InvestmentNews

# When outperformance puts active managers out of business

## Taking on too much risk to stay on top

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The legal jargon about past performance not being indicative of future returns might need to be tweaked to suggest that past performance could be indicative of future underperformance.

New research from S&P Global Market Intelligence and S&P Dow Jones Indices shows that outperformance of an actively managed fund could lead to underperformance because of what it takes to beat a benchmark.

"It's hard to beat your peers because you have to be different, and that can mean taking on more risks," said Todd Rosenbluth, director of ETF and mutual fund research at S&P Global Market Intelligence.

The findings, which further bolster the case against chasing performance, show that it is not only difficult for active funds to consistently outperform, but in some cases the outperforming funds have a hard time surviving.

According to S&P Global's most recent persistence scorecard, published last week, only 19% of small-cap funds and 24% of mid-cap funds that were top-half performers in the 12-month period through March 2014 were able to maintain their top-half performance during the next two 12-month periods.

The numbers looked better for large-cap funds, but still only 30% were able to stay in the top half for performance.

In line with other research comparing active and passive investing, Mr. Rosenbluth stressed the advantages of lower fees, but he also focused on manager tenure and an analysis of portfolio holdings.

Scott Opsal, director of research at The Leuthold Group, has even studied the cyclicality of active-management performance.

“Our research suggests relative returns between active and passive are cyclical, depending on the market environment,” he said. “We examine several factors that may explain this pattern and shed light on current trends.”

The best argument for considering every variable available when evaluating an active fund is that top-performing active funds are generally more likely to have shorter life spans.

S&P Dow Jones Indices looked at 868 domestic equity funds that finished in the top half of their respective market-cap categories and found that 34% were either merged or liquidated within five years.

“It's not surprising that some investors just want to go for the easier-to-understand alternative of indexing,” Mr. Rosenbluth said. “There's a lot more than just past performance that investors can and should use when choosing funds.”