

Maybe There Is No Such Thing as Passive Investing?

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Reframing a Debate That's Gone on Too Long

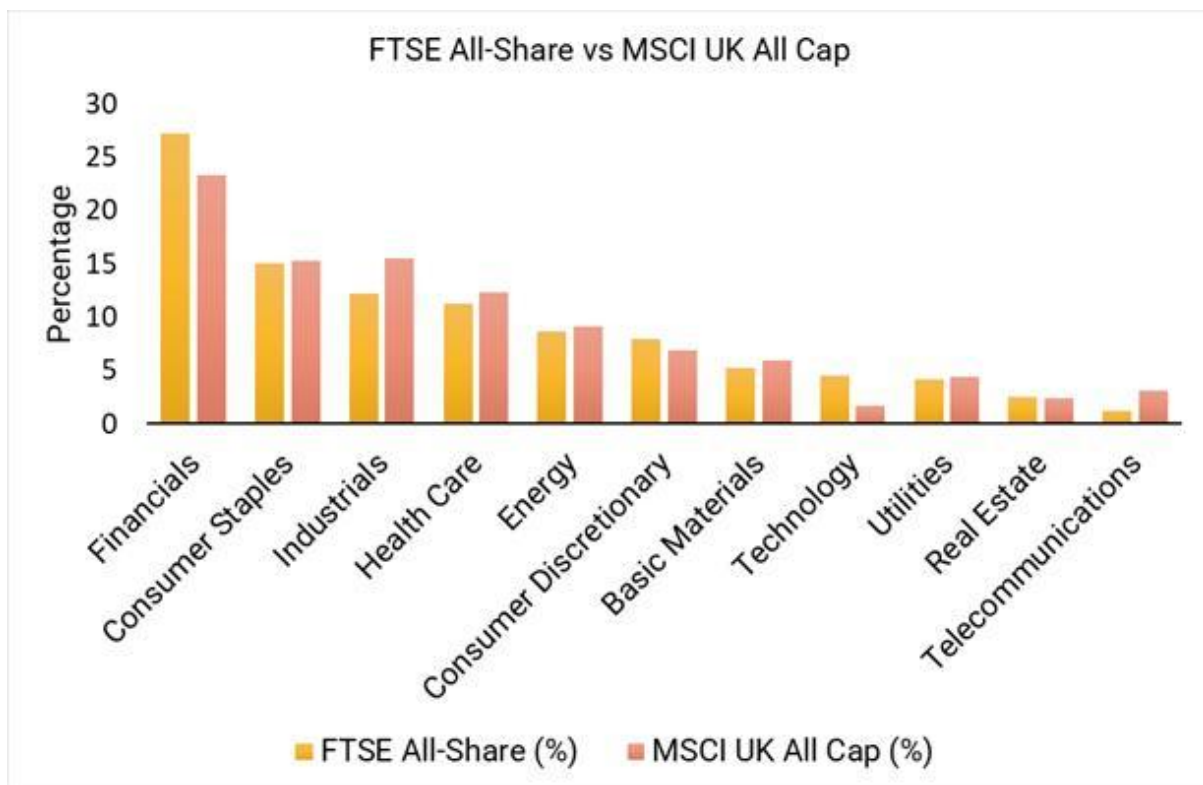
The active versus passive debate has long been a fixture in the investment world. Often framed in binary terms, it suggests that investors must choose between costly human intervention and cost-efficient automation. But the reality is more nuanced. What if the difference between active and passive is not so much about method as it is about mindset?

While passive investing plays a valuable role in portfolio construction, it's rarely as neutral as it's made out to be. Even the most rules-based, index-tracking investment involves a range of embedded choices. Recognising those choices helps us use passive tools more effectively, not dismiss them.

Passive in Name, Active in Nature

Passive investing is often described as hands-off and objective. In practice, it's anything but. Every index is a human creation, designed with intention, shaped by assumptions, and revised over time.

Take the FTSE All-Share and the MSCI UK All Cap. Both are designed to represent the UK equity market, yet they differ significantly in their construction. These differences arise from variations in index construction and stock inclusion criteria, leading to materially distinct allocations across areas such as financials, industrials, and consumer goods. What seems like a minor structural choice can result in very different investment outcomes over time.



Source: FTSE All-Share Index and the MSCI UK All Cap Index as of April 30, 2025

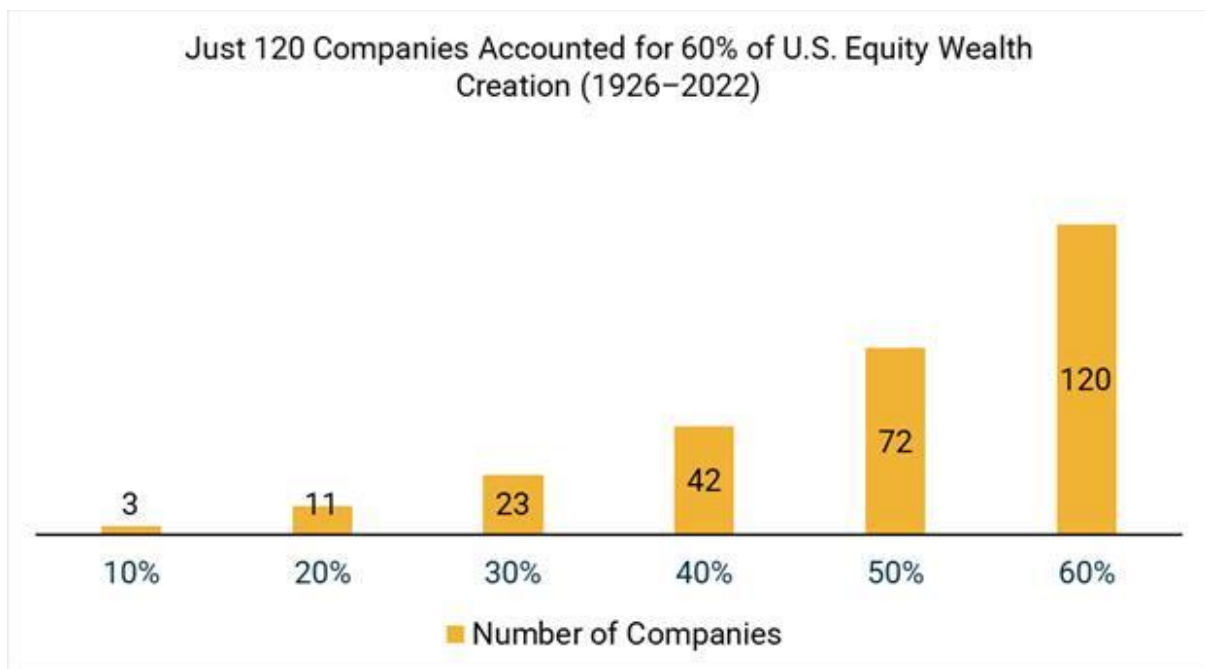
Even within the same index, implementation choices matter. One provider may replicate fully, another may sample. Some may engage in securities lending, others may not. Policies around rebalancing, cash handling, and execution quality vary widely. None of this is passive.

Then there's the S&P 500, one of the most widely used indices in the world. It isn't rules-based in the purest sense; it has a selection committee that decides which companies qualify for inclusion. These are decisions, made by people, that affect every investor tracking that index.

Understanding Market Concentration

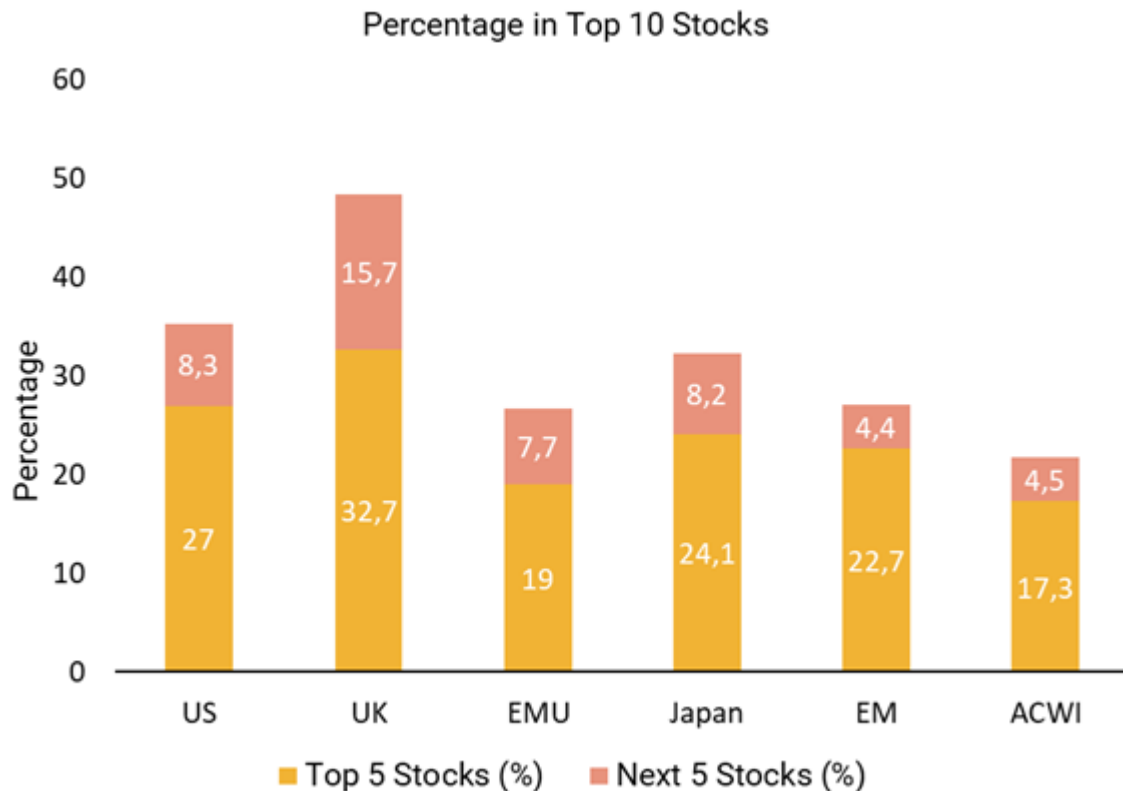
One of the more frequently raised concerns about passive investing is rising market concentration. It's true that many indices today are heavily weighted towards a small number of companies, particularly in the U.S. technology sector.

This isn't necessarily an error in the system. History suggests otherwise. Research shows that just 120 companies have accounted for over 60% of U.S. equity wealth creation between 1926 and 2022. Concentration, in other words, may be a feature of capital markets – not a flaw of index design.



Source: Vanguard calculations using data from Shareholder Wealth Enhancement, Bessembinder (2023). Data as of 2022. Calculations based on total net wealth creation of individual U.S. publicly traded stocks as a percentage of total U.S. net wealth creation from all publicly traded U.S. stocks.

However, this reality must be understood and managed. Owning a market-cap weighted index fund means owning more of what's already done well. That brings momentum and sector exposure into the picture, whether intended or not. For investors, the key is to understand these exposures and how they interact with the rest of their portfolio.



Source: LSEG Datastream, MSCI and Schroders Strategic Research Unit. Data as at 31 May 2025

Every Passive Allocation Is Still a Choice

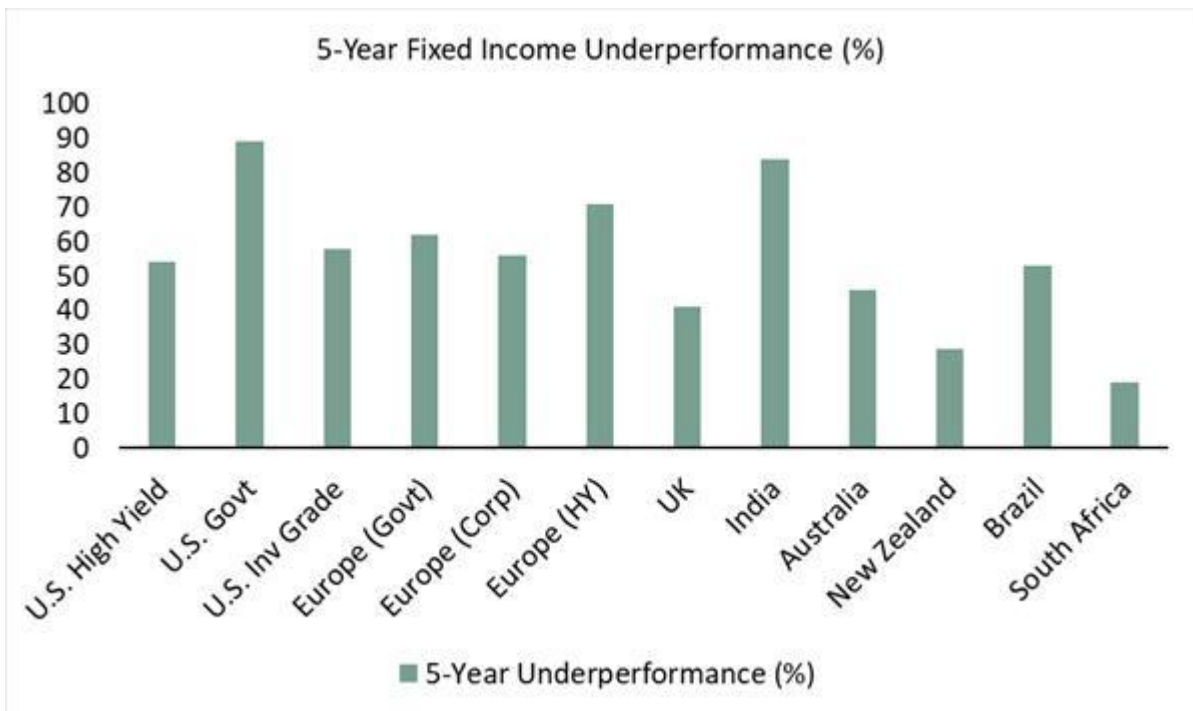
Investing passively may appear to be a straightforward route, but in reality, it involves a number of intentional decisions. Choosing one index over another is not a neutral act; it determines regional exposure, sector tilt, and the kinds of companies you hold. The selection of a fund provider matters too – from how they track the index, to their handling of costs, rebalancing, and operational policies.

Even the overarching decision to prefer passive, over active reflects an investment belief: that markets are broadly efficient, and that cost-effective exposure is preferable to the potential of active outperformance. These choices deserve just as much thought as any active investment decision.

Where Active Still Adds Value

None of this is an argument to abandon passive investing. Far from it. Used well, passive strategies are efficient and scalable. But they should not be used blindly.

Active strategies still have a powerful role to play, particularly in areas where inefficiencies persist, such as smaller companies, emerging markets and complex credit markets. Good active managers take intentional, well-researched risks. They diversify sources of return and focus on repeatable processes.



Source: SPIVA around the World 2025 and SPIVA Fixed Income Around the World 2025

Done well, it brings resilience, diversification and, over time, a more consistent client journey.

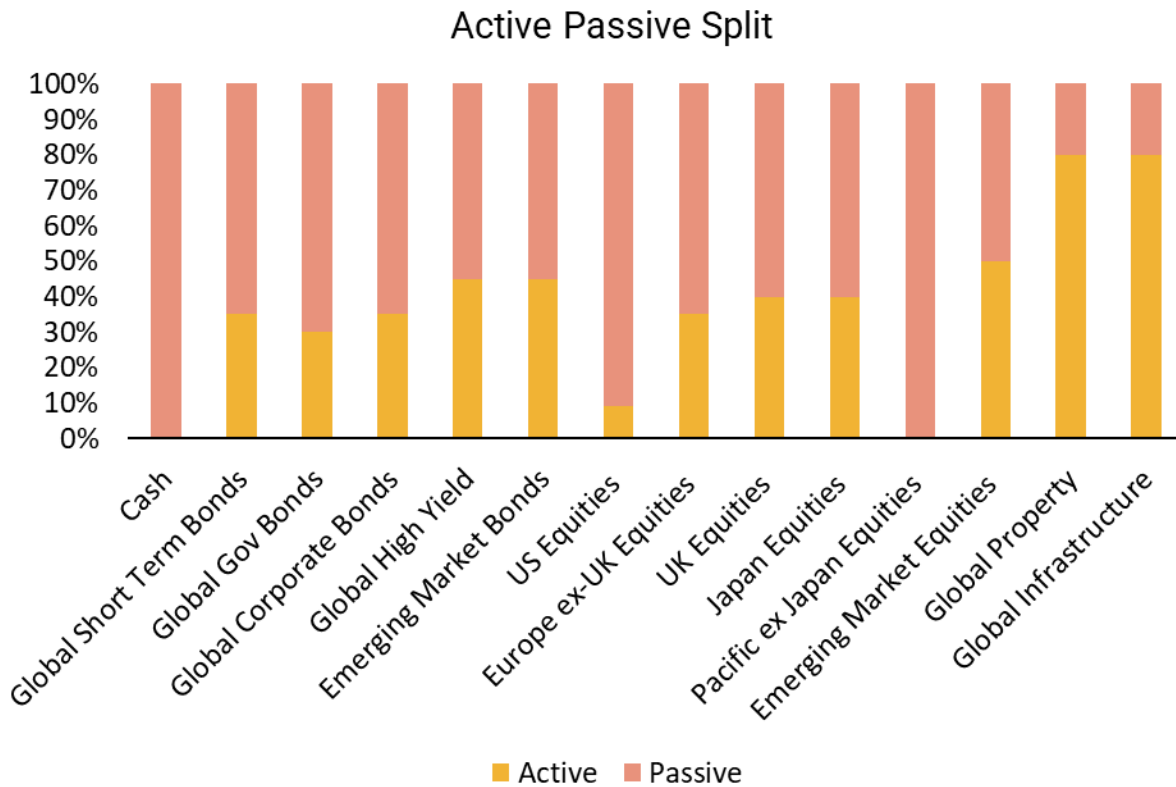
Blending for Better Outcomes

Passive exposures can deliver reliable, low-cost access to broad market returns. Active exposures can introduce diversification and enhance return potential where market inefficiencies are present.

Crucially, the balance between active and passive should not be driven by a fixed formula. It is not linear. Instead, it depends on understanding where the inefficiency premia reside within a

portfolio and applying the appropriate approach accordingly. In well-researched, efficient markets, passive may be most suitable. In less efficient corners of the market, a skilled active approach may add meaningful value.

This bottom-up view allows you to design portfolios that are not merely cost-conscious but outcome-focused, built intentionally to balance systematic exposure with targeted opportunity.



Source: PortfolioMetrix, for Illustrative Purposes Only

Final Thought: The Danger of Labels

The real risk in portfolio design isn't just being wrong. It's being unaware. The term "passive" can give a false sense of safety, leading investors to overlook the hidden exposures they carry.

There may be no such thing as purely passive investing. But that's not a weakness. It's an opportunity to look deeper, to think more critically, and to be more intentional with every allocation decision.

Because at the end of the day, success doesn't come from choosing a camp. It comes from understanding what you own, why you own it, and how it fits within the bigger picture.