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Top-Down vs. Bottom-Up: What's the Difference?

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By [INVESTOPEDIA](https://www.investopedia.com/contributors/0/)

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Top-Down vs. Bottom-Up: An Overview

Top-down and bottom-up approaches are methods used to analyze and choose securities. However, the terms also appear in many other areas of business, finance, investing, and economics. While the two schemes are common terms, many investors get them confused or don't fully understand the different approaches at all.

Generally, each can be quite simple. The top-down approach goes from the general to the specific, and the bottom-up approach begins at the specific and moves to the general.

Comprehensively these methods can be possible approaches for a wide range of endeavors such as goal setting, [budgeting, and forecasting](https://www.investopedia.com/ask/answers/042215/whats-difference-between-budgeting-and-financial-forecasting.asp). However, in the financial world, analysts or whole regimes may be tasked with focusing on one over the other so understanding the nuances of both is important.

KEY TAKEAWAYS

* Top-down usually encompasses a vast universe of macro variables while bottom-up is more narrowly focused.
* Top-down investing strategies typically focus on exploiting opportunities that follow market cycles while bottom-up approaches are more fundamental in nature.
* While top-down and bottom-up can be very distinctly different they are often each used in all types of financial approaches like checks and balances.

Top-Down

[Top-down analysis](https://www.investopedia.com/terms/t/topdownanalysis.asp) generally refers to using comprehensive factors as a basis for decision making. The top-down approach will seek to identify the big picture and all of its components. These components will usually be the driving force for the end goal.

Overall, top-down is commonly associated with the word macro or [macroeconomics](https://www.investopedia.com/terms/m/macroeconomics.asp). Macroeconomics itself is an area of economics that looks at the biggest factors affecting the economy as a whole. These factors often include things like the federal funds rate, unemployment rates, global and country-specific gross domestic product, and inflation rates.

An analyst seeking a top-down perspective will want to look at how systematic factors are affecting an outcome. In corporate finance, this can mean understanding how big picture trends are affecting the entire industry. In budgeting, goal setting, and forecasting the same concept can also apply to understand and manage the macro factors.

Top-Down Investing

In the investing world, top-down investors or investment strategies focus on the macroeconomic environment and cycle. These types of investors usually want to balance [consumer discretionary](https://www.investopedia.com/terms/c/consumer-discretionary.asp) investing against staples depending on the current economy. Historically, discretionary stocks are known to follow economic cycles with consumers buying more discretionary goods and services in expansions and less in contractions.

[Consumer staples](https://www.investopedia.com/terms/c/consumerstaples.asp) tend to offer viable investment opportunities through all types of economic cycles since they include goods and services that remain in demand regardless of the economy’s movement. Comprehensively, when an economy is expanding, discretionary overweight can be relied on to produce returns. Alternatively, when an economy is contracting or in a recession, top-down investors will usually overweight to havens and staples.

Investment management firms and investment managers can focus an entire investment strategy on top-down management that identifies investment trading opportunities purely based on top-down macroeconomic variables. These funds can have a global or domestic focus which also increases the complexity of the scope. Typically, these funds will be called [macro funds](https://www.investopedia.com/terms/g/globalmacro.asp). Generally, they make portfolio decisions by looking at global then country-level economics. They further refine the view to a particular sector, and then to the individual companies within that sector.

Top-down investing strategies typically focus on profiting from opportunities that follow market cycles while bottom-up approaches are more fundamental in nature.

Bottom-Up

The [bottom-up analysis](https://www.investopedia.com/terms/b/bottomupinvesting.asp) takes a completely different approach. Generally, the bottom-up approach will focus its analysis on specific characteristics and micro attributes of an individual stock. In bottom-up investing concentration is on business-by-business or sector-by-sector [fundamentals](https://www.investopedia.com/terms/f/fundamentals.asp). This analysis seeks to identify profitable opportunities through the idiosyncrasies of a company’s attributes and its valuations in comparison to the market.

Bottom-up investing begins its research at the company level but does not stop there. These analyses weigh company fundamentals heavily but also look at the sector, and microeconomic factors as well. As such, bottom-up investing can be somewhat broad across an entire industry or laser-focused on identifying key attributes.

Bottom-Up Investors

Most often, bottom-up investors are buy-and-hold investors who have a deep understanding of a company's fundamentals. Fund managers may also use a bottom-up methodology. For example, a portfolio team may be tasked with a bottom-up investing approach within a specified sector like technology. They are required to find the best investments using a fundamental approach that identifies the companies with the best fundamental ratios or industry-leading attributes. They would then investigate those stocks in regards to macro and global influences.

Metric focused smart-beta index funds are another example of bottom-up investing. Funds like the AAM S&P 500 High Dividend Value ETF (SPDV) and the [Schwab](https://www.investopedia.com/articles/investing/120915/charles-schwabs-top-funds-retirement-savings.asp) Fundamental U.S. Large Company Index ETF (FNDX) focus on specific fundamental bottom-up attributes that are expected to be key performance drivers.1﻿2﻿

Special Considerations

Generally, while top-down and bottom-up can be very distinctly different they are often used in all types of [financial approaches](https://www.investopedia.com/ask/answers/193.asp) like checks and balances. For example, while a top-down investment fund might primarily focus on investing according to macro trends, it will still look at the fundamentals of its investments before making an investing decision. Vice versa, while a bottom-up approach focuses on the fundamentals of investments, investors still want to consider systematic effects on individual holdings before making a decision.