Actives vs passives:
A global perspective on the current debate

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Theme 1

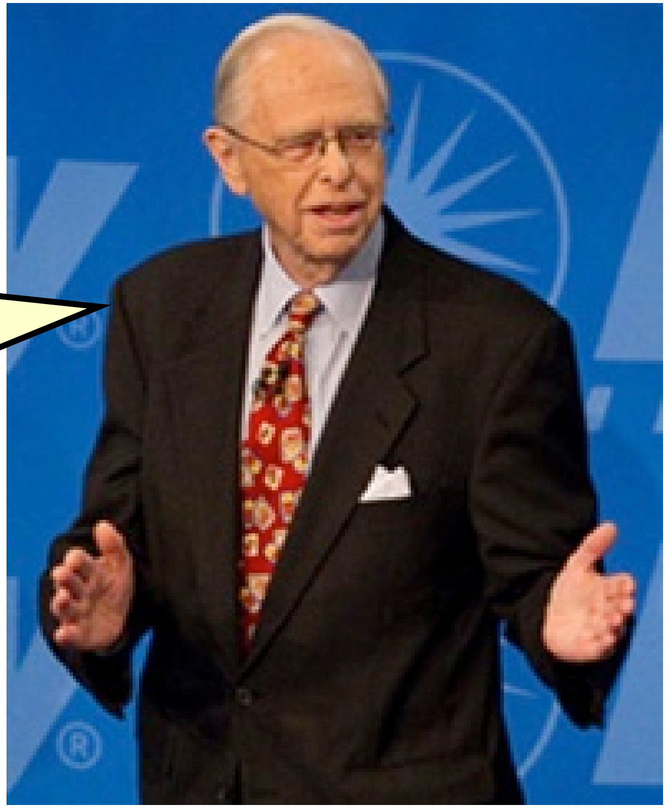
1. **Since the 2008 crisis, a vast majority of active funds have struggled to outperform their market benchmarks. But it is inadvisable to write off active management. Passive funds have their own issues.**

"The active-passive debate is far more nuanced than suggested by the media discussion. It also ignores the role of technology in bringing about a convergence between them."

A US Pension Plan

Pro-active funds

"I can't believe that that the great mass of investors are going to be satisfied with an ultimate goal of just achieving average returns."



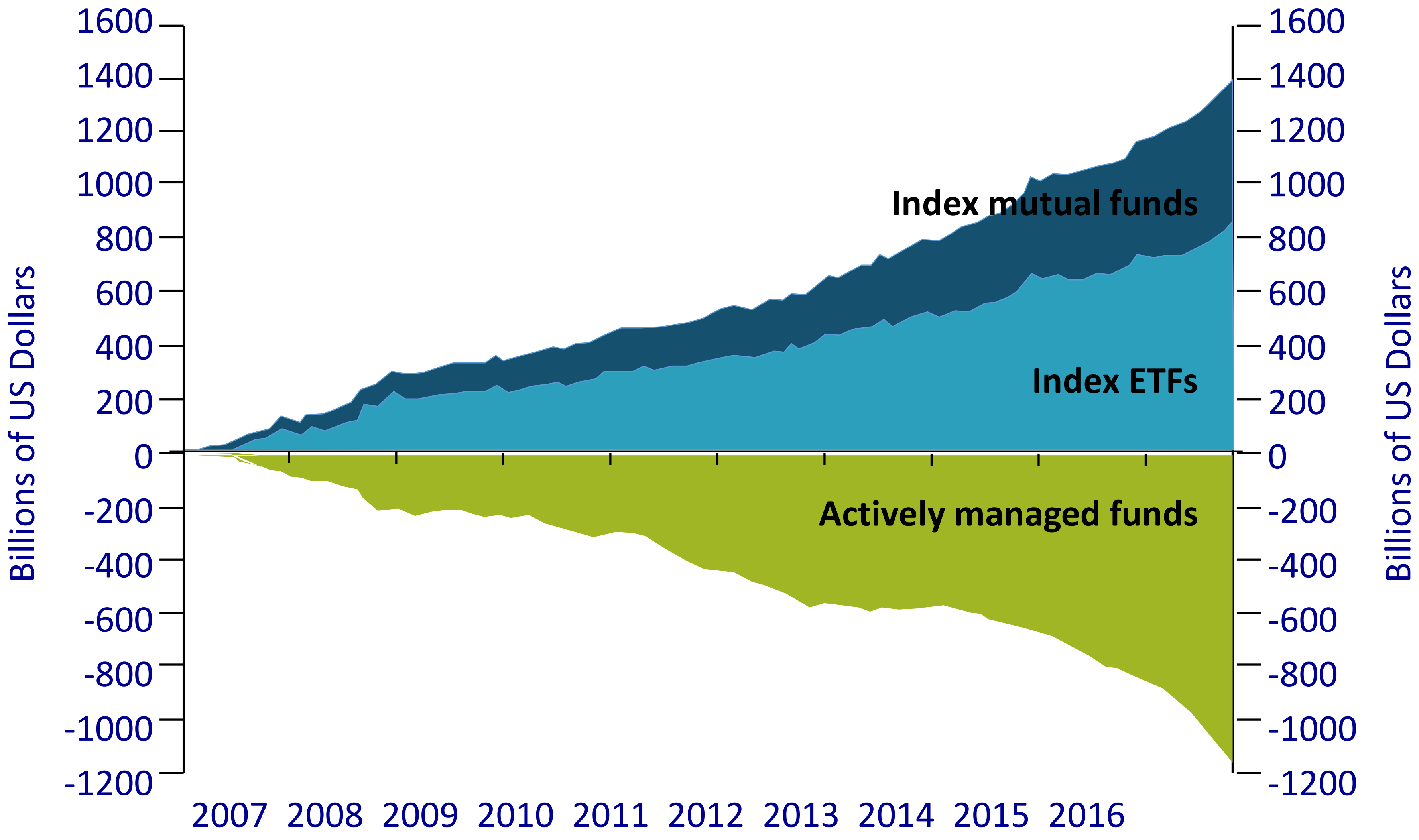
Ned Johnson, Chairman of Fidelity Investments
Talking to *Boston Globe* three years after **Vanguard** rolled out the first index mutual fund in 1976

Pro-passive funds

"Most of the money I am leaving for my wife in a trust after my death is to be invested in an S&P 500 tracker. I believe the trust's long-term result from this policy will be superior to those attained by most investors who employ high-fee managers."

Warren Buffett
Berkshire Hathaway Annual Letter, 2014

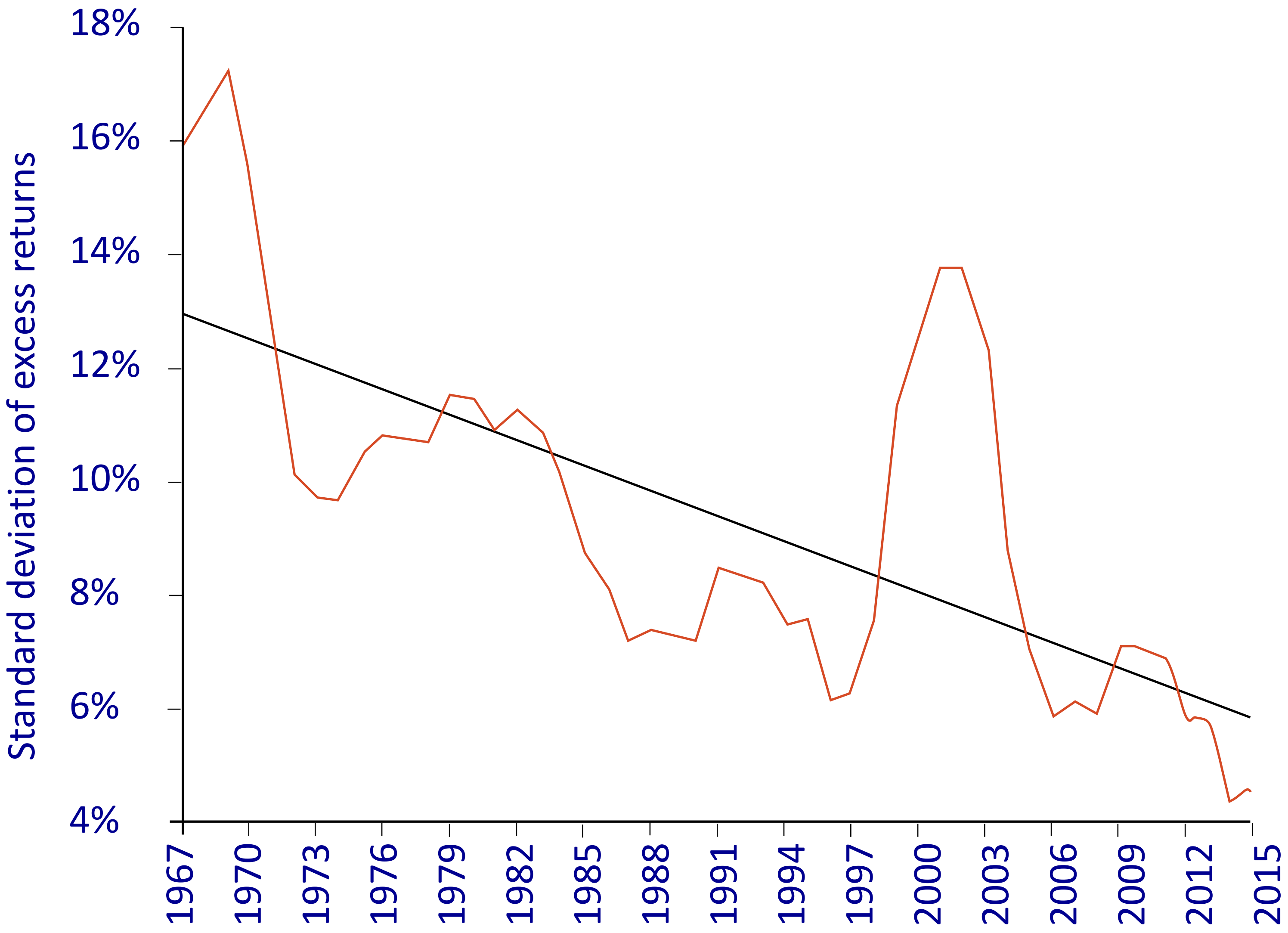
Flows from active to passive funds in US equities



Note: US domestic equity funds; figure as of 30 Nov 2016

Source: Investment Company Institute; Simfund; Credit Suisse

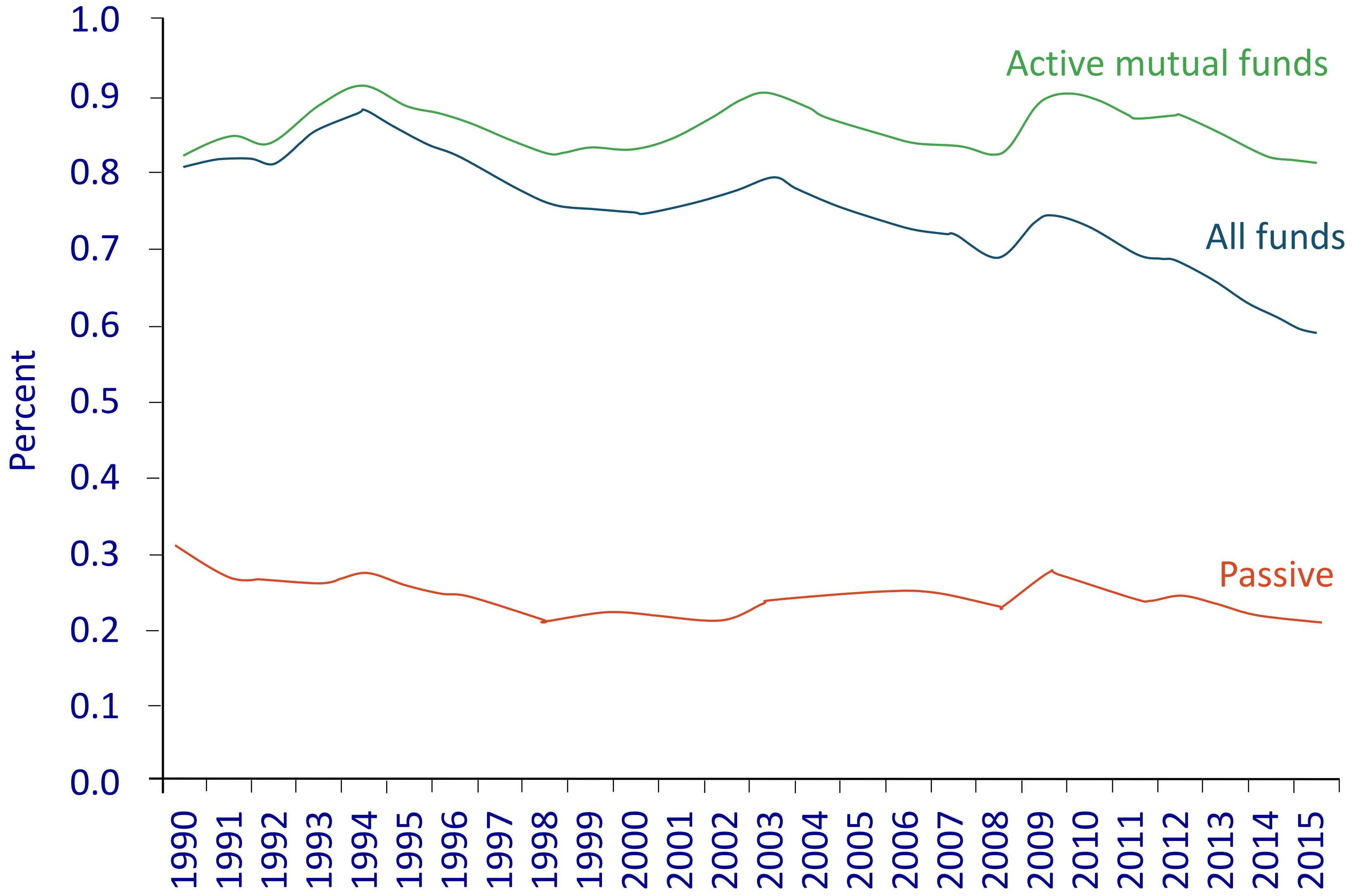
Decline in standard deviation of excess returns for US large capitalised funds



Number of funds: 69 120 147 207 353 712 1274 1236 1082

Source: Markov Processes International; Morningstar; Credit Suisse

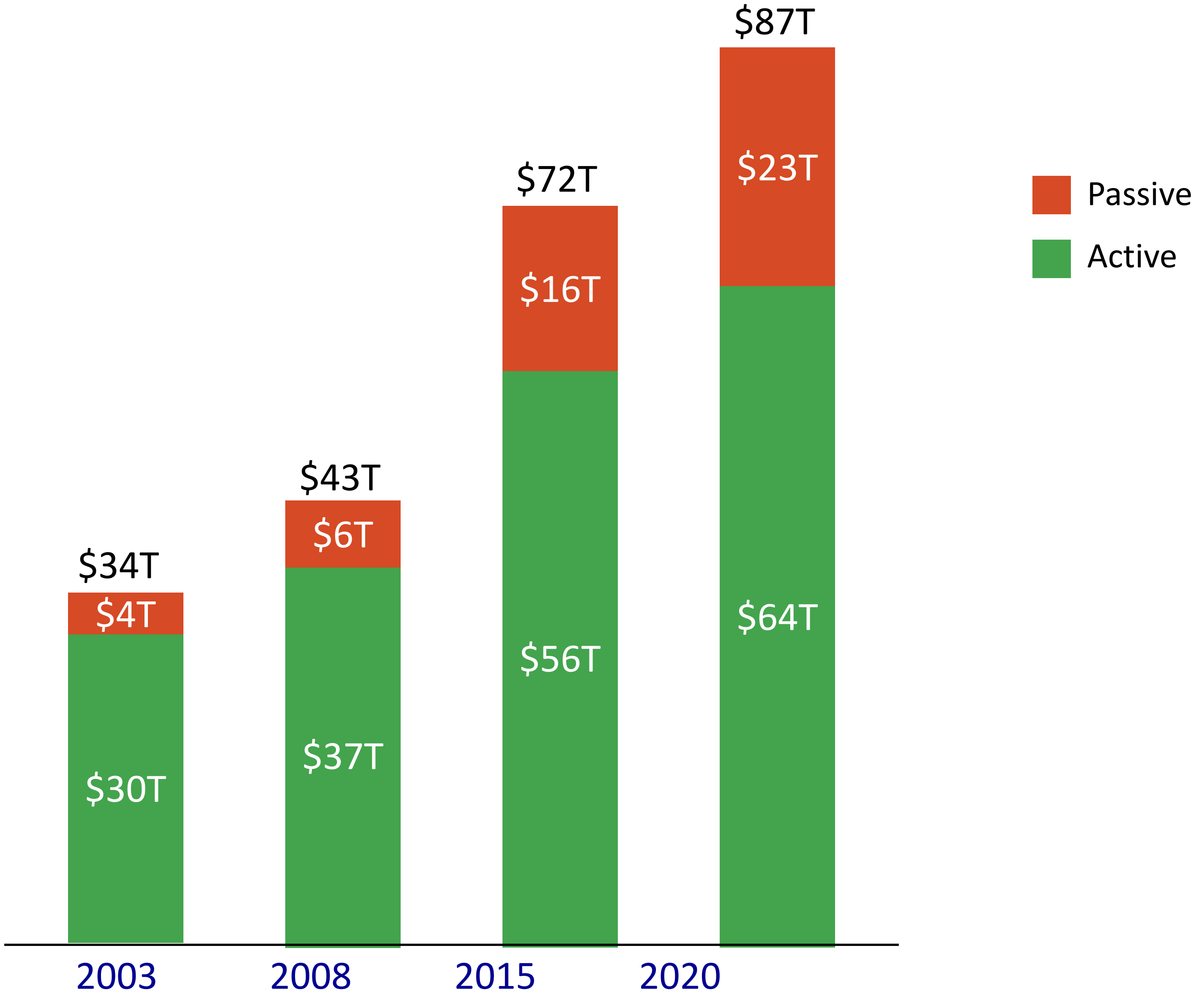
Fees on US equity mutual funds



Note: Weighted by AuM, passive includes index funds and passive ETFs

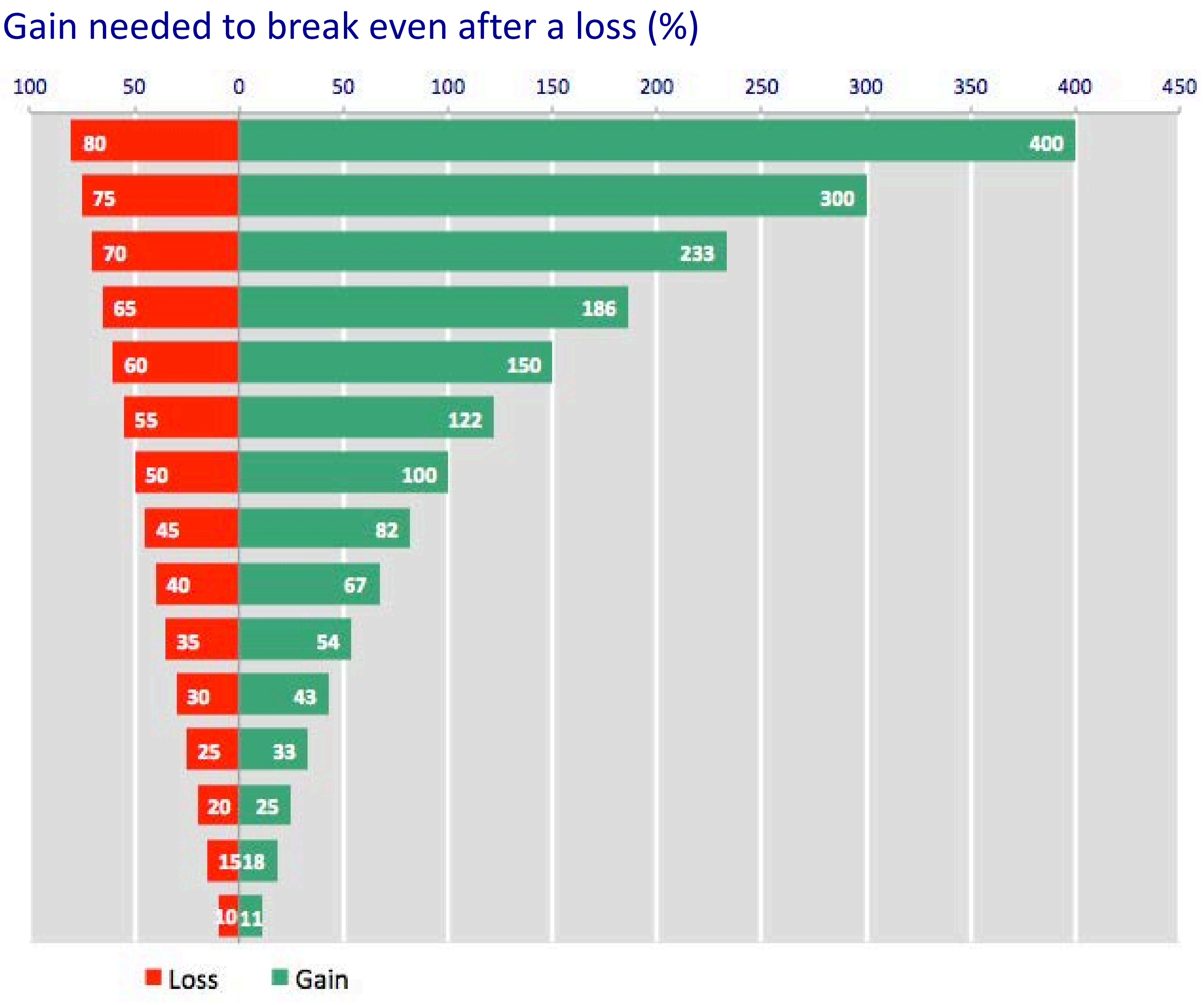
Source: Morningstar

Global AuM: active *vs* passive



Source: Greenwich Associates 2016; BCG Global Asset Management 2016

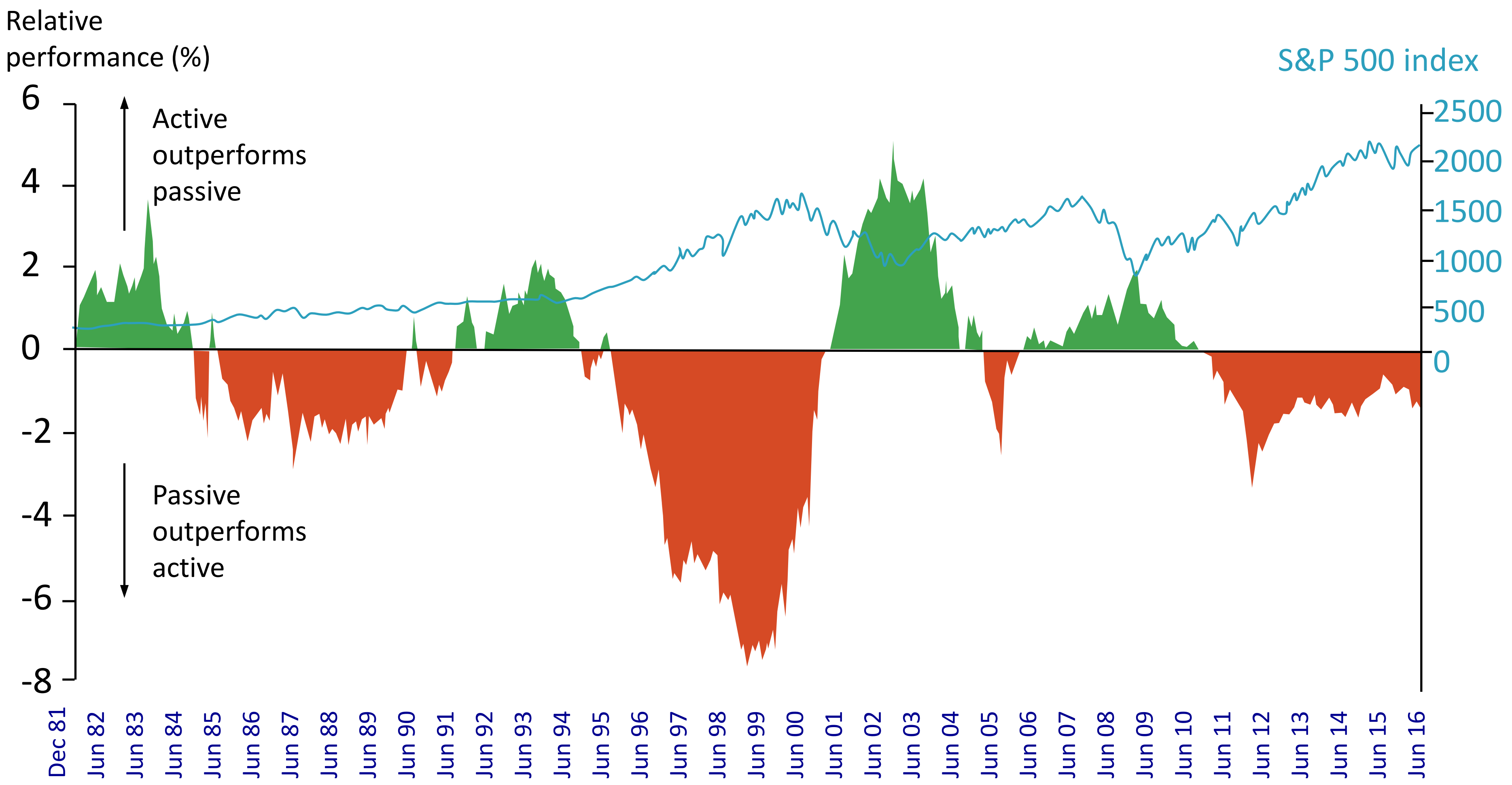
Drawdown containment is critical in a low return world



Source: Bloomberg 2016

Performance of active and passive funds has been cyclical

Difference in performance between large cap active and passive funds



The analysis of monthly rolling 3 year returns for the period 31Dec1981-30Jun2016

Source: Morningstar Direct, Baron Capital 2016

Factor investing will change the contours of the asset industry helped by artificial intelligence and machine learning

1. **Big data will revolutionise factor investing due to their sheer variety, volume and velocity**

2. **A new people-machine interface will emerge. Humans will still make judgement calls on which factors to select, when to underweight or over weight, or when to switch them off**

3. **Machine learning is set to revolutionise investing, creating a clear distinction between *"commoditised"* alpha and *"pure"* alpha**

4. **Artificial intelligence will industrialise investing and favour those managers with technology, scale and reach**

"Systematic strategies based on factor investing will have the unstoppable momentum of a super tanker. They have worked well for us"

A Danish Pension Plan

Theme 2

1. Since the 2008 crisis, a vast majority of active funds have struggled to outperform their market benchmarks

2. An era of low interest rates in America and Europe has seen innovation in asset allocation approaches

"Investing in an era of negative yields is like learning to drive a car backwards. There are no precedents or history books to guide us."

A Swedish Pension Plan

1. Greater diversification outside the traditional 60:40 equity/bond portfolios

Retail investors	% of respondents
Multi-asset class funds	63
Funds with income focus	60
Passive bonds/equity funds	60
Regulated mutual funds	55
Exchange traded funds (ETFs)	44

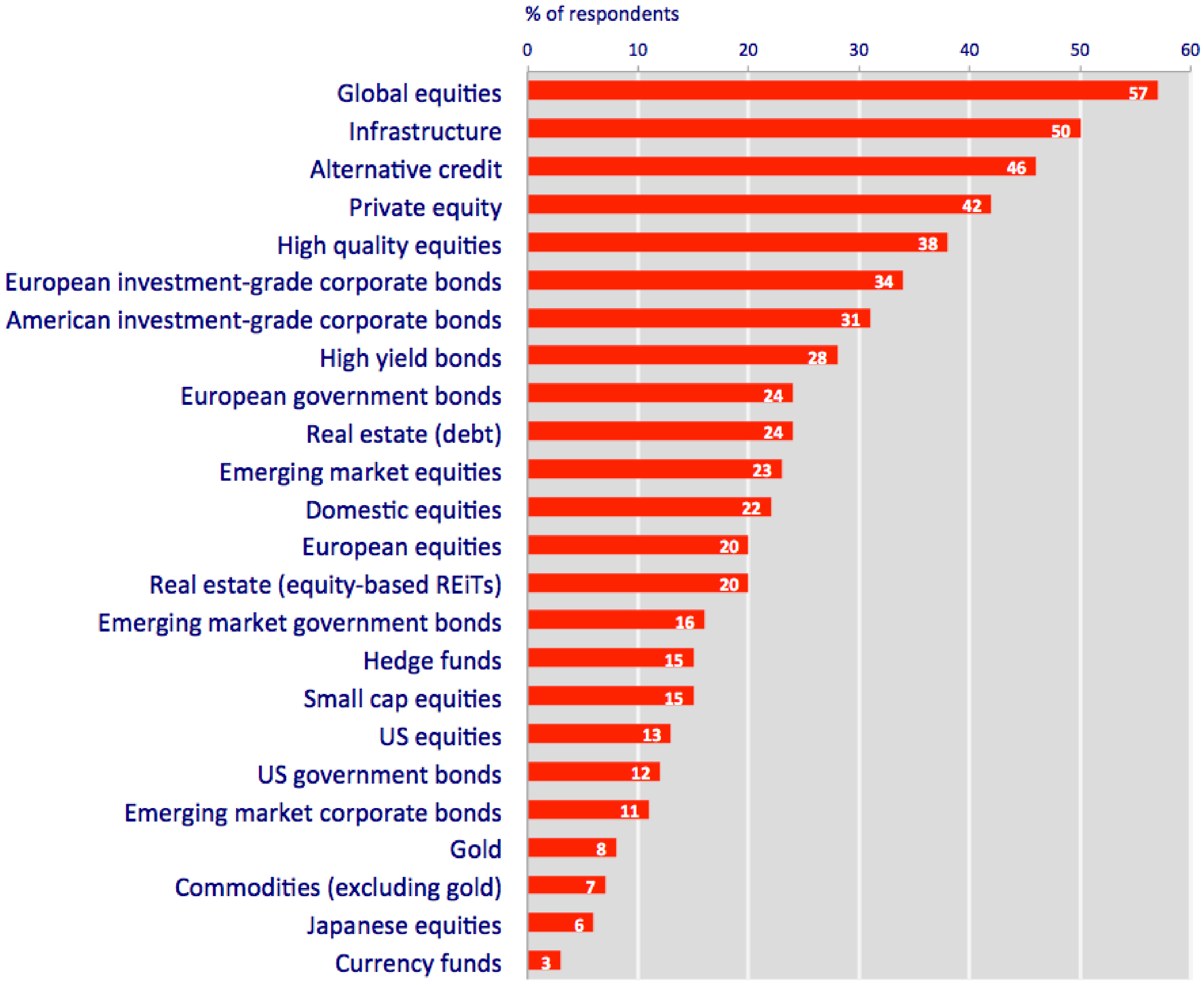
DB investors	% of respondents
Passive bonds/equity funds	70
Global equities	69
Real estate (debt and equity)	68
Infrastructure	65
Low variance equities	62
Developed market government bonds	58
Alternative credit	56

High Net Worth investors	
Real estate	63
Actively managed equities/bonds	56
Private equity	55
Hedge funds	54
Multi-asset class funds	54
Passive bonds/equity funds	52

DC investors	
Diversified income funds	68
Passive bonds/equity funds	66
Target date retirement funds	60
Target income retirement funds	58
Diversified growth funds	52
Actively managed equity-bond funds	42

Source: Principal Global Investors / CREATE-Research 2015 survey

2. Higher risk appetite by going into equities and alternatives



Source: Amundi / CREATE-Research Survey 2016

3. Search for surrogate assets with equity like returns and bond like features

RETURN SEEKING ASSETS

- Global equities
- Regional equities
- Private equity
- Investment grade bonds
- High yield bonds
- Private real estate
- Hedge funds

ALTERNATIVE CREDIT

- Senior loans
- Mezzanine finance
- Subordinated corporate debt
- Collateralised Debt
- Private equity (secondaries)
- Floating rate notes

REAL ASSETS

- Commercial Real estate
- Mature infrastructure
- Farm land
- Social housing
- Student accommodation
- Toll roads and mobile masts
- Ground rents

LIABILITY HEDGING ASSETS

- Gilts
- Index linked bonds
- Sovereign bonds
- Swaps

Asset growth ⟷ **Liability matching**

Source: Amundi Asset Management / CREATE-Research 2014 Survey