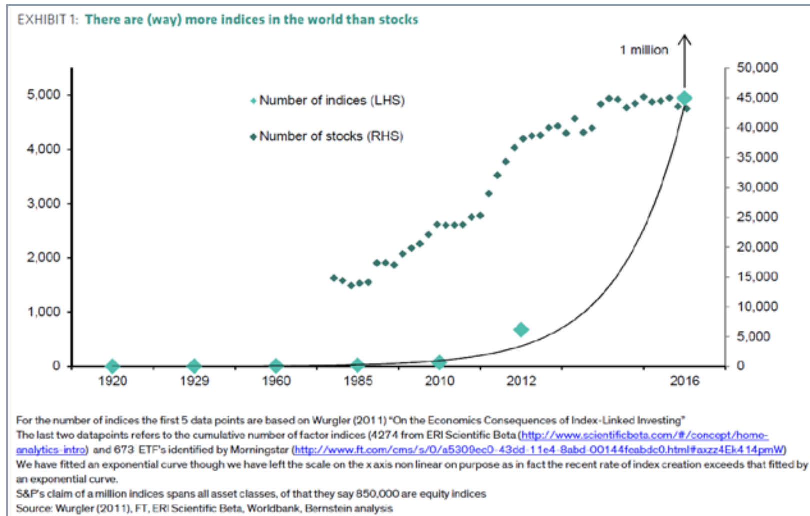
"Active management refers to the attempt by a fund manager to deliberately pick and choose specific investments that will perform better or be less risk than other investments."

- Morningstar



Source: Bernstein

Did you know that there are currently more indices in the world than the number of stocks that they track? In an August article in *The Economist* magazine, Standard and Poor's which provides indices and benchmarks to investors stated it had more than one million indices that it provided to investors across various asset classes and 850,000 for equities alone. As Sanford Bernstein research notes, according to the World Bank, there are only 43,192 stocks in the world as of the end of 2016. The increase in the number of indices relative to stocks is depicted above.

Why does this dynamic matter? First, some background. In 1896 Charles Dow created the first index that bears his name. Now three large firms, S&P, MSCI, and Russell Investments make the majority of indices used by market participants. Indices cost nothing to make, hence their proliferation. These companies do, however, charge a fee to ETF providers for the right to use their brands and methodologies to create publicly-traded vehicles. This market of passive investments now totals $4 trillion globally. Their sometimes subjective decisions have powerful ramifications. Should Chinese shares be included in MSCI Emerging Markets although markets are opaque? Yes. Should Venezuelan bonds be excluded from J.P. Morgan's emerging bond index to protest the government? No. Should Snap shares be excluded from the S&P 500 because it has non voting shares? Yes. We ask: do these decisions not resemble that of an active manager in the quotation above?

Depending on the "active" decisions of these index providers, investors have begun to question these decisions as they are effectively impacting asset allocation and benchmarking. While the index providers may have originally thought they were creating benchmarks to track an asset class, they have effectively become asset allocators as passive ETF investments are following their decisions.

Another example of how these unintended consequences manifest themselves is on the following page that shows two popular biotechnology equity vehicles, the Van Eck Vectors Biotech ETF and the S&P Biotech ETF. If an allocator is seeking exposure to domestic biotech through an ETF or benchmarking an active manager's active biotech performance, one can see that while both provide exposure to "biotechnology," over the most recent three year period, there is a dramatic difference in the rates of return. The decision on how to structure the tool, its holdings, and subsequent performance makes a big difference in investor exposures and potential assessment of an active manager assuming they are used for benchmarking purposes. While this example is dramatic, it points to a reason why there has been an increased interest in the "active" choices in what constitutes the "right" index exposure, and in this case biotech equity exposure.

Security	Currency	Price Change	Total Return	Difference	Annual Eq
BBH US Equity	USD	26.73%	27.46%	-41.26%	8.42%
XBI US Equity	USD	66.51%	68.72%		19.05%

Source: Bloomberg

Bernstein research notes that the creation of a million indices has come at a time over the past 35 years where a steady upward march in the market has enabled allocators to post positive returns by fine tuning their exposures. Bernstein has another view stating "really though we think the point of a million indices is the last hurrah of a mode of investing that is going away. What matters is the outcome that is delivered to the investor." For active managers such as ourselves, using the same underlying securities to make active investment decisions should target the same goal – generate outcomes based investing for clients.

Sterling as a firm has prided itself on protecting capital in times of uncertainty and the Equity Opportunities "dare to be different" approach since its founding has had the audacious goal of generating "above average returns with below average risk" for clients as an integral part of its outcomes-based approach. Should general market returns become more challenging given the maturing of the bull market, stock selection rather than allocation should prove a valuable component of investor returns. In addition, the ability to protect capital in market rough patches has enabled clients to stay invested with their trusted intermediaries over the long term.

As part of that long term relationship we thank you for your interest and trust managing your investments.

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