



6 reasons why now could be the era of the active manager

2022 was an annus horribilis for active funds, where expert active managers sift through a market to construct a portfolio of the best stocks it has to offer.

According to investing broker AJ Bell's Manager versus Machine report, after fees just a quarter (27%) of active funds beat their passive equivalent, in which stock market indices — the benchmark against which active funds are compared for performance purposes — are simply copied.¹

It comes hot on the heels of a decade of investors shifting into passive strategies. In the US, where much of the global stock market resides, 10% of total assets in US mutual funds was allocated to passive strategies at the onset of 2010; by the end of the 2022, it was 25%.²

The allure is simple: while it isn't possible to outperform the market, passives offer investors the opportunity to access stock market returns for very little cost and drag on their returns.

Since 2022 however, long-term market conditions have been evolving, as we move into an era where inflation and interest rates are likely to be structurally higher, and stock market volatility elevated for some time to come. It's changing the playing field for active managers, and begs the question: as markets become choppy and uncharted, could now be the time to consider an experienced captain to navigate your investments through the storms?

Here are six reasons why we believe the era of active may have arrived:

All aboard

1. Inflation and slowing economies create stock market winners and losers

Last year we saw sharply rising interest rates alter the relative values investors were prepared to pay for shares. This year, the driver of stock markets may shift towards news flow surrounding company profits. Given that high inflation and slowing economies will hit company profits in varying ways, it implies a wide range of stock returns is likely.

It points to a need to separate the troubled companies that face existential threats from those with a brighter future. Active managers will be able to find companies that can navigate a tricky trading environment by identifying qualities such as strong pricing power, profits and profit margins, and low levels of debt.

¹https://www.ajbell.co.uk/sites/ajbell.co.uk/files/Manager_vs_Machine_July_2022.pdf
²Hargreaves Lansdown; as of 20/01/2023



2. New investing 'styles' come into vogue

In the decade running up to the start of 2022, stock market returns were dominated by a handful of mega-sized technology businesses, particularly in the US. This trend may be about to go into reverse for an extended period: the winners of the last decade may face continued selling, and areas of the market that had stagnated in the former market regime may do much better, for example cheap 'value' stocks.

Given the new market order, winners are likely to be found in various corners of the market, and it will take a discerning eye to find them.



3. Profits likely to fade for some companies

For more than a decade, globalisation, low inflation, and cheap money spurred an era of ever-higher profits for companies, and now they're looking vulnerable. As economic growth slows and costs rise, profits are likely to become increasingly squeezed, which may affect share prices. Experienced active managers will be needed to find companies that can sustain profitability.



4. US loses its dominance

In the former market regime, US markets outperformed non-US markets in eight out of the past ten years, largely on account of its heavy weighting towards popular 'growth' stocks.³ In the new regime, given that inflation is impacting countries in varying ways, a global investment approach, with asset allocators who can direct portions of the portfolio's cash into different markets depending on how the economy is being impacted, will be needed. You typically won't find this with passive global strategies.



5. Volatility makes for an active managers' paradise

We need shares if we are to beat inflation and yet stock markets are likely to remain volatile. According to data from index provider MSCI, stock volatility is above average in all major regions across the globe, bar Japan.⁴

Big differences in stock valuations mean active managers can find cheap companies that have a chance of performing strongly over the long term, while avoiding those that appear overvalued and expensive. What's more, the last two occasions when variations in stock valuations were as wide as they are now, were the tech bubble at the dawn of the millennia and the global financial crisis — following both periods, active managers went on to do well.⁵



6. Fee hurdles reduce

Passive funds are cheap by design, and the impact has been to drive down fees across the whole industry including active funds. As a result, active managers find themselves having to leap over a smaller hurdle of fees when comparing their performance to the index.

It needn't be tempestuous

Journalists and commentators have long indulged in 'active versus passive' debates, often portraying the rise of passives as stoking an existential fight between two sides of an industry. In truth, many investors appreciate that it is not an either/or situation — our portfolios are likely constructed best through a combination of both.

That said, in a bygone era of cheap money and low interest rates that have raised markets more broadly, passive has been favoured. Since 2022 however, higher inflation and interest rates are changing the status quo, with markets becoming a choppy sea of winners and losers. So an experienced captain is likely required. Enter the era of the active manager.



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³<https://www.blackrock.com/us/financial-professionals/literature/investor-education/why-bother-with-international-stocks.pdf>

⁴<https://www.quiltercheviot.com/news-and-views/articles/active-anticipation/?Region=uk&Role=fadv>

⁵<https://www.quiltercheviot.com/news-and-views/articles/active-anticipation/?Region=uk&Role=fadv>



Further information

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