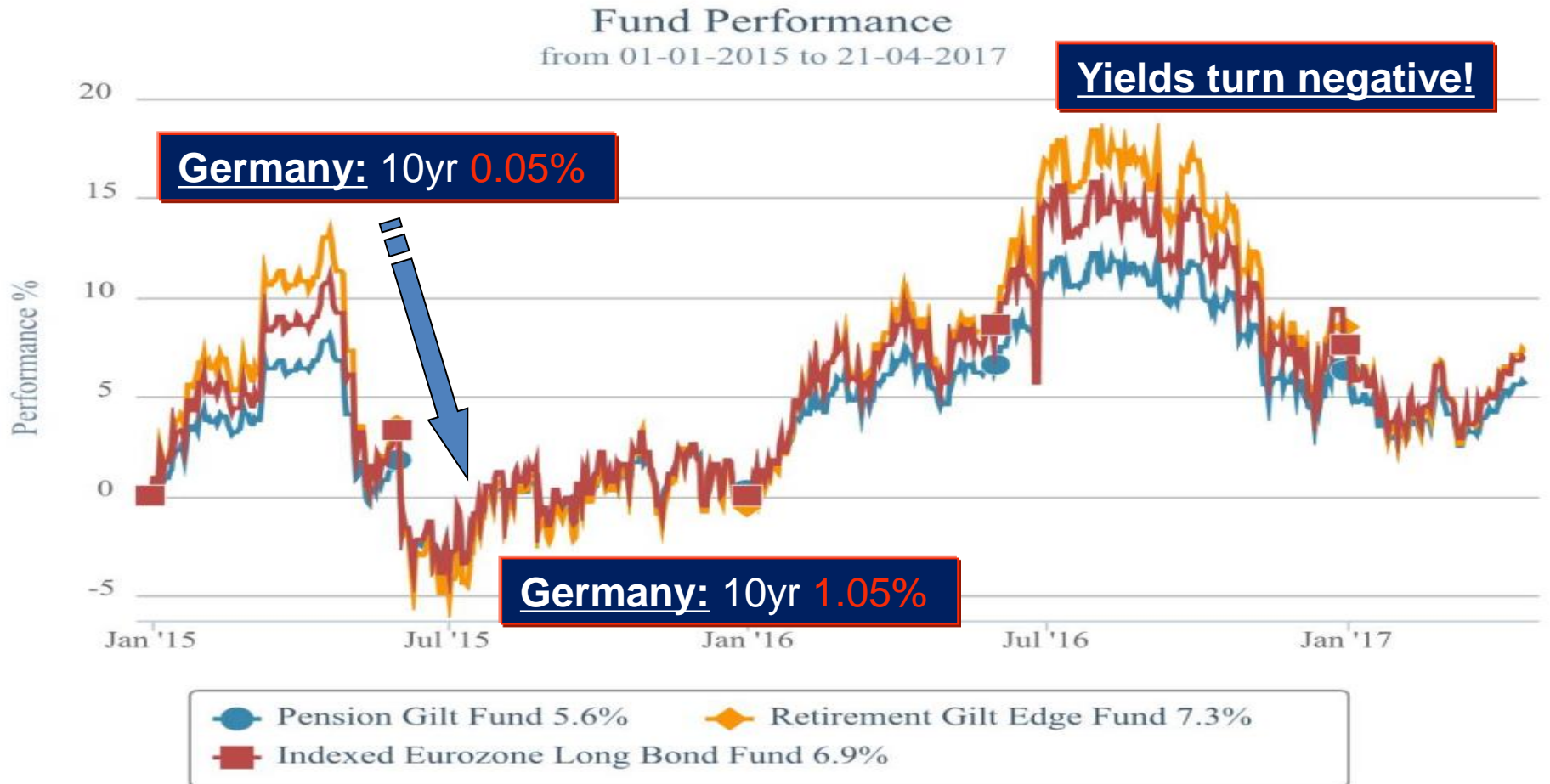
# What about currency, should this be an active call?



Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total Return P.A.
MSCI World 75% Hedged	34%	17%	48%	-5%	-12%	-31%	11%	8%	28%	9%	0%	-38%	30%	15%	-5%	15%	26%	12%	4%	9%	6.64%
MSCI World	36%	16%	46%	-7%	-12%	-32%	11%	6%	26%	7%	-2%	-38%	26%	20%	-2%	14%	21%	20%	11%	11%	6.77%
Difference	-1.3%	1.3%	1.3%	2.2%	0.7%	0.7%	0.7%	1.2%	2.1%	1.2%	2.1%	-0.2%	4.3%	-4.4%	-2.4%	0.5%	5.1%	-7.6%	-7.4%	-2.2%	-0.13%



# Bonds – ‘return free risk’?

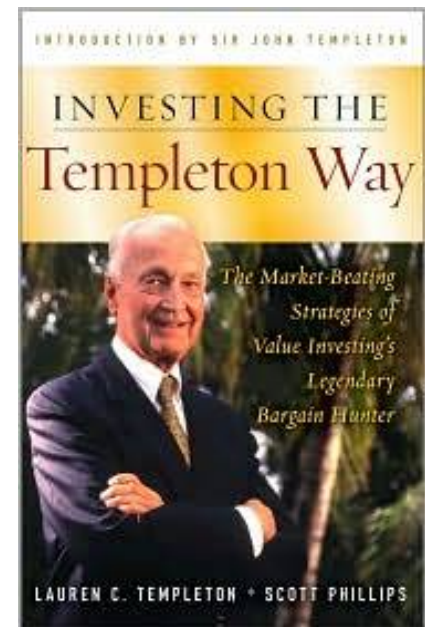


# Active v Passive Fund management, final thoughts!

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- There is no conclusive evidence that either style is 'best'.
- Client objectives and time frame are important considerations.
- Members need both default options and investment choice, each can play an important part in a portfolio.
- Behavioural science tells us that as investors we are generally not rational, mind the behaviour gap!
- We should not choose a strategy purely on past performance, recent tailwinds assisting passive?
- Equities, Bonds, Alternatives, Currency, Risk Management all part of the decision making process!

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- ***“Avoid the popular. When any method of selecting stocks becomes popular, then switch to unpopular methods”***
  - Sir John Templeton.









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# Last 7 years Passive strategies have benefited from a number of significant tailwinds!

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- Low Volatility 
- High Correlations 
- Slow growth 
- **QE** distorting the valuation of risk assets! 
- **QE** distorting the value of monetary assets! 
  
- A difficult time for Active managers but we've been here before, **1983 – 1988** and again **1995- 2000**.
  
- Each time Active management (after being pronounced dead) proceeded to surge thereafter delivering superior returns.