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Active vs. Passive: Volatility Matters

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Finance Professor George Athanassakos, head of the Ben Graham Centre for Value Investing, thinks actively managed funds may have the upper hand

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The average actively managed portfolio has had a tough time keeping pace with its benchmark. A March 2010 study by Standard & Poor's found that nearly 61% of large-cap growth funds trailed the S&P 500 in the five years ended December 2009. For years, "you didn't have to be a genius to make money," says George Athanassakos, professor of finance at the University of Western Ontario's Richard Ivey School of Business and a guest columnist in Canada's largest daily newspaper, *The Globe & Mail.* "You just left money in an index fund and went to sleep."

KEY INSIGHTS

- With inflation, interest rates, and taxes on the rise, the stock market may be choppy
- Amid a volatile environment, active managers may outperform index funds
- Value managers may find plenty of mispriced stocks in a rocky market

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But in today's bumpy market, Athanassakos says active managers will have the advantage. "We're going to have a lot of ups and downs. To make money in that kind of market, you have to be both active and disciplined." (Volatility is a *Focus Opportunities* theme for July.) And he notes, the environment should favor investors with a value bias—the sort of style he promotes as head of his school's Ben Graham Centre for Value Investing (named after the author of the *Intelligent Investor*). "Value investors actually love volatility," says Athanassakos.

Athanassakos attributes the choppy market to a perfect storm of economic factors. "Inflation's going up, interest rates are going up. To deal with the deficit, taxes are going to be raised and government spending is going to be cut," he says. And stimulus money, a critical economic prop at the moment, will eventually run out. The result: a rollercoaster ride—rather than a slow, gentle rise—for stock market investors.

It's an ideal environment for value investors, says Athanassakos. In volatile times, he believes, such managers may find a plethora of underpriced

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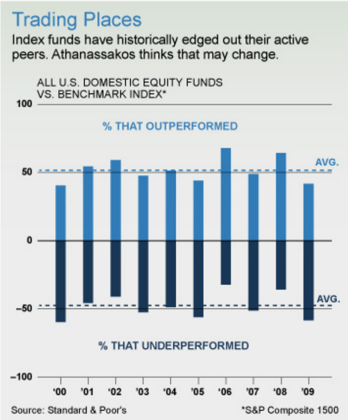

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companies as stocks trade up and down on euphoria and panic. Growth investors, he says, tend to get caught up in the momentum and overpay for stocks.

The numbers reveal the bargains, Athanassakos says. He recommends looking for companies with both low price-to-earnings ratios *and* low price-to-book ratios, a combination that suggests a stock's price has fallen below its intrinsic value. Then, of course, investors need to stick with their convictions—the buy-and-hold approach espoused by Warren Buffett and the rest of Benjamin Graham's devotees. Says Anthanassakos: "You have to have the nerve, and the emotional control, and the patience to be able to take full advantage. The worst thing you can do is panic and follow the herd—because the herd is always wrong."