PRESS RELEASE

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300 CLUB: ASSET MANAGEMENT INDUSTRY NEEDS TO CONSIDER CORE ROLES AND RESPONSIBILITIES

The asset management industry exerts unprecedented influence on the global economy. With global investable assets expected to increase to more than $100trn by 2020 (six times total US GDP in 2013), and the need to find scapegoats in the wake of the 2008 financial crisis, it is important to consider the role and responsibilities of core asset managers in the global economy, says Yves Choueifaty, in the latest paper published by the 300 Club entitled *The role of core asset managers in the global economy.*

Yves Choueifaty 300 Club, said: "One of the most fundamental purposes of the asset management industry is to invest savings back into the economy in a way that both maximises the scale of reward investors can achieve for a given level of risk and drives future economic growth and stability. It is this purpose that 'core' asset managers, who represent the bulk of investors' portfolios in order to deliver returns in line with their long-term strategic asset allocation, need to remain resolutely focused on."

In the ninth paper from the 300 Club, Yves Choueifaty discusses how the job of core asset managers within the overall wealth creation process is to reinvest savings into the economy and create wealth for investors through growth and development. He believes the real source of wealth is not the "skills" of portfolio managers, but the "skills" of employees working in the companies in which savings are invested.

Immunity from speculation

Choueifaty explains that whenever any investor builds a core allocation to any asset class, it is done with the belief that risk will be rewarded by a risk premium. He highlights that core asset managers are access providers to that risk premium, without which a core allocation to any asset class is not justified, regardless of the manager's potential skill. This involves building portfolios that are as protected as possible from any speculative bets, focusing purely on the existence of a future risk premium.

He highlights the difference between 'speculators' and 'core investors': "Imagine there are two gold mines. A speculator will only buy one of them "speculating" on the fact that the other would soon be exhausted. A core investor, however, would evenly allocate risk to both mines, believing the likelihood of exhaustion is taken into account in the prices of both mines. This second approach provides access to the true equity risk premium, rather than trying to take advantage of mispricings."

Passive is not the same as neutral

Choueifaty believes that much of the misunderstanding about the role of core asset managers comes from the ambiguity of the word "efficient" and outlines that if it is not possible to forecast accurately, and the 2008 Financial crisis proved the extent to which this is true of markets, the only alternative open to investors is to diversify. For managers to maximise the risk/reward available to investors, it is essential to build a portfolio that offers access to "pure" and neutral beta in the most diversified way possible.

He says: "Passive investing has nothing to do with achieving neutral access to the risk premium. Buying a capitalisation-weighted benchmark means buying something that is hugely biased and does not offer pure beta or immunity from financial speculation. These benchmarks can take on heavy structural biases that evolve over time. They are fundamentally biased as they attribute greater index representation to stocks or factors as they appreciate and less as they fall. They are a sum of speculations and these implicit bets change dynamically over time as the benchmark re-weights assets and alters those it tracks.

"Because they attribute greater representation to stocks whose share prices have risen, market capitalisation-weighted benchmarks reflect past successes. Furthermore, because an investor tracking these indexes would therefore have to allocate more money to the largest stocks, these benchmarks inherently forecast that the success of the past will be the successes of the future."

Correlations, not portfolio weights, drive diversification

Choueifaty asserts that an efficient portfolio is one where it is not possible to achieve less risk and more reward. It is on the efficiency frontier, along which the reward available for a given level of risk is maximised.

"For a portfolio to provide immunity through diversification and capture the full risk premium available for a given universe of securities, it must maximise diversification by selecting a range of stocks within the given universe that minimise the degree to which the constituent parts of the portfolio are exposed to the same source of risk. This means neutrally allocating across the effective independent sources of risk. In other words, correlation, not portfolio weights, must drive diversification."

Choueifaty concludes that the total alignment of interests between core investment and the economy at large is paramount. Economic growth and development generated by labour is the real source of wealth generation. Taking a neutral approach to core asset management maximises the risk reward ratio available to investors and helps generate prosperity and stability in the global economy, which ultimately drives wealth for savers.

He says: "Core asset managers should therefore be doing two things: firstly, they should be moving away from asset-weighted benchmarks, which are inherently biased, in their efforts to provide access to true beta; secondly, they need to maximise diversification in order to achieve the best possible risk reward for savers.

"By definition, a maximum diversification approach intrinsically promotes companies that stand out in terms of innovation, efficiency and strong governance. It is these characteristics that, through time, create growth, wealth and improve the overall wellbeing of society."

-Ends-

The 300 Club is a group of leading investment professionals from across the globe who have joined together to respond to an urgent need to raise uncomfortable and fundamental questions about the very foundations of the investment industry and investing. The mission of the 300 Club is to raise awareness about the potential impact of current market thinking and behaviours, and to call for immediate action.

The role of core asset managers in the global economy, is the ninth paper published by The 300 Club and can be downloaded alongside previous papers online:
http://www.the300club.org/WhitePapers.aspx

Members of the 300 Club:

Lars Dijkstra	Kempen Capital Management (Chairman of the 300 Club)
Dylan Grice	Aeris Capital
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Alan Brown	Former CIO, Schroders
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Yves Choueifaty	TOBAM
Roger Urwin	Towers Watson

The mission of the 300 Club* is to raise awareness about the potential impact of current market thinking and behaviours, and to call for immediate action. For further information, please visit the 300 Club's website: www.the300club.org

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Note to Editors:
*The "300" refers to the legendary 300 Spartans who in 480 BC held off the vastly numerically superior invading Persian army at the Battle of Thermopylae to give sufficient time for the remaining Greek forces to regroup. The story of the 300 has become a symbol of what can be achieved by a small band of high conviction individuals against overwhelming odds.