Just How Many Active Managers Beat the Index?

The results are in for the 5 years ending December 31, 2010

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Active asset managers (those that attempt to time the market) generally underperform their respective index benchmarks. In fact, studies have repeatedly found that over long periods of time roughly 80% fail to do so (approx 86% fail when taxes are considered).

One argument for active management is they will outperform their benchmarks during times when markets are in steep decline. This argument relies on the theory active managers are nimble and smart enough to side-step steep market declines while index funds merely follow them down. Alas! We now have such a market with which to test the theory! The 2008-2009 market decline was the worst since the Great Depression. So how did active management perform? On the next page you will find the results for the past 5 years.

You will see the majority of active managers continued to underperform their benchmark indexes in every asset category except for International Small Cap. Not only were most active managers not nimble and smart enough, but they even had an advantage since the benchmarks don't hold much cash while active managers tend to hold much more. Larger cash positions soften the blow of a steep decline, but once again the majority of active managers could not beat their benchmark even with this "advantage".

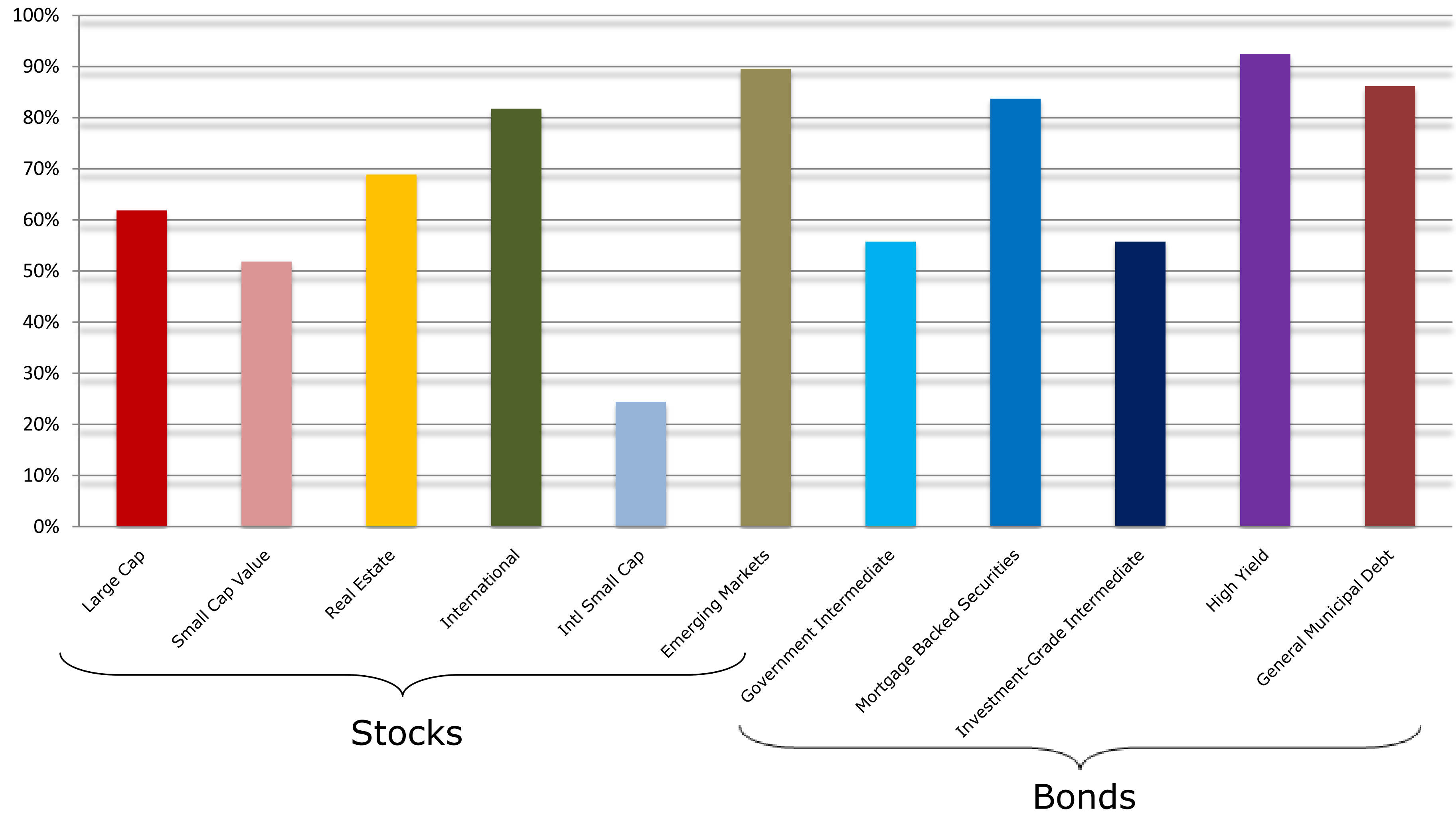
Over longer periods of time, history has repeatedly shown us active managers fail even more miserably. Benchmarks continue to chug along beating most active managers each and every year; while active managers have good and bad years with *many* actively managed funds even going out of business! (This last point is very important to remember when looking at the universe of funds available since the only funds visible will be those that have managed to survive. This is known as "survivorship bias".)

Let's play a game where 10 numbers are placed in a box. You are then given the choice of taking $8,000 or drawing a number and having to live with it. Which would you choose? Most would take the $8,000 instead of risking a lower number. Investing is no different. You can choose a fund that history repeatedly shows consistently beats the vast majority or you can press your luck and hope for a little extra. I know which option I would choose.

$1,000	$3,000	$5,000	$7,000	$9,000
$2,000	$4,000	$6,000	$8,000	$10,000

Saving and investing is a game we win by not losing. **This is not to be taken lightly.** If you press your luck by not saving and/or investing prudently you had better be good with the prospect of eating Alpo in your retirement years. I for one am good with much better than average returns and with much less risk. Don't be hoodwinked. If you need assistance, a fee-only financial advisor will give you straight-forward unbiased advice.

"The greatest enemy of a good plan is the dream of a perfect plan"
~ Prussian General Karl von Clauswitz



Source: Standard & Poor's Indices Versus Active Funds Scorecard, year-end 2010. Index used for comparison: US Large Cap—S&P 500 Index; US Small Cap—S&P SmallCap 600 Value Index; Real Estate—S&P BMI U.S. REIT; International—S&P 700 Index; International Small—S&P Developed ex. US SmallCap Index; Emerging Markets—S&P IFCI Composite; Government Intermediate—Barclays Capital US Intermediate Government Index; Mortgage-Backed Securities—Barclays Mortgage-Backed Securities; Investment Grade Intermediate—Barclays Capital US Intermediate Government/Credit; High Yield—Barclays High Yield; General Municipal Debt—S&P National Municipal Bond Index. Data for the SPIVA study is from the CRSP Survivor-Bias-Free US Mutual Fund Database. Barclays Capital data, formerly Lehman Brothers, provided by Barclays Bank PLC.