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Knowing the difference

# Passive vs Active Investing

**There is much debate over whether Passive or Active investing provides the best return on investment.**

Actively managed funds have traditionally been the preferred options amongst investors, with passive funds largely overlooked. However, the trend is rapidly changing and in 2019, US domestic assets in passive funds exceeded active funds, for the first time.

The value of investments can go down as well as up & it is possible to get back less than the amount invested

## Passive Investment Management

Mimics an index of market returns, & does not require a manager to buy & sell at will. This investment method is lower cost & lower risk than active management, & seeks to minimise costs by limiting the number of trades performed.

Research shows that in the long-run, passive investments are likely to outperform active investments due to the lower costs, fewer timing errors & less likelihood of poor investment choices.

## Active Investment Management

Aims to outperform the market index by stock picking; active managers analyse the market to identify investments that are undervalued, while selling investments that become overvalued.

Typically, fees & risk are much higher with active management, as an investment manager must continuously analyse & trade securities, with each trade incurring its own cost.

### Captures market returns

Aims to capture the return of the market with a buy-&-hold strategy via index trackers & rules-based funds. They minimise trading & stay invested through good times & bad.

### Targets excess returns

Attempts to beat the market & deliver excess returns. This can increase risk of deviating from the market index. Research shows that only about 1% of active fund managers beat the market over the long term*.

*New Evidence on Mutual Fund Performance, D, Black. et al. 2017.

### Focus on minimising costs

Portfolios are built around a core of ultra-low-cost index tracker funds. ebi focuses on minimising all the costs of trading & timing errors, including avoiding the cost of underperformance by active managers.

### Typically, higher costs

Typically, costs are higher as a manager is paid to pick stocks, furthermore managers will look to buy & sell securities in an attempt to beat the market, with each trade incurring a cost.

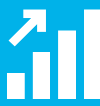
### Access to broad global markets

Trackers provide access to most of the world's publicly available equities & bonds through some of the world's largest asset managers. These portfolios aim to reduce risk via diversification.

### Concentration risk

Active strategies are often constructed in a more concentrated manner than passive strategies. In an attempt to pick the next 'winning' stocks, portfolios are tilted to a smaller number of names, leading to fewer securities and lower levels of diversification.

### Believes that markets are efficient



The Efficient Market Hypothesis (EMH) contends that stocks will always trade at a 'fair' price that quickly compounds available new information.

### Believes that markets are inefficient

Believes that markets are inefficient & stocks are often mis-priced. Active managers attempt to identify market opportunities & exploit pricing inefficiencies.

### Buy & Hold

With a buy-&-hold strategy when markets go down, the portfolio goes down with it, when the market rises the passive fund matches that rise.

### Risk In Timing

Active managers may attempt to time market by tactical asset allocation. They would need to make two correct decisions, when to take risk off & when to add it back, something research suggests is near impossible over the short run.

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Best MPS Technology/Platform — IFA mps Awards Winner 2022

THE VALUE OF INVESTMENTS CAN GO DOWN AS WELL AS UP & IT IS POSSIBLE TO GET BACK LESS THAN THE AMOUNT INVESTED.
PAST PERFORMANCE IS NOT A RELIABLE INDICATOR OF FUTURE PERFORMANCE.

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