



# The investment strategy spectrum

Considerations to help maximize your investment portfolio's potential

For a long time, investors have known about two distinct investment choices: active and passive strategies. But with the advent of smart beta indexes, passive strategies are no longer clearly defined. “Traditional” passive indexes involve selecting and weighting securities according to their market capitalization. Smart beta indexing involves tilting the index toward particular investment characteristics to satisfy a goal.

# Investment strategy comparison

The table below highlights the many differences across the investment spectrum.

	Traditional indexing	Smart beta indexing	Active strategies
<b>Overview</b>	<ul style="list-style-type: none"> <li>Seeks to provide cost-effective beta exposure to market segments</li> </ul>	<ul style="list-style-type: none"> <li>Uses strategies that leverage academic research</li> <li>Emphasizes improving returns or potentially reducing risk relative to traditional indexes</li> </ul>	<ul style="list-style-type: none"> <li>Vary by manager</li> <li>Are designed to outperform benchmark index on a risk-adjusted basis</li> <li>Employ a range of strategies across risk, return, and asset class spectrum</li> </ul>
<b>Index construction</b>	<ul style="list-style-type: none"> <li>Index selects and weights components based on market-capitalization</li> <li>Index naturally leans toward larger companies</li> </ul>	<ul style="list-style-type: none"> <li>Index selects components using alternative, not market-cap weighted approach</li> <li>Index tilts toward desired factors or objectives</li> </ul>	<ul style="list-style-type: none"> <li>An index is provided as a benchmark against which fund performance is measured</li> </ul>
<b>Investment discipline</b>	<ul style="list-style-type: none"> <li>Seeks to track the returns of the index (minus fees and expenses)</li> <li>Limited number of annual rebalances of the underlying fund holdings</li> </ul>	<ul style="list-style-type: none"> <li>Seeks to track the returns of the index (minus fees and expenses)</li> <li>Limited number of annual rebalances of the underlying fund holdings</li> </ul>	<ul style="list-style-type: none"> <li>Managers have active discretion over investment selection and weighting within a portfolio</li> <li>Performance relative to benchmark index can vary due to manager buy/sell discipline</li> </ul>
<b>Potential tax impact</b>	<ul style="list-style-type: none"> <li>Generally considered more tax efficient versus active because of lower portfolio turnover</li> </ul>	<ul style="list-style-type: none"> <li>Typically considered tax efficient due to less securities turnover</li> <li>Tax efficiency can vary by smart beta index due to the rebalancing frequency</li> </ul>	<ul style="list-style-type: none"> <li>Typically is not tax efficient due to manager buy/sell discipline</li> <li>Certain asset class types may be more tax oriented</li> </ul>
<b>Costs and performance</b>	<ul style="list-style-type: none"> <li>Low-cost strategy is due to general ease of approach</li> <li>Performance is expected to track index returns (minus fees and expenses)</li> </ul>	<ul style="list-style-type: none"> <li>Costs vary because of exposure and complexity of index strategy</li> <li>Performance is expected to track index returns (minus fees and expenses)</li> </ul>	<ul style="list-style-type: none"> <li>Generally the most expensive investment strategy because of manager skill and discretion</li> <li>Performance over time for active managers may differ from that of index</li> </ul>



## Summary

Charles Schwab Investment Management has long been a proponent of considering traditional indexing and smart beta indexing as complements rather than competing strategies.

Both traditional indexing and smart beta can offer a low-cost approach to portfolio building. Smart beta further allows unique exposures and the ability to emphasize a particular portfolio concentration. The most important consideration for investors is to understand their investment objectives and how these different strategies can help.

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