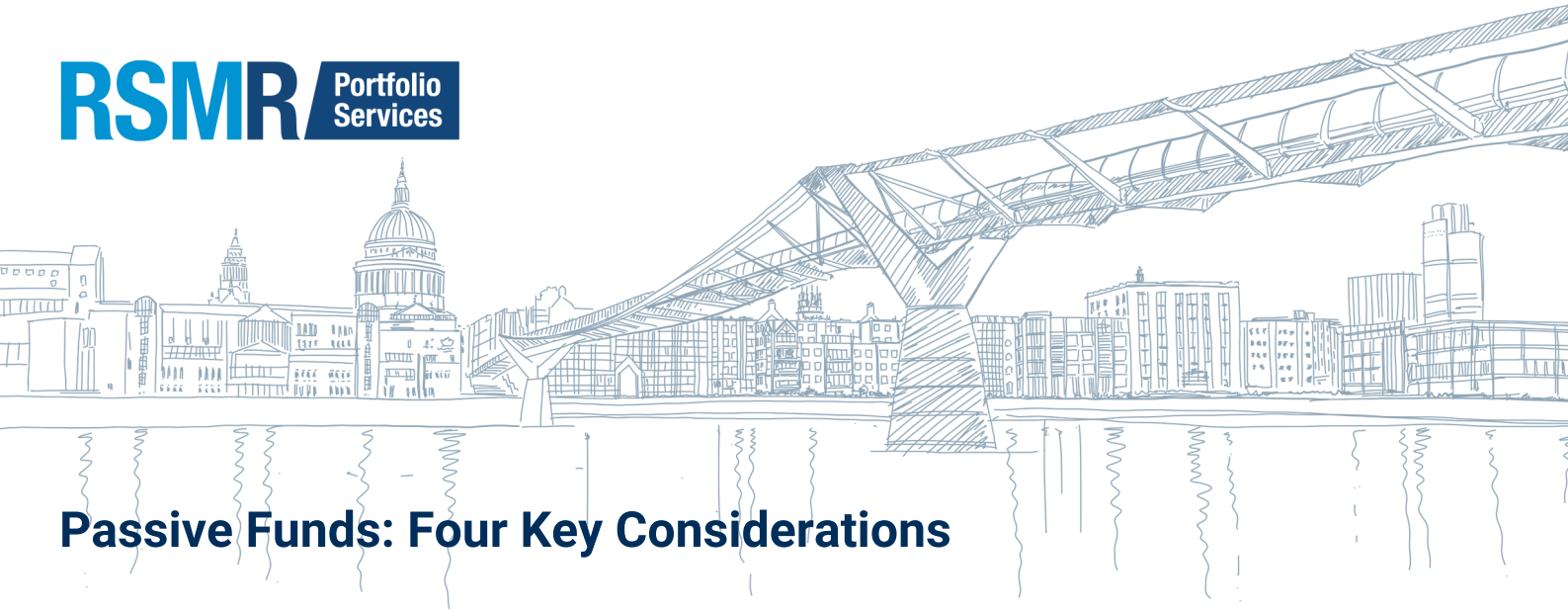


Passive Funds: Four Key Considerations

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Passive funds are playing an increasingly prominent role in investment propositions, whether used alongside active funds or as standalone solutions. While quantitative factors such as past performance, volatility, and published OCFs (Ongoing Charging Figures) can make a passive fund appear attractive, there are other critical factors that can significantly impact investment outcomes.

At RSMR, we have been researching passive funds for over 10 years and active funds for more than 20 years, often blending both within portfolios to optimise results. While historical quantitative analysis is an essential part of our process, we place equal emphasis on qualitative factors that we believe are fundamental to long-term success.

To support advisers in discussing, recommending, or reviewing passive funds, we've highlighted four key areas that warrant close attention:

1. Fund domicile and tax treatment

It is essential to consider the withholding tax treatment of the specific index variant used by a passive fund. There are benefits to UK investors accessing certain exposures via UK-domiciled funds, as opposed to using cross-border domiciled funds distributed in the UK. This mainly applies to US, Global, Japan, and to some extent emerging market exposures.

2. Index replication and tracking error

A fund's benchmark index is often used as a guide to how it invests. However, tracking an index tightly is not necessarily easy or cheap, and some stocks may be less liquid. In fixed income markets, where an index may comprise thousands of bond issues, many passive funds employ stratified sampling to replicate the index more cost-effectively. Similarly, several passive equity funds utilise optimised replication to achieve the same objective. However, this approach inevitably involves a trade-off between tracking error and investment costs.

3. Charging policies

At RSMR, we conduct a thorough analysis of charging policies to ensure a clear understanding of the costs investors may incur, as fund group policies can vary significantly. While OCFs (Ongoing Charges Figures) are sometimes capped, they typically fluctuate, making it essential to assess fee structures carefully. With passive funds, as with active funds, the OCF will not include the transaction charge which, given the lower OCFs of passive funds, will represent a larger proportion of all the fund-related charges. If you want a reliable, combined figure, look for the MIFID II charge.

4. Fund pricing and valuation timing

Mismatches in the times that a fund is priced and when stocks in the index are priced also contribute to the tracking error of a passive fund. Many passive fund providers use custom or midday benchmarks that adjust valuation times to better capture market openings and closings across different regions. Additionally, many operate global trading desks that facilitate 24-hour trading, ensuring access to fair and accurate pricing.

The Passive Plus MPS range from RSMR combines the cost-efficiency of passive investing with targeted exposure to active funds – enhancing diversification and smoothing volatility. With five risk-profiled portfolios, built from RSMR-rated funds, the range benefits from our rigorous and highly regarded research process and has a consistent, long-term track record. Available on multiple platforms, and with a low DFM charge of just 0.15% p.a., Passive Plus offers a smart, robust investment solution.

Want to learn more about our MPS ranges? Contact our dedicated accounts team using the details below:

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