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# What Is My Mutual Fund's 'Active Share'?

It's a measure of how much a fund's portfolio differs from its benchmark index, and it might help you save some money



Active-share disclosure might reveal so-called closet indexers, or managers who are supposed to be running an active fund but in reality closely track an index. PHOTO: ISTOCKPHOTO/GETTY IMAGES

By *Simon Constable*

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Investors recently gained access to more information about how their actively managed mutual funds are managed. Now they need to figure out how to use it.

New York state's attorney general announced in April that 13 mutual-fund firms that run 400 or so actively managed funds agreed to disclose the "active share" of those funds' portfolios quarterly on their websites. The agreement didn't include Fidelity Investments, which already disclosed active-share data.

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The active share is a measure of how much, if at all, a fund's stockholdings differ from the stocks in the fund's benchmark index. It can range from 0%, meaning the fund's holdings are identical to the stocks in the benchmark index, to 100%, meaning the fund doesn't hold any of the stocks in the benchmark index.

So, how does that figure help investors? For one thing, it could save some investors money, by indicating

whether the active management they're paying for is active enough to be worth the cost. It also can serve as a signal that investors need to take a look at whether a fund's portfolio is what they expected it to be.

Here's a look at what the new data can do for investors—and one thing it can't.

### **Outing the closet indexers**

Actively managed funds typically have far higher annual fees than funds that simply track an index. The higher fees can be worth it, if a fund outperforms its benchmark. But if a fund is keeping its holdings closely in line with the stocks in its benchmark index, investors might be able to do better with a much cheaper fund that simply tracks that index.

Investors “cannot necessarily assume that a high fee means that a fund will have a higher level of active management,” says the attorney general's report on the disclosure agreement.

Active-share disclosure will throw a spotlight on so-called closet indexers, or managers who nominally run an active fund but in reality closely track an index.

“If you are paying someone to actively manage your money and they are a closet indexer, then you want to know about it,” says Jeff Powell, chief investment officer at San Rafael, Calif.-based Polaris Greystone Financial.

If the active share is close to zero, then the fund is likely a closet indexer.

### **Detecting style drift**

Funds with high active shares can also be problematic: They might not be investing in a way you expected or wanted.

Remember, the active-share figure isn't a measure of trading activity, it's a measure of how far a fund has departed from its benchmark. So, for instance, if a fund that claims to focus on value investments has dedicated a large percentage of its portfolio to growth stocks instead, that would result in a high active share, because those growth stocks wouldn't be included in the fund's benchmark index. This phenomenon is known as style drift.

“There is different risk associated with that,” compared with what an investor would expect from the fund's stated investment approach, says Mr. Powell. In the example above, for instance, growth stocks typically are more volatile than value stocks, so the fund's performance may be more erratic than an investor would like.

### **Monitoring investment decisions**

Anytime a high active share indicates a fund manager is buying a lot of

stocks that aren't included in the fund's benchmark, investors should take a look at the latest information on what stocks are in the fund's portfolio.

"You have to look at what you are getting," says Bob Schmidt, head of the San Diego-based Brandes Institute, part of Brandes Investment Partners.

Fund managers who venture outside their stated investment strategy could be making brilliant investments that will help the fund outperform its benchmark over the long haul, or they could be making faultier decisions—purchasing hot stocks that are vulnerable to a reversal, for instance. A high active share doesn't tell investors whether a fund manager is making good or bad decisions, but it does tell them decisions are being made that they should be aware of.

## What counts as high?

One drawback of active-share disclosure is that an individual fund's figure doesn't provide any context to help an investor interpret it.

For instance, an active share of 60% might sound high, but it would help to know what the figure is for similar funds. A Brandes study found that in 2014, emerging-markets funds had a median active share of 80%, while the median among global health-care funds was 47%.

Unless the investor knows what's normal for a particular type of fund and how that compares with other kinds of funds, it's hard to fully understand the data without some expert help.

"To me, it would be great if it said 'This active share is, say, 82, and you should ask your financial adviser about it,'" Mr. Schmidt says.

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