Active, Passive, and In-Between Investing

[Presenter Name]

[Location]

[Date]

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- Non-profit professional society of over 5,800 investment professionals
- New England’s largest investment professional membership organization
- Founded in 1946, CFA Society Boston is a founding society of CFA Institute.

CFA Institute

- Global association of investment professionals
- Sets the standard for professional excellence and credentials
- Champions ethical behavior in investment markets
- Respected source of knowledge in the global financial community.

Who We Are

Presenter A is a financial services professional with 25+ years of experience in corporate and commercial banking. She has worked for several financial institutions, serving as credit analyst, client relationship manager, risk manager, and or portfolio manager. Mary is in career transition and enjoys volunteering in financial literacy and mentorship programs.

Presenter B is a financial services professional with 25+ years of experience in corporate and commercial banking. She has worked for several financial institutions, serving as credit analyst, client relationship manager, risk manager, and or portfolio manager. Mary is in career transition and enjoys volunteering in financial literacy and mentorship programs.

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When building a nest egg, practice patience and diversification

Agenda

- Time Horizon
- Diversification
- Passive Investing
- Active Investing
- What's right for you?

Photo by Harli Marten on Unsplash

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Patience is a virtue; the average annual stock market return has been 9.07%

S&P 500 (and predecessors) 1872 -2022

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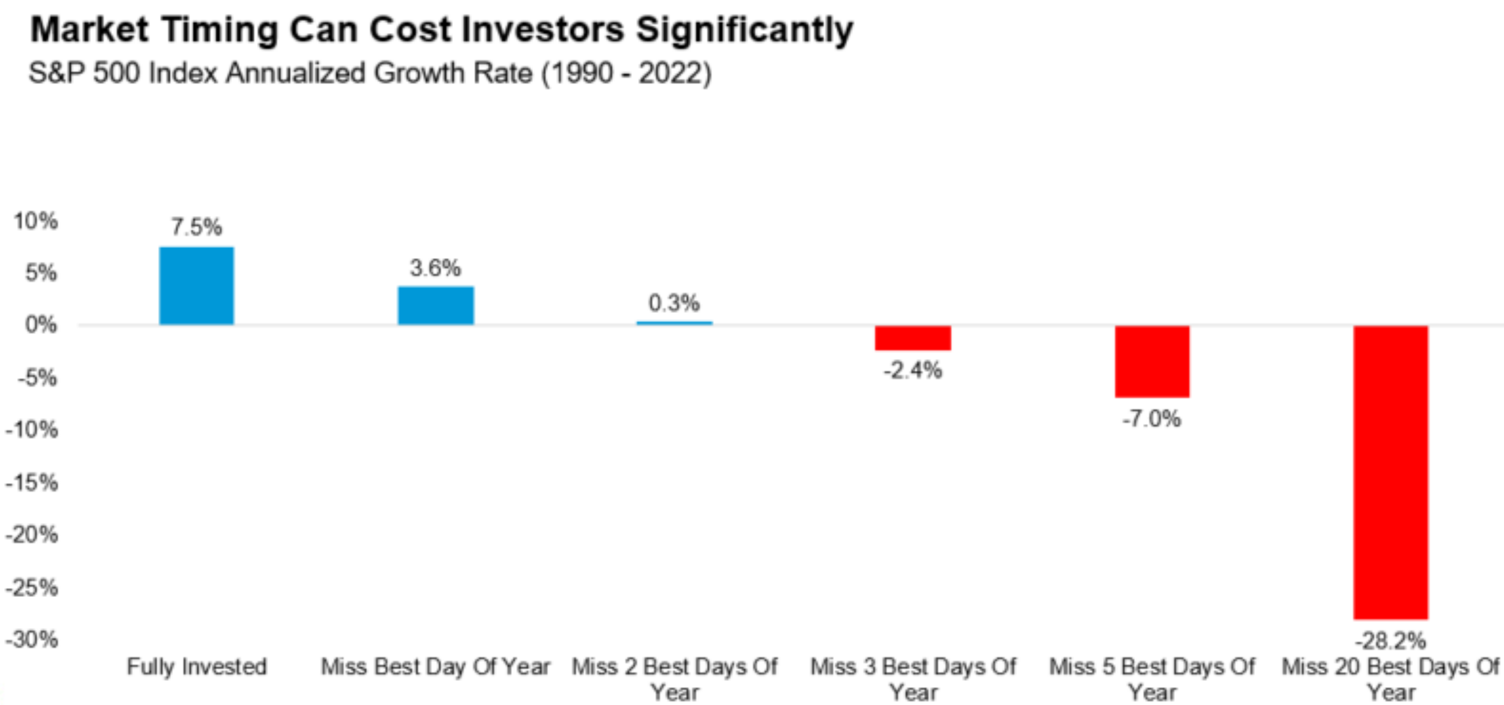
[S&P 500 Returns since 1872 (officialdata.org)]

Trying to time the market exposes you to the risk of missing out on good days



Source: Carson Investment Research, FactSet 3/23/20

All indexes are unmanaged and cannot be invested into directly.
Past performance is no guarantee of future results.

Diversification is the foundation of portfolio construction

Photo by Woodleywonderworks on Flickr

Definition:

Spreading your investments across different asset classes (i.e., stocks, bonds, cash)

Why Diversify?

It lowers the severity of up/down movements in your portfolio (also known as volatility)

Image by Mediamodifier from Pixabay

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A weather-based portfolio shows how diversification reduces risk

Stock A Two stocks perform differently depending on the weather: the umbrella maker returns 12% when it rains, but 0% when it’s sunny; the sunscreen maker return 12% when it’s sunny, but 0% when it rains

If you owned only one or the other, you’d make the same **expected return***, but your risk would be higher (because it could be completely sunny and you’d make 0% with the umbrella maker)

If you own both, you have the same expected return, but with lower risk

*Your expected return is 6%, but it could be 12% or 0%; assuming it can only be rainy or sunny, the simple diversified portfolio will always return 6%.

Image generated by Dan Latimore with Microsoft Copilot

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A weather-based portfolio shows how diversification reduces risk

Stock A an Umbrella Maker

Returns 12% when it rains
0% when it’s sunny

Stock B a Sunscreen Maker

Returns 12% when it’s sunny
0% when it rains

You have the same expected return* if you own **EITHER s**tock.

If you own **BOTH**, you have the same expected return, but with lower risk

*Your expected return is 6%, but it could be 12% or 0%; assuming it can only be rainy or sunny, the simple diversified portfolio will always return 6%.

Image generated by Dan Latimore with Microsoft Copilot

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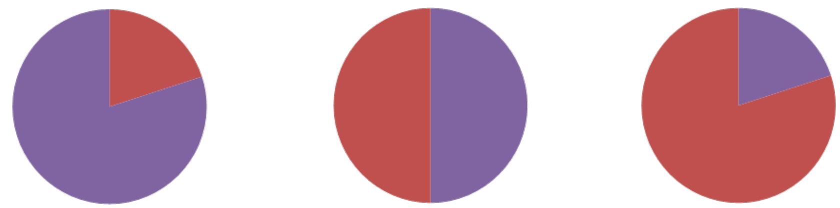
Benefits of Diversification

Portfolio Allocation Models

Stocks

Bonds



Shorter time horizon/lower risk tolerance

Longer time horizon/higher risk tolerance

Historical Risk/Return (1926 – 2013)	20% Stocks / 80% Bonds	50% Stocks / 50% Bonds	80% Stocks / 20% Bonds
Average Annual Return	6.7%	8.3%	9.6%
Best year	29.8% (1982)	32.3% (1933)	45.4% (1933)
Worst year	-10.1% (1931)	-22.5% (1931)	-34.9% (1931)
Years with a loss	12 of 88	17 of 88	23 of 88

Source: The Vanguard Group, Inc.

Investing can be Passive or Active

Passive (Index) Investing

- Professional money managers construct portfolios to mirror an underlying index
- Trading occurs only to rebalance the portfolio
- Fees are low (average of 0.12%)

Active Investing

- Professional money managers invest in securities to try to beat average index returns
- Trading occurs much more frequently
- Fees are higher (0.5% - 0.75%, and sometimes higher)

Source: https://www.investopedia.com/ask/answers/032715/when-expense-ratio-considered-high-and-when-it-considered-low.asp

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Fees make a big difference over time

Initial investment of $1,000, gross return of 7.5% before fees

Year	Amount – 0.12% Fees	Amount – 0.75% Fees	Difference - %
0	$1,000	$1,000	0
10	2,038	1,922	6.1%
20	4,154	3,693	12.5%
30	8,466	7,096	19.3%
40	17,256	13,637	26.5%
Year 40 multiple of year 1	17.3x	13.6x	

.63% may not seem like a big difference, but it adds up

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Common Types of Indexes

Stock (Equity)

- S&P 500 Index
- NASDAQ

Bond (Fixed Income)

- Barclays Capital U.S. Aggregate Bond Index
- Barclays Municipal Bond Index

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Index Strategies

- Index investors use a "buy and hold" strategy to build their portfolios because it takes emotion out of the process and creates discipline.

- Occasionally, the portfolio may be rebalanced so that successful investments do not become too heavily weighted in the portfolio.

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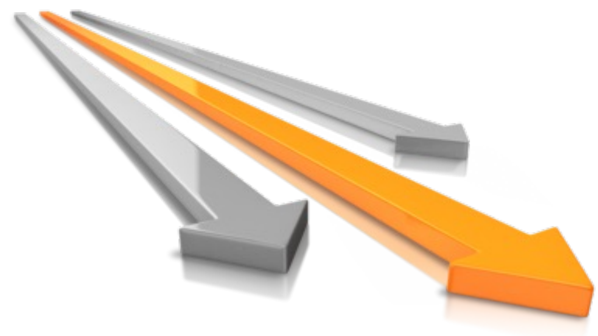
Index Strategies

Generally, it is **not considered a passive or index strategy** if investors do any of the following:



- Actively trade individual securities
- Actively trade index products
- Time the market by switching between cash and/or other investments

Types of Investments

Mutual funds
- Typically available for many indices or actively managed strategies
- Mutual funds trade daily at the close of business and typically settle the following day

Exchange traded funds (ETFs)
- Typically managed as passive strategies
- Have a unique structure that often further reduces the tax burden associated with interest, dividends and capital gains on investors
- Taxes can reduce the return available to taxable investors, creating an additional hurdle for active managers in generating excess returns
- ETFs trade intra-day and settle, like a stock, three days later

Individually-managed portfolios of securities are available to investors who prefer to own stocks, bonds or other assets directly or who have a special need.

Benefits of Passive Investing

Passive investment strategies

- Typically provide a **substantial cost advantage** over active investment strategies
  - *Compared to active management fees and transaction costs that create a higher hurdle for managers to overcome (in their effort to outperform the designated benchmark)*

- Passive investment strategies are often more **tax efficient** than active strategies as a result of their low turnover

- Passive strategies are relatively **easy to understand and manage** and are not dependent on a star investment manager or research team to execute

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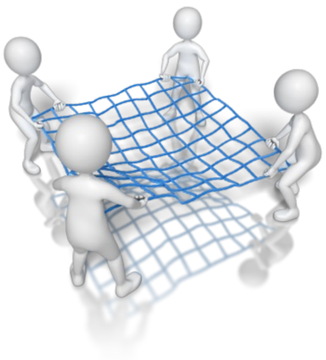
Active Investing is generally suited for more experienced investors

Active managers often seek to **generate a return in excess of the index** and – depending on their investment approach – may incur lower risk in doing so (whereas passive or indexed investing strives to replicate the returns of a designated index).



Active managers may **avoid less attractive, slow growing companies** and provide greater exposure to companies with superior valuations or growth potential. Passive investing is "valuation agnostic" – the index buys the security regardless of valuation.

Depending on underlying index and its construction, passive investment can have unintended consequences including **concentration in economic sectors** or industries (e.g., NASDAQ Index is heavily weighted to Apple Inc. and technology stocks).

Active Investing can help with specific goals and circumstances

- Some asset classes or market segments better lend themselves to active or passive investment; active managers often have an **edge in less efficient markets**, such as smaller or international company stock investing.

- Active management may also provide a greater degree of flexibility to accommodate or complement existing investments. For example, active strategies can be appropriate for taxable portfolios where there are low-cost basis holdings that need to be managed. The manager **can customize the strategy** to meet the client's needs.

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It’s tough for active fund managers to outperform their benchmarks over time

Selecting an active manager who can outperform a designated benchmark after management fees, expenses and taxes is challenging. It’s important to note that **performance can vary greatly between the best and worst managers in any given asset class** – even within “efficient” asset classes

Active fund category	Managers who exceeded benchmark, 1991-2023	Median return vs. benchmark
US Large-cap	47% (worse than coin flip)	-0.38%
US Mid-cap	48% (worse than coin flip)	-0.79%
US Small-cap	50%	0.37%
International Large-Cap	59%	1.59%

*Source: *US Mutual Fund Performance, 1991-2023 by Gene Hochachka, Frontier Financial Inc., February 19, 2024*

Your circumstances will influence your investing choices

- Stage of life (time horizon)
- Investing knowledge
- Liquidity needs (education, home purchase, retirements
- Type of account (pre-tax (retirement) vs. taxable)
- Risk tolerance – how much are you willing and able to lose?

Photo by NEOM on Unsplash

Remember: pay attention to fees!

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About CFA Society Boston Financial Literacy Program

Who We Are

CFA Society Boston is dedicated to putting investors first and raising ethical standards within the investment profession. We unite Boston's investment community and provide a forum for collaboration, education, and innovation. Originally called the Boston Security Analysts Society, Inc., we are a non-profit professional society founded in 1946. In 2017, we became CFA Society Boston. More than 6,000 investment professionals locally and globally are members of CFA Boston, representing over 650 investment firms. 96 percent of CFA Boston members hold the Chartered Financial Analyst designation from CFA Institute.

Our Financial Literacy Mission

This community outreach program aligns with non-profit groups to reach a wide variety of audiences, from late high school onward. Since its inception in 2014, the initiative has touched thousands of people, partnered with over 30 organizations, and currently has over 30 active volunteers. This community outreach program makes valuable financial literacy content available to the general investing public through collaboration with our alliance partners. The initiative addresses issues such as Personal Finance, Basics of Investing, Retirement, Bonds vs. Equities, Choosing a Bank, and more.

How it Works

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How to Partner with the CFA Society Boston Financial Literacy Program

What CFA Society Boston Commits To

- Provide neutral, expert presenters
- Set up and present topics
- Supply the presentation / activity
- Bring a laptop and materials
- Be experienced in presenting in-person and in a virtual setting

What Your Organization Commits To

- Provide the audience and venue, either in-person or virtual
- Promote the event onsite, local newspapers and website
- Make a projector or USB connection available
- Briefly introduce presenter(s)Complete a post offering survey

For more information on how CFA Society Boston can partner with you visit www.cfaboston.org/financialliteracy or email finlit@cfaboston.org.