The importance of active share

Neptune Investment Team

At Neptune, we believe active share is an important tool for investors to judge whether they are truly getting the most value for money when buying an actively-managed fund. Whereas passive funds aim to merely replicate the performance of a benchmark, such as the FTSE All-Share or MSCI World Index, investors rely on active fund managers to try and beat these benchmarks over the long-term. In order to do this, we believe that truly active managers must take significant, high conviction positions in the parts of the market that they believe are the best-placed to outperform. This will naturally lead to a high active share.

What exactly is active share?

Active share measures how a fund's portfolio holdings differ from its benchmark. If a fund has an active share of 100, it would mean that it is completely different from its respective benchmark, while a score of 0 would mean that it is identical. At Neptune, we are truly active fund managers and that is why we are committed to publishing the active share of our equity fund range monthly. This is because we believe the active share should be an important consideration for investors when assessing whether they are getting value for money from an active Fund. If a supposedly 'active' fund has a low active share, this can signify to an investor that they are being charged higher fees for a product that is unerringly similar to it benchmark. An investment that could be better made through a low-cost passive.

Active share of Neptune's equity fund range	% as at 31 May 2015
Neptune China	55.2
Neptune Greater China Income	69.3
Neptune European Opportunities	81.7
Neptune Global Alpha	96.9
Neptune Global Equity	89.3
Neptune Global Special Situations	96.7
Neptune Global Income	85.9
Neptune Japan Opportunities	79.7
Neptune US Income	79.1
Neptune US Opportunities	88.9
Neptune South East Asia	72.9
Neptune Africa	46.6
Neptune India	60.4
Neptune Latin America	74.7
Neptune Russia & Greater Russia	70.6
Neptune UK Opportunities	77.9
Neptune UK Mid Cap	93.9
Neptune Income	64.1
Neptune Quarterly Income	69.9
Neptune Emerging Markets	81.3

Are there any limitations?

Of course, there are limitations of the active share measurement. Active share shows how active a manager is, not how effective, and is no guarantee of outperformance. However, we believe it is an important tool that should be used alongside many others in fund selection. It is also reasonable to note that some funds should have a lower active share than others. For example the Neptune Russia & Greater Russia Fund has an active share of 70.6% – below our average. This is because – given the crisis in Russia – we believe it is essential to remain invested in the largest and most-liquid Russian stocks at times of market stress. Therefore we do not believe an arbitrary number is good or bad, but must be judged relative to the situation.

The real debate

In the UK, we believe the real debate lies not between active and passive, both of which have their merits, but the billions of pounds worth of assets invested in closet-trackers under the counter. This damages active management's reputation and distracts from the real debate, which is between passive, closet-passive and truly active.

We believe that managers who are truly active would want to disclose their active share figures, to prove they are delivering what their investors pay a premium for. Otherwise, investors will remain unsure whether their specific investments are being managed in truly active strategies or not. We accept that high conviction, actively managed strategies can lead to shorter-term volatility. However we believe that over the long-term, significant outperformance can be achieved.

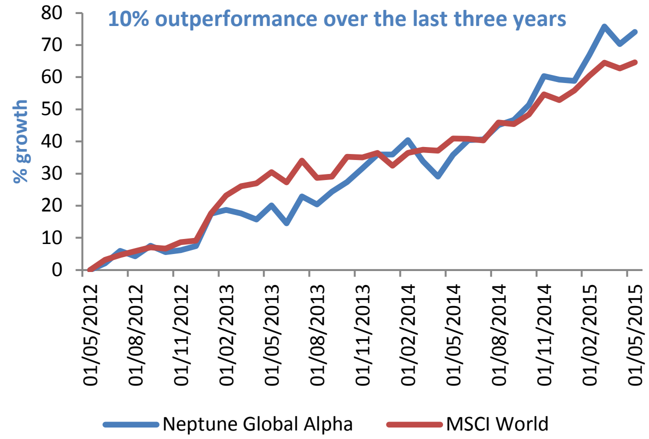
Short-term volatility versus long-term gain

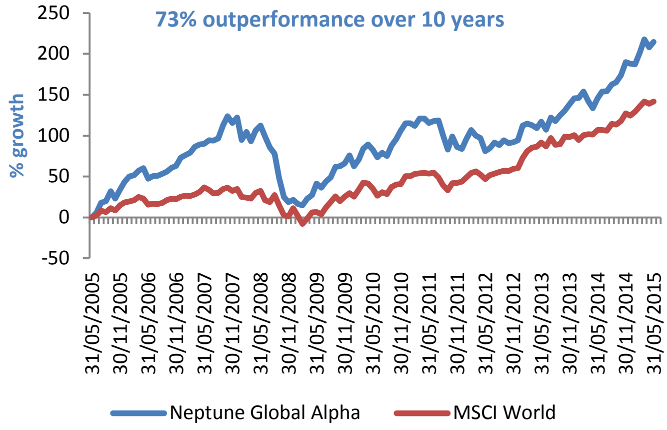
We believe that this ability to accept volatility is important, as the biggest risk for pension investors is that the sum of money they will receive on retirement will fall far short of what is required to meet their expectations. This is because they simply were not willing to accept enough volatility in the price of their investments when younger in life. For example, the average length of retirement for those who are 65 today is 20 years – yet this could continue to grow significantly in the coming years. This is because the average life expectancy of each of us in the UK is increasing by around 6.3 hours a day for men and 4.6 hours a day for women.

However, since the global financial crisis, low volatility products have dominated the pensions marketplace, despite often producing inferior returns. In contrast, history has shown that equities are the right investments to beat inflation over the long-term. To illustrate this, between the years 1900 to 2013, the real value of global equities, with income reinvested, grew by a factor of 325.0 compared to 8.4 for bonds and 2.7 for treasury bills.* Consequently, we believe investors must be prepared to take on more risk earlier in life.

The Neptune Global Alpha Fund

For example, the Neptune Global Alpha Fund has delivered strong returns over the long-term, despite short-term periods of volatility. However, an overly cautious approach – which slavishly works to avoid volatility in a portfolio – would have found it near-impossible to fully exploit the opportunities that the Global Alpha Fund has benefited from. This is because the Fund is a high conviction, multi-cap portfolio with an active share of 96.9%.





Source: Lipper, as at 31.05.15. C Accumulation share class performance, in pound sterling, with net income reinvested and no initial charges. The performance of other share classes may differ.

This is demonstrated by the fact the global equity benchmark – the MSCI World Index – has only 8% exposure to Japan. However, we believe that a powerful cocktail of reforms, put in place by Prime Minister Shinzo Abe, can lift the economy out of two decades of economic malaise. As a result, the Neptune Global Alpha Fund has more than 30% of its portfolio invested in Japanese companies, a position that has significantly contributed to the Fund's outperformance. This is an example of the importance of active, high conviction positions in generating benchmark-beating returns.

*Source: Credit Suisse Global Investment Returns Sourcebook 2015.

Important Information – for investment professionals only. Not for retail clients.

Investment risks

Forecasts are not a reliable indicator of future performance. The Fund may have a high volatility rating and past performance is not a guide to future performance. The value of an investment and any income from it can fall as well as rise as a result of market or currency fluctuation and your clients may not get back the amount originally invested. Investments in emerging markets are higher risk and potentially more volatile than those in established markets. Neptune funds are not tied to replicating a benchmark and holdings can therefore vary from those in the index quoted. These are Neptune's views and as such this article is deemed to be impartial research. We do not undertake to advise you as to any change of our views. This is not a solicitation or an offer to buy or sell our funds. Some information and statistical data herein has been obtained from sources we believe to be reliable but in no way are warranted by us as to their accuracy or completeness. Neptune does not give investment advice and only provides information on Neptune products. Please refer to the Prospectus for further details.