Passive Investing May Be Here to Stay: Buy These Stocks to Take Advantage of the Trend

Description

Passive investing is an investment strategy that typically seeks to track major indices and attempts to avoid fees associated with buying and selling that could negatively impact performance over the long term. In the years since the 2007-2008 financial crisis, passive investing has been mainstreamed. There have been massive outflows from actively managed funds into index funds and exchange-traded funds (ETFs). This trend has been buoyed by these funds outperforming actively managed funds over the past decade.

In recent years, financial institutions have started to invest in robo-advisors, which provide digital financial advice based on mathematical rules or algorithms. **Bank of Montreal** (TSX:BMO)(NYSE:BMO) rolled out its robo-advisory service in early 2016, which was specifically catered to millennials. Since then, other major financial institutions have explored this service; early estimates have projected that robo-advisors could manage up to 10% of all global assets under management by 2020.

In early February, investor Carl Icahn called passive investing a “dangerous bubble” that could spark a market implosion in the future. He is not alone. Central banks in the developed world have vowed to raise interest rates and end the period of loose monetary policy that has fueled speculation since the financial crisis. This could see global markets enter a new era of volatility that may put a serious damper on the strategy of passive investing.

Researchers at Sanford C. Bernstein & Co. called into question whether or not passive investing can even be said to exist considering the active management of indices in recent years. There are now far more indices in the world than stocks, and these are being invested in and benchmarked against more than ever.

In 2016, Sanford C. Bernstein & Co. called passive investing “worse than Marxism.” We can discuss the merits of dialectical materialism another day, but the point being made by the research firm was that the trend of passive investment in a capitalist economy was “worse than either a centrally planned economy or an economy with active market led capital management.” With regards to the future of passive investment, the firm said in a recent research note, “This does not mean that people give up on buying cheap exposure to markets, but instead that the active-passive distinction breaks down."

According to *Bloomberg Intelligence,* index funds and ETFs recorded $692 billion in inflows in 2017. Compare this to the $45 billion in outflows for actively managed funds.

Despite the risks, the trend of investors adopting robo-advisors and passive funds does not appear to be going away any time soon. Digital financial solutions also make it easier to avoid sit-down sessions with an investment advisor — something many young investors dread in the present day. Instead of dipping into a passive fund or an ETF, investors can look to companies that will benefit from the record inflows we are seeing.

At the beginning of the article, I'd mentioned the recently launched robo-advisor service at BMO. **Royal Bank of Canada** (TSX:RY)(NYSE:RY) also launched a robo-advisor in late 2017 called Investease. **CI Financial Corp.** (TSX:CIX) has long been known for its actively managed funds, but in recent years it acquired First Asset Capital Corp., which at the time had over $2 billion in "rules-based" ETF assets, and BBS Securities Inc., which provides investment services that include robo-advisors.

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