ACUMEN WEALTH ADVISORS®

ACTIVE VS. PASSIVE FUNDS

THE ACTIVE VERSUS PASSIVE[1] DEBATE HAS BEEN WITH US FOR A WHILE. GENERALLY, PROPONENTS OF ACTIVE MANAGEMENT ARE LOOKING TO "BEAT THE MARKET"

For several years, during our recent raging bull market, the average passively managed fund has outperformed the average actively managed fund.

Morningstar data revealed that "passive investing is now the mainstream approach," with nearly $2 flowing into passive investments for every $1 flowing into active investments.[2] Of course, past performance may not be indicative of future performance, but there is a strong case to be made for investors and plan fiduciaries, to offer participant access to an array of index funds covering major core asset classes. Fees, market coverage and tracking error are key considerations in the selection process.

The growth in passive investment utilization has been significant. In 2004, there were only 150 exchange-traded funds (ETFs), and by 2014, there were 1,300.[3] Morningstar indicates that asset flows to actively managed funds was 2 percent during 2014, compared to 11 percent organic growth of flows to passive investment portfolios.[4]

While recent history has favored passive funds, active funds have had long stretches of outperformance and relative performance of active versus passive funds runs in cycles. Historically managers generally appear to have done better when stock picking or defensive positioning is called for. Periods of rising interest rates have shown outperformance by active managers.[5] While few active managers outperformed their index in 2014, long-term numbers are somewhat better with about 45 percent of active managers outperforming their index over the 10 years ending in 2013. Because the indices are generally market-cap weighted (the larger companies have a bigger weighting than smaller companies) passive funds are somewhat skewed toward the largest stocks.[2]

It is important to note that during periods in which passively managed funds are said to be outperforming actively managed funds, they are typically referring to the average active manager.[6] The average active manager scores a 6 in our system, which is not typically generally a fund our methodology would identify as a replacement/selection option.

Our approach in selecting actively managed funds is to identify those where the manager has exhibited skill over various market conditions. Identifying manager skill is the main goal of the Scorecard Methodology™. To monitor investments, we have selected analytics that work well together to enable us to truly identify manager skill, as opposed to managers that might get "lucky", or those who might generate good returns while operating outside the comfort level of some prudent ERISA fiduciaries. We are less concerned about the averages than we are how a manager measures up against an appropriate benchmark which we chose and which is a better measure of skill.

Investors looking to reduce market risk may also wish to consider active managers whose performance analytics reflect lower market volatility (e.g. standard deviation, down market capture, less correlated to market/peer group). Market risk is inherent in passive management. If it increases, it will increase the risk in your (passive) fund as well. Further, we believe some sectors are inherently less efficient making it possible for active managers to outperform their passive counterparts.

We believe there is an opportunity for both active and passive investments in a well-designed portfolio. We call this a "core-satellite" approach, where passive management serves as the "core" of the portfolio, comprising half or more of the portfolio's allocation, and active management, comprising the balance, or "satellite" portion. While the "core" keeps the allocation intact and tracking, the "satellite" portion provides incremental return opportunities and risk control through a combination of out-of-benchmark weights and skillful active management. As the passive versus active debate continues, and as one philosophy dominates the other over the short term, it may be more beneficial to determine how they best fit together to optimize the real long-term opportunities.

[1]Active funds are where the fund manager is trying to add value and outperform (for that style of investing). Typically, these investment strategies have higher associated costs due to the active involvement in the portfolio management process by the fund manager(s). Passive funds are where the fund manager is trying to track or replicate some area of the market. These types of strategies may be broad-based in nature (e.g., the fund manager may be trying to track/replicate the technology sector). These investment strategies typically have lower costs than active investment strategies due to their passive nature of investing and are commonly referred to as index funds.

[2]Rekenthaler, John. "Do Active Funds Have a Future?" Morningstar.com. August 6, 2014. http://news.morningstar.com/articlenet/arti-cle.aspx?id=659902

[3]Karabell, Zachary. "Solving the Active Vs. Passive Investing Debate," Barrons.com. January 26, 2015. http://online.barrons.com/arti-cles/solving-the-active-vs-passive-investing-debate-1422304950

[4]http://www.financial-planning.com/gallery/fp/active-vs-passive-fund-flows-for-2014-2690725-1.html

[5]Max, Sarah. "Return of the Stockpickers; Active managers are likely to recapture their lost glory as interest rates rise," Barron's, January 23, 2015. http://online.barrons.com/articles/return-of-the-mutual-fund-stockpickers-1420870199

[6]Active management is the use of a human element, such as a single manager, co-managers or a team of managers, to actively manage a fund's portfolio. Active managers rely on analytical research, forecasts, and their own judgment and experience in making investment decisions on what securities to buy, hold and sell. The opposite of active management is passive management, better known as "indexing."

All investments involve varying levels and types of risks. These risks can be associated with the specific investment, or with the mar-ketplace as a whole. Loss of principal is possible.

The Scorecard System is a ranking of funds in approximately 30 asset classes to identify skillful managers utilizing quantitative and qualitative factors. Scores range from 1 to 10.

Investors should consider carefully information contained in the prospectus, including investment objectives, risks, charges and expenses. Please read the prospectus carefully before investing. Exchange-traded funds (ETFs) do not sell individual shares directly to investors and only issue their shares in large blocks.

ETFs are subject to risks similar to those of stocks. Investment returns will fluctuate and are subject to market volatility, so that an investor's shares, when redeemed or sold, may be worth more or less than their original cost.

ACR#222960 01/17

Acumen Wealth Advisors
250 Forest Avenue
Chattanooga, TN 37405
(423) 825-4796

Acumen Wealth Advisors, LLC® is a Registered Investment Adviser. Advisory services are only offered to clients or prospective clients where Acumen Wealth Advisors, LLC® and its representatives are properly licensed or exempt from licensure. Past performance is no guarantee of future returns. Investing involves risk and possible loss of principal capital. No advice may be rendered by Acumen Wealth Advisors, LLC® unless a client service agreement is in place. Acumen Wealth Advisors, LLC® is affiliated with RPAG and utilizes their robust retirement plan consulting tools and resources to deliver enhanced value to plan sponsor clients. RPAG™, a wholly owned subsidiary of NFP (NFP Corp.), provides retirement advisors premier technology, systems, training, and resources through its practice management platforms.