Active vs. passive investment debate misses point

The investment industry has seen extensive debate, both globally and locally, around active versus passive investment strategies and which of these yield better results.

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According to Grant Watson, a boutique head at Old Mutual Investment Group, this binary debate, however, is an oversimplification that misses the point. Instead, investors should be turning their attention to a third option; that of index investing as an essential component within a blended active and passive investment solution.

Watson oversees South Africa's largest passive funds, with more than R75bn passive funds under management, as well as a range of active, risk managed and hedge funds both locally and globally.

He says that while leading local and global institutional funds are incorporating blended investment strategies to deliver specific risk and return outcomes on the capital entrusted to these funds, retail investors are still predominantly following either one approach or the other – but generally still favouring active funds.

"It shouldn't be a question of selecting one approach over another, but rather seeking an investment solution which blends both active and passive approaches to ensure optimum risk-adjusted returns," says Watson.

Blended approach

Watson explains that institutional investors have been following a blended approach for a number of years now as a means of positioning their overall investment portfolios for the low-growth, volatile global investment landscape which South Africa currently finds itself in.

“Institutional investors understand that a blended approach provides the ideal balance between maximising returns (after fees) and minimising the risk of capital losses. This is especially true in South Africa where asset class and sector allocations are the main drivers of investment outperformance.”

He points to industry statistics by S&P Dow Jones Indices which indicate that 75% of active investment managers have underperformed their benchmarks after fees over the last 5 years, both in South Africa and globally. “As we already know, investing via an index-tracking strategy is increasingly becoming a major trend in South Africa, driven largely by investors looking for simpler and lower cost investment strategies.”

However, this does not imply that investors should shy away from active management. “It is important to remember that many passive managers tend to underperform active managers in bear markets. It is key to select an active manager that has a proven track record and the ability to build portfolios that consistently outperform.

Best of both worlds

According to Watson, a blended approach provides investors with the best of both worlds, offering a reduction in the risk of underperformance and lower fees, a key consideration given the current low-yield environment.

He goes on to say that the weightings of active and passive investments in an investor’s overall portfolio will depend on the individual investor’s investment goals.

“Investors who are considering a blended portfolio approach should, as a point of departure, have a long-term investment horizon and mind set. It is imperative that investors seek professional investment advice when constructing their portfolio, as the allocations to active and passive investment options depends on each individual investor’s risk appetite and life stage.”

Watson concludes: “We believe that there is a place for both active and passive investing ideally through a blended approach that offers the best of both worlds.”