DiligenceVault

An APFI discussion on:

Fund Selection and the Role of Active Management

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WEBINAR TAKEAWAYS

01 There are 3 primary driving forces behind the movement from active to passive.

- Central Bank policy has generated asset price inflation to help ease volatility.
- The rise of technology and mega-cap stocks has skewed the weighting of valuations in market cap weighted ETF's.
- Managers are under fee pressure and there is less alpha. The 'easy' opportunities don't exist anymore and the non-performers are weeded out because they lack a sustainable advantage or differentiation factors.

02 Passive is not without risk, and Alpha still exists but requires diligence.

- There is a myth that active is risky and passive is without risk. By being invested in the market there is an inherent risk. You have the financial risk of course, but there is also a career risk for the fund selector.
- Manager selection opportunities cannot be done passively. Like searching for a diamond in the rough, it requires manual review and human touch, which often means traveling and seeing the managers in person.
- On the topic of China or other emerging markets, simply looking at the data on its own is not sufficient. More effort is required to gain insights from these strategies which requires seeing and speaking to managers.
- There are niche investment areas that are great for active management: Emerging Markets, Frontier Markets, Latam, Small and Micro Cap.

03 Though passive strategies and active strategies have been seen in opposition in the past, the real solution is a mix of both.

- Active is challenging to manage at scale when hundreds of billions of assets are held under management.
- The changing landscape and rising regulation, specifically in the tech sector, will make the trade around mega-techs less appealing in the coming years. This has already been occurring in markets such as China, as authorities begin to implement new rules on the consumer-lending industry, with Ant serving as it's biggest player.

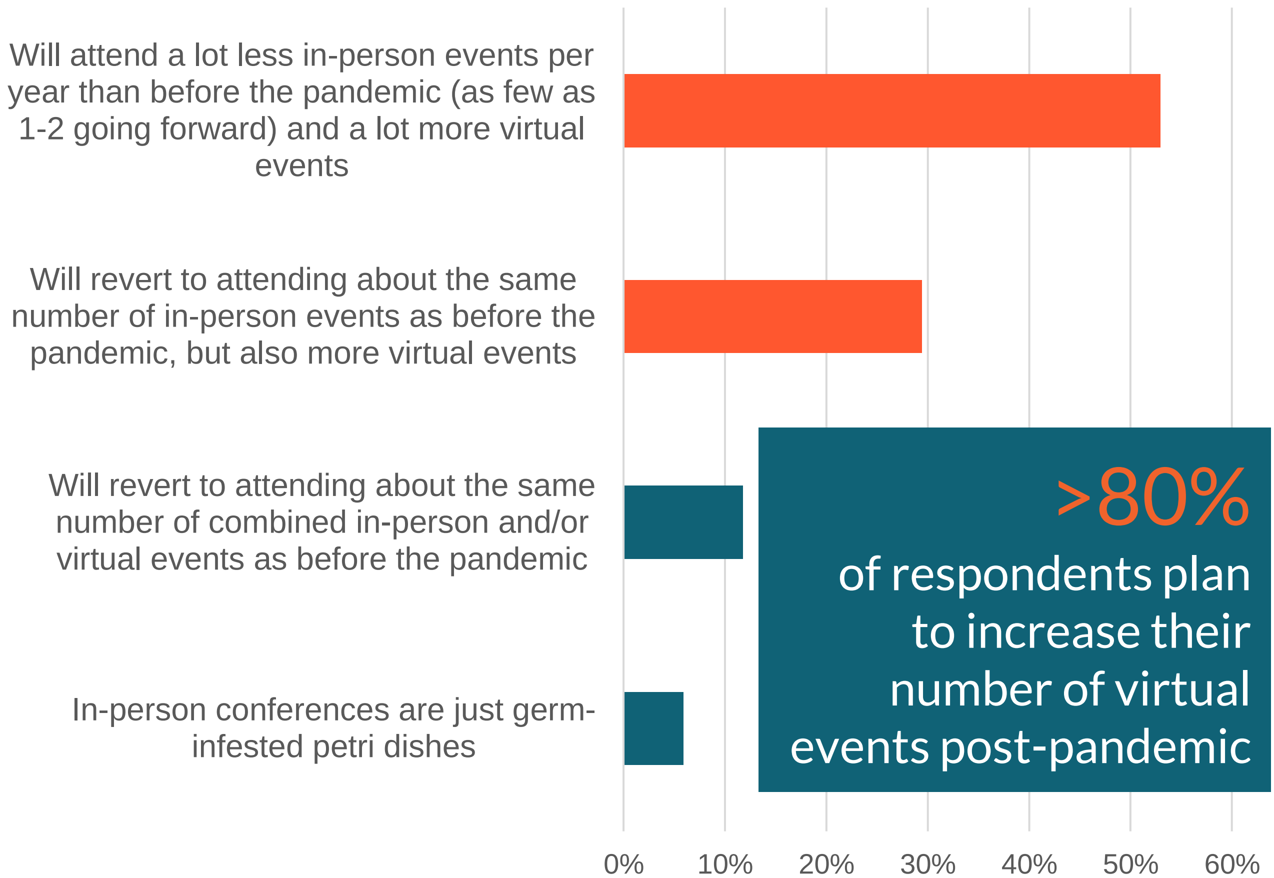
03 Though passive strategies and active strategies have been seen in opposition in the past, the real solution is a mix of both (continued).

- There was a swing from active management to passive management. Now, the expectation is that there is a middle ground where both are incorporated to be most effective.
- Passive has changed over time, and now requires a new set of skills. Whereas 15-20 years ago, it may not have required any investment knowledge, that is no longer the case. It requires a great number of checks, reviews of spreads, and diligence.
- For skilled active managers, there are still opportunities, but they are responsible for putting in the work and helping to drive capital stewardship and thought leadership rather than just following a trend. A good screening process is important for an active manager.

04 With or without technology, one still needs to be able to interpret data.

- Tech enables scale and drives increased productivity, but it does not replace human analysis and decision-making. Tech is efficient with certain tasks, but when there are changing market conditions (for example: staff turnover), it is hard for a system to be able to explain itself and the thought processes behind conclusions.
- Robo-advisors are a reality in the retail segment, but much less so on the institutional side where interpreting the data and being able to comprehend and share a complete story are important. These things are not replicable by technology (yet).
- Technology platforms such as Evestment and DiligenceVault allow for more efficient exchange and capture of data from the managers. These systems are very useful because they enable selectors to cut through the noise during the due diligence process.
- New technology hasn't necessarily altered the underlying tenets of data analysis. Cutting out the manual aspects of an end-to-end data process makes it easier to analyze larger volumes of data, while the fundamental selection and research process stays the same (or get better).
- As we think about interpreting data and making decisions, there is value from in-person meetings for assessments that should persist post-pandemic. The remote setting has proven to be unique and challenging in performing diligence on a new manager without an in-person physical meeting.

05 Poll: Looking ahead to after the pandemic, what will be your new set of preferences for attending conferences?



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