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ACTIVE MANAGERS LEAD INDEXES IN THE BULL MARKET
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The argument between passive and active investing has been going on for years. Passive, which is buying exchange traded funds (ETFs) that mimic a certain benchmark versus active, which utilizes a research team and fund manager to make investment decisions. Passive investors favor low cost performance but that lower cost comes at a price - namely risk. Active managers of course get paid for their work and often can't outperform their benchmark after the cost is considered. The indexing gets you 100 percent of the returns but also 100 percent of the risk. Active managers strive to return 90-95 percent of the index but with only 60-70 percent of the risk. Therefore, you need to determine what your goal is for each category and invest accordingly.

Index investing can be very valuable and certainly has its place when used as part of an overall strategy. You still need to know how much exposure you are willing to take in certain segments of the market. You also should build your portfolio to help mitigate the risk by having proper diversification. It is prudent to consider active managers when you can both outperform and reduce the risk of a given index or benchmark. This is most valuable in your riskiest categories such as small cap equity or emerging market investing.

A recent article by Jeff Cox on CNBC.com reported that active managers are having their best year since 2009. Managers who have been overweighting some favored sectors have been outperforming their passive counterparts by following the stocks that are moving the markets. The first half of 2017 reports 54 percent of large-cap managers beat their benchmarks and 60 percent beat in the second quarter alone.

Low volatility can be the enemy of stock pickers when there is not much price movement to trade. However, many fund managers have gotten better at sector selection according to Cox's article. They over-weighted positions in the tech sector, discretionary and health care, the top three performing categories. They have been under-weighting staples, utilities, and telecom shares.

Another factor is correlations, or when stocks move up and down together. The more closely stocks are in tandem with one another, the more difficult it is to find a winner. Many sectors have splintered off from the broad market trends and have created enough price discrepancy for active managers to benefit from.

Valuations and style also have a bearing on performance. So far this year 71 percent of value managers and 64 percent of growth managers have outperformed their benchmark.

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Despite the better performance of active fund managers, investors have pushed $701.9 billion into passive exchange traded funds, or indexes, for the 12 months ending this May, according to Morningstar. It seems just as indexing may be catching on, the tables are turning with performance in favor of some active managers.

Whether you use passive or active management, or hopefully some of each, it is important to have a strategy before you invest. This will help you determine how much exposure to have in each market sector and when to take profits from the high performers. Then you can determine which sectors benefit the most from active management so you know when it makes sense to pay for that expertise.

Patricia Kummer has been an independent Certified Financial Planner for 31 years and is President of Kummer Financial Strategies, Inc., a Registered Investment Advisor in Highlands Ranch. Kummer Financial Strategies, Inc. is a 6 year 5280 Top Advisor. Please visit www.kummerfinancial.com for more information. Any material discussed is meant for informational purposes only and not a substitute for individual advice.