INVEST £100k THE EASY WAY AND BEAT THE MARKET

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INTRODUCTION

The biggest influencing factors that determine investors' investment returns are asset allocation (where and what to invest in) and investments charges (how much it costs to invest). The other factor that investors will struggle with is scarcity of time. Not only a lack of time to spend on the aforementioned where, what and cost factors but also a lack of time to manage their investments going forwards.

After extensive research this succinct guide tells you not only where and what to invest in but also how to do so as cheaply as possible. Perhaps most importantly this guide reveals how to successfully invest with the minimum amount of time and effort on your part.

WHAT IS PASSIVE INVESTING

Passive investing is an investment strategy that tracks a market-weighted index or the price of an asset. The term passive refers to the fact that there's no overt attempt to try and second guess the market or predict the future in order to try and boost returns. As such by using a passive investment strategy investors are able to minimise investing fees and avoid the pitfall of failing to correctly anticipate the market.

A simplistic passive investment strategy would be to invest in a fund which just mimics the performance of the FTSE 100 index. As such, a passive strategy will typically not require a fund manager and can be run automatically by computer algorithms. Unsurprisingly running a passive investment portfolio is the cheapest form of investing.

The alternative is to invest in funds which are run by a fund manager who tries to anticipate the market. These funds are known as active funds The two biggest issues with active funds are that most managers fail to beat the market yet continue to deduct their fees from your portfolio. Secondly these fees make the cost of investing much more expensive than passive investing. Typically equating to around 1.5% of your portfolio value versus the 0.3% for a typical exchange traded fund (ETF).

ACTIVE VS PASSIVE INVESTING

Which is best?

The debate that is waged within the fund management industry and the national press is whether active investing is better than passive investing. However, the debate is waged by opposing parties who have vested interests in persuading investors that either style is superior. Active fund managers understandably champion active management while passive fund providers pour scorn on their clams, before extolling the virtues of passive investing.

Most research on the subject is often biased and funded by either side of the debate. The truth is that it is not a binary choice between active and passive investing. You can use both investment styles and arguably should. The best piece of research I've seen on the active vs passive debate discovered that:

- Fund managers (active funds) tend to perform better in bull markets (i.e. rising markets)
- Passive funds (ETFs) tend to perform best in bear markets (i.e. falling markets).

Fund managers, driven by greed, take extra risk in rising markets and then chase returns in falling markets. In the latter case investors not only suffer from the manager's inability to anticipate the market but also pay higher fees than a passive investor does for the privilege of underperforming. The optimum investment strategy is to invest in whichever passive and active funds are working in the current market and knowing how to identify the funds to buy ahead of time.

Even Billionaire Warren Buffett, arguably the most successful active investor of all time, acknowledges the benefits of passive investing. This was evidenced when it was disclosed that his written advice to the trustees of his estate, in the event of his death, was that his widow's retirement fund should be split between 10% in short-term government bonds and 90% in a particular Vanguard ETF that tracks S&P 500 index.

WHY INVEST PASSIVELY?

- **It can protect you** from the pitfall of failing to correctly anticipate the market.
- **It is cheap** - excessive costs have a huge impact on your eventual investment size. £100,000 invested for 30 years would be worth £695,700 if growing at 7% per annum with an annual investment charge of 0.3%. If that charge was 1.5% a year your investment would be worth just £485,000. Over £200,000 less!
- Investing passively is the **simplest form of investing**. You only need a small portfolio of passive funds spread across a range of assets.

TYPES OF INVESTMENT

Passive investors will usually invest via either an index fund or an exchange traded fund (an ETF).

- A tracker fund is normally a unit trust, the performance of which tracks a chosen index. The funds are not actively managed by a fund manager, who decides which assets to buy and sell, and simply reflect the index they are tracking. They usually have cheaper annual management charges than actively managed funds. Tracker funds were the original type of passive investment before ETFs. Tracker funds are priced once a day and you can only buy and sell them on a daily basis

- An ETF is an investment vehicle that usually tracks an index, a commodity, bonds, or a basket of assets like an index fund. Unlike ordinary funds ETFs are traded just like shares. So their price fluctuates throughout the day and they can be bought and sold at any time. Again ETFs are not actively managed and simply reflect the index they are tracking. ETFs usually have lower annual charges than traditional tracker funds although, like shares, there are dealing fees payable when you buy and sell them.

THE ALTERNATIVE FOR THOSE LOOKING FOR AN EVEN GREATER RETURN

Before you even get to the stage of deciding which ETF or index fund to invest in you need to decide your investment strategy. This can be either a simple buy and hold strategy or, somewhat ironically, a more active approach.

Buy and Hold

A buy and hold strategy is where you decide your asset allocation (how much you want to invest across different asset classes) at outset and then leave the portfolio alone to work its magic. In doing so you hold the ETFs or index fund regardless of market fluctuations, instead focusing on the long term rather than short term price fluctuations. The difficulty is in deciding the appropriate asset allocation and the fund to buy and hold. However, later in this guide I reveal the Perfect Passive Portfolio for buy and hold investors. The portfolio is a result of in depth research I carried out for members of my DIY investment service, 80-20 Investor. It's so simple anyone can use it.

Actively Managing a Portfolio of ETFs

Now do not confuse this strategy with investing in active funds. As mentioned earlier, active funds are run by a fund manager who charges higher fees as a result. Their objective is to try and outperform the market, which few do on a regular basis.

However actively managing a passive portfolio is where, rather than buying and holding a number of ETFs, you periodically make strategic allocation decisions based on market conditions. For example, you may decide that European equities are no longer a good buy so you decide to sell your European equity ETF in favour of a UK focused one.

Alternatively, you may decide to use a buy and hold strategy at the core of your portfolio and then invest more actively with a portion of your portfolio. For example you may decide to gain some exposure to small cap companies in the UK, rather than the FTSE 100 which is made up of large companies.

ETFs' trading frequency and live pricing lend themselves to an active strategy as you can move in and out of markets at the drop of a hat. Index funds on the other hand are only really suited to a 'buy and hold' strategy because they are priced and traded less frequently, usually daily.

Taking an active investment approach requires making strategic decisions, preferably as a result of adequate research in order to boost your investment returns. Yet a lot of investors using ETFs, who are attracted to the simplicity of investing passively, would not know where to start when it comes to strategic asset allocation decisions. However, at the same time, they don't want to simply track the market using a buy and hold strategy.

The good news is that later in this guide I tell you how anyone can run an actively managed portfolio even if you

- don't have the time or inclination to do your own research
- are a complete investing novice

ADVANCED ETF INVESTMENT STRATEGIES

One of the great positives of the growth in passive investing is the sheer number of ETFs available which allow investors to gain exposure to a diverse array of assets. For novice investors this can be daunting but for the more confident investor it opens up the opportunity to use more advanced investment strategies such as:

Swing trading

Swing trading is where investors attempt to take advantage of large price swings in the price of an index or asset. ETFs allow investors to enter and exit markets quickly and their low charges and range of asset coverage make them ideal for this type of advanced trading. Swing trade positions can be held for days or months and while the potential profits are significant so too are the potential losses.

Short selling

Short selling is where you position your portfolio to profit when the price of a chosen index or asset falls. Traditional funds are only able to take long positions whereby they invest and hold a market that they think is going to rise. Some ETFs are specifically designed to make money if, for example, the FTSE 100 index falls. Short sellers run the risk of calling the market incorrectly. If a market rallies then an investor holding a short position will lose increasing amounts of money until they close their short position.

Hedging

Occasionally investors may want to reduce their portfolio’s exposure to a particular investing theme or asset. For example an investor may have a sizeable portfolio with exposure to UK stocks and wants to quickly and temporarily reduce its exposure ahead of a key event they feel might be detrimental to the asset class. Rather than selling assets they could temporarily invest in an ETF which shorts a UK equity index such as the FTSE 100.

THE EASY WAY TO RUN AN ACTIVE ETF PORTFOLIO

Those looking for a better return than what is on offer from the top paying savings accounts will need to be comfortable with accepting a certain amount of investment risk to achieve their goal. Savings accounts pay relatively low interest because there is no risk that your money will fall in value. However, it is possible for some low risk investments to boost your returns in excess of that available on deposit accounts.

This doesn't mean having to invest all the money you currently have on deposit. Instead you could invest just a portion of this money, while keeping most of your money in a savings account, in order to increase your potential return.

The key to success is to keep any investment costs and associated risks as low as possible. Now thanks to competition in the investment management industry it is possible to achieve both and have your money professionally managed at the same time.

A simple actively managed ETF solution

The simplest solution when investing part (or all of) of your savings is to outsource the investment management to a company which has the benefit of its own in-house analysts and investment committees to make strategic allocation decisions. Moneyfarm is an interesting proposition for those trying to find the best investment ISA or pension to invest in. After successfully running money for investors in Italy since 2011, Moneyfarm launched in the UK back in 2016 following the rise in demand for investment ISAs, robo-advice, cheap stocks and shares ISAs and pensions for beginners.

Moneyfarm uses a proprietary behavioural questionnaire to place investors in one of seven portfolios ranging from the more cautious to the more adventurous. If you are attracted to low risk assets (as you probably are) then you will end up in their cautious portfolio.

The good news is that you can build a bespoke portfolio for free using Moneyfarm's portfolio tool without committing to the service. Registering is free and there is no obligation to contribute any money. The tool suggests a portfolio with an asset mix dependent on how long you want to invest for as well as your risk profile (as determined by Moneyfarm's risk questionnaire).

Moneyfarm asset allocates based on volatility and regularly rebalance each portfolio. They run the portfolios on a discretionary basis, so investors can sit back and relax, using a wide range of Exchange Traded Funds (known as ETFs). I am particularly impressed by the fact they don't constrain their asset allocation. Many investment managers say that they make tactical asset allocation decisions yet in reality don't deviate much from their initial selection. Moneyfarm doesn't do this.

Moneyfarm's minimum investment is £500. If you decide to invest £500 or more with Moneyfarm, you can do so via our fee-free offer* meaning Moneyfarm will waive its management fee for the first year. This offer is only available until the 30th March 2022.
If you have at least £500 to invest you could consider Nutmeg as an alternative. It will also waive its management fees for the first 12 months (see our Nutmeg review for full details). If you want to invest less than £500 have a look at our Wealthify review, which lets you invest from as little as £1 in an ISA, Junior ISA, general investment account or pension.

Moneyfarm is well suited for:

- Those who want a designated human investment consultant (not offered by other robo-advice services) and the possibility of an initial investment review
- People who also want a discretionary investment service at a low cost
- Those who want to invest at least £500, the same minimum investment amount as Nutmeg. Those looking to invest smaller amounts may wish to look at Wealthify which has a minimum investment amount of £1
- Those who want flexibility. Moneyfarm has no exit fees and so is good for those wanting to keep their future options open by avoiding any lock-ins
- Those looking to invest via a managed Stocks and Shares ISA, pension or general investment account

THE PERFECT PASSIVE "BUY AND FORGET" PORTFOLIO

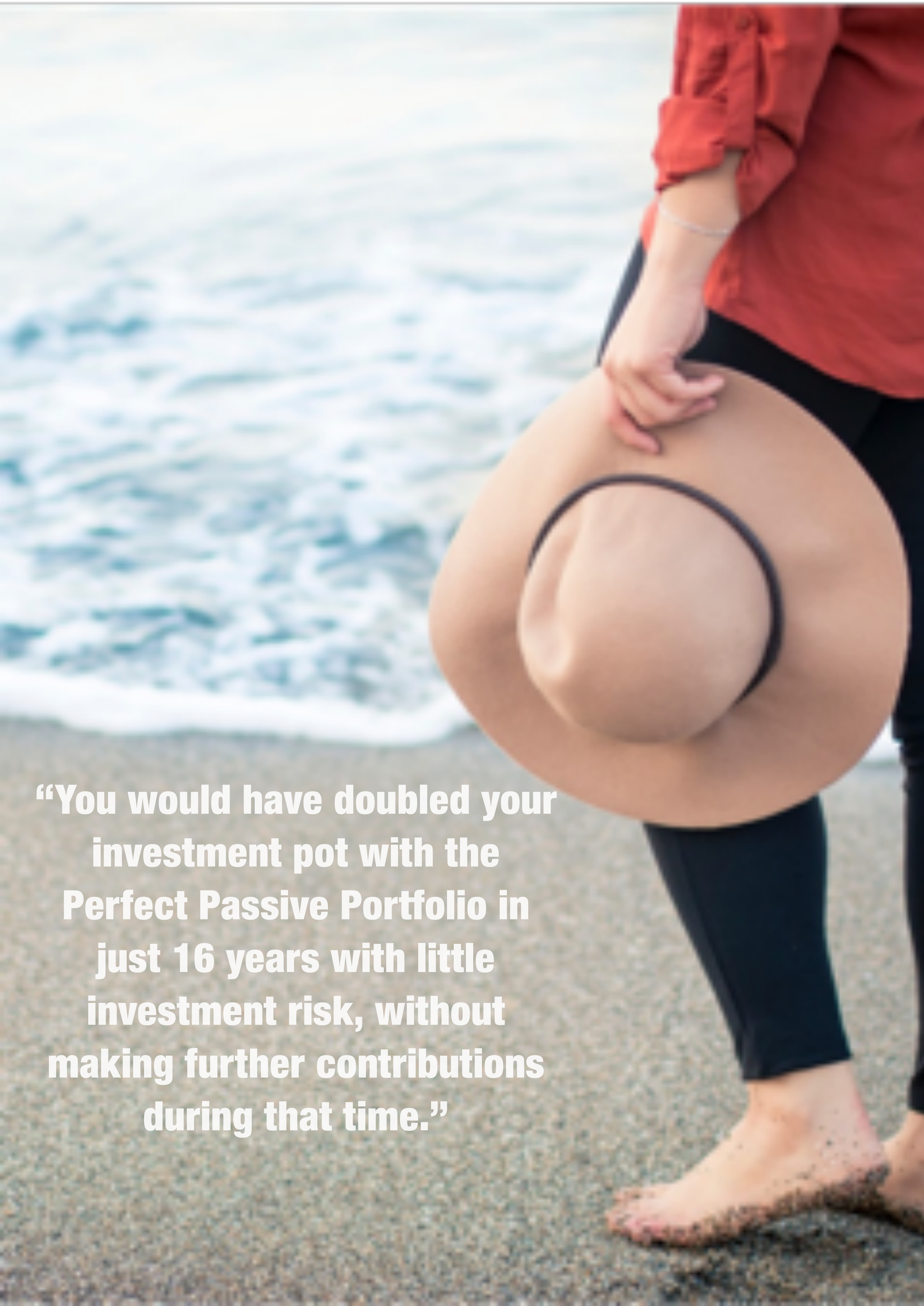
If you want to keep things even simpler then it is possible to just use a buy and forget passive approach. The trick is to know which asset allocation performs best across a range of market conditions. To answer this I carried out the following research to identify the Perfect Passive Portfolio. Not only did I want to determine the perfect asset allocation but also the best ETFs to put it into action. The first thing I had to do was lay down some ambitious ground rules:

- There would be no constraint over which assets could be included in the portfolio or in what proportions they could be held. This led to a mind-boggling number of possible asset allocations.
- The portfolio must have made money every tax year since the last market peak back in 2000 and NEVER lost money during a tax year. By going back to 2000 this covered a number of market cycles as well as market rallies and crashes.
- The asset allocation also had to outperform a FTSE 100 Index tracker and
- The asset allocation had to remain constant throughout that time (i.e. truly buy and forget)

The reason for focussing on tax years was to see if it was possible to notionally not lose money on Stock and Shares ISA contributions (remember ISA contributions are paid with reference to tax years). Also, this allowed me to identify a single portfolio which a person of any age would find useful. Don't forget that the older you are the less time you have for your investments to recover from a fall in value.

The analysis took hundreds of hours and included 27 different assets classes from around the world. My research revealed that the Perfect Passive Portfolio has the following asset mix:

- 9% invested in cash
- 71% invested in UK Gilts
- 20% invested in UK Equity Income


"You would have doubled your investment pot with the Perfect Passive Portfolio in just 16 years with little investment risk, without making further contributions during that time."

HOW HAS THE PORTFOLIO PERFORMED?

The chart below shows how the portfolio has outperformed the FTSE 100 since the market high in the year 2000. You would have doubled your investment pot with the Perfect Passive Portfolio in just 16 years with little investment risk, without making further contributions during that time.

The Perfect Passive Portfolio has returned an average return of 4.4% a year over the last 20 years. The table below gives a full list of the return for each of the last 20 years vs the return if you'd bought an ETF which tracked the FTSE 100.

Not only has the Perfect Portfolio outperformed the market over the long term but it has also avoided the worst market sell-offs because of its limited equity exposure.

Tax Year	FTSE 100 % return	Perfect ISA % return
2019	-21.84	2.91
2018	8.27	2.78
2017	2.26	0.03
2016	23.75	8.44
2015	-7.42	0.90
2014	5.73	10.93
2013	11.04	0.60
2012	13.44	6.83
2011	-1.74	9.87
2010	7.95	4.78
2009	50.49	7.71
2008	-29.94	0.02
2007	-3.63	0.86
2006	9.37	2.47
2005	26.34	10.27
2004	14.46	6.38
2003	21.3	4.69
2002	-24.52	0.63
2001	-4.11	0.30
2000	-11.13	3.23

THE ETFS TO USE TO BUILD THE PERFECT BUY AND HOLD ETF PORTFOLIO

Amazingly you can achieve the above by using just one ETF, namely the Vanguard - LifeStrategy 20% Equity. The fund is not only very cheap (with an ongoing charge of just 0.22%) and is passively run, it is packed full of index trackers (hence the low cost) with around 20% exposure to equities with the rest in fixed interest.

Important Investment Notes

The material in this guide, any email, the MonetotheMasses.com website, 80-20 Investor, associated pages, channels, accounts and any other correspondence are for general information only and do not constitute investment, tax, legal or other form of advice.

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Funds invest in shares, bonds, and other financial instruments and are by their nature speculative and can be volatile.

You should never invest more than you can safely afford to lose. Unlike cash, stock market investments can fall in value as well as rise, so you could get back less that you invest and you should regard them as long-term investments (5+ years).

Any yields will vary over time so income is variable and not guaranteed. Past performance is no guarantee of future results. Whilst any tax benefits we refer to are those that currently apply, they can change over time and their value will depend on your circumstances. Before investing in a pension, please remember you cannot normally access the money until at least age 55.

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This guide is written for readers who like to make their own investment decisions, it is not personal advice. If you have any doubts about the suitability of an investment for your own circumstances please seek expert advice. All information correct as at 11/03/22.

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