Passive Investors, Beware: This Is a Do-it-Yourself Investors' Market. Here's Why

Description

For those who want to invest but don't have the time to analyze individual securities on a regular basis, index funds and ETFs are the best thing since sliced bread. They keep things simple and are great for those who are not confident enough to construct their own portfolios of individual stocks. Over the years, the U.S. market has been saturated with a tonne of passive-investment instruments, overcomplicating something that was invented to keep things simple and easy.

A wide array of passive instruments is now popping up in Canada, such that you've now got a tonne of passive vehicles to ride with your cash from emerging indices to smart beta strategies. Things are getting complicated, without a doubt, and as more investors flock to these passive-investment options, the more bubbly and expensive the broader market will become.

Index investing is fantastic, but unfortunately, there's also a downside. And I believe the downside is more apparent in today's frothy global market. U.S. markets are absurdly expensive, and as an investor, value picks are few and far between. They do exist; however, only individual stock pickers are able to filter the expensive stocks from those that offer compelling value.

Since a majority of U.S. stocks today are extremely overvalued, with passive investments like index funds or ETFs, you're buying a whole basket of stocks, most of which are extremely expensive. If you're a newcomer, odds are that you're investing in a low-fee cap-weighted index fund or ETF, and if that's the case, your investment goes towards some really frothy and overvalued stocks.

Once the next correction or bear market comes around the corner, the entire market is going to suffer, and index investors will lose big, creating a gigantic opportunity for do-it-yourself investors to select cheap, overly beaten-up stocks that have fallen along with the broader market.

With passive instruments, you have no control over what you're buying. You're buying the broader basket, which is expensive. If you pick your own stocks, you can select the few value names that remain, like **Apple Inc.** (NASDAQ:AAPL), and avoid frothy growth stocks with absurd multiples, like **Shopify Inc.** (TSX:SHOP)(NYSE:SHOP) or **Square Inc.** (TSX:SQ).

As a value-conscious individual stock picker, I believe you'll be better protected in the event of the next crash, which will be exacerbated by the overuse and abuse of passive-investment instruments. Stock pickers still stand to be impacted from a likely valuation reset; however, I believe such sell-offs will result in some of the best buying opportunities for individual investors who can spot the vast number of bargains that'll be created.

Bottom line

Passive investing is a great strategy until the markets as a whole become too frothy, then do-it-yourself investors will prevail, because they have the ability to hand-pick the few value stocks, which remain in what appears to be an extremely expensive U.S. market.

While index investing may seem like a simple solution, there are major benefits to learning the active investing game to become a do-it-yourself investor. It's these investors who sustain a lesser amount of damage once the bear rears its ugly head to bring valuations back down to reasonable levels.

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