ACTIVE vs PASSIVE: is the debate over?

Active fund managers will tell you that the debate is over. Passive fund managers will tell you it is not.

The debate is still fully alive and well, and we are no closer to a resolution than we were since the debate began.

Don't try to beat the market

In 1975, John Bogle - the founder of Vanguard, the world's largest provider of unit trusts and ETFs - realised that the cost of active investing was one of the main reasons it did not do as well as the market itself. In fact, Bogle discovered that the longer the timeframe, the more active investing would fall behind the market.

Bogle came up with a revolutionary idea: Do not try to beat the market. Instead, invent a fund that delivers the performance of the market, but without active management and its associated costs.

In other words, use the market to grow your wealth and cut the costs of investing to the bone. ETFs are now one of the most popular and fastest growing investment products in the world.

Don't look for the needle, buy the haystack

Active investing is like looking for needles in the haystack. You need skill to pick the winners all of the time. Passive investing would be like owning the entire haystack, and thus being exposed to the profits of all of the needles all the time.

PASSIVE FUNDS	ACTIVE FUNDS
Fund constituents are decided by the contents of an index.	Fund constituents are decided by a fund manager who "chooses" the winners from the apparent losers.
Rarely change fund constituents. This costs less.	Constantly buy and sell stocks (churn) whilst looking for the "winners". This costs a lot.
Neither outperforms nor under-performs the index. It provides the performance of the index, no more and no less.	Performance depends on the fund manager's skill and luck. It may or may not outperform its investment objectives.
ETFs are 100% transparent. Constitu-ents of the fund are published freely by the ETF issuers.	Most actively managed funds do not disclose their holdings regularly – they would be disclosing information to rival companies.

It's hard to beat a passive fund

Each year, academic studies comparing the returns of actively managed funds vs passive funds show that in the aggregate, actively managed funds do not generally deliver returns higher than their passive counterparts.

Consider the next table.

Percentage of active funds beating the index up to Dec 2015

INDEX	1 Year	3 Years	5 Years	7 Years	10 Years
FTSE/JSE Top 40 TR	22%	32%	29%	27%	21%
FTSE/JSE Top 40 SWIX TR	48%	32%	20%	13%	14%
All Share Index TR	39%	38%	33%	25%	20%

Source: Profile Data 2016. (General equity fund classification).

Simply put, if you had invested in a Top 40 index over the last five years you would have beaten 71% of active managers whose mandate it was to simply beat the market.

Exchange Traded Funds do not try to do better than the market, but because of their lower costs they often end up beating the funds that try.

Passive costs less

Consider the analysis below over a one year period up to 31 December 2015.

General Equity Average TER 1 year average return before fees	1,52% 3,52%
TER as a % of return	43%
Broad Market Equity ETFs* Average TER 1 year average return before fees	0.39% 3.06%
TER as a % of return	13%

Source: Profile Data 2016

Despite ETFs performing slightly less than the active funds, their percentage of costs expressed against their returns are remarkably lower than their active counterparts.

Keep it simple

You may say that it is possible to beat the market, and you may be right in some cases, but the odds are heavily stacked against you.

If you are looking for a simple low cost way to grow your wealth over the long term, ETFs are the answer.

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