Registered Investment Advisor Firm

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WHY INVEST IN AVERAGE?

While passive investing is a popular strategy, it isn't the only or always the best strategy.

Passive management, or indexing, is an investment management approach based on investing in exactly the same securities, and in the same proportions, as an index such as the Dow Jones Industrial Average or the S&P 500. It is called passive because portfolio managers don't make decisions about which securities to buy and sell; the manager follows the same methodology of constructing a portfolio as the index uses. The manager's goal is to replicate the performance of an index as closely as possible. Passive managers invest in broad sectors of the market, called asset classes or indexes, and are willing to accept the average return that the asset class produces.

The predominant investment strategy today is active investing, which attempts to outperform the market or asset class. The goal of active management is to beat a particular benchmark. The majority of mutual funds are actively managed.

Analyzing market trends, the economy and the company-specific factors active managers are constantly searching out information and gathering insights to help them make their investment decisions. Many have their own complex security selection and trading systems to implement their ideas. There are almost as many methods of active management as there are managers. These methods include fundamental, technical, quantitative and macroeconomic analysis.

Active managers believe that because the markets are inefficient, anomalies and irregularities in the capital markets can be exploited by those with skill and insight. Prices react to information slowly enough to allow skillful investors to outperform the market.

The main advantage of active management is the possibility that the managers will be able to outperform the index. They can make informed decisions based on experiences, insights, knowledge and ability to identify opportunities that can lead to superior performance. If they believe the market might turn downward, they can take defensive measures by hedging or increasing their cash position to reduce the impact on the portfolio.

A disadvantage is that active investing is more costly, resulting in higher fees and operating expenses which can impact consistent outperforming over the long term. Also, a manager's style could be out of favor with the market for a period of time, resulting in lagging performance.

A passively managed investment will never outperform the underlying index and the investor must be satisfied with the performance of the index. Managers are also unable to take action if they believe the overall market will decline or they believe individual securities should be sold.

The debate about which is the better approach has been going on since the 1970's. On one side you have very low fees; transparency and tax efficiency (buy and hold not triggering annual capital gains) – passive investing. On the other side is the flexibility; hedging; risk management (get out of holdings or sectors when risk is too high) and tax management (tax loss harvesting) – active investing.

While actively managed funds still dominate the landscape, trends are shifting towards passive vehicles. Many investors are advised to use Exchange Traded Funds (ETFs) and index funds almost exclusively and are warned that the high cost of actively managed funds will constantly dilute their returns.

I find that diversification works best, and that means I regularly review and monitor the best funds, active and passive, to meet client needs.

While the different groups of managers battle for fund flows and the upper hand in a market debate, most investors are best served not by and either-or approach. Instead, investing on selective active managers should be combined with select positions in passive funds. This is the approach I take. I do not think that a fund or asset class will always beat the market. Trends happen, and so do fund performance. I do not become "married" to an active or passive manager; they have to continually prove themselves to me. I don't like average for me or my clients.

If you need more information, or if these strategies are suitable for your accounts, contact me so we can discuss.

The debate continues.

FED Watch

The Fed moved at the March meeting as the market wanted it to. They moved .25% to a range of .75% to 1.00% Fed Funds rate. That leaves 2 more planned moves for 2017. The Fed also released their quarterly statement and projections, with little change from last quarter.

Market observers give a 6% chance of a quarter point rise in the Fed Funds at the next meeting and a 50% chance at the June meeting.

The next meeting is May 2nd and 3rd.

Davis Investment Group

Davis Investment Group is a fee-based Registered Investment Advisor firm servicing the needs of clients across the United States.

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If you have questions or would like further information on this month's topics or any other financial or investment related subjects, including Social Security claiming strategies, please contact me by phone or through my email address at: bob@davisinvestmentgroup.biz