

PRESS RELEASE

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HERMES: BEWARE OF AVERAGE MANAGERS HIDING BEHIND ACTIVE SHARE SMOKESCREEN

The growing focus on active share as a singular reliable guide for future fund outperformance could be detrimental for investors, according to a new white paper published by Hermes Investment Management today.

Looks like a lion, manages like a lamb, which explores a body of academic research, has found that the use of a single portfolio attribute - such as active share - does not give a complete picture of a fund's ability to generate excess returns over a benchmark.

The paper also reveals that simply identifying the correct investment opportunities is not enough for managers to deliver outperformance. This skill must be allied with strengths in other areas of portfolio construction, such as ensuring the size of individual positions is commensurate with the level of risk taken.

Key findings on active share:

- A high active share portfolio picked by an unskilled manager is more likely to significantly underperform
- A top-heavy index will necessitate muted active share
- Single index portfolios may naturally find it harder to generate a high active share
- Active share is not associated with any consideration of portfolio risk

The paper also addresses a number of key questions about how applicable active share really is in modern portfolio management:

- Do funds with the highest active share really outperform benchmarks?
- Does outperformance hold up even after the inclusion of fees and transaction costs?
- How does this contrast funds with the lower active share?

Eoin Murray, Head of Investment Office, Hermes Investment Management, warns the growing investor reliance on active share is materially oversimplifying the complex fund selection process: "In the search to gauge a manager's chance of future success, investors have been focusing on active share. Some interpret this as the manager's conviction in their portfolio – by extension, a manager with high active share looks like a lion.

"However, just using active share as a measure is a gross oversimplification. It can only really be considered in the context of other factors, such as tracking error, to give an indication of how skilled a manager is and, therefore, how they might be expected to perform in the future. Without the presence of skill, a manager that looks like a lion based on their active share, might actually manage like a lamb."

Aside from active share, the research also identifies additional metrics valuable in the investor toolbox. These include a return ratio, timing history, hit ratio, total value added and risk attitude.

Mr. Murray adds: "It is not sufficient only to have the skill to identify opportunities. It must be allied with an ability to construct portfolios so that the size of individual positions will be commensurate with the size of the opportunity and the risk taken.

"Active share holds a great deal of practical utility for assessing active managers, but cannot be used in isolation, and will be one in a set of tools available for investors trying to identify managers that are capable of delivering desired outcomes.

"We are focused on helping our fund managers to deliver consistent, positive long-term outcomes for clients. In seeking this, other measures of forward-looking risk and a deeper level of understanding about a manager's strengths and weaknesses form an important consideration alongside active share."

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Notes to Editors:

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Hermes manages assets on behalf of more than 200 clients* across equities, fixed income, alternatives and real estate, with £30.1 billion* assets under management. In Hermes EOS, we have the industry's leading engagement resource, advising on more than £124.3 billion* of assets.

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- **Responsibility:** We believe it is our responsibility to lead discussion and debate about the fiduciary responsibilities of fund managers to our clients, their stakeholders and, ultimately, society at large. We have always sought positive engagement with the firms in which we invest.
- **Innovation:** We have the entrepreneurial culture to identify forward-looking products that meet those needs, along with the resources and speed-to-market mentality to develop them rapidly.

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