



# INDEPENDENT JAMES

GUIDE TO  
**ACTIVE AND  
PASSIVE INVESTMENT  
MANAGEMENT**

WHAT'S BETTER – ACTIVE OR PASSIVE  
MANAGEMENT?

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# GUIDE TO ACTIVE AND PASSIVE INVESTMENT MANAGEMENT

## *What you need to know*

If you are looking to invest in shares or bonds, you may think about putting your money into one or more managed funds. Managed funds are pooled investments that contain different securities, so you reduce the risk of holding just a few individual shares or bonds.

**Y**ou can invest in funds which provide access to a variety of different markets and sectors. But wherever you invest, you will be faced with one of the most basic questions: do you want to put your money in 'actively' or 'passively' managed funds?

### **CHOICE OF 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 deciding how 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 MANAGEMENT STYLE**

Active funds typically have higher annual management charges than passive funds. This reflects the investment managers' potential to outperform the market, and they are managed with the aim of generating returns greater than the relevant markets, as measured by an index –

known as its 'benchmark'. The index contains the companies whose shares are being bought and sold daily by the fund. All equities belong to at least one index depending on the location of the company and the type of business.

### **GOOD STOCK SELECTION**

Professional fund managers or investment research teams run active funds, and they make all the investment decisions – like which companies to invest in or when to buy and sell different assets – on your behalf. The manager will pick stocks to buy and then compare the returns that they make against the benchmark. Good stock selection is designed to pick the companies that the fund manager thinks will outperform others within the index.

### **BEST DIVIDEND PAYMENTS**

The manager does not have to buy all the index stocks, only the ones they believe will increase the most in value or, in some cases, pay the best dividends to give the best overall returns. They have extensive access to research in different markets and sectors and often meet with companies to analyse and assess their prospects before making a decision to invest. Typically, active fund managers base their stock

buying and selling decisions on several factors including market conditions and the political climate, the state of the economy, and company-specific factors (for example, profitability and market share).

### **MOST PROMISING OPPORTUNITIES**

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, and aim to maximise gains in rising markets and limit the effects when markets are falling.

### **PASSIVE MANAGEMENT STYLE**

The passive management style of investing is called 'passive investing', also known as 'tracking'. A passive, or index-tracking, fund is managed with the aim of replicating the performance of a specific index. Passive investment funds track a market and charge less in comparison to an active fund. 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.

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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. Typically, the fund will buy all the stocks in, for example, the FTSE 100 in the same proportion they represent in the index. So if Vodafone accounts for 6% of the FTSE 100 Index by value and a smaller company such as Tate & Lyle accounts for 1%, some 6% of fund by value will be in Vodafone shares and 1% by value in Tate & Lyle, and rebalancing will occur to ensure the fund is consistent with the index.

### LOWER TRANSACTIONAL COSTS

Passively managed funds perform well when markets rise and poorly when they fall, and they 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 should have no impact on its performance, and they generally offer lower annual management charges, with a lower turnover of shares leading to lower transactional costs.

### DEGREE OF RISK

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 have less investment risk associated with it than an actively managed fund, there are still risks (such as stock market risk) involved.

### DOES YOUR INVESTMENT PORTFOLIO TRULY REFLECT YOUR INDIVIDUAL INVESTMENT OBJECTIVES?



It's important to understand the difference between 'actively' or 'passively' managed funds before you embark on choosing a fund or combination of funds, and we always recommend you obtain professional financial advice. That way, you can build an investment portfolio which truly reflects your individual investment objectives. To discuss your particular situation, please contact us.

INFORMATION IS BASED ON OUR CURRENT UNDERSTANDING OF TAXATION LEGISLATION AND REGULATIONS. ANY LEVELS AND BASES OF, AND RELIEFS FROM, TAXATION ARE SUBJECT TO CHANGE.

THE VALUE OF INVESTMENTS AND INCOME FROM THEM MAY GO DOWN. YOU MAY NOT GET BACK THE ORIGINAL AMOUNT INVESTED.

PAST PERFORMANCE IS NOT A RELIABLE INDICATOR OF FUTURE PERFORMANCE.



# WHAT IS THE RIGHT INVESTMENT APPROACH FOR YOU?

As with most investment decisions, the choice is down to you, your investment objectives, your attitude to risk and the economic and market environment at the time. We always recommend that you obtain professional financial advice.

To discuss your particular situation,  
please contact us.

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