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Investment Views

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Passive, Not Neutral

Recent Investment Views have noted that our bar for investing with active managers is very high, meaning a reasonable proportion of our assets are held in passive instruments. It is a strategy we have described as "simple, but not easy". This month, we provide some insight into exactly what that means.

Passive Is Not the Same as the Benchmark

Our global equity mandates are typically measured against the FTSE All-World index. Obviously, a single fund tracking that index would be the simplest portfolio to implement. Also obviously, that is not what we do. Instead, we build each portfolio from a series of index building blocks, and each block is chosen because it expresses a house view.

For instance, our Growth equity mandate has a significant allocation to the S&P 500 index, since the US comprises more than 60% of the FTSE All-World index. Alongside that passive core sit deliberate allocations to our key equity themes – currently Global Quality, US Healthcare, India and China A shares. These provide diversification the benchmark cannot: over the past three years, for instance, China A, India and US Healthcare have had correlations with global equities of just 0.32 to 0.43.

These are all examples of our active asset allocation decisions implemented passively. Every building block impacts the portfolio versus the benchmark by region, by sector, by industry and by individual company. Those moves are intended. They also have side effects, and managing those side effects is another part of the process that is not easy.

Seeing the Side Effects

Implementing the themes added diversification to the portfolio in areas with lower correlations but also caused us to have slightly less technology exposure than is ideal. Taking our holdings together, Growth was running close to a 3% point underweight to the Technology and Communications sectors, a 4% overweight to defensive ones, and a predicted beta of 0.95, indicating it should move slightly less than the market.

Some of that defensiveness is welcome, but a sector bet we never set out to take is still a bet. If today's market leaders continue to lead – and over the long term we believe they will - it would cost clients performance for reasons unrelated to any of our highest convictions.

The NASDAQ 100

In November, the committee approved a switch of 5% of our Growth mandate (and 2.5% of our multi-asset mandates), from the S&P 500 index into the NASDAQ 100. The latter holds the 100 largest non-financial companies listed on the NASDAQ exchange and has more than 60% in Technology and related sectors. Its leading companies combine strong balance sheets and cash generation with exposure to the long-term productivity gains from AI. Following the recent pullback, they trade on only a modest valuation premium to the wider US market despite materially higher profitability and growth, a more attractive entry point than earlier in the year.

It is a modest change. Here is how we tested it, and we apply the same tests to any change, however small:

- *Region:* Both indices are overwhelmingly US-listed, so the switch reshapes our US exposure rather than adding to it.
- *Sector:* This is where the intended effect lies. Technology and Communications exposure rises to close much of the underweight, and the defensive overweight reduces.
- *Industry group:* Most of the increase falls in semiconductors, which make up 32% of the NASDAQ 100 against 17% of the S&P 500. Software and hardware change far less. Knowing where the money goes within a sector matters as much as the sector total.
- *Individual holdings:* Perhaps surprisingly, our weighting in the largest company barely moves. NVIDIA is around 8.4% of both indices, and the top three combined are around 21.5% in each. The difference lies further down: the NASDAQ's top ten make up 47% of the index, against 39% for the S&P 500. It also includes companies the S&P 500 does not yet hold, notably SpaceX, which joined the NASDAQ in July but cannot enter the S&P 500 until it has traded for twelve months and met its profitability tests.

Risk is both Relative and Absolute

Two measures guide us here. Tracking error estimates how far the portfolio's returns are likely to stray from the benchmark. Growth's forward-looking tracking error is projected to be 1.6%, well within our 2.5% ceiling, although the figure measured over the past twelve months has hit that level, an illustration that projections are only that. Since the switch reduces an unintended sector bet, we expect it to lower tracking error - relative to the benchmark, the portfolio moves closer to it.

Beta and drawdown tell the other half of the story. The NASDAQ is more volatile than the S&P 500 and has historically fallen further in technology-led selloffs: in 2022 it lost around a third of its value, against about a fifth for the S&P 500. The portfolio's beta therefore edges up slightly, and in a sharp technology sell-off the portfolio would fall a little more than before.

The scale of the allocation keeps this in proportion. If the NASDAQ were to underperform the S&P by 10 percentage points, a 5% position would cost Growth around half a percent, and our multi-asset mandates a quarter of a percent. Sizing the change so that in the event we are wrong remains acceptable, if not ideal, is a vital part of the process.

This is the subtle point. Lower relative risk and higher absolute risk can arrive together. Managing passive allocations well means being clear about which risk we are managing at any time.

Cost

Passive does not mean free. The NASDAQ 100 fund we use has an annual charge of 0.13%, against 0.03% for our S&P 500 fund. Across Growth, the 5% switch adds roughly half a basis point (0.005%) a year to the portfolio's overall ongoing charges. That is small, but we check it every time, because a series of small increases can add up.

EXHIBIT: How a 5% switch into the NASDAQ 100 changes our Growth mandate

	Before	After switch
PORTFOLIO EXPOSURE		
US equities: S&P 500 / NASDAQ 100	54% / 0%	**49% / 5%**
Technology & communications vs benchmark	-2.9 pts	**c. -1.7 pts**
Defensive sectors vs benchmark	+4.1 pts	**c. +3.9 pts**
Largest holding: NVIDIA (benchmark 4.7%)	4.3%	**4.3%**
RISK		
Beta (sensitivity to the market)	0.95	**Slightly higher**
Tracking error (forward-looking)	1.58%	**Expected to fall**
Potential loss in a technology sell-off	–	**Slightly larger**
COST		
Additional ongoing charges	–	**+c. 0.005% a year**

Source: Bentley Reid, Morningstar, Bloomberg PORT, October 2026. "After" figures are Bentley Reid estimates. pts = percentage points relative to the FTSE All-World.

What Else We Weigh

The numbers above are only part of the work. For any change we also consider:

Implementation: the size, liquidity and dealing costs of the fund, and whether to make the change in stages rather than all at once.

Tax: for individually managed portfolios, selling one fund to buy another can realise capital gains, so the benefit must outweigh that cost.

Currency: in the present case, the switch is between two US dollar indices, so our currency exposure does not change.

Index rules: how and when an index adds or removes companies quietly shapes what you own, as the SpaceX example shows.

Simple, But Not Easy

Index funds remove the expense, risk and uncertainty of choosing active managers. They do not remove the need for asset allocation and judgment. Which index to own, in what size, funded from where, and how it interacts with everything else you hold: these decisions shape long-term outcomes, and they need revisiting as markets change.

A 5% switch between two well-known US indices looks like a minor adjustment. In practice, it touched regional and sector weights, industry groups, individual holdings, tracking error, beta, potential drawdowns, cost and tax. That is what we mean by simple, but not easy. Our aim is that every part of your portfolio earns its place, and that the risks you carry are ones we have chosen deliberately, based on our macroeconomic and asset allocation views.

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