Université PANTHÉON - ASSAS (PARIS II)

Droit - Economie - Sciences Sociales **7041**

Assas

Session : Janvier 2018

Année d'étude : Magistère Banque - Finance, Deuxième année

Discipline : *Anglais magistère Banque-Finance 2ème année*
(Structure 1er semestre)

Titulaire(s) du cours : Mme Elizabeth DODARD

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Durée de l'épreuve : **1h30**

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1. **Explain the following. Write 3 to 6 lines (double spaced) in full sentences** **(/4)**

a. Efficient Market Hypothesis

b. Sovereign Wealth Funds

2. **Translate the following into English** **(/4)**

a. Les Futures sont des produits financiers à effet de levier important, négociables en Bourse. Ils permettent à un acheteur et à un vendeur de s'engager, à une échéance fixée, sur la livraison et le paiement d'un actif

b. Le géant à la pomme a franchi de nouveaux sommets en Bourse, et dépassé le seuil inédit, dans l'histoire moderne, des 900 milliards de dollars.

3. **Essay: Comment on the following sentences**
(2 to 4 pages double-spaced – about 250 words) **(/10)**

Total debt levels in the economy have not fallen; the debt has been shifted away from the financial sector and onto the government (and via QE, on to the books of central banks). For as long as it stays on the books of central banks, the system is more stable but if QE is ever fully unwound, the system will be just as risky as before.

4. **Read the article, then answer the following questions.** **(/12)**
Write 3 to 6 lines (double spaced) in full sentences for each answer. Use your own words

a) What are passive funds as opposed to active funds? (2)

b) Explain the two criticisms directed at active funds. (4)

c) Explain the following sentence: "These criticisms cannot surely both be true. They require index funds simultaneously to be uncritical sheep-like investors and ruthless capitalists devoted to overcharging consumers." (2)

d) Why does *The Economist* believe the criticisms are not robust enough? (4)

Criticism of index-tracking funds

Adapted from *The Economist*, Nov 14th 2017

INDEX funds were devised in the 1970s as a way of giving investors cheap, diversified portfolios. But they have only become very popular in the past decade. Last year more money flowed into "passive" funds than into "active" funds.

In any other industry, this would be universally welcomed as a sign that innovation was coming up with cheaper products to the benefit of ordinary citizens. But the rise of index funds has provoked some fierce criticism.

Two stand out. One argues that passive investing is, in the phrase of analysts at Sanford C. Bernstein, "worse than Marxism". A key role of the financial markets is to allocate capital to the most efficient companies. But index funds do not do this: they simply buy all the stocks that qualify for inclusion in

a benchmark. Nor can index funds sell their stocks if they dislike the actions of the management. The long-term result will be bad for capitalism, opponents argue.

A second argument is that index funds pose a threat to competition. The asset-management industry used to be remarkably diverse. It was hard for any active manager to keep gaining market share; eventually, their performance took a hit. But passive managers benefit from economies of scale. The more funds they manage, the lower their fees can become, and the more attractive the product.

Since passive managers like BlackRock and Vanguard own the shares of every company in an industry, the fear is that they might play a role reminiscent of the monopoly "trusts" of the late 19th century. Studies have argued that the concentrated ownership of shares is associated with higher fares in the airline industry and fees in the banking sector.

These criticisms cannot surely both be true. They require index funds simultaneously to be uncritical sheep-like investors and ruthless capitalists devoted to overcharging consumers. Furthermore, passive investors, in the form of mutual funds and exchange-traded funds, own only 12.4% of the American equity market. It seems remarkable that they can have such a big impact on the corporate sector with such a small stake.

It is worth examining the criticisms in detail. The Marxist criticism implicitly assumes that the investment community is divided into two—passive investors and active managers devoted to combating corporate excess and ferreting out exciting new bets. But a lot of "active" investors run portfolios that cling closely to a benchmark index for fear of getting fired if they underperform. So they, too, own shares in the biggest firms. A few "activist" investors do try to change corporate strategy but most fund managers don't have the time to campaign. They may be active but they are not activist.

When it comes to voting at annual general meetings, moreover, passive managers can and do get involved. In one 12-month period, BlackRock says it voted in support of proposals from activists 39% of the time, compared with 33% of occasions where it backed existing management.

As for the studies that found evidence of anti-competitiveness caused by passive money, they have been challenged. A recent academic paper* found "no relationship between common ownership and prices in the airline industry"; another** from the Federal Reserve on the banking industry found some results that were consistent with an anti-competitive effect but "the sign of the effect is not robust, and implied magnitudes of the effects that are found are small."

Even if you concede the potential for a small group of fund managers to exert baleful influence on a few sectors through their cross-holdings, passive managers are surely the least likely participants in such a conspiracy. The point of their existence is that they hold the market weight in every industry; they have no reason to favour the success of one over any other. If a conspiracy were to occur, it would surely be driven by active managers buying very large stakes in a particular industry, and hoping to benefit accordingly.