

ECPI Press Clipping

“Index Providers Moving Into the Alpha Space”

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INDEXATION: and so it comes to passive

Index providers are moving into the alpha space, trying to make the most of the opportunity created by the disappointing performance from active managers. *Angèle Spiteri Paris* finds out more...



Active management has fallen out of favour following poor results in the fourth quarter of last year. This is opening the door for index providers to capitalise on the situation and develop products, including those with an 'alpha' component.

Throughout the crisis index providers have, by and large, delivered on their promise of transparency to investors. They met their targets when it came to performance so they may not have lost as much investor trust as active managers have.

Many investors spurned active management as the passive market grew exponentially over the last two years. Ricardo Manrique, CEO of Stoxx, says: "From July 2007 to mid-2009 the peak-to-trough move in the Dow Jones Eurostoxx 50 was close to 60%. In that same period of time, European fund assets fell about 13%."

This state of affairs may therefore provide the ideal landing strip for index providers to move to launch alpha-generating products. The take-up may arguably be more successful than it would have been in the glory days of active management.

Andrew Clark, chief index strategist at Thomson Reuters, says: "They [active managers] have been losing assets or have been stabilised at best, and what's left that's done well are the plain vanilla beta products."

Thomson Reuters launched its index business just last month. The new business covers 44 countries and 18 regions, and has an overlay of global, regional and country indices by economic sector. One may say the timing was ideal as the firm seeks to make the most of investor appetite for passive products.

Alpha moves

FTSE is another index provider that has sought to capitalise on the opportunity the crisis has presented. It launched a range of investment strategy indices that are geared towards seeking alpha. This range includes the short and leveraged FTSE 100 and 250 indices.

Paolo Sardi, CEO of ECPI, an environmental, social and governance (ESG) research and indices company, says: "The move into the alpha arena has already begun with plenty of opportunities offered in the form of alpha indices."

Sources of alpha can be different: from research-based selection to quant and algo models... Passive investment has already staked its claim in the investment space and changes in the active space, with the increasing interest in alpha generation through an index instrument, is an interesting, challenging and potentially high-yielding opportunity."

New entrant Thomson Reuters has not yet launched any alpha indices although Clark says: "Simply because they aren't being released doesn't mean that the research isn't going on our side... We would want to see that the market has truly recovered. When it does and things are more stable, then we'll release some of the products."

Peter Preisler, head of EMEA at T. Rowe Price Global Investment Services, says: "It's clear that the mistrust some people have developed for active management takes time to repair. At the same time index providers have been delivering on their targets, on the relative scale... so I do think that there could be some truth in the argument that claims the advantage is on the side of the index providers or the passive managers."

T. Rowe Price does not offer passive management and Preisler himself is an advocate of active management; however, he points out that asset managers have more to prove in the current environment, which could be making life on the active side of things a little bit more difficult.

This could be part of the reason why index providers are looking to make the most of the situation following the financial crisis. Imogen Dillon Hatcher, executive director global sales, at FTSE, says: "The value-add is where we

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provide research and customisation to our clients. Also where we start to add more investment strategy-based ideas. Although they are the same passive indices, those [strategy-based or alpha indices] are more complex.”

The more onerous the indices the more complex the end product will be and therefore fund managers are able to command higher fees. Dillon Hatcher explains that in FTSE’s case, the index provider benefits from this, with a proportion of those higher fees as well.

Dillon Hatcher says: “Our model is based around the shared risk and reward idea. We encourage our clients to innovate with us and use our services and our data on which to base investment products. If that product flies then we both do very well. If that product is less successful then we encourage them to come back and innovate with us again.”

So although disappointment in active management may have left investors more open to solutions from index providers, this move may not necessarily revolutionise the industry.

According to Manrique, of Stoxx, “Index providers are being given a certain opportunity. It’s large, but I wouldn’t say it is huge... it’s a good thing but I don’t think its going to be a watershed by index providers.”

Alexander Matturri, executive managing director of index & portfolio services for Standard & Poor’s, believes that the preference for passive over active actually dates back further than last year.

“Historically, many active managers didn’t provide the transparency index providers did so this trend [towards passive management] has been going on for quite a while.” He adds that in the US between 10-12% of all dollars invested are held within some form of passive product.

Back to active

But Preisler, of T. Rowe Price, believes that the growth in passive products may turn around as active managers prove their worth. He says: “Part of what people called the stunning success of passive management is basically just a tactical move for institutional investors putting money to work.” Preisler says that many institutional investors have been using exchange-traded funds (ETFs) for tactical plays to gain market exposure. This means that these assets could very well flow back into the hands of active managers.

Matturri, of S&P, does not believe money will flow out of ETFs any time soon. “The overall pile [of assets] will continue to grow, but money might move from one segment of the market to another.” He says one could see assets moving from equity to fixed income, or from broad-based equity to a more narrow view. But ultimately, Matturri is confident the growth will be sustained.

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Contacts

MILAN

Tel: +39 02 721411

indices@ecpindices.com

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