
Active Versus Passive Investing

Posted on: October 10, 2016

There are very passionate views on both sides of the debate as to whether it is better for individual investors to use active investment managers versus using an index approach, with its main selling feature being lower fees.

Let us first bear in mind why people invest in the first place, whether it is bond funds or stock funds or other assets. Generally, with some exceptions, people invest their savings to provide them with income and growth over time, with the primary objective being to protect their hard earned savings first and then earn a return. There are very few people who have made their fortunes through investing in the markets.

The debate is not whether investing in stock funds or bond funds can make you rich, but rather if active management can increase your returns over many years to help you meet your retirement and income planning needs when compared to index investing.

The answer, I believe, is yes. The reason this is the case, is because active portfolio managers can provide a basic element to beating the market that the market or broad economy cannot provide and that is "concentration".

Deceased billionaire Paul Desmarais of Power Corp. was once quoted in the media as saying that "to get rich you have to concentrate your investments and to stay rich, you have to diversify your investments." Only active management provides the investment concentration needed to grow most Canadian's assets.

In past articles, we noted that in order to generate a \$50,000 pension, which according to published surveys, is the ideal retirement income that Canadians aspire to, you will need to build investment assets of \$1 million earning an average return of 5%.

Given that the average RRSP value across Canada is around \$60,000 and that the average liquid savings of the Boomer Generation is reported to be \$100,000, Canadians desperately need growth in both their investment returns and savings rates to have a shot at their ideal retirement income and lifestyle. And yet, many of them seek safety in GICs and fixed income because it "feels" safe. Not taking risks is actually risky in terms of your long term financial health!

When you employ a passive or index approach to investing, you are buying all of the Canadian economy for example, as well as its overall growth. Given today's sluggish economic growth and pro-spending and pro-tax governments in Quebec, Ontario, Alberta and federally, can you really expect the returns to even approach 5%? Why buy average?

The only selling point for the passive camp of investors is the lower overall investment management costs. But if you do not or cannot grow your investments over time, faster than inflation, taxes and even the general economy, then how does even a zero cost of executing your investment strategy help you achieve your retirement income needs?

The above question brings us back to the topic of investment concentration, which applies in two ways. The first being that an active manager can limit his portfolio to only the highest quality or fastest growing and most profitable companies, in, say Canada. Research shows that companies whose dividends grow over time, provide greater returns than dividend paying stocks which have in turn outperformed the TSX index over the past 30 years.*

The second way is that your portfolio can be diversified across more than one economy and subsets of each economy. Most Canadians have over 50% of their assets in Canada which only represents 2% or so of the global economy. For example, if China is doing well, perhaps the best place to invest is in small companies with low debt, growing profits and so on. It is hard to find an index to replicate the portfolio of a strong active manager in these types of situations.

Active management can also mute or reduce draw downs in weak markets by switching to defensive assets or sectors. The key point is that it is unlikely that you can achieve your asset accumulation and savings targets only by focussing on investment costs. While fees do matter, as your assets get larger, they are not the key determinant to investment returns but they are like the icing on the cake. But they are not the cake!

[Call us today](#) [1] to review the many investment options and approaches that can be used to assist you in achieving your lifestyle and retirement goals!

^{*}From RBC Capital Markets Qualitative Research: June 1986- June 2016. Courtesy of Fidelity Investments Canada.

Do you have questions about your investments?

[Contact our office today !](#) [1]

Copyright © 2016 AdvisorNet Communications Inc., under license from W.F.I. All rights reserved. This article is provided for informational purposes only and is not intended to provide specific financial advice. It is strongly recommended that the reader seek qualified professional advice before making any financial decisions based on anything discussed in this article. This article is not to be copied or republished in any format for any reason without the written permission of AdvisorNet Communications. The publisher does not guarantee the accuracy of the information and is not liable in any way for any error or omission.

Tags: [investment](#) [2]
[investment planning](#) [3]
[investing](#) [4]

Source URL: https://wealthwise.ca/e-newsletter/2016/2016-10/article-1.htm?qt-tabbed_block=0

Links

[1] <https://wealthwise.ca/contact-us> [2] <https://wealthwise.ca/taxonomy/term/30> [3]
<https://wealthwise.ca/taxonomy/term/20> [4] <https://wealthwise.ca/taxonomy/term/49>