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GROWTH IN PASSIVE INVESTMENT MANAGEMENT IS OUTSTRIPPING ACTIVE FUND MANAGEMENT WORLDWIDE

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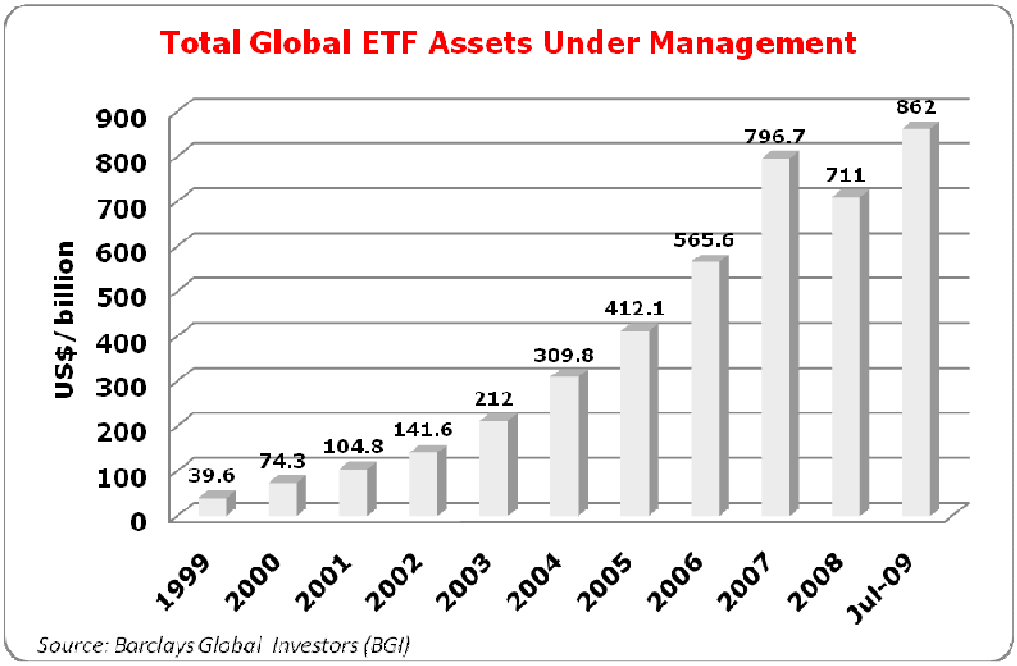
Over the past ten years, according to a recent research report by Watson Wyatt a US research house, passively managed investment assets have grown at an annual rate of 10 percent, compared with a growth rate of 6 percent in actively management assets. The Watson Wyatt Survey measures the assets under management (AUM) of the 500 largest asset managers worldwide.

Passively managed investment funds look to match the performance of the main stockmarket indices, by holding only the actual number and weighting of the securities that comprise these indices. Actively managed assets look to outperform these indices, by constant trading of securities to unlock alpha (outperformance of the index benchmark).

The most popular products to provide passive investment performance products over the past decade have been Exchange Traded Funds (ETFs), which are open-ended index fund products that trade like normal securities through stock exchanges. The stock exchange listings made ETFs far more transparent (both in cost and performance) and more liquid (tradeable) than the typical actively managed product.

Barclays Global Investors (BGI) reported that at the end of 2008, there were 1590 ETFs listed on 42 stock exchanges around the world, with a total of US$711 billion in assets under management. This had grown from some US$40 billion under management by ETFs worldwide in 1999. A recent report by BGI indicates that the AUM by ETFs had growth to US$862 billion worldwide by the end of July 2009.



Although, the global actively managed asset industry continues to dwarf the passively managed assets – about 90 percent of global AUM are still actively managed, the gap is steadily closing.

The reasons for the growth in popularity of passively managed investment products globally, particularly ETFs, include the following:

- The majority of actively investment managers do not beat the index over time. Most surveys indicate that even in developed markets, such as the US, 70% or more of actively managed portfolios fail to match the performance of the main US stockmarket indices.

- This underperformance by actively managers is before taking all costs into account. If all the administration costs, transaction costs, platform fees, management fees and performance costs are taken into account, the actual cost structure of actively managed products can be significantly higher than disclosed and these high costs, over time, significantly erode investment performance.

- Index tracking passive funds, particularly ETFs offer low costs and the certainty of closely matching index performance – this is difficult to beat. In South Africa, for instance, the FTSE/JSE All Share index has grown at an annual rate of 19,2% over the past ten years and by 21,1% over the past thirty years. Few, if any, active fund managers can match this performance.

- More and more investors worldwide are accepting that it is difficult to choose, in advance, which active managers will provide alpha performance, particularly after taking costs into account. In which case, it is completely irrational to rely extensively on active fund management technologies. Economic theory and practise indicates that individual human behaviour will often initially make irrational decisions, such as taking on the odds of choosing an outperforming active manager, but over time, human behaviour should become more rational.

- ETFs are perfectly placed to benefit from investors realising the merits of passive investment. Also the retail investor appears to be taking more control of their own investments worldwide and ETFs are perfect for the do-it-yourself type of retail investor.