Is there Such a Thing as a Passive Investor?

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Bloomberg posted a shocking article on February 27, 2018 about how index funds are no longer passive. In fact, in a blog post from a week ago, I contended that buying or selling a passive fund is an active decision. The concept of passive investing is flawed. There is no such thing as a passive investor, only passive investments. How do I know this? During the five day trading period between February 2 - 9, 2017, the SPY, the largest ETF that mimics the Standard & Poor's index had net redemptions of almost $25 billion, or 8% of it's total assets. Selling this passive investment was very much an active decision for those that sold during this period. Click here to read the post. Today, with the proliferation of thousands of indexes and ETFs that mimic those indexes, there may be no such thing as a passive investment either. Trying to get your head around this is a daunting task. Consider this fact, today there are about 3,000 liquid stocks in the collective U.S. stock markets and over 5,000 indexes. How can this happen?
Here is Bloomberg's take:

Passive has gotten so large that it's killed everything in its path -- including itself. Welcome to the "Passive Singularity. "There are now so many indexes that putting your money in an index-tracking fund is a move requiring an active decision, according to researchers at Sanford C Bernstein & Co. The industry's growth has even forced active managers to focus on selecting indexes themselves -- be that to invest in, or to benchmark against.

"Ultimately, this brings us to a bigger point, which is that there is, really, no such thing as passive investing," wrote the quantitative research team headed by Inigo Fraser-Jenkins in a note this week. "This does not mean that people give up on buying cheap exposure to markets, but instead that the active-passive distinction breaks down. "It's the latest broadside from Bernstein's team, which in 2016 labeled passive investing "worse than Marxism." Investors so far aren't paying heed: passive mutual funds and ETFs absorbed $692 billion last year, compared to $45 billion in outflows for active funds, according to data compiled Bloomberg Intelligence. The Bernstein strategists base their conclusions around the millions of indexes in existence, which far surpass the number of single securities. Do a little math and the madness is clear: with 3,000 easily-investable stocks, the number of possible combinations to turn into an index is a Googol (that number, written out, would be 1 followed by 100 zeros.)

Sorting through it all means that no passive manager can truly be passive -- allocating to indexes will always require a discretionary decision at some level, the researchers argue. To cope with this abundance of indexes, many ETF shops have turned to model portfolios and roboadvisers to aid clients with asset allocation, according to Andrew Craswell, vice president of investor services at Brown Brothers Harriman & Co. in London.

"We continue to see even traditional active managers using passive holdings in their portfolios either as some sort of tactical or long term asset allocation decision," Craswell said. "The active and passive divide is certainly blurring."

Fighting for Trust
With nearly half of equity assets managed passively in the U.S., there's no sign that investors will stop gravitating toward cheaper, index-tracking products. Bernstein's new research wrestles with a world where passive is larger than ever, and active managers have to fight for the trust of their clients. The team concedes that "passive investing has been a great force for democratizing access to capital markets and reducing the costs to society of managing assets. "But a massive bull market rally across equities and debt markets has left many investors blind to the risks, which smart asset allocation can help to mitigate, Bernstein said. In January, investors added $25 billion to active ETFs and mutual funds while allocating $103 billion to passive vehicles, data from Bloomberg Intelligence show. "By all means, investors should save money on implementation by using passive vehicles as part of their allocation," the strategists wrote. "But the myth of purely passive investment will be exposed by a low-return world."

Why so many new ETFs?
Money managers are under pressure to cut costs, says Balchunas, as investors shift their money into funds with low fees. Smart-beta ETFs are generally more expensive than S&P 500 funds but cheaper than actively managed funds. It remains to be seen how well the new funds will perform.

What drove the jump?
Demand. Many new benchmarks essentially repackage active investment strategies into indexes, says Eric Balchunas, senior exchange-traded fund analyst at Bloomberg Intelligence. They can then be tracked by so-called smart-beta ETFs, which fund companies are rolling out rapidly.

Source: Bloomberg LP, [Link to original article]()

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