ACTIVE VS. PASSIVE
Portfolio Management

SHAMROCK
WEALTH MANAGEMENT

The supremacy of one school of thought over the other in the active versus passive investing arena is indeed a worthy debate. Both sides argue convincingly that their approach will generate better returns over time. But it can be confusing, even paralyzing, for average investors to make sense of the rhetoric and to develop a clear, disciplined strategy tailored to their individual needs.

Let's examine each approach, including its relative strengths and weaknesses, so that you will gain a better perspective on the debate and, ultimately, more clarity about your own investment approach.

Active Management

Active management is simply an attempt to beat the market, as measured by a particular benchmark or index. The S&P 500 and the Russell 1000 are two benchmarks that measure the performance of large-cap U.S. companies. Active managers that buy these types of companies attempt to give you a better risk-adjusted return than the benchmarks. Active managers look at the economy, political events, and company-specific factors to determine which stocks to buy and when to buy them. Of course, it is just as important for these managers to determine when a stock should be sold.

The concept seems simple, right? But the catch is that these active managers incur significant expenses in conducting their research and effecting frequent transactions, and these costs are passed on to you by reducing your net return. For example, before any fees are assessed, a manager might beat the relevant index by 10 percent. But after transaction costs, marketing fees, and administrative expenses are deducted, the reduced margin over the index could be reduced to as little as 3 percent. Certainly, a 3 percent return over the index is preferable to the index return; however, the point is that beating the market is difficult when factoring in these costs.

All indices are unmanaged and are not available for direct investment by the public. The S&P 500 is based on the average performance of the 500 industrial stocks monitored by Standard & Poor's. The Russell 1000 Index offers investors access to the extensive large-cap segment of the U.S. equity universe representing approximately 92% of the U.S. market.

Passive Management

Passive management, on the other hand, makes no attempt to beat the market. Passive managers simply buy the same stocks in the same proportions as their relevant index or benchmark; therefore, returns closely approximate the return of the particular benchmark. These managers incur transaction costs also, but the costs associated with passive, or index, investments are typically well below those of actively managed investments. Over time, it is this lower cost that many believe will allow passive portfolios to provide higher returns.

	Active Management	Passive Management
Advantages	• Professional analysis • Possible to beat the market • Manager strives to protect assets during market volatility	• Lower operating expenses • Manager should never significantly underperform benchmark • Low turnover typically leads to greater tax efficiency
Disadvantages	• Higher fees and operating expenses • Manager could underperform benchmark or index • High turnover may create greater tax liability	• Manager cannot protect assets during market volatility • Manager will never beat benchmark

So, Which Is Better?

It is impossible to say with any degree of certainty whether active management is more beneficial than passive. The more relevant question might be which is better for you? The comparisons shown above may prove helpful.

Perhaps it makes sense to use a combination of active and passive management to take advantage of their relative strengths. Active stock managers could be used in tax-deferred accounts so the higher turnover is not a concern, while passive managers could be used in nonqualified accounts where turnover should be kept to a minimum.

Whether you decide to use active, passive, or a combination of the two management styles, research has shown that the most important aspect of any investment portfolio is the overall asset allocation.* Work diligently with us to ensure that the percentages you allocate to stocks and bonds are in line with your objective, time horizon, and risk tolerance. Only then should you entertain the great active versus passive debate.

*Asset allocation does not ensure against market risk. There is no guarantee of returns for any investment.

Will Berigan, CFP®
Shamrock Wealth Management
991 Sibley Memorial Highway | Suite 201 | Lilydale, MN 55118
651.317.4330 | 651.560.7956 fax | www.shamrockwm.com | wberigan@shamrockwm.com