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Indexing Wins Again: New S&P Dow Jones Data

Mutual funds and exchange-traded funds (ETFs) are generally managed in one of two ways. Active managers attempt to outperform their benchmark by picking stocks they find to be compelling investments and by excluding or underweighting those they do not. Index funds, on the other hand, simply buy the entire index to provide exposure to the intended asset class or market segment.

Active managers often promise to perform better when markets are dropping or are volatile. Some active managers claim they can anticipate business cycle changes and major market moves and structure portfolios that can benefit from these changes. Newly released research, however, undercuts these claims.

The S&P Dow Jones SPIVA® (S&P Indexing Versus Active) U.S. Scorecard highlights multiple eye-opening data points:

- **79%** of U.S. equity active managers underperformed their benchmarks in 2021.
- Active performance does not improve over longer time periods or by adjusting for risk. Among U.S. stock funds**, 90%** of active managers underperformed their benchmarks over the past 20 years and **95%** did so on a risk-adjusted basis.
- In 2021, among those managers in the large-cap growth space (large companies that are growing quickly, many of which are in the technology sector), **98%** of all growth managers underperformed their indexes.
- This underperformance extends to the bond market as well. **Over 60%** of active managers underperformed across all categories of fixed income over the last 15 years.

The data is clear. Even when giving active managers a long time period (such as 15 or 20 years) to earn their keep, they still tend to underperform their respective indexes. These 15- and 20-year periods include multiple periods of high volatility - such as the Global Financial Crisis, the 2013 "Taper Tantrum", and the COVID-19 market drop in 2020. Their "expertise" does not bear fruit when it matters the most.

Why Does Active Underperform?

In 2021, to beat the equity benchmark, you had to have owned a *very* small number of stocks that outperformed their benchmarks. In other words, winners were highly concentrated. Stock-picking is a difficult exercise in any year, but in 2021, you had an even *lower* probability of beating the benchmark.

Furthermore, active managers charge significantly higher fees. They employ highly credentialed research staff to search for opportunities and often incur higher trading costs than index funds. Morningstar found that in 2021, the asset-weighted fund fees for index funds were 0.12% versus 0.62% for active funds.

See for Yourself

S&P Dow Jones publishes an interactive website where you can view active returns versus their benchmarks across multiple countries and different time periods. There you can see that active managers underperform in just about every time period and across multiple markets around the world.

At Garde Capital, we believe that capital markets are efficient - meaning that it is nearly impossible to outperform a benchmark consistently, even on a risk-adjusted basis. Our investment management approach is guided by the work of Harry Markowitz and William Sharpe, both of whom have won Nobel Prizes for their research into financial returns. The results of the latest SPIVA® Scorecard further bolster this claim. Instead of trying to outperform the benchmark, we believe in providing exposure to asset classes through the lowest-cost vehicles available and regularly meeting with clients to ensure their investment allocations meet their specifical financial planning goals.

As always, if you have any questions about your investments or how they impact your financial plan, please reach out to your advisor.