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Is active management really dead?

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In June 2015, our firm published an article on how best to navigate an increasingly complex investment world. In it, we reiterated what has become a mantra in financial planning: *Euphoria and panic are investors' biggest enemies.*

Our recommendation: Work with an advisor you trust, and stick to your plan.

In the debate over active versus passive management, we feel it's just as important to keep this lesson in mind: ***Just because a certain investment or investment category has performed well lately doesn't mean it always will.***

As an example, think about hot IPOs like Pets.com or a big investment name like Hewlett Packard. For many years, HP was a better investment than Apple—until it wasn't. Pets.com was a guaranteed success—again, until it wasn't.

Instead of betting everything on the most recent "hot investment," we constantly tell our clients about the value of diversification.

We believe that the same applies to active and passive investment management, and that opportunities exist to utilize both active and passive management within a well-designed financial and investment plan. We educate our clients on the specific value each strategy provides, rather than making a sweeping argument for which is better.

Those who recommend investing only in index funds and ETFs have a limited viewpoint: The goal of an actively managed mutual fund is to outperform its respective index. In six of the last seven years (2010–2016), the S&P 500 index outperformed the broad actively managed Morningstar Large Blend category. So, the fact that many active managers have lately underperformed their indexes must mean it can't be done and isn't worth the cost. What this argument fails to mention is that in nine of the previous 10 years (2000–2009), large-cap active management outperformed its passive counterpart[1].

Instead of focusing on just the past seven years, we take a long view, recognizing that passive and active performance has been historically cyclical. During market corrections, the flexibility of active management can allow for portfolio positioning to reduce downside exposure and capture alpha in the early stages of a recovery.

We also believe there to be specific strengths of both passive and active management. In large-cap equities, the benefits of passive management often outweigh the drawbacks. With large companies, information is more publicly available and greater analyst coverage exists. Accordingly, fewer opportunities exist for active managers to beat market returns, and the low fees associated with index funds and ETFs allow them to outperform active managers, net of fees.

However, in asset class like small cap, emerging markets or bonds, opportunities exist for fund managers to provide additional returns. Active managers can leverage their teams' due diligence to be more focused and selective than can a market-cap weighted index fund.

In this active-versus-passive debate, we don't have to go "all in," using one strategy over the other. Understanding the relative strengths of each allows us to utilize both, to ultimately achieve our financial goals. ●

[1] *"The cyclical nature of active and passive investing," Hartford White Paper, Q1, 2017*

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ABOUT STEPHEN A. SCHWARTZ

Pioneer Financial at Northwestern Mutual provides financial services to high net worth and emerging high net worth individuals, families and business enterprises. Pioneer Financial's team of 17 associates and staff serve clients nationwide from their Park Avenue office in New York City. Kevin R. Luchetta, Stephen A. Schwartz and James L. DiNardo are wealth-management advisors and Certified Financial Planner™ practitioners. The practice is focused on assisting clients through comprehensive financial planning that includes asset management, retirement funding, risk management, estate preservation and distribution.

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