

# Market Briefing

May – June 2025



## Why it's important to be cautious when investing actively

### Avoiding the trap of expensive index funds and closet trackers

It's no secret that markets evolve continuously. Access to data, trading tools, and fund structures has dramatically improved over the past two decades. The advent of technological enhancements will no doubt continue this process. Yet, in a curious twist of irony, many investors still find themselves trapped in outdated models of investing—paying active fees for what are essentially passive or index tracker outcomes.

**In this edition of the Market Briefing, we want to unpack why that matters. We'll explore:**

- The changing face of 'active' and 'passive / index' management.
- How to spot and avoid the closet trackers.
- What genuine value from active management looks like.
- And ultimately, how we think about navigating this landscape in your portfolios.

### A false binary: active v passive

Let's start with the basics. The investment industry loves a good debate—and one of the most enduring is the tug-of-war between active and passive investing.

Passive, we're told, is cheap, simple, and effective. Active is sometimes framed as expensive, complex, and risky. But framing it that way misses a much more important point: cost and value don't sit neatly on one side or the other. The truth is more nuanced and subtle.

There are 'passive' funds out there that charge a management fee annually of more than 0.5% to track basic benchmarks. There are 'active' funds that hug (closely replicate) indices so tightly they might as well be a passive tracker, but cost upwards of 10x more. And then there are managers who justify their fees with real skill, flexibility, risk control, and conviction.

So, it's not active versus passive but rather transparent versus opaque.

#### ***So what?***

***Don't get distracted by labels. Whether a fund says it's 'active' or 'passive' means little without context. What matters is what you're getting for your money — and whether it does 'what it says on the tin'. Judge funds by their behaviour, outcomes, and cost-effectiveness, not by their marketing.***

## 1. The rise of expensive index funds

You'd be forgiven for thinking that all index funds are cheap. After all, that's their original selling point: low-cost access to broad market exposure. But over time, the lines have blurred.

We're increasingly seeing funds that carry the name 'index' or 'tracker' but come with layers of costs that eat into returns—platform fees, wrapper costs, and active asset allocation overlays that start to make them look suspiciously like active products. Now there are legitimate reasons for these, but the investor should ensure they go into them with their eyes open. That is where having a trusted adviser is invaluable in navigating the landscape.

Some so-called 'smart beta' or 'factor' strategies operate under the broad passive / index umbrella but start to build in more complex rule sets that cost more to run. Others layer on ESG tilts, macro screens, or 'momentum overlays' which, while arguably useful in some contexts, can stray a long way from the simplicity that passive is supposed to deliver.



### So what?

***Just because it's called an index fund doesn't mean it's cheap or simple. Investors need to look under the bonnet.***

To be clear: there's nothing inherently wrong with these ideas. But if you're paying for something that looks like active decision-making, why accept the lack of transparency and flexibility that may come with it?

A passive fund that starts to behave actively, but without true accountability, could be described as an expensive compromise.

## 2. Closet trackers: A sheep in wolf's clothing

At the other end of the scale are the funds marketed as 'active' that are anything but. These are the so-called closet trackers—funds that charge full active fees while sticking close to their benchmark to avoid tracking error and the risk of underperformance.

The motives are understandable. Fund managers don't like to underperform—especially not visibly. But the result is a portfolio that's barely distinguishable from the index, yet costs significantly more.

For example, take a UK All Companies fund that holds 90% of the FTSE 100's biggest constituents with near-identical weights, adds a few outliers to maintain the appearance of activity, and charges 0.75% per year. On paper, it's 'active.' In reality, it's just a passive vehicle in disguise.

### So what?

***If a fund says it's active but behaves like a tracker, you're likely overpaying for something you could get cheaper elsewhere. Watch out for funds with high fees and low conviction — they'll quietly eat into your returns while giving you very little additional return.***

What's the issue? You're paying for supposed insight and active decision-making but getting benchmark-like returns. That's value erosion, plain and simple.

These funds underdeliver not because markets are 'too efficient,' but because they've been designed to minimise deviation from the index, not maximise value. It's risk aversion masquerading as professionalism.

### 3. What are you paying for?

This is the crux of it: the importance of understanding what's under the bonnet. Investors shouldn't mind paying fees when they're matched with results. But the price must be linked to something tangible—such as skill, risk control, conviction, and accountability.

In practice, too many investors are stuck in the middle, for example:

- Paying 0.6–0.8% p.a. for a 'tracker-plus' fund that simply overweighs tech or avoids oil
- Paying 0.75–1.00% p.a. for an active fund that ends up looking like the benchmark
- Paying for style tilts that disappear as soon as markets move against them

None of this is sustainable. Especially not in a world where inflation-adjusted returns are harder to come by, and where genuine alpha (active outperformance) is rare—but not mythical.

#### **So what?**

***If you're paying a premium, make sure you're getting premium ingredients — not just a relabelled supermarket basic. Don't settle for the middle ground where costs are high and potential added value is low. Know exactly what role each fund plays and whether it earns its keep.***

### 4. The value of authentic active management

When done properly, active management isn't about chasing the hot hand or trying to 'beat the market' every quarter. Rather, it's about:

- Allocating capital with discipline and an eye on risk control
- Spotting inefficiencies that broad index funds miss
- Being able to go to cash or sidestep parts of the market when risk is asymmetrically high
- And crucially, acting tactically when the world changes

Take the early days of COVID-19 as an example. Index funds didn't (and couldn't) make a call. They just followed the market down. Meanwhile, genuinely active managers had the opportunity to reduce risk, shift sector exposure, and prepare for the recovery.

Or more recently, think about how some managers have been positioning for a higher-for-longer interest rate regime. Indexes can't adapt. But active managers can trim long-duration assets, pivot to higher-quality earnings, or explore value plays in unloved sectors.

It's not about getting every call right. It's about having the freedom to make the call in the first place.

#### **So what?**

***When markets shift or get choppy, genuine active managers can step in, adapt, and manage risk. Index funds can't. So, if you want protection or the potential to capitalise on market inefficiencies, active management can help — but only if it's authentically active and accountable.***





### 5. Have a disciplined, transparent, and adaptive approach

When selecting active funds, it's essential to consider the managers and structures used. Portfolios shouldn't chase headline-grabbing funds but focus on clarity, value, and conviction.

That means:

- Avoiding closet trackers and expensive passives with weak differentiation to the specified index.
- Holding managers to account for their decisions and performance.
- Using passive tools where appropriate—but not overpaying for complexity when it's not needed.
- Blending strategies to capture genuine diversification without unnecessary fees.



Importantly, underlying data—not labels—should be used to assess the credibility and authenticity of the claims of an active manager. Are the holdings differentiated? Are they behaving as expected through the whole market cycle? Is there true active share?

#### So what?

***It's not about having the flashiest funds, it's about having the right blend of strategies that complement each other, work in different market conditions, and don't duplicate. Your fund selection process needs to cut through the marketing noise and focus on actual behaviours, costs, and outcomes.***

### 6. The cautionary tale: paying more for less

Here's the reality: most underperformance comes not from risk-taking but from stagnation or inertia.

Investors get trapped in expensive trackers that quietly erode the after-charge returns over the years. Or they sit in active funds that never really act—just shadow the index in a more expensive suit.

That's why answering this simple question is essential: Is the price fair for the job being done?

If you want the index, fine—get it cheap and efficiently. If you want skill, insight, and protection in tough markets—pay for it. What you don't want is the expensive middle ground. That's where returns go to die.

#### So what?

***This is where portfolios quietly lose momentum. Not because the market didn't perform — but because fees bled away value or the funds failed to act. Avoid the “expensive middle ground” by making clear choices: go low-cost when you want the market and only pay for active when it earns its keep.***



### 7. Looking ahead: a harder world to hide in

With cost transparency, Consumer Duty, and client outcomes under greater scrutiny than ever, fund managers won't be able to hide in the same way they once did.

That's a good thing. But it means investors—and their advisers—must be more forensic. Questions that need answers include:

- Is your 'passive' fund authentically passive?
- Is your 'active' manager taking risk with purpose—or just closet tracking to stay safe?
- Is your portfolio actually diversified—or just full of funds tracking the same benchmark with slightly different wrappers?



These aren't academic questions. They're the difference between compounding real returns over time and slowly losing ground, year by year.

#### **So what?**

***The days of managers hiding behind vague labels and inflated fees are numbered — but only if investors stay sharp. With greater transparency and regulatory pressure, now's the time to be more forensic. If it walks like a tracker and talks like a tracker... it shouldn't cost the same as an active fund.***

### Final thoughts: thoughtful transparent investing wins

There's no single right answer when it comes to fund selection. But there are clear wrong turns—chief among them, paying too much for too little.

So, the message is one of caution. Not caution in the sense of sitting on your hands, but in being forensic about the quality of the products and strategies in use.

Pay attention to:

- Fees (especially in so-called passive vehicles)
- Active share and benchmark deviation
- Evidence of conviction and process
- How your funds behave in different markets

In short: trust the process but interrogate the components because in a world where everyone says they're adding value, it pays to know who actually is.

### Key takeaway: where we stand

Across the Dynamic Portfolios, recent changes continue to reflect this mindset. We:

- reinforce our processes to ensure fund labelling doesn't influence fund selection;
- remove managers who claim to be active, showing signs of benchmark hugging;
- ensure funds in our active ranges constantly display high active share and high tracking differences; and
- constantly looking to reduce costs in our index ranges.

### On this day

23 <sup>rd</sup> June 1972	Chancellor Anthony Barber ended the UK's fixed exchange rate regime, allowing the pound to float – a fundamental shift in Britain's financial system and its interaction with global markets. Moving to a floating pound represented a big leap towards modern monetary policy, giving the UK commercial flexibility but also exposing it to more volatility and global economic forces.
23 <sup>rd</sup> June 2016	Brexit Referendum. The UK voted to leave the EU (51.9%), sending shockwaves through politics, markets, and society, and prompting PM David Cameron's resignation. Brexit was a seismic political and economic event. It forced rethinking of trade agreements, labour flows, financial regulation, and national identity, and its ripple effects continue to shape Britain's future.
24 <sup>th</sup> June 1277	Edward I's First Campaign Against the Welsh Begins. King Edward I launched his first military campaign against Llywelyn ap Gruffydd's refusal to pay homage—marking a pivotal moment in England's conquest of Wales. This campaign laid the groundwork for the eventual the political map of Britain.
25 <sup>th</sup> June 1797	Admiral Horatio Nelson Wounded. During the naval engagement at Santa Cruz de Tenerife, Nelson was struck in the right arm, an injury so severe it required amputation. At this point, he had already lost sight in his right eye during action three years earlier. Nelson's sacrifice exemplified the personal cost of leadership during Britain's naval dominance. His resilience helped shape the legend that inspired Royal Navy morale and British maritime identity well into the 19th century.
26 <sup>th</sup> June 1846	Parliament Authorises the Great Northern Railway. By Act of Parliament, Britain greenlit the Great Northern Railway – its largest single railway scheme at the time – connecting London and York and marking a new era in transport and commerce. This massive infrastructure project symbolised the peak of Railway Mania, enhancing trade, labour mobility, and economic integration across England and Wales.
27 <sup>th</sup> June 1967	First Cash Machine Installed at Barclays Enfield. The first automatic cash dispenser (voucher-based ATM) was installed by Barclays Bank in Enfield, north London. This innovation revolutionized banking, ushering in 24/7 access to cash and paving the way for today's ATM networks and digital banking convenience.
28 <sup>th</sup> June 1960	A devastating explosion at Six Bells Colliery in Abertillery, Wales killed 38 miners. The tragedy highlighted ongoing safety challenges in the coal industry and spurred improvements in UK mine regulation and worker protection.

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