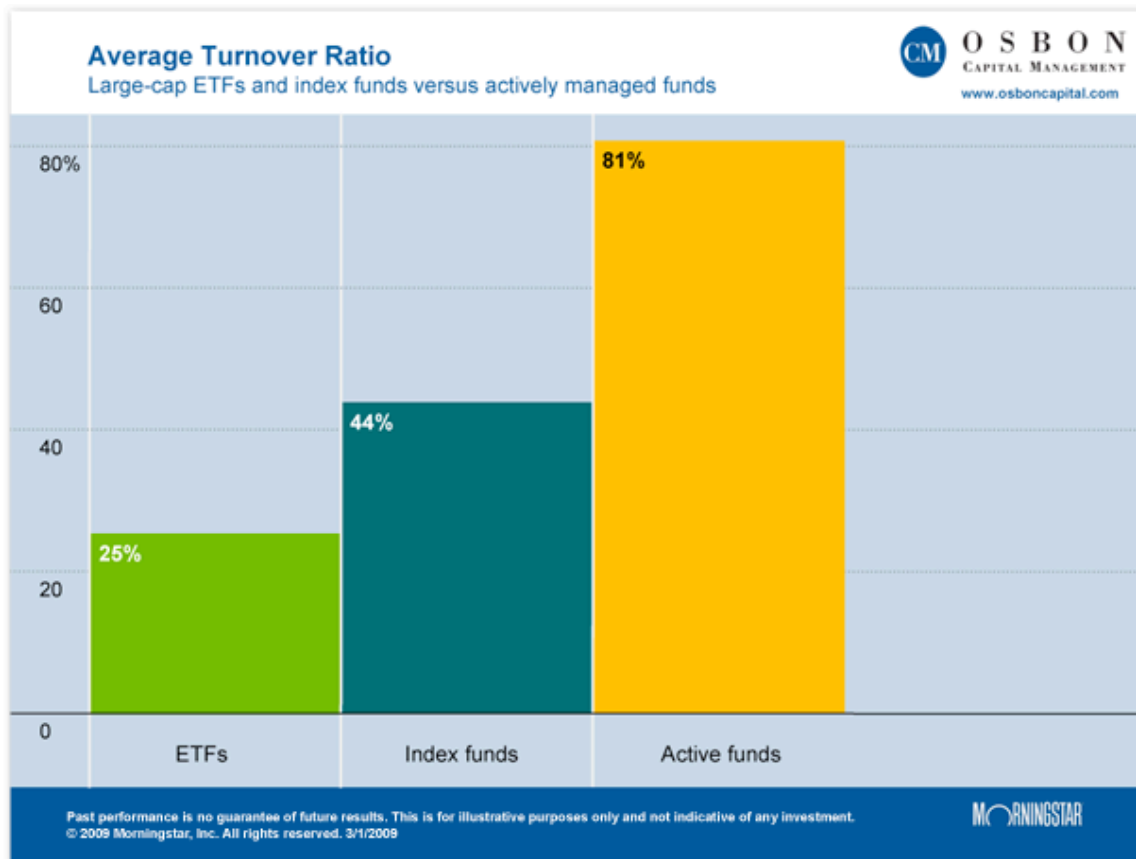




Quick Q & A #13

Q: Isn't "passive" just a fancy word for "lazy"?



A: No, in investing, "passive" means "disciplined."

Proponents of active investment management – those who seek to beat the market through stock picking, market timing, sector weighting, etc – often criticize passive management as unimaginative, laissez-faire, or even lazy. They argue that passive investing is too...well...passive.

But don't let the name fool you.

It's true, passive management typically involves much less trading than the active approach. The chart above shows the turnover rate for large cap ETFs



and index funds – the core tools for passive portfolio management – is much lower than for active funds. By tracking the contents of the Dow and other indexes, passive investing typically requires far fewer trades, which benefits investors with lower transaction costs and fewer taxable gains, other things being equal.

Disciplined versus predictive

But passive is anything but lazy. Fewer trades does not mean less strategy or sophistication. We feel the strength of passive management – which could just as easily be called “disciplined” – is that it defuses the temptation to chase fads or try to outguess the market. It removes emotion from the equation. By tracking indexes and carefully mixing asset classes to shape expected risk and return, a passive portfolio offers market level returns, without undue exposure to individual stocks, industries, markets, or currencies.

By contrast, active management – which could just as easily be called “predictive” (or even “speculative” in the extreme) – bases investment decisions on the ability to foresee earnings, sector growth rates, interest rates, and other variables that cannot systematically be known in advance. Faulty predictions, flawed security choices, or bad timing can result in big disappointments.

No single investment strategy is right for every investor. We strongly believe in the passive/disciplined approach, while others advocate active/predictive techniques. Make your own choice, but base the decision on the method, not the name.

Read more: [More Quick Q&As from Osbon Capital Management](#)

Next time: What’s the best international market?

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Turnover ratio for ETFs is an average of all large-cap ETFs listed in the Morningstar open-end database. Turnover ratio for index funds is an average of all large-cap index funds listed in the Morningstar open-end database. Turnover ratio for active funds is an average of all large-cap actively-managed funds in the Morningstar open-end database. Funds with turnover ratios exceeding 1,000% were excluded from this analysis. Source: Morningstar, Inc.

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