

BEYOND THE INDEX

Why “Set It and Forget It” Isn’t Enough

“Just buy the index” has become one of the most repeated pieces of financial advice. The appeal is clear: index funds are typically low cost, broadly diversified and have historically delivered market-level returns consistently. They’ve become a common recommendation for investors that prefer a straightforward approach.

For many investors, that advice works. But many high earners with ambitious goals may already have meaningful exposure to index funds through workplace retirement accounts, and rightfully find themselves looking for alpha.¹ Core beta² is fundamental and necessary but, if you’re able to fund it, selective alpha³ is where you’ll have the opportunity for outsized returns. The larger your portfolio is, the more those extra returns matter. Bottom line: index funds provide a strong foundation, but some may choose to build upon them with other strategies.

I. What Index Funds Do Well

There’s no denying the various strengths of index funds:

- **Diversification:** Index funds spread your money across hundreds of companies with a single purchase.
- **Market-level returns:** Their goal is to help you capture the performance of the overall market rather than concentrating risk or underperforming with individual holdings.
- **Low fees:** With expense ratios measured in low, single-digit basis points, they’re generally cost-efficient.
- **Simplicity:** For many, index funds are a gateway into disciplined investing.
- **Tax efficiency:** Typically generate fewer taxable events than actively managed funds, but taxes on dividends and capital gains can still apply.

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Alpha is a way to measure how much better or worse an investment performs compared to the overall market. If your investment has positive alpha, it performed better than the market. If it has negative alpha, it performed worse.

² Beta measures how much an investment’s value changes compared to the overall market. A beta of one means it moves about the same as the market; higher than one means it’s likely to move more; less than one means it’s likely to move less.

³ Selective alpha means trying to get better returns than the market by choosing specific investments or strategies, instead of just following an index fund. This approach involves more decision-making and risk, and results aren’t guaranteed.

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As a core holding in your current employer's 401(k), index funds do their job well. But once you've mastered the basics, the real question becomes: What comes next?

II. Why Index Funds May Fall Short for Some High Earners

For affluent investors, there can be potential drawbacks to a strategy that begins and ends with index funds:

- **Redundancy:** Many high earners already hold large allocations to index funds in their 401(k)s or other qualified plans. Simply adding more of the same outside of those accounts doesn't create balance; it may lead to duplication with the top holdings.
- **Limited flexibility:** Index funds track the market by design and are "take it or leave it." They don't account for your unique needs around timing, liquidity or risk tolerance, nor do they allow you to customize your exposure to specific sectors.
- **Missed opportunities:** Limiting yourself to index funds may mean overlooking strategies like tax-loss harvesting through direct indexing or income from private credit which may offer additional benefits but also involve different risks and costs.

Point being, index funds are an excellent starting point. But building lasting wealth requires a strategy that matches *your* goals, not just the market's average.

III. Strategies Beyond the Index

Sophisticated planning doesn't mean abandoning index funds. It means knowing how to use them as part of a broader structure:

- **Tax-smart placement:** Index funds are relatively tax-efficient, making them useful in taxable accounts. Income-heavy investments like bonds, by contrast, are often better placed inside retirement accounts or annuities where taxes are already deferred. Aligning assets to accounts with the right tax characteristics can help keep more of your money compounding over time.
- **Direct indexing for tax efficiency:** Direct indexing replicates an index, but by holding the individual stocks inside it. When certain positions decline, you can harvest losses to offset other taxable gains, all while maintaining your target market exposure. This approach can provide diversified market exposure with more control over tax liability. Direct indexing can be more complex to manage versus owning index funds, often requiring regular monitoring and trading, and may involve higher fees and minimum investment amounts.
- **Adding strategic tilts:** Style or sector-based approaches (like tilting toward value or small-cap) or selective active management can complement index exposure. This may help manage volatility, generate alpha and create opportunities the broad market doesn't capture on its own. It's important to note that these strategies can also involve additional risk.

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- **Exploring private markets:** As portfolios grow, many investors may benefit from diversifying beyond public equities. Private equity, private credit and real estate can offer return streams that aren't correlated with the S&P 500, potentially adding resilience and optionality to long-term plans. However, these investments may be illiquid and carry additional risks.

Conclusion: Beyond the Basics

“Just buy the index” is a good place to begin, but it may not be the whole answer for high earners with larger investment capacity and bigger ambitions. Index funds provide stability and structure, but a wealth strategy that stops there may miss opportunities for efficiency, diversification and long-term growth potential.

A stronger approach treats index funds as the foundation, not the finish line. At Azura, we help clients evolve beyond cookie-cutter advice to strategies designed to maximize flexibility, efficiency and impact. When your wealth reaches scale, the real question changes from, “what’s the market giving me?” to, “what do I want this wealth to help me achieve?”

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Alternative strategies may offer benefits but also involve unique risks, higher costs, and may not be suitable for all investors. Investing involves risk, including possible loss of principal, and there is no guarantee of achieving your goals or outperforming index funds. Diversification and past performance do not assure profit or protect against loss.

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