

News Release

Equity investors have ‘10 good reasons’ to be active rather than passive, says AllianceBernstein

Sydney, July 15, 2014—There are “10 good reasons” why equity investors in today’s markets should consider an active strategy despite the temptations offered by a passive approach, global asset manager AllianceBernstein said today.

"We understand the appeal of lower fees and simplicity, and many investors are sceptical about the ability of active managers to consistently beat a benchmark," said Sharon Fay, AllianceBernstein’s New York-based Head of Equities.

"However, there's also a lot of evidence supporting active asset management, and we believe that investors can find plenty of good reasons for an active approach just by looking around at the markets. Hugging a benchmark has its risks and many opportunities cannot be captured by being passive."

Fay listed 10 reasons, split equally between those that helped to avoid risks and those that helped to secure opportunities (see table on page 3). "Not every point is relevant to every investor in every market, but they are good reasons to stay active in equities today."

Avoiding risks

1. To steer clear of expensive areas—When a stock or sector becomes pricey, it continues to be included in a benchmark. Even after the decline in high momentum stocks this year, many Internet and biotech names aren’t cheap. An active manager can think twice about owning a stock trading at an exponential multiple to its future earnings—or decide to focus on specific companies where the disruption potential appears to justify the valuation. This applies to sectors too.

2. To manage a rising rate environment—What will happen when interest rates rise from current, historical lows? Stocks in some “safer” (income-oriented) industries like tobacco and telecom tend to have a negative sensitivity to rising rates. On the other hand, many stocks that are more cyclically exposed could do well as rising rates signal a healing economy. Active managers can fine-tune their exposures accordingly.

3. To navigate political risk—There’s no such thing as an exchange-traded fund that can prepare for—or react to—an unfolding political crisis, whether in Ukraine, the Middle East or Washington. Similarly, in many emerging markets, government meddling in companies and industries poses unique challenges. An active investor can make a measured assessment of when political involvement isn’t worth the risk.

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4. To deal with disintermediation—Many industries face disruption because of technological change. Remember Blockbuster video or Kodak? Today, countless large, benchmark companies are facing similar threats to traditional businesses, from shoemakers in China to banks around the world. Benchmarks aren't very good at keeping away from tomorrow's Blockbuster.

5. To avoid bubbles—This is perhaps the classic passive flaw. In 1980, the US energy sector ballooned to 27% of the S&P 500. In 1999, the technology sector accounted for 29% of the index. Both sectors collapsed in the subsequent two years. Japanese stocks reached 44% of the MSCI World Index in 1988—more than five times more than today and a bigger weight than the US at the time. Active investors should always be on the lookout for the next market bubble—and you never know where one might pop up. For example, real-estate investment trusts now comprise almost 9% of the US small-cap index—toward the high end of its 10-year history.

Capturing opportunities

6. To capture technological innovation—Benchmarks look backwards, by definition. So they are unlikely to help you benefit from the cutting-edge companies of tomorrow that will post rapid growth with new technologies.

7. To adjust to economic recovery—Every country is at a different stage of its economic cycle. In a global portfolio, a selective pro-cyclical tilt can help focus on those companies that are best positioned to benefit from regional variations of recovery. And in a single-country or regional portfolio, an active manager can shift toward companies that appear to be in the right place at the right time of an economic rebound.

8. To find higher revenue growth—In an era where it's becoming harder to expand profit margins, companies that can increase revenue may have an advantage. An index isn't really able to point your portfolio toward high revenue growers that have a better chance of posting stronger earnings in a tough environment.

9. To benefit beyond the benchmark—There's always something exciting going on just out of the benchmark. When emerging markets underperformed in a recent quarter, frontier markets—that aren't included in typical emerging markets indexes—held up much better. What about surging M&A activity in the pharmaceutical industry? An active portfolio might find a way to buy a British or Swiss drugmaker that isn't in its benchmark but could benefit from the trend.

10. To exploit less intensively researched universes—Small- and mid-cap stocks are fertile ground for active managers, because these companies tend to get much less coverage by analysts. We've built a "mind share index" to measure the intensity of research based on the frequency that analysts publish and adjust estimates. Based on this measure, we found that large-cap companies get more than three times more attention than small-cap companies. The same concept can be applied to emerging markets. The return and diversification potential from companies in frontier markets can't be obtained in a typical emerging markets benchmark. And frontier market indexes are even more prone to the vulnerabilities of benchmarks in general, as they tend to be heavily weighted toward a few countries.

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Ten Reasons to Stay Active in Equities Today

Avoiding Risks

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2. To manage a rising rate environment
3. To navigate political risk
4. To deal with disintermediation
5. To avoid bubbles

Capturing Opportunities

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Source: AllianceBernstein

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As at June 30, 2014, our firm managed US\$480 billion in assets, including US\$240 billion on behalf of institutions. These include pension plans, superannuation schemes, charities, insurance companies, central banks, and governments in more than 45 countries.

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