

SHOULD YOU HIRE AN EXPENSIVE MONEY MANAGER OR INVEST IN LOW COST UNMANAGED INDEXES?

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Investors have two broad investment approaches to choose from when it comes to managing their portfolios. These approaches are typically referred to as active or passive.

- The active approach uses professionally managed investment accounts or professionally managed mutual funds.
- The passive approach uses unmanaged or index mutual funds and/or index Exchange-Traded Funds (ETFs) that mirror a market index like the Dow, NASDAQ, S&P 500 or any of hundreds of others.

The early work of Nobel Prize winners Markowitz, Miller and Sharpe in the 1950s developed the theory of “efficient markets”, whereby they provided evidence that led to the hypothesis that, on average, over time, professional money managers underperform unmanaged indexes equal to the management fees. Looking at later tests of this hypothesis, there is not one major published study that successfully claims that managers beat markets by more than one would expect by chance.¹

All studies to date cogently show that portfolios allocated among unmanaged indexes (passive approach) will outperform about 75% of all managed portfolios.¹ Investing a portfolio in index funds eliminates the opportunity to earn greater-than-index returns. However, the benefits are increased efficiency, lower fees and eliminating the chance of earning significantly less-than-index returns.

Previously, most investors would place their assets with professional money managers directly or through managed mutual funds. More recently, investors have been choosing to invest in index-based mutual funds or the newest innovation – Exchange-Traded Funds (ETFs). ETFs are index-based (i.e. unmanaged or passive) and have begun to attract a lot of attention. This is mainly because there are significant performance, cost, and tax advantages to investing in a diversified portfolio of index-based ETFs rather than with professional money managers directly or through actively managed mutual funds.

Vern Sumnicht has 25 years experience as a successful financial planner and has been recognized for four consecutive years by “Worth Magazine” as one of the Nation’s Top Wealth Advisors. Vern and his team developed iSectors’® diversified ETF allocation portfolios. For more information about iSectors’® ETF allocation portfolios, visit www.iSectors.com, email Vern at vern@isectors.com or call 1-800-iSectors.

1. Active vs. Passive Management, By: [Rex A. Siquefield](#), October 1995