July 1, 2020

VICTORIA
Capital Management, Inc.

Market Musings

A newsletter brought to you by Victoria Capital Management, Inc.

VOL. 3, ISSUE 7

The chart to the right shows how passive investing has become more popular since 2009. The proliferation of indexed exchange-traded funds over this same period has been a large contributor to this growth.

The Case for Passive Investing

In recent years, the financial community has become increasingly divided regarding the merits of two investment approaches with divergent philosophies: active management and passive management. The principal reason for advocating an active approach is that active management can be expected to produce above-average investment results over reasonable time periods compared to a passive approach that mimics an index or benchmark of a particular segment of the equity market. Indices changes from time to time when companies are merged or go out of business and these changes are made by the creator of the index and thus, passive investors must make the same changes. Active managers do not have to follow changes in indices as they are actively seeking investment opportunities that will outperform a benchmark or index. Proponents of the passive approach argue that the "market" is a portfolio of stocks that are not managed and there are no assessments about the prospects for individual companies. This belief has been reinforced by many academic studies leading to the development of Modern Portfolio Theory that has encouraged investment in one or more index funds.

Active and passive managers have distinctly different portfolio strategies. Many active managers apply disciplined analysis to find underlying value in individual companies, sectors and markets that are perceived to be unrecognized by other investors. Conversely, passive managers invest only in stocks that are in a specific index, they do not make decisions or evaluations about specific companies. Their goal is to mimic a specific index, for example, the S&P 500. Passive managers argue that the market is efficient meaning that an investor cannot know more than is reflected in the combined knowledge of all investors who determine the current price of a stock and that it is improbable to systematically outperform the market. When looking at all time periods, there are active managers who have outperformed the benchmark, but they are few and far between. There is no guarantee that any of these managers can continue to outperform their benchmark. In addition, passive managers often use various derivatives to achieve portfolio returns thereby increasing the risk of such an approach.

In summary, active management often requires buying and selling to out-perform a specific benchmark or index while passive management replicates a specific benchmark or index to match its performance.

"A man who both spends and saves money is the happiest man, because he has both enjoyments."

Samuel Johnson.

Market Commentary

The stock market rally continued in June because of improving economic and coronavirus metrics. Given current economic circumstances, discussing the "market" is misleading because there are "winners" and "losers" depending on the impact of enforced shutdowns and the coronavirus. Companies that benefit from the virus continue to appear on the new high list while those companies, especially leisure-related, are experiencing the most volatility as news about the virus is perceived to be either good or bad. Investors are challenged by the decision to buy the winners as they hit new highs as manifested by the NASDAQ index or to take a bet that the losers will rally strongly after the fall is over. This dichotomy lends credence to the value of active management.

61% of the world's foreign exchange reserves, i.e., cash holdings of central banks around the world, were held in US dollars as of the end of calendar year 2019 *(source: International Monetary Fund).*

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