ACTUARIAL SOCIETY OF SOUTH AFRICA

Active versus Passive

Redefining the rules

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The Business of Change: 2010 and Beyond

The arguments against active management

- Managers do not outperform consistently over time
- Active management is a zero sum game
- Trading costs means you lose money paying active managers, whereas passive managers are inexpensive

Lets unpack the arguments

1. Active managers do not outperform consistently
    1. So, Exactly what do they not outperform?
    2. Are the indices correct?
2. What about loss of capital?
3. What does a pure Passive World actually look like?

1. Active managers do not outperform consistently. What should they outperform?

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- A noble goal would be inflation plus a reasonable reward for risk
- …but if a static asset allocation e.g. 60/40 gives this to you…
- …you must be able to ***offer*** more…
- …without ***losing*** more

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The traditional framework

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- Actuaries determine liabilities
- Strategic asset allocation set
- Asset class benchmarks set
- Measurement of “bet” sizes away from the benchmark
- “Tracking error” assumes you’re doing something wrong

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Our approach to active
We start the other way

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- What assets can give you what likely return
- How risky are they
- How much should you have of them
- Actively allocate to rewarding pay-offs and away from losing ones
- Measure the returns over long periods

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Investec Opportunity Fund

Over 10 year track record, out-performing equities, bonds & traditional balanced

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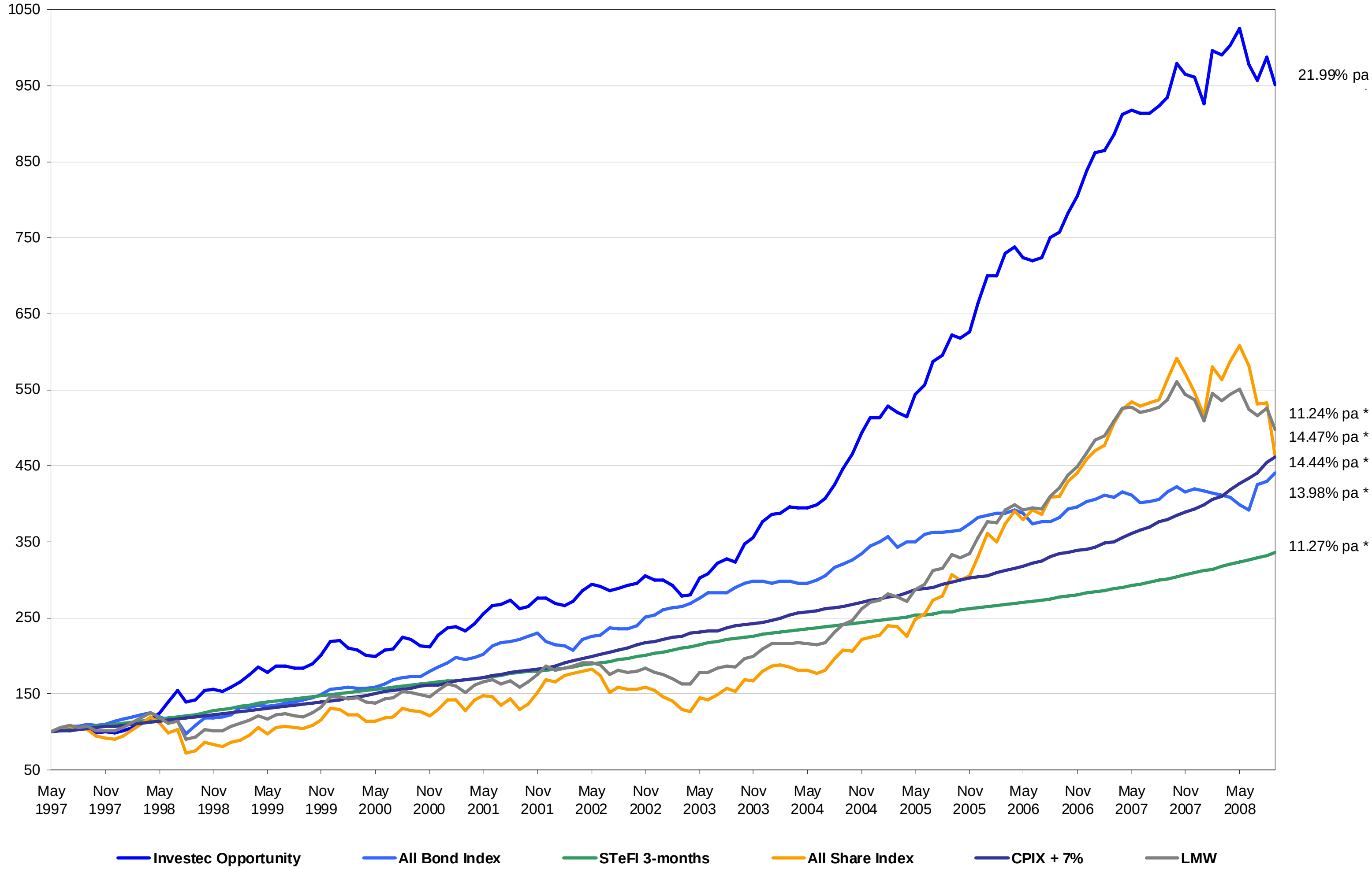

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*Annualised returns for the period: 31 May 1997 to 30 September 2008, CPIX lagged by 1 month
Source: Alexander Forbes Large Manager Watch™ Survey & Investec Asset Management (net of fees)

2. Loss of capital
The potential danger of index weightings

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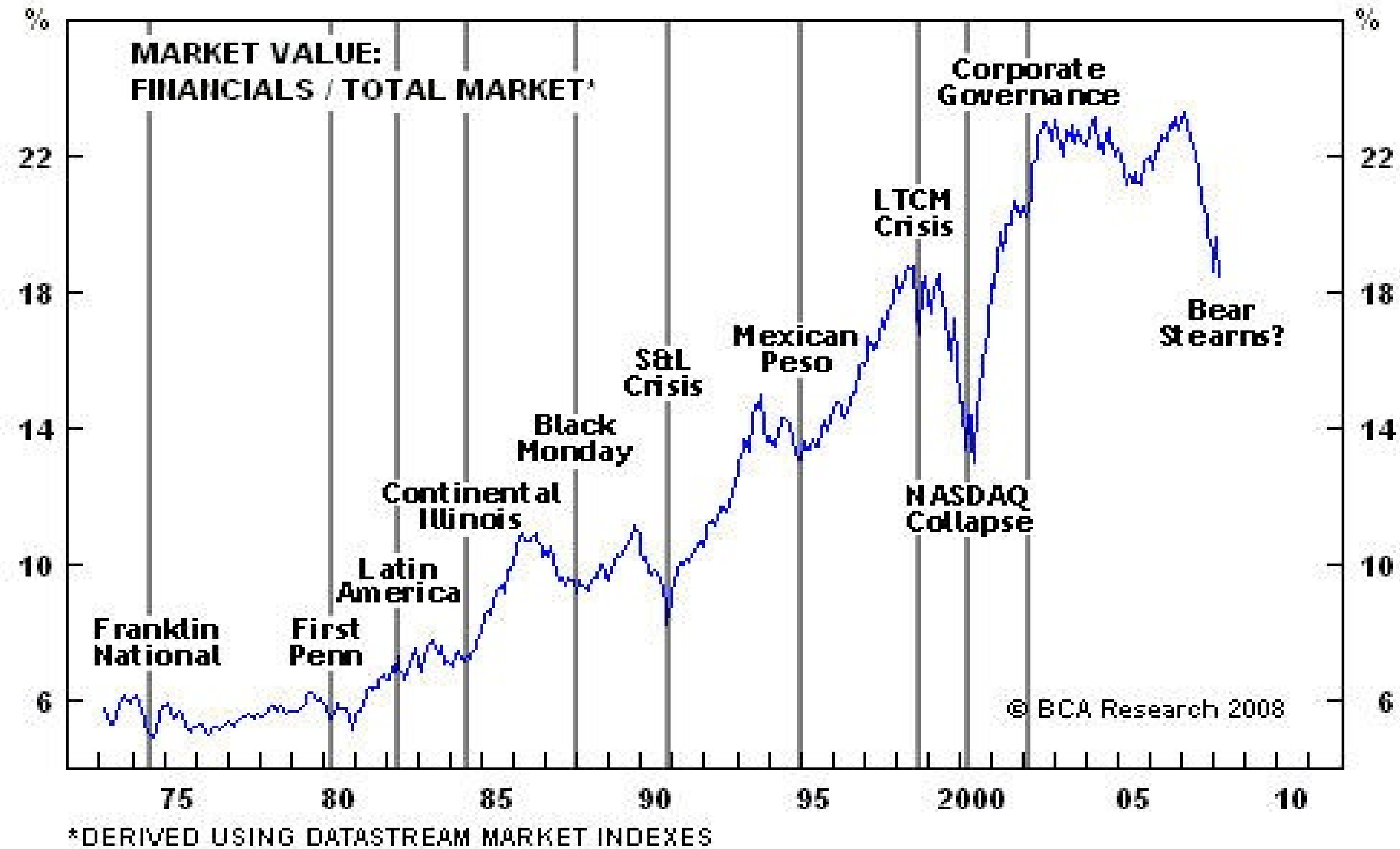

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What should you do, lemming?

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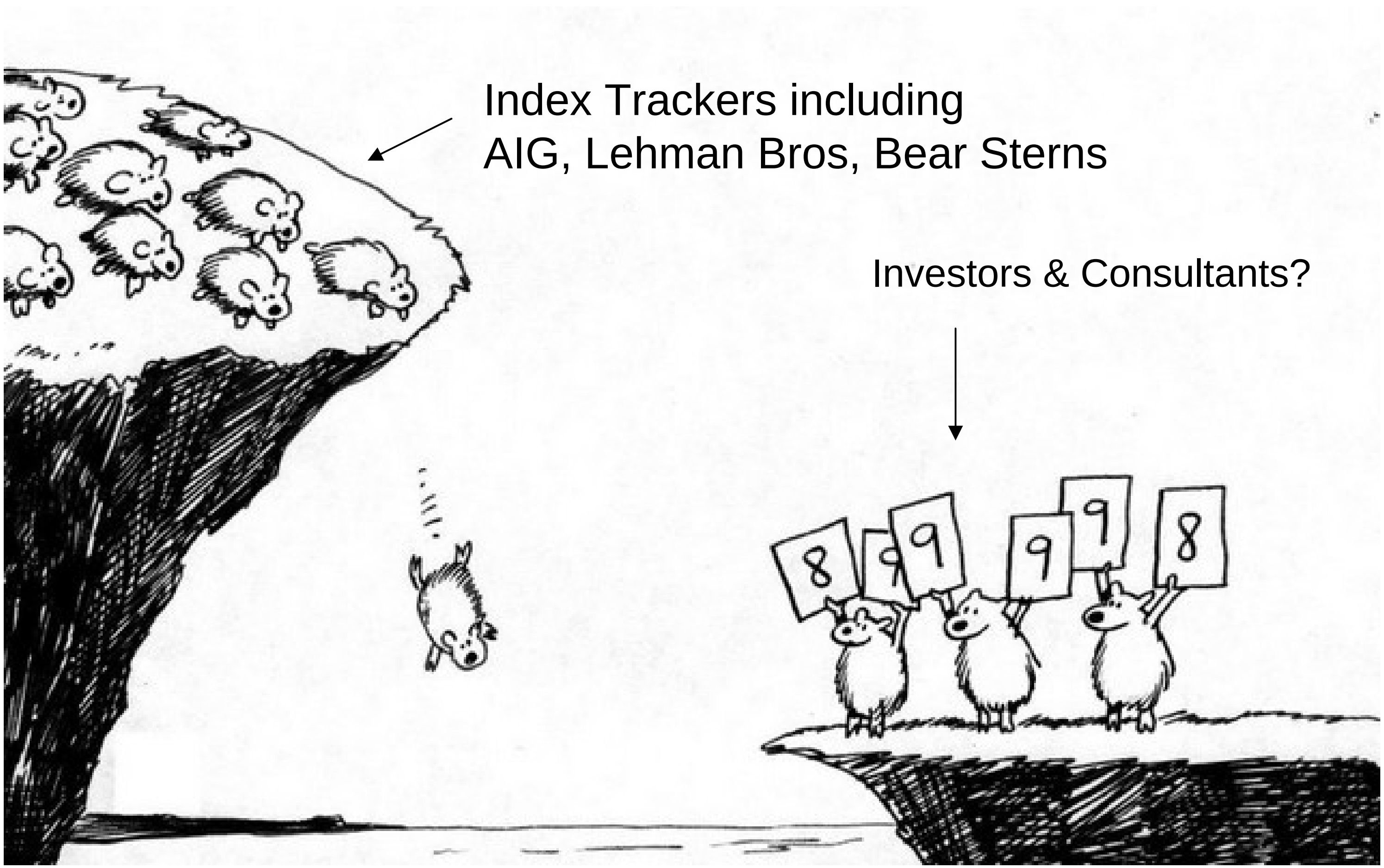

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Massive differences create opportunities

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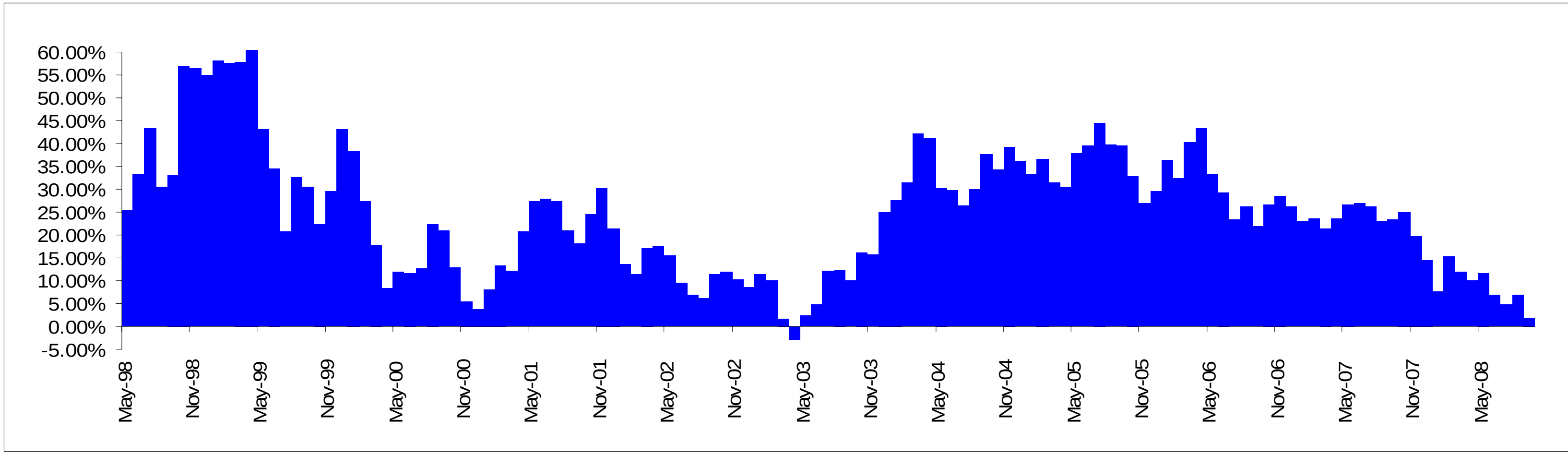
Dow Jones Total Market Index Sector Performance (1992 - 2008)

1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Financials 26.31%	Technology 24.16%	Technology 23.43%	Healthcare 54.86%	Technology 36.42%	Financials 48.94%	Technology 70.30%	Technology 83.68%	Utilities 56.07%	Consumer Services 2.65%	Consumer Goods -4.74%	Technology 51.04%	Oil & Gas 32.43%	Oil & Gas 34.09%	Telecom 36.83%	Basic Materials 34.56%	Consumer Goods -11.44%
Consumer Services 17.61%	Industrials 16.37%	Healthcare 10.78%	Financials 50.77%	Financials 33.84%	Telecom 40.64%	Telecom 51.82%	Consumer Services 30.10%	Healthcare 37.84%	Basic Materials 1.64%	Basic Materials -8.32%	Basic Materials 35.68%	Utilities 24.04%	Utilities 15.35%	Oil & Gas 22.77%	Oil & Gas 32.24%	Healthcare -12.86%
Telecom 16.19%	Telecom 15.89%	Basic Materials 5.51%	Technology 43.12%	Oil & Gas 28.25%	Consumer Services 40.58%	Consumer Services 47.30%	Basic Materials 27.10%	Financials 26.94%	Consumer Goods -1.10%	Financials 12.35%	Industrials 33.24%	Telecom 18.70%	Healthcare 8.32%	Utilities 21.28%	Telecom 22.40%	Oil & Gas -25.82%
Industrials 10.69%	Oil & Gas 13.68%	Oil & Gas 1.51%	Telecom 40.52%	Consumer Goods 23.95%	Healthcare 36.88%	Healthcare 39.09%	Industrials 26.72%	Oil & Gas 26.56%	Financials 6.38%	Oil & Gas -13.52%	Consumer Services 32.64%	Industrials 17.25%	Financials 6.46%	Financials 19.42%	Utilities 22.10%	Consumer Services -26.20%
Basic Materials 10.25%	Basic Materials 13.05%	Consumer Goods 0.49%	Industrial 35.03%	Industrial 22.22%	Consumer Goods 28.82%	Utilities 13.32%	Oil & Gas 20.18%	Consumer Goods 4.49%	Industrials -10.16%	Healthcare - 20.81%	Financials 32.23%	Financials 13.39%	Basic Materials 4.97%	Basic Materials 17.63%	Consumer Goods 18.90%	Utilities -28.43%
Consumer Goods 9.53%	Utilities 11.71%	Industrials -1.74%	Utilities 31.91%	Healthcare 18.55%	Utilities 28.76%	Industrials 10.98%	Telecom 18.41%	Industrials -9.72%	Oil & Gas -11.66%	Utilities -21.19%	Oil & Gas 25.74%	Basic Materials 13.05%	Industrials 4.82%	Consumer Goods 14.92%	Industrials 15.70%	Technology -30.02%
Utilities 8.04%	Consumer Services 11.32%	Financials 4.28%	Consumer Goods 31.84%	Consumer Services 13.25%	Technology 22.91%	Consumer Goods 10.80%	Financials 1.52%	Basic Materials -15.67%	Telecom -12.77%	Consumer Services -25.10%	Utilities 24.91%	Consumer Goods 13.02%	Technology 3.31%	Consumer Services 14.36%	Technology 15.22%	Industrials -30.94%
Technology 7.09%	Financials 8.36%	Telecom -5.15%	Oil & Gas 30.12%	Basic Materials 12.605	Oil & Gas 22.48%	Financial 7.51%	Healthcare -4.03%	Consumer Services -26.50%	Healthcare -12.84%	Industrials -25.54%	Consumer Goods 24.30%	Consumer Services 10.27%	Consumer Goods 2.04%	Industrials 13.87%	Healthcare 4.64%	Basic Materials -32.34%
Oil & Gas 3.83%	Consumer Goods 6.15%	Consumer Services -8.32%	Consumer Goods 21.64%	Utilities 3.95%	Industrials 21.15%	Oil & Gas -5.20%	Consumer Goods -10.21%	Technology -36.99%	Utilities -26.18%	Telecom -34.55%	Healthcare 19.43%	Healthcare 4.55%	Consumer Services -1.93%	Technology 10.10%	Consumer Services -2.90%	Telecom -36.60%
Healthcare 13.56%	Healthcare 4.80%	Utilities -12.14%	Basic Materials 18.15%	Telecom 0.11%	Basic Materials 11.57%	Basic Material -8.27%	Utilities -13.19%	Telecom -40.27%	Technology -28.34%	Technology -38.66%	Telecom 7.33%	Technology 1.76%	Telecom -4.00%	Healthcare 6.88%	Financials -7.50%	Financials -39.86%

Don’t lose the money



Drawdown analysis: 10-years of rolling 12-months returns to end September 2008			
	ALSI	**Dom Pru AA Med-Eq**	**Investec Opportunity**
No of rolling 12m periods	120	120	120
No of negative periods	26	16	1
%-of negative periods	21.7%	13.3%	0.8%
Worst 12-months	-30.1%	-11.3%	-2.9%

Source: Morningstar
Data to 30 September 2008

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3. What does a passive world look like?

- Investment returns would consist of dividends and income only
- **No instruments would trade** as everyone will hold the same proportion of the same instruments once benchmarks are set
  - But indices cant be calculated without trade (Sum (Price x outstanding shares/nominal))
- **No capital would be raised** and no capital gains would accrue – stock markets would not exist
- Capital could not be recycled through the economy to create growth

Rather be active…

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Concluding thoughts

- Managers with skill should be given maximum freedom to perform
- Managers without skill should be avoided or indexed
- Active management can exist without passive management, but not the converse

Appendix