Passive investing strategy – what is it and how does it work?

Having a laid-back attitude in life may not work in your favour. However, this should not stop you from adopting this strategy in investing. The stock market is often seen as a place where timely decision-making and active trading are extremely important. However, there exists a passive investing strategy that concentrates more on the 'sit back and relax' method of investing. Let's find out more about this.

What is passive investing?

A passive investing strategy is a long-term investing style. It involves investing in instruments that mimic benchmark indices. Passive funds follow and track a benchmark index with the aim of copying its performance. They do not necessarily outperform them but mimic their performance and deliver returns accordingly. Some examples of passive funds can include passive index funds and exchange-traded funds (ETFs).

Passive investing removes the hassles of actively monitoring your investing portfolio. It also eliminates the costs of active trading and the time and effort spent on finding short-term market movements to take advantage of. Passive investment assumes that the market will likely deliver good returns over time. This is also known as the buy and hold strategy, where you invest your money and let it work to earn returns in the long run. So, by investing in a passive fund for the long term, you can eventually earn returns without making active investing decisions.

Active investing vs passive investing

If you are wondering where to invest money, you can refer to the following differences between active and passive investing and then make up your mind:

- **Process**: Active investing is a dynamic process that requires continuous time and attention. This is why actively managed funds have a fund manager who buys and sells stocks and actively looks for opportunities to profit from. On the other hand, passive investing follows a benchmark and mirrors its returns.

- **Costs**: Active investing can mean relatively higher expense ratios because it involves ongoing buying and selling of securities. So, passive investing can be a comparatively low-cost investment style. The expense ratio is one of the major considerations in the passive vs active debate and can help you make a choice between the two.

- **Volatility and risk**: Passive funds may be less volatile as they perform just like the benchmark they follow with no room for much deviation. This makes them a relatively low-risk option. However, active funds are more susceptible to volatility and speculation, making them a comparatively high-risk approach.

Conclusion

Passive investing can offer benefits like low costs, long-term capital appreciation, and less volatility. But there is no fixed approach to financial planning, and you can select either of the two strategies – active or passive. However, it can help to keep a balanced view of your goals and needs before making a choice.