

# **Common Misconceptions about “Passive” Investments**

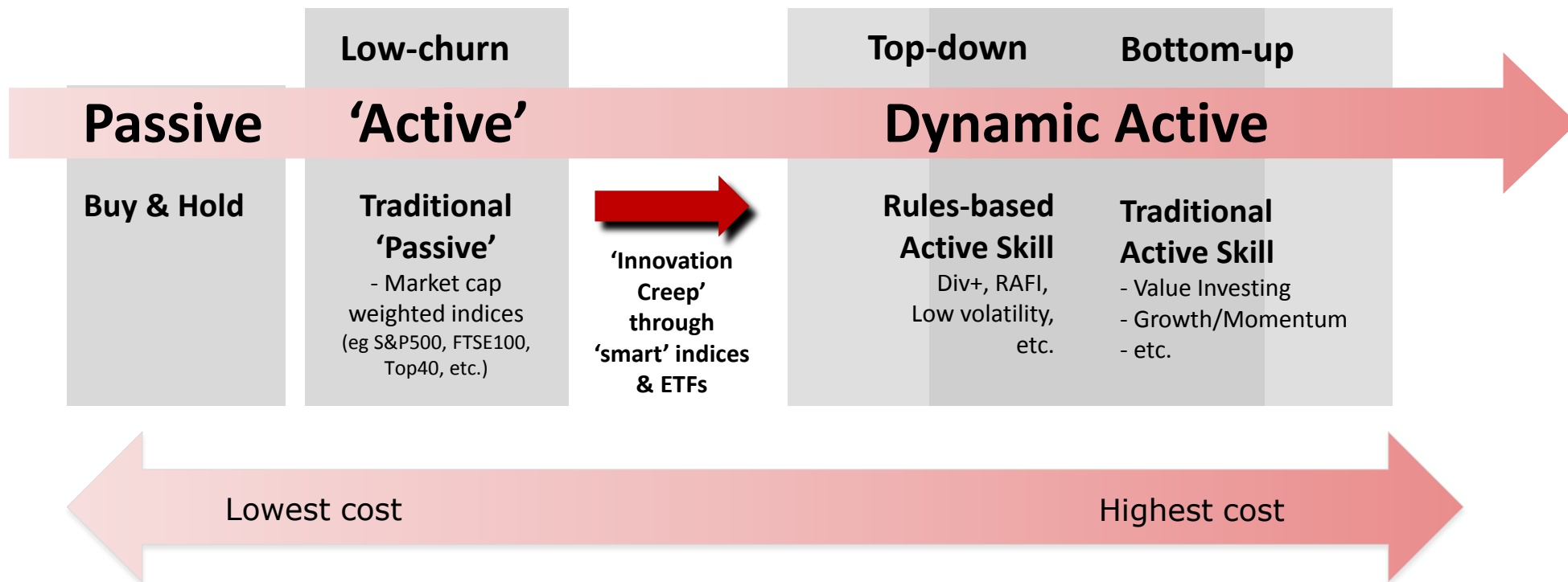
**Wealth Life Cycle Investing  
Seminar**

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# "All Investing is Active"...

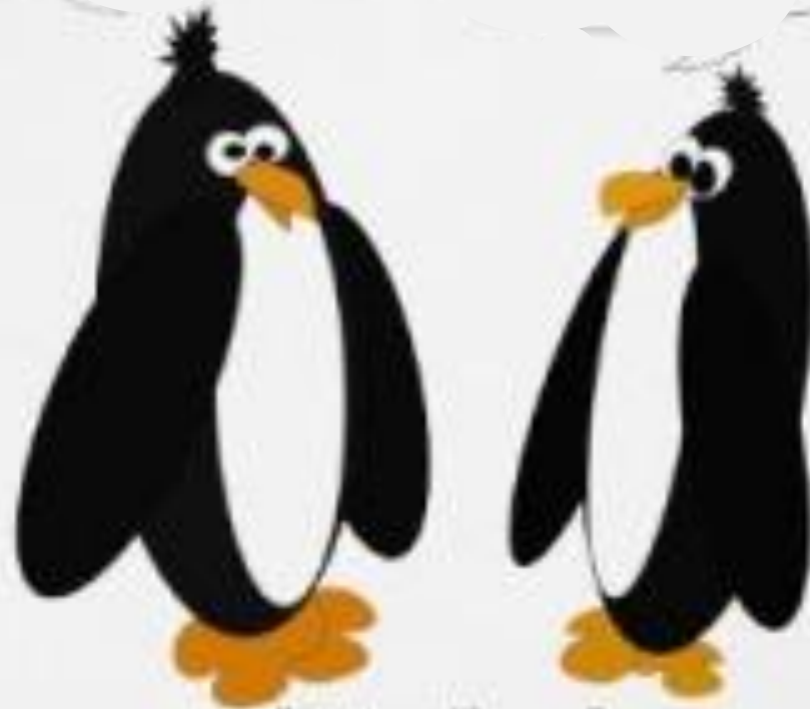
...it's just the level of activity that varies



**You  
deserve  
the best**

"I'm mediocre  
...at BEST"

"At least you're  
BEST  
...at something"



*"Mediocre Penguins"  
Vol. Speech*

Passive is  
Average

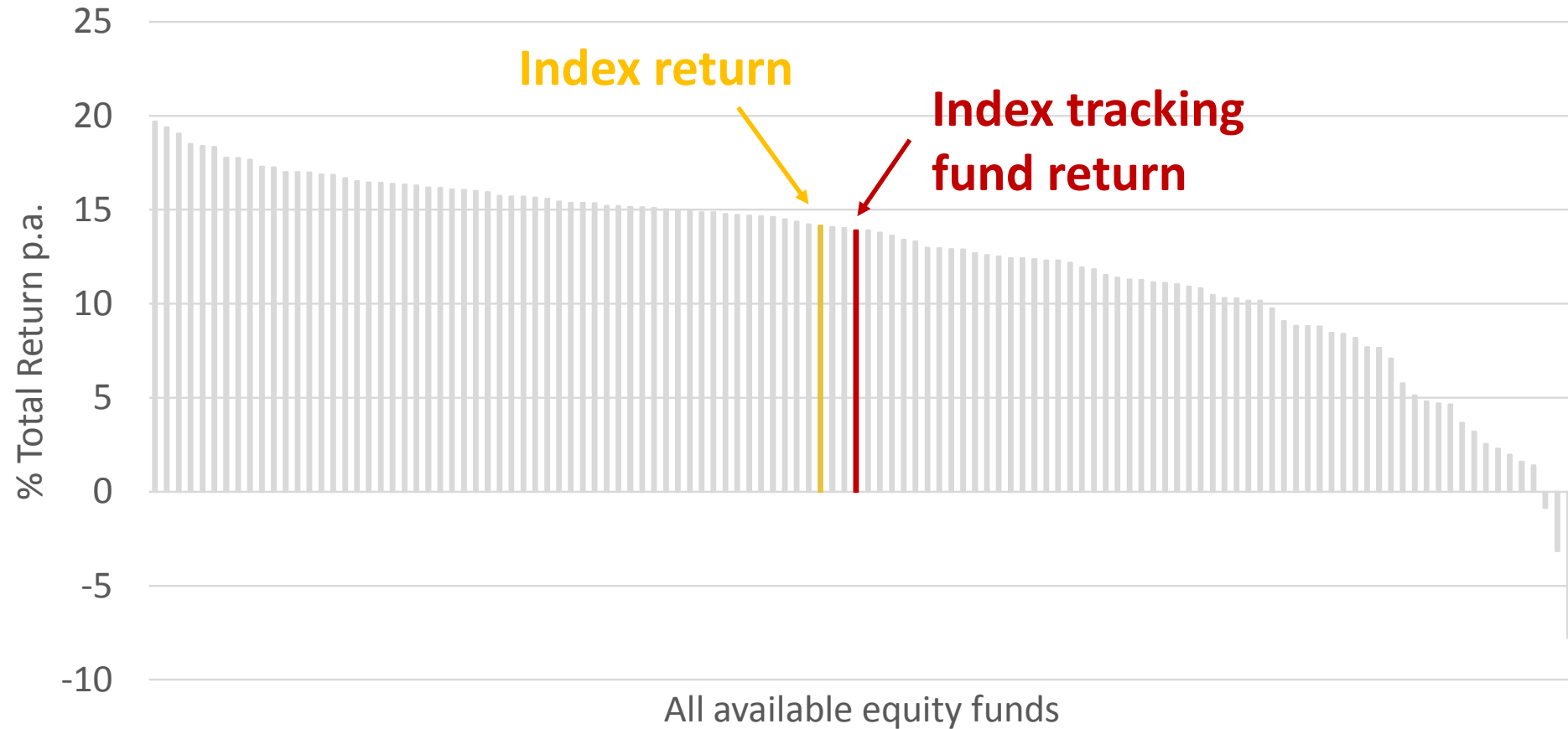
Why settle  
for mediocre

An *ETF* is  
guaranteed to  
outperform the  
index, after costs

# What is average?

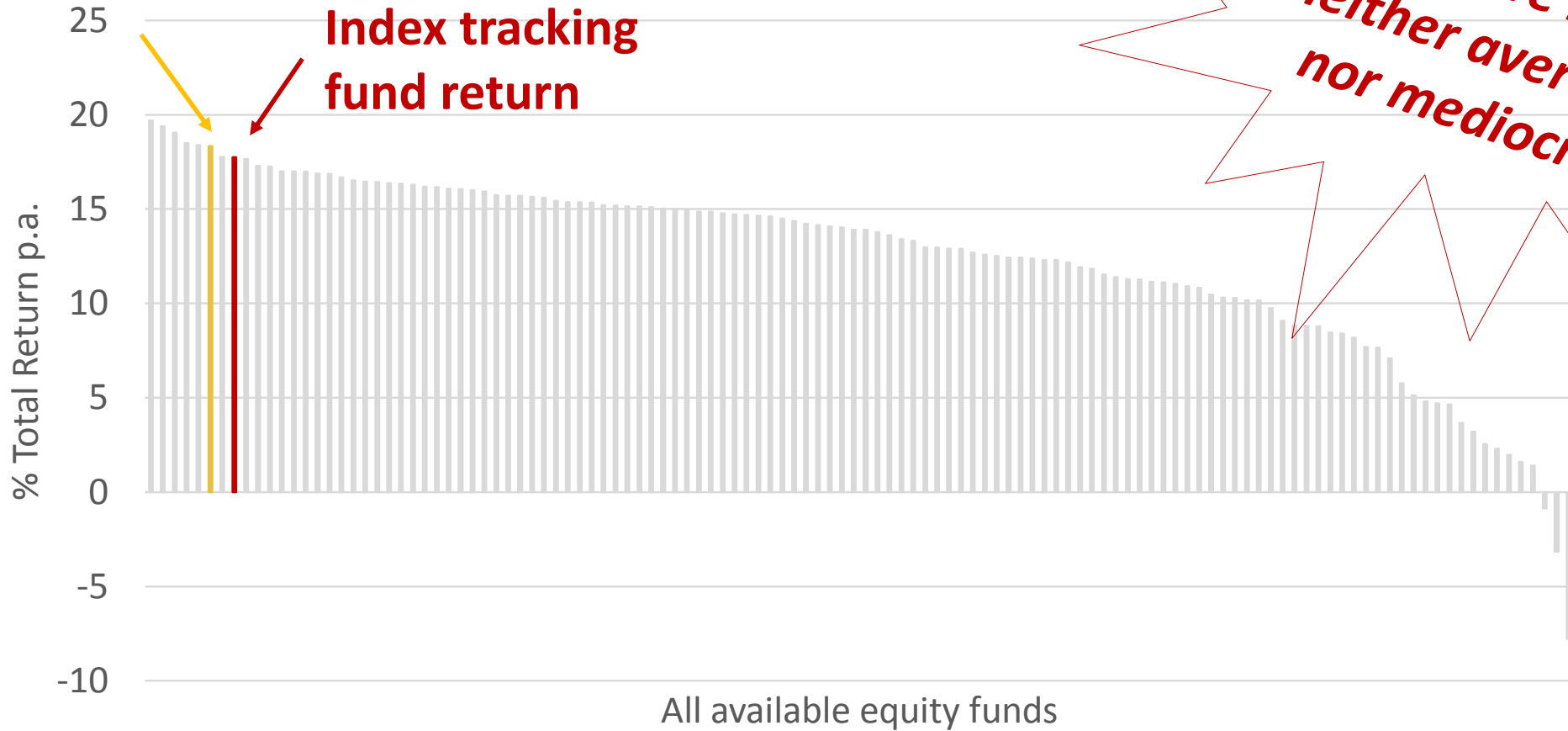
- **Index** performance
  - (Weighted) average performance of all shares
  - Mathematical calculation – **costless**
- **Fund / portfolio** performance
  - Rand value of all investment holdings + cash distributions compared to initial investment amount
  - **After** all costs incurred to make those investments
    - Transaction costs
    - Administration costs
    - Management costs
    - Tax implications

# Perception of "average"



# Reality of "average"

Index return



*Passive is  
neither average  
nor mediocre*

# How Well Do Actively Managed Funds Perform?

% of active managers who failed to outperform their benchmarks (broad-based market index)

	1 year	3 years	5 years
USA	86%	76%	89%
Europe	83%	76%	82%
South Africa	84%	82%	85%

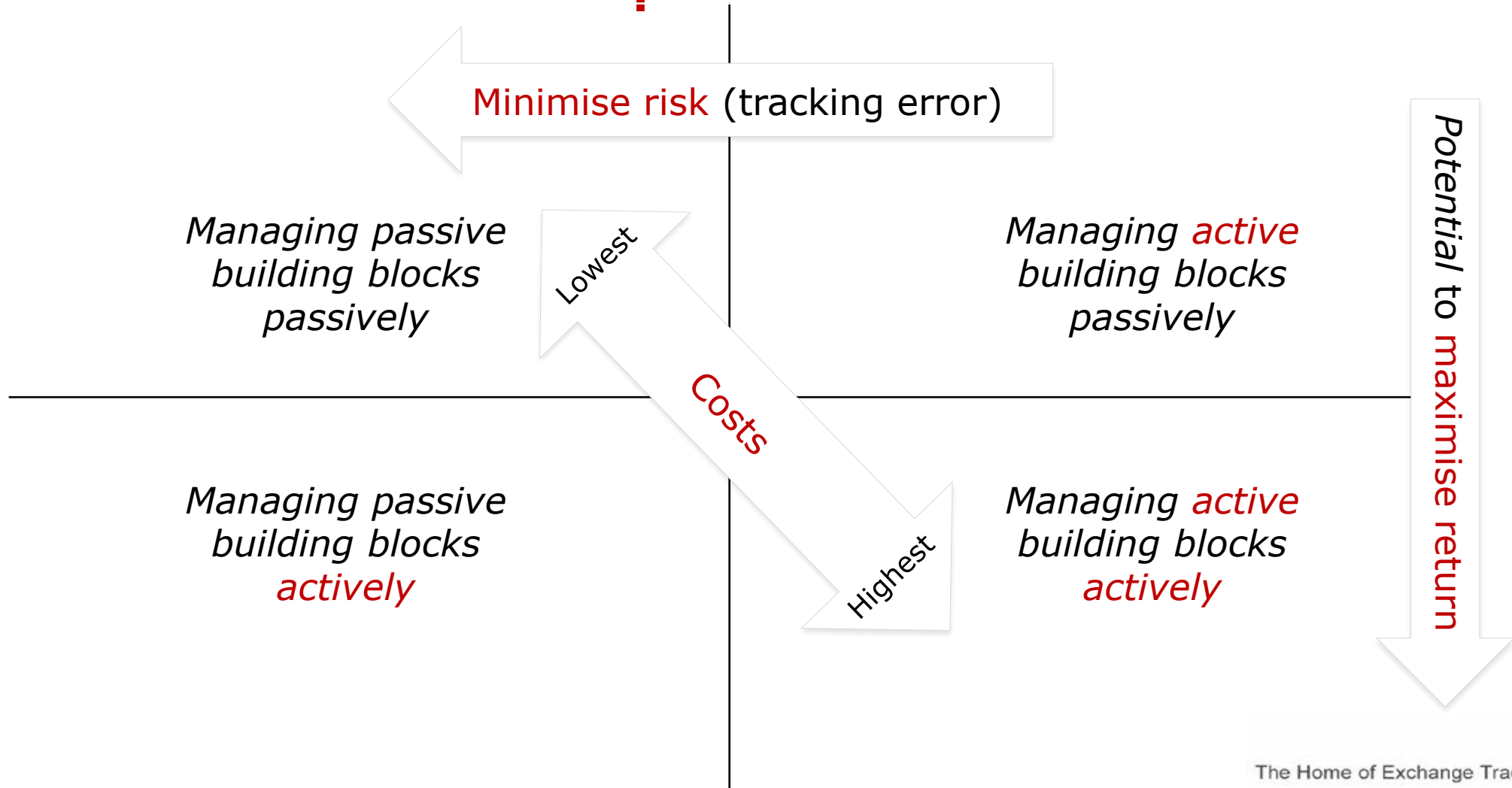
*Source: S&P Dow Jones Indices (SPIVA Scorecard) (June 2015)*

# What causes this underperformance? (other than costs)

- Size matters!
- Investable share universe decreases as fund size increases
- If you invest 5% of your fund in 1 company and do not want that own more than 5% of that company:
  - Fund size R 100 m – 170+ shares to choose from
  - Fund size R 1 bn – <160 shares to choose from
  - Fund size R 10 bn – 80 shares to choose from
  - Fund size R 40 bn – 35 shares to choose from

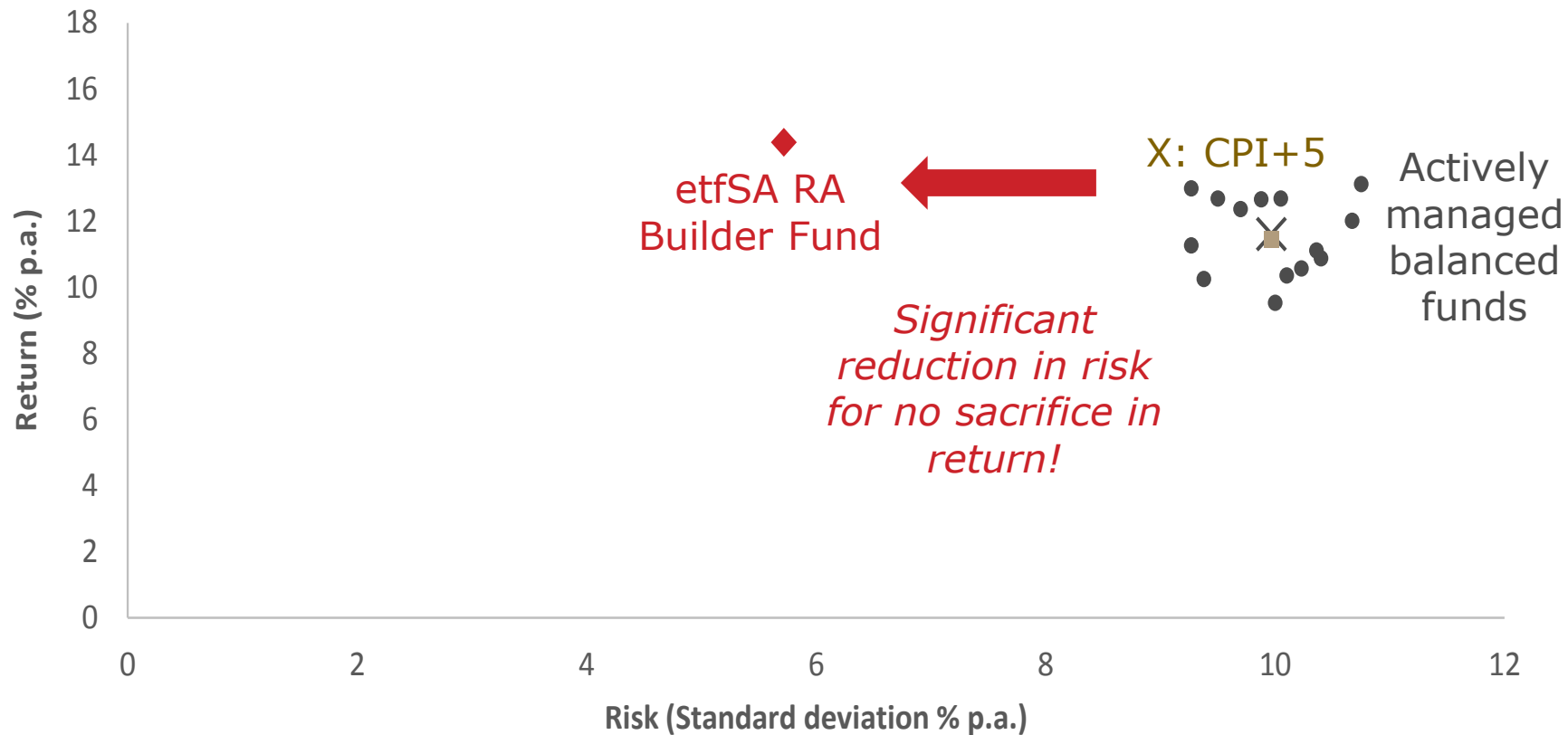


# What constitutes 'passive' at the overall portfolio level?



# Comparative Risk and Return Profiles of Passive and Active Strategies

Historical Performance of Balanced Funds - Medium Equity Mandate



Notes: Average performance for the 10 years from Jan-05 to Dec-14  
Source: ProfileMedia data; etfSA calculations

# ETF vs Index tracking unit trust – clarification of misconceptions

- A **bid-offer spread** is not a cost, and not hidden
  - etfSA investments are done directly with market makers, at the NAV
- There is no such thing as “**no admin fee**”
  - Beware subsidised cost structures to attract new inflows, with subsequent increases in costs, or hidden fees elsewhere
- Total Expense Ratio (**TER**) is **not the full story**
  - This only covers annual / ongoing fees, not regular transaction costs to invest in underlying assets

# Cost Effectiveness of ETFs

- Buying 40 individual shares is **MUCH** more expensive than buying 1 ETF unit...

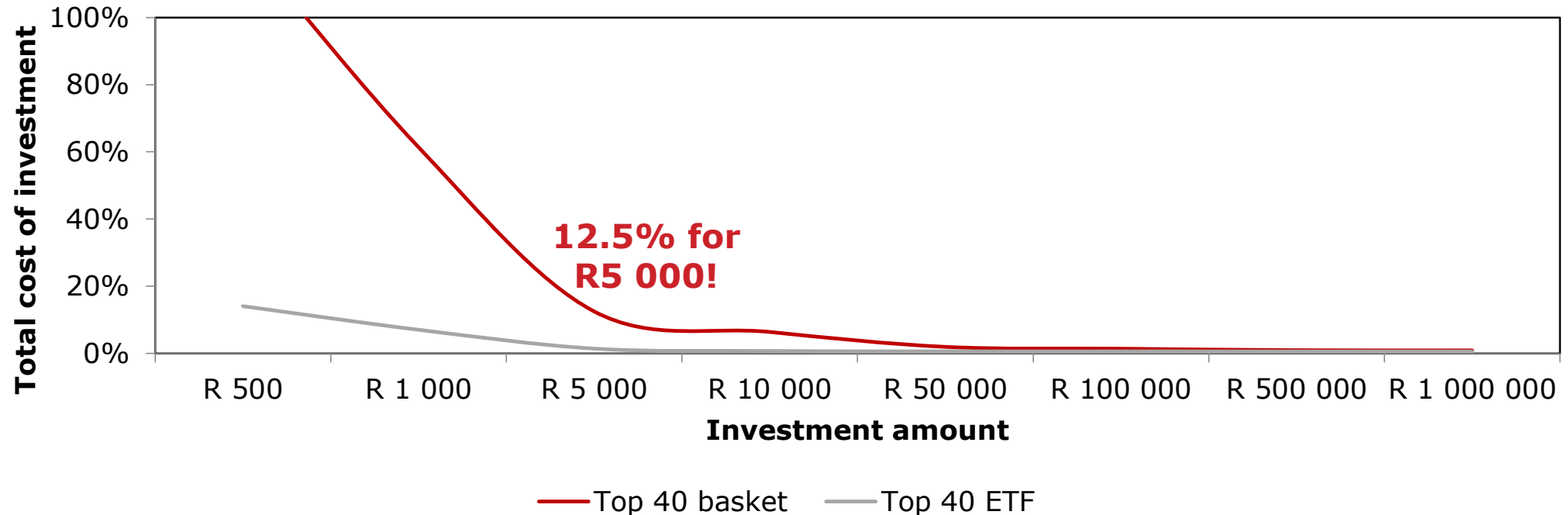
	<b>Portfolio of Top 40 shares</b>	<b>Top40 ETF</b>
Gross investment amount	R 100 000	R 100 000
Brokerage (0.5%+VAT)*	R 570	R 570
JSE fees & levies	R 555	R 13
Securities Transfer Tax (STT)	R 250	
Net investment amount	R 98 625	R 99 417
<b>Total cost of investment</b>	<b>1.4%</b>	<b>0.6%</b>

\* *etfSA.co.za* brokerage is only 0.08%+VAT

Source: JSE / Strate data; etfSA calculations

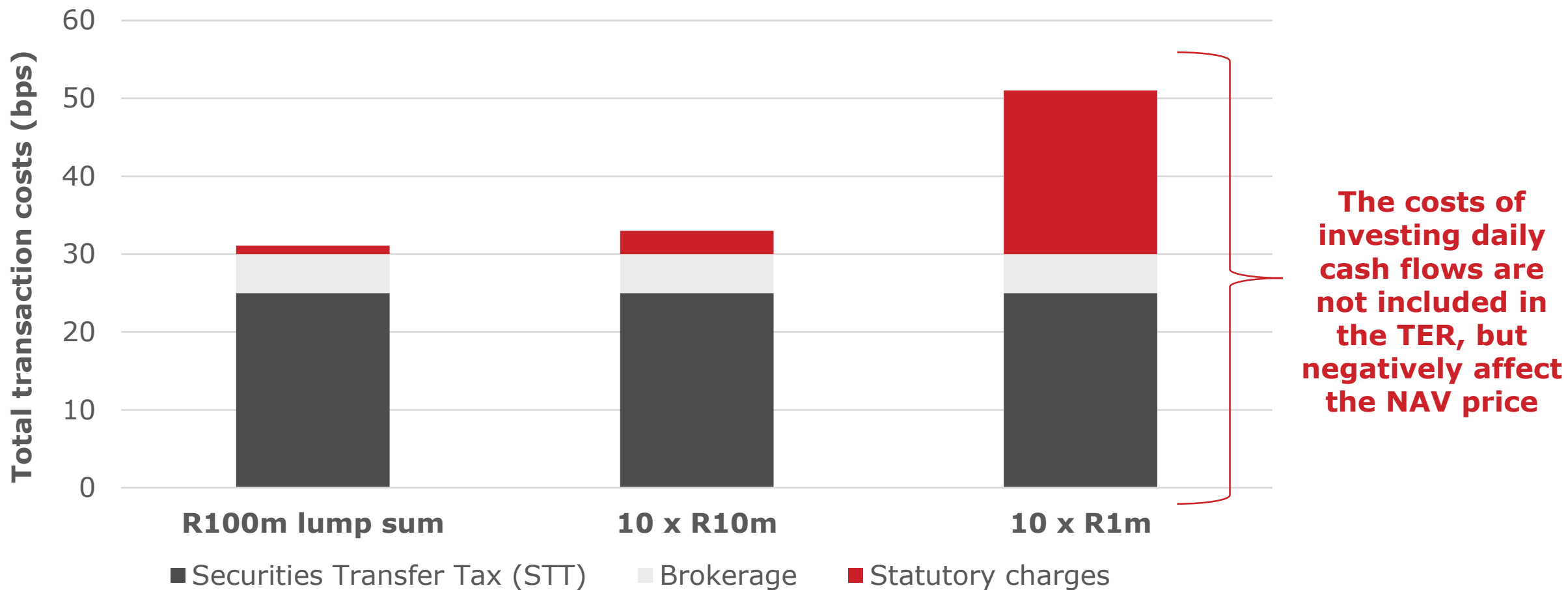
# Cost Effectiveness of ETFs

... especially if your investment amount is **relatively small**



Source: JSE / Strate data; etfSA calculations

# Why not an index tracking unit trust?



Source: JSE / Strate data; etfSA calculations

# Comparison of ETF performance to index-tracking unit trust

1 year performance to 22-Oct-14 – total return

- Satrix 40 **ETF: 15.78%** vs.

Satrix 40 **Index Fund: 15.45%**

3 year performance to 22-Oct-14 – total return p.a.

- Satrix RAFI40 **ETF: 10.31%** vs.

Satrix RAFI40 **Index Fund: 10.07%**

- Satrix Divi+ **ETF: 4.83%** vs.

Satrix Dividend **Index Fund: 4.67%**

*Source: ProfileMedia*

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