

Dear Members,

ACTIVE VERSUS PASSIVE INVESTING

The theme of active versus passive investments is a topical one at present, although this is a debate that has been going on for a long time in the investment industry. There is perhaps more focus on the issue in the South African market at the moment, because National Treasury indicated in draft legislation that they want Boards of Trustees of retirement funds to consider passive investments (not to necessarily invest passively but simply to consider the relative merits of this approach), as well as the fact that many active investment managers have struggled to beat widely-used equity indices such as SWIX in the South African market and MSCI in the global market.

Passive investments have the advantage that they are less expensive than active investments and this has been a primary driver of those who advocate the passive approach. Fees charged by service providers in the investment industry have been under scrutiny for some time and there is considerable pressure on the industry as a whole to reduce these fees and to simplify fee structures with full disclosure. However, fees cannot be considered in isolation and it is the return on investments after deduction of fees that is the important statistic to measure when comparing investment strategies.

An important aspect of passive investing that is generally overlooked is that there are many active decisions that need to be made in a passive investment strategy. For example, the type of index to track needs to be selected and, most importantly, the asset allocation decision (that is how much should be invested in the various asset classes, such as equities, bonds, cash and property, both locally and offshore) still needs to be made.

The ISASA Trustees have historically adopted an active approach to investments and implemented the Lifestage model approach to address the asset allocation issue mentioned above. The Lifestage model addresses the question of asset allocation by considering the risk profile of members as determined by their term to retirement and provides a default structure for those members who are unable or unwilling to make investment decisions. However, for those who take financial advice and wish to make their own choices, various portfolios from which to choose have been provided.

The performance of the portfolios is regularly monitored against their respective benchmarks and there is concern that a number of these portfolios have been recently underperforming their benchmarks. The Investment Committee (“IC”) addresses this issue at each of its quarterly meetings, with a view to fully understanding the reasons for this underperformance and to ensure that appropriate actions are taken if it is felt that the current strategy is unsuitable.

As part of their ongoing review of investments, the IC is considering the passive approach. It is unlikely that the current active approach will be replaced by a passive one, but the IC is considering introducing passive as an alternative. The IC is mindful of making too many options available to members and the additional complexities that come with too many options. However, the IC also wishes to ensure that the Fund remains at the forefront of investment thinking in the industry and addresses issues and concerns raised by National Treasury and members.

As an aid to understanding the topic, two documents have been posted on the ISASA website. One is a slide presentation prepared by the Fund’s multimanager, Investment Solutions, which explains the concepts of active and passive in detail. Some of the slides may be a bit complex, but the presentation provides a number of slides that summarise the pertinent facts quite simply. The other is a short document, entitled “The Big Debate-Active vs Passive Investments”, which provides a simple overview of the issues around active versus passive investing.

I trust that the above provides some insight into the activities of the IC and the importance placed on ensuring that members are provided with the most appropriate investments. The Trustees will keep members informed of further developments with regard to the adoption of passive investment strategies.

Kind regards,

Howard Rodd

Chairman of Investment Sub-Committee: On behalf of ISASA Pension Scheme and Provident Fund