ETFs Versus Actively Managed Funds

- Think of ETFs as index funds that offer intraday tradability.
- They are generally low cost, which is important, and can be relatively tax efficient.
- However, COMPASS has found its approach of carefully constructing a portfolio of actively managed mutual funds can provide its clients with enhanced returns and reduced risk than can be found by passive investing alone.

Do we have a winner? Ever since passively-managed funds like exchange-traded funds (ETFs) came into being, there has been much debate about active management versus passive management. Research published by industry professionals presents different arguments. Some studies show that only a fraction of active funds beat their respective benchmarks. Other studies show that, while active funds have failed to beat their benchmarks, they do provide added-value when a disciplined approach is adopted over longer periods.

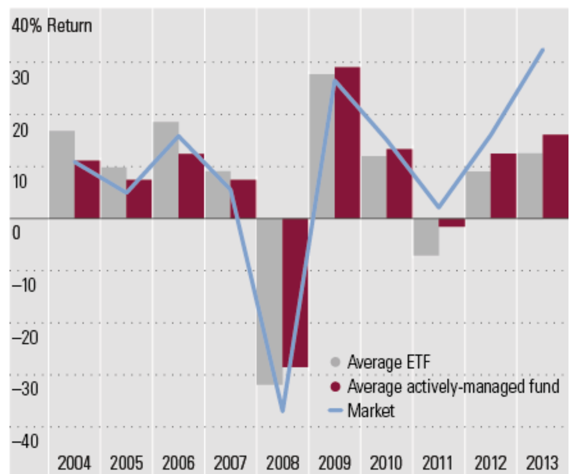
An exchange-traded fund strives to achieve a return similar to a particular market index. The ETF will invest in either all or a representative sample of the securities included in the index that it is seeking to imitate. ETFs provide passive diversification, are tax-efficient investment vehicles and have cost advantages. However, the return on an ETF is capped by the return of the index it tracks. Active managers, on the other hand, attempt to pick the best investments in the market and, if well executed, their performance is not limited by the return on an index. However, active funds are prone to style drift—the tendency of a fund to deviate from a particular investment style over time to improve performance. These modifications in investment style may be attributed to changing trends in the market environment.

Let's take a look at how the "average" ETF and "average" active fund performed over the last decade. The image compares the performance of the "average" ETF with the "average" actively managed mutual fund during the past 10 years. As evident from the image, in periods of poor market performance (2008 and 2011) when the market experienced negative or very low returns, the "average" actively managed mutual fund performed better than its passive counterpart. When the market experienced strong positive performance, ETFs fared better in some years (2004 to 2007, for example). In other years, actively-managed funds performed better (2012 and 2013).

Why is this, you may ask? One reason for this behavior is the underlying structure of active and passive funds. Passive funds like ETFs are designed to track a particular index or benchmark. This means that when the benchmark experiences poor performance, the ETF also fares badly. On the other hand, active managers may be able to quickly adjust their portfolios depending on the underlying market conditions. This may be one reason for better performance in down markets.

Making a choice between active and passive investing isn't an easy one. When deciding which style of management is better for you, it is important to take into account several factors, such as costs, style, risk, transparency of investments, manager performance, and tax implications. Consult your financial advisor to learn more about investing in ETFs and actively managed funds.

Performance Over the Past 10 Years



This information is for illustrative purposes only and not indicative of any investment. The investment return and principal value of mutual funds will fluctuate and shares, when sold, may be worth more or less than their original cost. Investors should read the prospectus and consider this information carefully before investing. ETFs are subject to similar investment risks as common stocks. An ETF's performance may not be exactly that of its underlying index. Past performance is not a guarantee of future results; holding a portfolio of securities for the long term does not ensure a profitable outcome. Investing in securities always involves risk of loss. An invested cannot be made directly in an index.

Source: The market is represented by the Standard & Poor's 500® index, which is an unmanaged group of securities and considered to be representative of the U.S. stock market in general. Average ETF and average mutual fund performance from Morningstar's open-end database.