ThinkAdvisor
An ALM Website
JANUARY 21, 2020
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News

Passive Investing 'Is Not a Strategy': Ariel Exec

By **Bernice Napach**

"Avoiding losers is more important than picking winners" in long-term investment portfolios, says Rupal J. Bhansali, chief investment officer and portfolio manager of international and global equities at Ariel Investments. In other words, "Risk management precedes return management."

It's mathematical, explains Bhansali. A portfolio that loses 50% one year, for example, would have to double in price (a 100% gain) just to break even. Such a huge loss could set the portfolio back years, lagging competitors, even if it had large gains in previous and subsequent years.

Bhansali herself is on a mission to find upset victories, those stocks that far outperform the consensus expectations, which is always a value approach. She eschews consensus. "There is no payoff from right answers if they're the consensus," she tells a gathering of journalists. "You must be right and prove the consensus wrong."

Bhansali also criticizes passive index investing — "a good idea taken to the extreme," with "high exit costs."

"Passive is not an investment strategy," she says. "It's owning past success."

Rupal Bhansali, chief investment officer and portfolio manager of international and global equity strategies, Ariel Investments.

In her new book, "Non-Consensus Investing," Bhansali explains that passive investing dominates the stock market, creating the risk of "owning overvalued assets and contributing to price distortions and market inefficiency … When too much money chases too few goods, it bids prices up simply through technical demand/supply imbalances, not fundamental factors."

She recalls the dot-com crash in the early 2000s and "suspects" a "milder" repeat of the downturn in today's overvalued stock market, telling the luncheon gathering, "If markets are going to decline, alpha becomes more precious than beta. Beta will be negative."

In other words, active management has greater potential to outperform in down markets.

But in up markets, which have prevailed for much of the past decade, active management has underperformed. Bhansali's funds have lagged their benchmarks and peers in four of the eight past years, according to Morningstar.

Bhansali says this consensus view of active funds is only half true because the active fund category includes closet active funds that "hug" their benchmark" and "pseudo active" funds that are "formulaic," using measures like low multiples or low price-to-book multiples to pick their stocks rather than doing fundamental research.

Truly active funds do that research and have a high active share, low turnover and a portfolio manager who invests in the strategy and manages risk, says Bhansali.

Morningstar analyst Connor Young in March called the Ariel International Fund, which Bhansali manages, "a solid option with below-average risk" with a "focus on high-quality firms and attention to downside risk." That approach helped the fund during "challenging markets like late 2018 but caused it to lag the rally in 2017 because of its cash position and poor stock selection in the eurozone."

For the next business cycle, which is likely to be challenging, Bhansali likes companies with positive net cash flow (no debt), high dividend coverage and the ability to control costs and lower prices rather than the ability to raise prices.

More specifically she likes MANG instead of FANG stocks. Rather than Facebook, Apple, Netflix and Google, she prefers Michelin (tires), Ahold Delhaize (supermarkets), NTT Docomo (telecom) and GlaxoSmithKline (pharmaceuticals) — all consumer staple companies with steady and sustainable growth and known risks from the competition. In contrast, the FANG stocks are consumer discretionary with heady but unsustainable growth and unknown risks, primarily regulatory, according to Bhansali.

Bernice Napach *is a senior writer at ThinkAdvisor covering financial markets and asset managers, robo-advisors, college planning and retirement issues. She has worked at Yahoo Finance, Bloomberg TV, CNBC, Reuters, Investor's Business Daily and The Bond Buyer and has written articles for The New York Times, TheStreet.com, The Star-Ledger, The Record, Variety and Worth magazine. Bernice has a Bachelor of Science in Social Welfare from SUNY at Stony Brook.*

Think Advisor: RJB Active vs. Passive (EPRINT) ©1/20 (exp 1/23/21) AI-569