FT Adviser
FINANCIAL TIMES

Index hugging

A recent research paper has come up with a potentially useful way of gauging manager skill (see page 6).

The study, by Yale's Martijn Cremers and Antti Petajisto, is of US mutual funds, but it seems a fair bet that similar trends are observable in the UK. In funds, as in world politics, Britain pretty much follows where the US leads.

The research has important implications for charges. Some fund groups try to be highly competitive on price, whereas others beat the drum for paying more and getting more. There is something to be said for both arguments. But the study found that, in general, charges are similar for all "active" funds; you only pay significantly less for passive strategies. In other words, you pay the same for a closet tracker as you do for truly active management – but without the same result. This finding will be of scant surprise to many.

However, what is new is the unveiling of a way in which stock-picker and index-hugger can more easily be distinguished. There are also some useful findings on which genuinely active approaches work best. Top down asset allocation calls do not deliver nearly as much alpha as diversified stock-pickers, possibly because the former must rely heavily on market timing.

Another useful thing arising from the research is that active share seems to persist. Advisers grappling with the knotty problem of whether a fund manager who has been performing well up to now will continue to do so may take some assurance from the "highly persistent" nature of active share, according to the authors.

On the face of it, this seems a useful way for advisers to judge fund manager skill. All we need is someone to crunch the numbers for the UK market.