The Government Pension Fund Seminar on Active Management

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Oslo, 20 January 2010

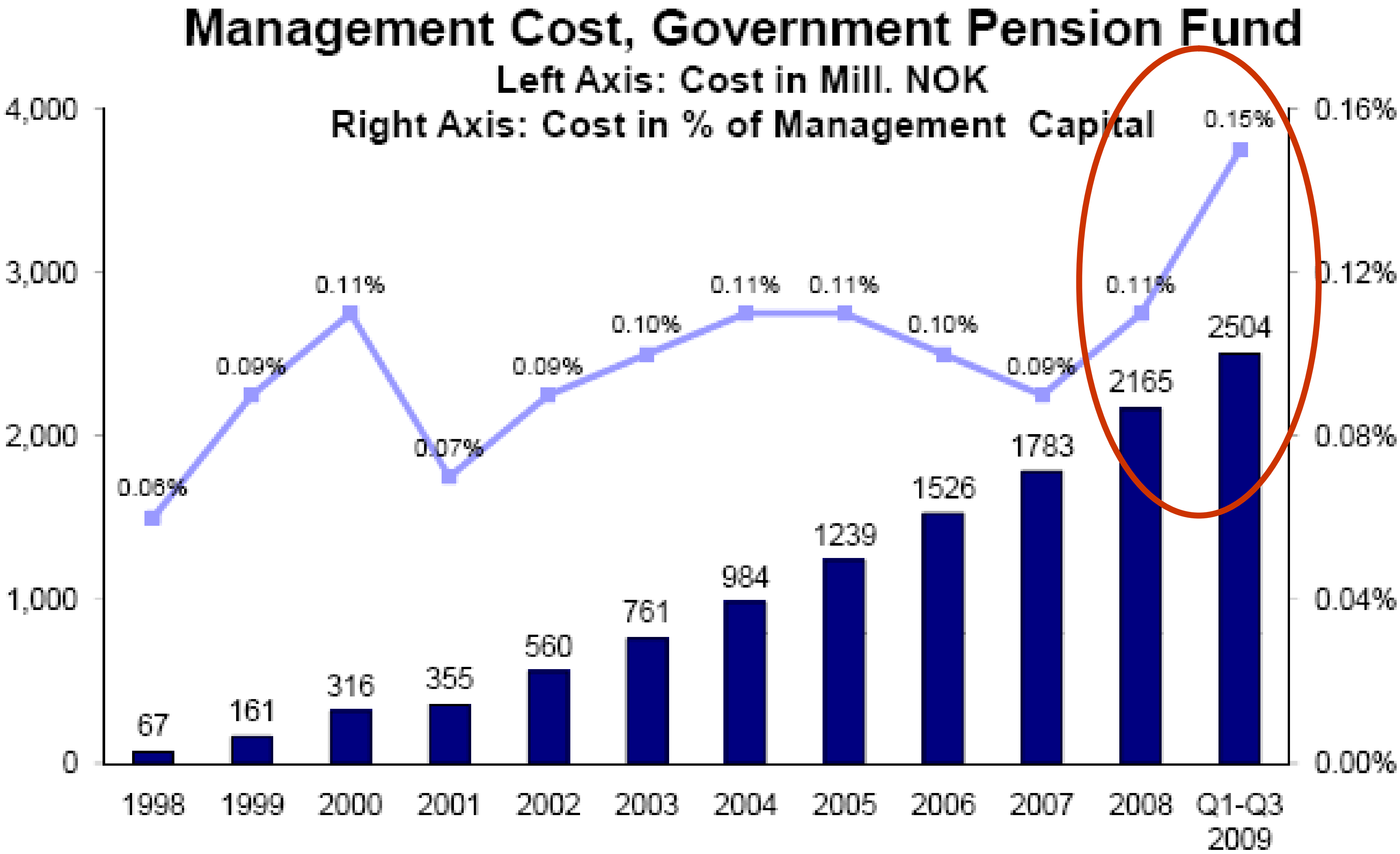
Ang-Goetzmann-Schaefer (2009)

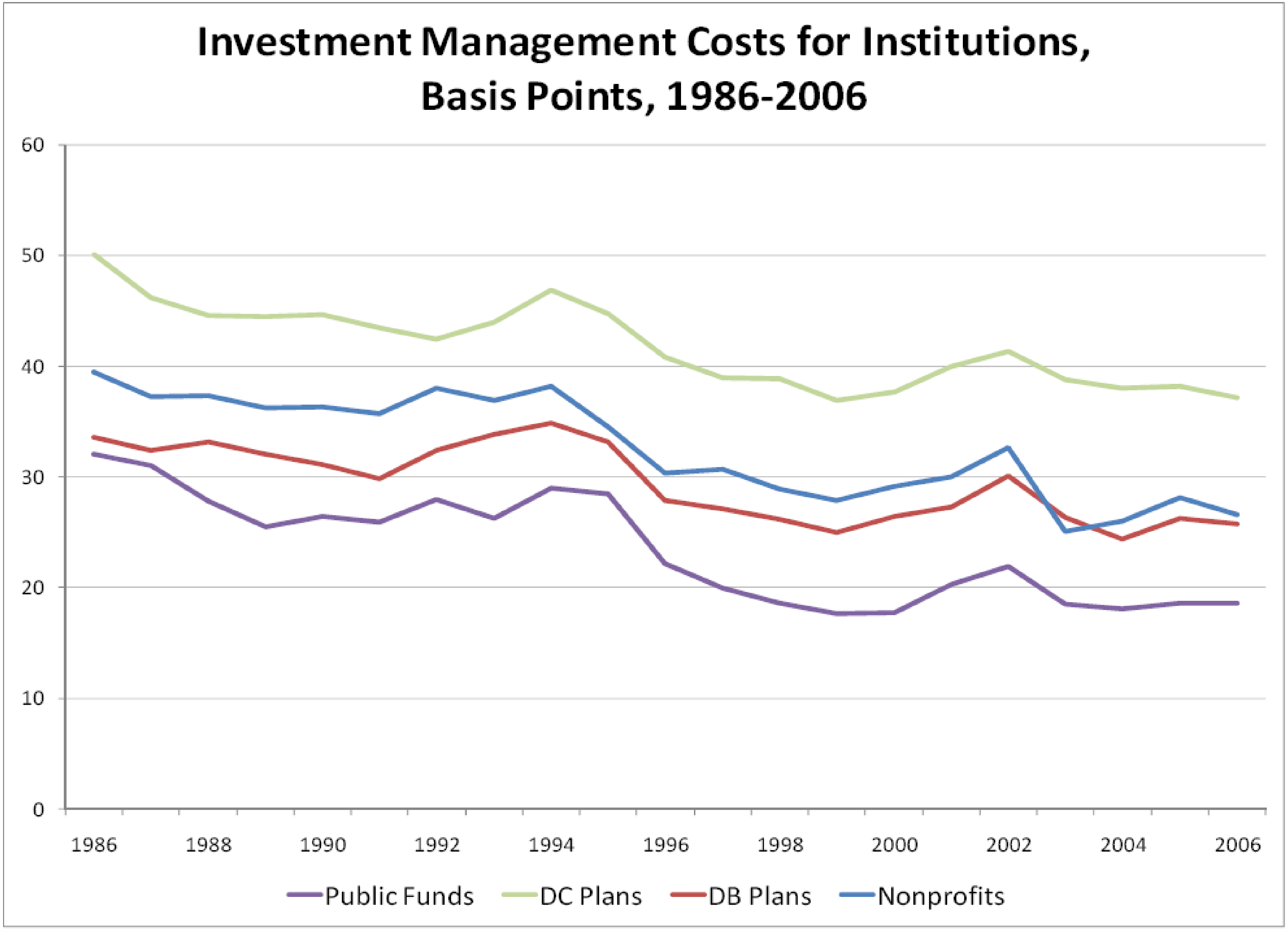
- The Government Fund “best in class” when it comes to large-scale index tracking at a low cost

- <u>However</u>, the Fund’s official benchmark is inefficient
  - The inefficient benchmark means that a large portion (70%) of the Fund’s alpha reflects known risk premiums

- Implications:
  - The true (adjusted) alpha is zero or negative after costs
  - The Fund is paying too much for the active mandates

The Fund's Management Cost 1998-2009




Investment Management Costs for Institutions, Basis Points, 1986-2006
60
50
40
30
20
10
0
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
Public Funds
DC Plans
DB Plans
Nonprofits

An Inconvenient Truth

- *"I'm not giving'em hell: I'm just telling'em the truth, and they think it's hell"*
  - President Harry Truman

- The expected value of active management, net of costs, is zero or more likely negative
  - Fund managers do not have access to, or let investors benefit from, unique information

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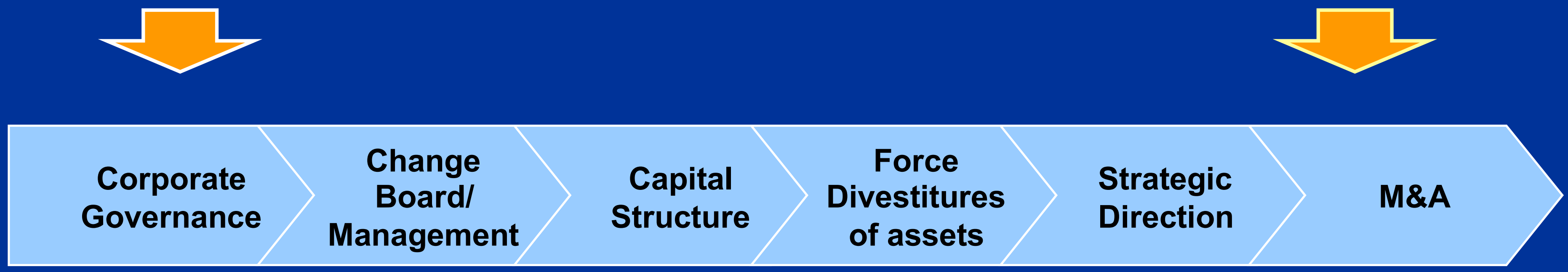
The Arithmetic of Active Management

- If passive investors do not lose to active investors when they trade, a passive market portfolio MUST have a higher return than the aggregate of all current (active and passive) portfolios

- "*Under reasonable assumptions, the typical investor would increase his average return by 67 basis points over the 1980-2006 period if he switched to a passive market portfolio*"
  - Kenneth French (2008)

Active Management that Makes a Difference (it alters the return distribution at the firm level)

Capitalize on NBIM's Own Corporate Governance expertise!



Suggestion: Add a (Small) Focus Fund