Active Vs. Passive Investing - What's the Difference?

Author – MARISSA HAYDEN Canstar Content Producer · 05 August 2021

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While there are many different types of investors out there with varying strategies and goals, some can be separated into two distinct groups, active and passive. Here's a breakdown of how active and passive investors typically differ in their tactics, tools and attitude towards investing.

What is Active Investing?

A key difference between the two portfolio managing strategies is that generally, an active investor tries to beat the market, whereas a passive investor tracks a market index. With this in mind, active investors tend to keenly watch the market and make trades appropriately. And some active investors choose to engage with a professional fund manager to actively manage their investments on their behalf.

What are the pros of active investing?

There are definitely advantages to taking the active approach to investing. Firstly, as active investors tend to try to beat the market when they succeed it may translate to higher than average returns. Although, taking this approach to investing usually requires a high level of confidence when making investment decisions, and would typically involve higher risk, which should be taken into account.

Therefore, for some, engaging with an active fund manager to oversee their investments might be a good option. Additionally, having an active fund manager on board may give investors access to products that the average person cannot obtain.

What are the cons of active investing?

By using a professional fund manager you are placing your trust in them and have to accept there is a possibility they could misjudge the market and choose underperforming stocks. It's important to do your due diligence before choosing a fund manager. Additionally, having a middle man, i.e. a fund manager, oversee your investments comes at a cost. Often fees for a managed fund will include a management fee and an administration fee. However, just as performance can differ greatly between managed funds, so too can the fees charged. Active investing is a highly involved strategy. So, if you decide to take the path of actively managing your own portfolio, be aware of the time you will need for stock analysis and keeping up with market movements.

In addition, if you decide to speak with a financial adviser for guidance on your investment choices, consider seeking one that is independent. It's important to be aware many financial advisers are aligned with institutions.

What is Passive Investing?

Often seen as a low cost and low maintenance way to invest, passive investing tends to suit those who would rather take more of a ‘set and forget’ approach and have a lower risk tolerance when compared with active investors. For this reason, passive investors are often investing over long periods of time, adopting the buy and hold tactic. They tend to keep their eye on the prize and ignore short term setbacks and even sharp downturns in the market. This is the opposite of active investing which tends to suit those who are chasing shorter-term gains.

What are the potential pros of passive investing?

For some, the relaxed nature of passive investing is a positive in itself. However, this investment strategy has a couple of other attractive qualities up its sleeve that may suit some investors. Taking the passive investing approach can be a more affordable way to access the market, as it can exclude the sometimes-hefty fees that come with an active fund manager. Also, passive investors generally have complete transparency over their investments. They often know exactly where their money is and can remove and reinvest it as they please. They also don’t have to worry about whether they’ve chosen the right professional fund manager.

What are the cons of passive investing?

On the other side of the coin, the passive investment strategy can be limiting in a number of ways. Firstly, there are fewer products available that suit the passive investing approach. Investors are basically limited to index funds, such as an index ETF and an index managed fund. Also, unlike active investors, passive investors will never beat the market, as they track the market (although, neither will they underperform the market!).

Choosing an investment option that’s right for you

In the end, it comes down to personal preference and what suits your investment goals. If time is on your side and you don’t need to access your funds for a while, you may want to consider passive investing. However, if time is of the essence and you prefer a more hands-on approach, active investing might be worth exploring.

Either way, having a clear strategy in place is a good first step in your investment journey. Or, if you’ve been investing for a while, it may be a good idea to review your strategy to ensure it still aligns with your goals and current circumstances.

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