SHINING A LIGHT ON……
7IM US VALUE FUND

At a glance

We know that the US market is extremely difficult to call, and certainly in the last five years there has been a strong argument that investing purely in a fund that tracks the index would have done as well as an actively managed fund. By actively managed we mean a fund manager who picks specific investments.

However, there is an argument that this could change over the next five years as certain sectors (i.e. oil) will drag down the sector as a whole and therefore picking the best will deliver better returns.

Additionally, there are active managers focusing on certain sectors like small and mid-cap who can outperform the market. However, for those just investing in US large cap what are the best options. Is it possible to hold onto the low cost passive fund charges but get performance close to active managers?

We have seen recently the introduction of Smart Beta /Passive Funds, these effectively aim to capture the out performance of active funds with the low charges of passive funds.

In this update we talk to Alessandro Laurent, of 7IM, who has set up a range of Smart Passive Strategies. In particular, we wanted to focus on the US strategies but the process applies to Emerging Markets, Europe and the UK.

Who are the team behind the fund?

The process has been established by Alessandro Laurent. The system was set up in 2007 where he ran the strategy at F&C. The system is based on the same process.

We talked about potential risks and he felt that at the start there was greater risk when it was just him. Now with two additional people working on the strategy this has reduced significantly. Much of the model is automated and the team could run it without Alessandro.

Fund highlights?

Alessandro started by explaining that passive investment carries risk due to its exposure to size, and no discrimination in terms of risk. For example, large exposure to the energy sector will have dragged down the sector. Active management relies on stock picking skills which can work in some periods, but rarely across all.

The idea is to apply a 'smart' process to the strategy using a system developed and tested by Alessandro which aims to outperform a traditional passive funds, yet retains the low costs.

Fundamentally the process identifies the risk factors involved with achieving positive out performance rather than individual fund manager style (which can fluctuate). In part the fund will invest in cheap stocks (or value stocks) but the team also understand that just buying cheap stocks can create additional risks and also force the fund into cheap stocks which remain cheap.

The system effectively runs a programme which scores companies across a range of financial data against risk factors and produces a clean score for each risk factor. It then aggregates the risk-factors to deliver an expected return for each company and uses the score to weight stocks accordingly. The fund is rebalanced monthly.

For the US Fund the benchmark is made up of 628 securities of which the fund holds 139. It can move 3% between the index. So for example, EMC is 0.26% of the benchmark and the fund holds 3.26%. On the flipside Apple is 3.55% of the index and the fund holds 0.68%.

The challenge is that the fund is new, launched in April 2015, and since launch it is down 5.98% compared to the L&G US Index Fund (which a pure passive fund) which is down 3.98% and the MSCI USA Index which is down 4.98%.

The theory behind the fund is good and it keeps costs down. There is a track record at F&C and some investors may take this as a reason to investors. Others may prefer a wait and see approach.