Active Versus Passive Management

Find out what distinguishes actively managed funds from passively managed funds and learn what benefits each has to offer.

Investment funds are perhaps the greatest financial invention of all time. By pooling their money and putting it under the watch of a professional manager, ordinary people are able to access market profits without making serious commitments or taking on huge levels of risk. Though this ease of use has made investment funds widely popular, the professional managers have not received default admiration. Many investors question whether a fund needs the attention of a manager to be a success.

Active and Passive

The difference between an actively managed fund and a passively managed fund is exactly what the name suggests: the managers of active funds make decisions that require attention and planning to earn profits. The fund's portfolio is closely monitored and regularly adjusted for what the managers believe is the optimal configuration.

On the opposite end of things, a passive fund has its initial investments chosen and then is left to grow without any regular or significant changes. Essentially, an investor's money is divided between several assets and then left on autopilot. The majority of passive funds are "index funds" that match a specific market index, such as the Dow Jones Industrial Average.

Why Choose Passive Funds?

When an investor buys shares in an index fund, the fund manager divides the money among some or all of the different assets that make up the index. The assets are generally not purchased in equal quantities, but rather in amounts according to how much market influence each has. This allows the fund to better track the general movements of the market. In most cases, fund shares will rise and fall in proportion to the index. When the fund makes profits from asset returns (dividends, interest, etc.), they are passed on to the investors.

Historically, passive funds have outperformed actively managed funds on average. The biggest reason for this higher performance is that passive funds do not pay nearly as much in fees. Active funds have dozens of managers and analysts trying to predict which stocks will do well. To pay these analysts, the actively managed fund must take a percentage of each investor's profits or total value. Though taking a small fee off the top of any profits

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may not seem like much, the compounded loss is significant enough to put most active funds behind similar index funds.

Why Choose Active Funds?

Actively managed funds can be very useful for the right investor. The biggest benefit is that an actively managed fund can provide a specific type of volatility or exposure an investor wants. For instance, a person may not like the volatility of technology companies, so he or she will search for an actively managed fund that excludes those types of investments. Alternatively, a different investor might want more volatility than an index fund offers, so he or she will seek out an active fund that uses riskier companies for investments.

Despite usually underperforming passive funds, some active funds do outperform index benchmarks. The past performance of a fund can give some insight into how efficiently it is managed, but investors should always remember that historical performance does not guarantee anything about future gains.

If you are considering changes for your portfolio or have questions about which funds would work best for you, contact Oasis Financial Solutions for professional financial guidance.

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