A Quick Guide to Active & Passive Investing

Quick facts

Active fund managers select individual stocks. Stock selections decisions in active funds are based on factors such as economic and market conditions as well as company-specific issues, e.g. the profitability of a company, the strength of its management, etc.

Passive or 'index-tracking' funds aim to replicate a specific market index.

Introduction

In recent years collective investment schemes such as ICVCs and unit trusts have become increasingly popular. When you consider that these funds can invest in a wider range of shares than most individuals, and can help reduce risk and keep costs down, although this is not guaranteed, it isn't hard to understand why.

Choosing between active and passive funds

Deciding if you would prefer your investment 'actively' or 'passively' managed is an important consideration and a useful step towards narrowing your choice of funds to invest in.

Your first consideration is how do you want your investments managed. Are you looking for a fund that will be impacted by an individual fund manager's choice of investments ?

Or are you more interested in keeping charges lower and prefer one that simply reflects the performance of a major index, such as the FTSE 100 ?

Active funds typically have higher annual management charges than passive funds. This reflects the investment managers' potential to outperform the market.

What are active funds ?

An active fund is managed with the aim of generating returns greater than the relevant markets, although this is not guaranteed, as measured by an index. Active fund managers base their stock buying and selling decisions on several factors including:

- Market conditions.
- Political climate.

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- State of the economy.
- Company-specific factors (e.g. profitability, market share).

Depending on the fund’s objective, an active fund manager may have little or no constraint on their investment choice.

Where this is the case, they can select what they consider the most promising opportunities, regardless of industry sector or company size. They aim to maximise gains in rising markets and limit the effects when markets are falling.

Actively managed funds features

Actively managed funds feature:

- Potential to outperform and, conversely, underperform compared to a market index.
- Flexibility to invest, where the investment manager believes, are the best market opportunities.
- Ability to minimise losses in a falling market by investing in shares outside the index.
- Typically higher annual management charges than for passive funds in return for the investment managers’ potential to outperform the market.

What are passive funds ?

A passive, or index-tracking, fund is managed with the aim of replicating the performance of a specific index. To track the FTSE 100, for example, an investment manager will aim to invest in the same shares, in the same proportions, as this index.

Passive fund managers won’t make any ’active’ decisions as they’re only trying to match the index. The fund will generally rise and fall with the index.

Passively managed funds features

They perform well when markets rise and poorly when they fall. Passive funds can be less diversified than active funds as the relevant index may be dominated by just a few large companies.

A change in the investment manager will have no impact on its performance. Passive funds generally offer lower annual management charges. Typically, a lower turnover of shares can mean lower transaction costs

Consider getting advice

It’s important to remember that a degree of risk is inherent with any investment and the potential for greater returns comes with a higher degree of investment risk. While a passive fund is considered to potentially offer less investment risk associated with it than an actively managed fund, there are still risks, such as concentration risk involved.

As with most investment decisions, there is no right or wrong selection. The choice is down to you, your investment objectives, your attitude to risk and the economic and market environment at the time. If you are unsure about any investment, we always recommend that you speak to an Independent Financial Adviser before making any financial or investment decisions.

Important Information

The value of investments and any income from them can go up and down (this may partly be the result of exchange rate fluctuations) and you may not get back the full amount invested. Past performance is not a guide to future returns.

Where individuals or the business have expressed opinions, they are based on current market conditions, they may differ from those of other investment professionals and are subject to change without notice.

This document is for information only and should not be construed as advice. No action should be taken based on this information alone.

Looking to start investing or receive a professional investment management service, then Tony Walker Financial Planning Services Ltd may be able to help.

For further information please feel free to contact us on the details provided or request to book a no obligation consultation online by filling in our enquiry form.