

Active versus Passive management – the real story

Active versus passive management for equity and bond investments has been a debate that has continued for some time. Whilst there are two schools of thought debating which type of approach give investors the better returns, Legal & General Investment Management (LGIM) believe that both approaches should be considered on their merits and in conjunction with a clients investment objectives.

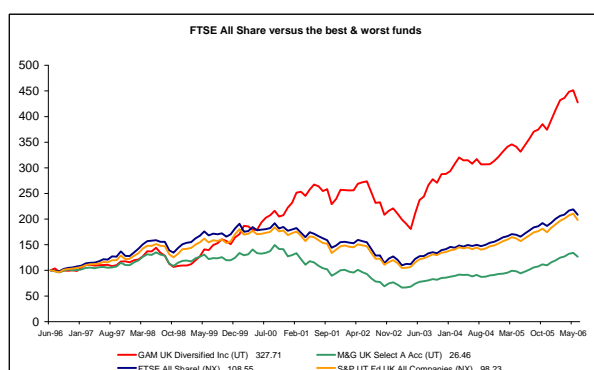
What's the difference?

In a nutshell passive fund managers generally believe that it is difficult to consistently beat the market. Therefore, they essentially offer asset class performance that closely matches an index for those investors who are unwilling to assume the risks of active management. Furthermore, management fees are lower due to reduced trading costs.

Active managers on the other hand believe the market can be beaten. While they can't beat it all the time, many active managers do believe there are certain irregularities in the market that can be taken into consideration to achieve potentially higher returns.

Passive Management Advantages	Passive Management Disadvantages
<p>Low operating expenses and fees</p> <p>No action required — There is no decision-making required by the manager or the investor.</p>	<p>Performance dictated by index — Investors must be satisfied with market returns because that is the best any index fund can achieve.</p> <p>Lack of control — Managers cannot take action. Index fund managers are usually prohibited from using defensive measures, such as moving out of stocks, if the manager thinks stock prices are going to decline.</p>
Active Management Advantages	Active Management Disadvantages
<p>Expert analysis — Seasoned money managers make informed decisions based on experience, judgement, and prevailing market trends.</p> <p>Possibility of higher-than-index returns — Managers aim to beat the performance of the index.</p> <p>Defensive measures — Managers can make changes if they believe the market may take a downturn.</p>	<p>Higher fees and operating expenses.</p> <p>Mistakes may happen — There is always the risk that managers may make unwise or badly timed choices on behalf of investors, which could reduce returns.</p> <p>Style issues may interfere with performance — At any given time, a manager's style may be in or out of favour with the market, which could reduce returns.</p>

There are significant advantages and disadvantages to both investment strategies and depending on the prevailing market conditions, one strategy will be more popular to investors than the other.



Put into perspective

Picking the right approach, the right fund manager and the right fund can be difficult. If we step back in time to March 1996 an investor would have been faced with a choice of 136 funds in the IMA UK All Companies sector. With the benefit of hindsight many investors with an investment horizon of 10 years would have put their money in the GAM

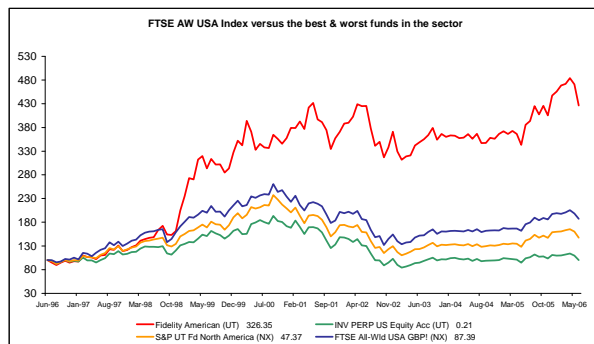
UK Diversified Inc fund and despite a volatile ride, the fund would have turned an investment of £100 into £470 in 10 years. On the other hand the worst performing fund in the sector, M&G UK Select which would have returned a mere 26.5%, considerably lower than the index return. Therefore it is safe to say that there is a wide divergence in performance of funds across the sector and picking the wrong fund 10 years ago could have been detrimental to your investment objectives.

Across all the funds in the sector, the average return was 98.2% compared to the FTSE All Share index return of 108% and shows that the index return has exceeded the average return in the sector over this period.

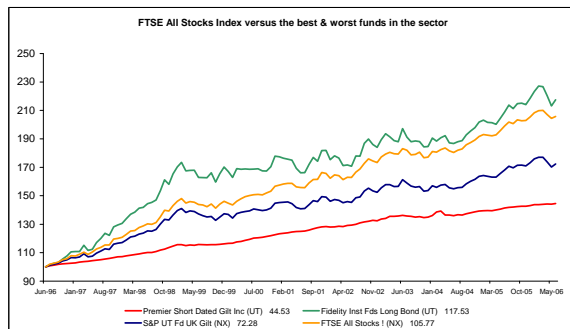
If we fast forward 9 years to March 2005, faced with a similar array of funds in the UK All Companies sector - 291 funds in total which funds do you choose and which will give you the best return?

Passive management on a specified index, has proved again that investors will receive consistently above average returns when compared to all the other funds in the relevant sector over a 10 year investment timeframe.

If we look at another market the US for example whilst there is a large divergence in the performance between the best and worst performing funds (out of 50) the index has yet again produced a better return over 10 years compared to the average fund in the sector.



The same can also be said for gilts bonds with the FTSE All stocks index returning 106% compared to the average fund in the sector being 72% over 10 years.



What does all this mean?

If you are looking for an above average return on your investments without taking on additional risk passive management should form a significant portion of your portfolio. Passive funds tend to track the specified index to within a small tolerance level and the return of the index is the return you will receive on your investment minus a relatively small management charge.

Legal & General Investment Management in one of the largest investment managers in the UK with over £210 billion under management and has a full suite of both passive and actively managed funds covering every geographical market and every asset class. We can help you build a portfolio that is in line with your investment objectives.

For further information, please visit www.lgim.co.uk

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Source: LGIM unless otherwise stated. All figures as at 31 May 2006 unless otherwise stated. Charts are sourced from Mircopal on a Bid to Bid, Basic Rate tax basis. The IMA UK All Companies sector, IMA North America sector and IMA Gilt sector have been filtered to exclude index tracking funds.

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