Advisors Still Favor Active Management, but Preferences Are Shifting: Practical Perspectives

Of the 40% of surveyed advisors who changed allocations, most did so by increasing their use of passively managed investments, Practical Perspectives found.

By **Bernice Napach** | May 29, 2015

Despite the continuing debate about active versus passive asset management and the increasing popularity of ETFs, the majority of financial advisors haven't changed their investment strategies and continue to favor active management, according to a new report from consulting firm Practical Perspectives.

An increasing number of advisors, however, have boosted their use of passively managed products, and that trend is expected to continue.

Sixty percent of the advisors surveyed left their investment allocations unchanged over the past year. Of the 40% who changed allocations, most did so by increasing their use of passively managed investments rather than their actively managed ones.

The report is based on data from 600 wirehouse, regional, independent and registered investment advisors, plus data from 525 advisors focusing on just liquid alternatives. "There are still a lot of traditionalist advisors," said Howard Schneider, president of Practical Perspectives and co-author of the report, *Major Trends Driving Change in Portfolio Construction*. "Most advisors still tilt toward being primarily active or a blend between active and passive."

Indeed, more than 80% of the advisors surveyed indicated significant or moderate use of active management strategies — with actively managed mutual funds being the most popular vehicle — while nearly 60% indicated the same for passive management. But the preferences may be shifting.

Over the next 12 months, almost 40% of advisors are expected to increase their investment in passively managed ETFs, compared with 30% in actively managed mutual funds. Driving the push for passively managed ETFs are the lower costs and tax efficiencies.

The investment categories for passively managed portfolios are the usual suspects. In equities they're large-cap core, blend, growth and value and specialized sector categories. Among bonds, they're U.S. government bonds, Treasury inflation-protected securities (TIPS) and short-term bonds.

Interest in actively managed stock ETFs is highest in what the report calls the "traditionally less efficient categories where managers can add alpha," such as small-cap, international or global equities. For bond portfolios the equivalent categories are emerging market, high-yield and international bonds.

Looking ahead, the report expects more interest among advisors in so-called “smart beta strategies.” These strategies use ETFs structured around indexes that are not capitalization-weighted like most investment indexes and are designed to outperform those indexes. Another potential product that could attract advisors is the ETMA — exchange-traded managed account — or ETMF — exchange-traded managed fund — which are hybrids between actively managed mutual funds and ETFs. Like ETFs, they are low cost and tax efficient, but like mutual funds, their portfolios are not transparent and disclosed daily.

One area in which advisors are not expected to make big changes in their allocations is liquid alternatives such as real estate, strategic income, commodities and long/short portfolios. “Advisors’ use of liquid alternatives appears to have already achieved critical mass and the question remains as to whether growth will accelerate,” the report states.

Still, Schneider says, “More innovative options are available for financial advisors… And for many of the existing products out there — smart beta or liquid alternatives — there still seems to be opportunities for advisors to learn about them.”

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