Many investors may hear about active share and not fully understand its meaning and how it should be applied in the investment process. It is up to those of us in the industry who understand active share, and how it can be used most effectively, to provide more than just the meaning of active share. And even then, some of us in the industry don't always agree on the value of active share.

In our recent blog post series, we address the three most important questions relating to active share – what is active share, how does it relate to excess performance, and how you can use it to help capture diversification benefits while working to help preserve returns.

Let’s start with the history of active share. Some investors may have been unaware of the concept prior to the publication of a 2009 academic article that touted the strategy. But in fact, evaluating active bets has been part of Russell Investments’ process since the 1980s. It’s been around for quite some time. When it comes to evaluating investments using what is known as “active share,” we understood its use before it became trendy – the hipsters of active share, if you will.

So what is active share? Put simply, it’s a way to measure the active bets of an investment. Often people in our industry think the larger the bets of an active manager, the better the portfolio’s performance will be. As recently discussed in a blog series by two of our experts, Leola Ross and Jon Eggins, active share is just one tool in the “investment tool box” when considering making investments.

Using active share as a “silver bullet” to make all investing decisions leads to misconceptions, which may expose investors to unintended risks. It is important for investors to work with experts who understand active management holistically to achieve their desired outcomes. Not only does Russell Investments understand active share well, we also know how to complement the measure with other quantitative measures and qualitative active manager analysis to deliver total portfolio solutions.

Additionally, high active share isn’t a guarantee of positive performance. As Leola and Jon’s example recently proved, low active share portfolios have the potential to deliver strong excess returns. For example, quantitatively oriented portfolios, often with low active share, have their place in a multi-manager portfolio and may diversify high active share portfolios that are more typically fundamentally oriented. Simply looking at portfolios with high active share may eliminate diversifying security selection strategies.

As Jon and Leola’s examples have shown, when high active-share managers are part of a multi-manager investing approach, it’s possible to diversify away much of the risk without diversifying away their good results. The math is pretty easy: High + high = low, i.e. combining two high active share portfolios will result in a lower active share combined portfolio with lower tracking error but retaining the average excess returns of the selected portfolios.

We view active share as one of the many options in our investment toolbox. Understanding how to use this measure with an expert’s help can be powerful, but needs to be used as part of a broader manager research process. In today’s investing environment, we believe Russell Investments’ experienced and balanced perspective on active share benefits investors. Read more of our detailed research and philosophy on the subject in this blog series from Jon and Leola.

1 Active share, also known as active money and/or commonality, is defined as the sum of differences between an active fund and a benchmark on a share by share basis. The greater the difference between the fund and its benchmark, the greater the active share.

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