Module 13: Overview of Equity Portfolio Management

13.1. Equity Management Roles
- Capital Appreciation
- Dividend Income
- Diversification
- Potential to hedge inflation

Client constraints (e.g. ESG) can be addressed via:
- negative screening
  (excludes companies / sectors that do not meet client standards)

- positive screening (i.e. best in-class screening)

- Thematic screening (i.e impact screening)

Equity Investment Segmentation

Size & Style.
- Size (i.e. large cap, mid-cap, small-cap).
- Style (i.e. value, blend, growth)

Advantages of segmenting by size & style:
- better address client investment considerations in terms of risk/return
- potential for greater diversifications
- ability to construct relevant benchmarks.
- ability to analyze companies characteristics over time

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Geography

Economic Activity

2 approaches : market-oriented & production-oriented

market-oriented : segment by markets served, how products are consumed & how CF are generated (i.e. GICS)

Production-oriented : segment by products manufactured & & inputs required during the production process.
(i.e. ICB, TRBC, RGS)

Equity Indices & BMs.

MODULE QUIZ 13.1

1. Equities typically offer diversification benefits when combined with other major asset classes in a portfolio. **Discuss** *two* reasons an economic crisis may affect the risk reduction archived through diversification.
2. Assume an investor is segmenting the equity investment universe by economic activity. **Describe** *two* advantages for applying this segmentation approach.

1. Risk Reduction is less likely than expected :
   - the correlation is moving towards 1.0.
   - the volatility is likely to increase
2. - Portfolio managers can analyze, compare & construct perf. BM based on sector
   - enhance diversification benefits

Several ways to earn (current) income :
- dividend income
- security lending (part of faciliating short selling)

- additional income strategies :
  - writing options (i.e. covered call)
  - dividend capture

Equity Portfolios fees & costs :

- Management & Performance (incentive) fees.
- Admin fees
- Marketing & distribution fees.
- Trading costs
- Investment strategy costs

Shareholder Engagement

Discussion @ general meetings includes:

- corporate strategy
- capital allocation
- Corp. governance
- Compensation structures.
- Composition of the board of directors.

Not free. b/c requires time & resources :

- active managers are more likely to do so
- passive managers are more likely to focus on minimizing costs
- Larger investors can more likely absorb costs
- engagement can be used to address nonfinancial issues
- Other stakeholders are also impacted

Active / Passive Management for Equity Portfolios

Rationale for shifting to active management include:
- confidence the manager has the expert knowledge
- growth strategies are often seen as more likely to benefit from active management while value may be more passive.
  - Manager needs to manage investor expectation.
  - Strategies w/ too much cap flowing in may find it harder to find opportunities to add value.
  - Manager must also select an appropriate BM investors are interested in
- Mandates (e.g. ESG) may require a more active approach

Potential Risk of Active Management:
- reputation risk.
- key person risk
- High portfolio T/O

MODULE QUIZ 13.2

1. **Explain** why actively managed portfolios are typically subject to higher fees and costs than passively managed portfolios.
2. **Explain** how shareholder engagement can benefit investors who are not actively involved in company issues.
3. **Identify** two disadvantages of shareholder engagement activities.
4. A client is concerned with low fees, seeks substantial value added versus their benchmark, has numerous ESG restrictions, and has selected a narrowly defined benchmark made up of large companies. Based on the client's concerns, **explain** *two* reasons the client should favor a passive approach and *two* reasons the client should favor an active approach.
5. Compared to passively managed funds, active funds tend to have higher research and trading costs. **Identify** and **describe** *two* additional types of risk for active managers and investors.

1. Actively Managed Portfolio requires more T/O & research.

2. They can earn a free ride (i.e. benefiting from the activities of others to increase the stock price w/o time & cost of engagement)

3. 1.) Time & commitment
   2) desire of short-term profit @ the cost of long-term goals.

4. Passive:
   - low cost
   - the narrowly defined BM of presumably efficient large cap stocks is going to provide the opportunity for active managers to find ways to add value.

   Active:
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5. - Reputation Risk
   - Key person Risk.

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