Elston

Elston Insights

9th December 2022

SPIVA® update: are active managers improving?

- Active managers in aggregate underperform the benchmark
- Past performance is not indicative of future performance
- Potential for outperformance declines with time

It is well known and straightforward to understand that an index fund delivers index performance less passive fees. It is less well known and less straightforward to understand that active managers *in aggregate* deliver index performance less active fees. This is explained in the paper "The Arithmetic of Active Management", by Nobel laureate Professor William Sharpe which is worth a read.

For that reason it becomes harder and harder for an active manager to outperform an index persistently over time. This is particularly the case in efficient markets (with lower potential for alpha), and less so the case in inefficient markets (with higher potential for alpha). To help analyse this, we can refer to the SPIVA® studies.

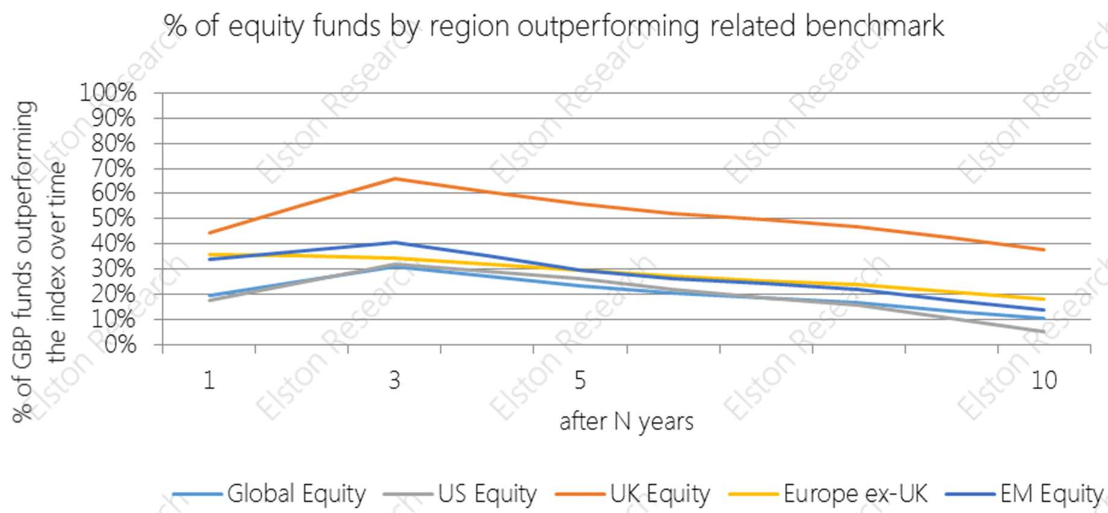
SPIVA®

Over the past 20 years, S&P Dow Jones Indices have looked extensively into the active vs passive debate. Their series of research reports called SPIVA®[1] (S&P Indices Versus Active) has compared active funds from nine different regions to an appropriate benchmark, producing a "scorecard". This determines the extent as to how well actively-managed funds have performed over different time periods.

The statistics are compelling. Over a 10-year time horizon to end 2021[2], no active funds in US equities outperformed the benchmark on a risk-adjusted return basis and only 5.3% of them outperformed on a total return basis. For efficient markets, this suggests that an index-based approach makes sense over the long-run. The percentage of equity funds by region outperforming their related benchmark can be seen below:

[1] Note: SPIVA® is a registered trademarks of S&P Global, Inc. ("S&P Global") or its affiliates.
[2] SPIVA Scorecard as at end 2021: https://www.spglobal.com/spdji/en/documents/spiva/spiva-europe-year-end-2021.pdf

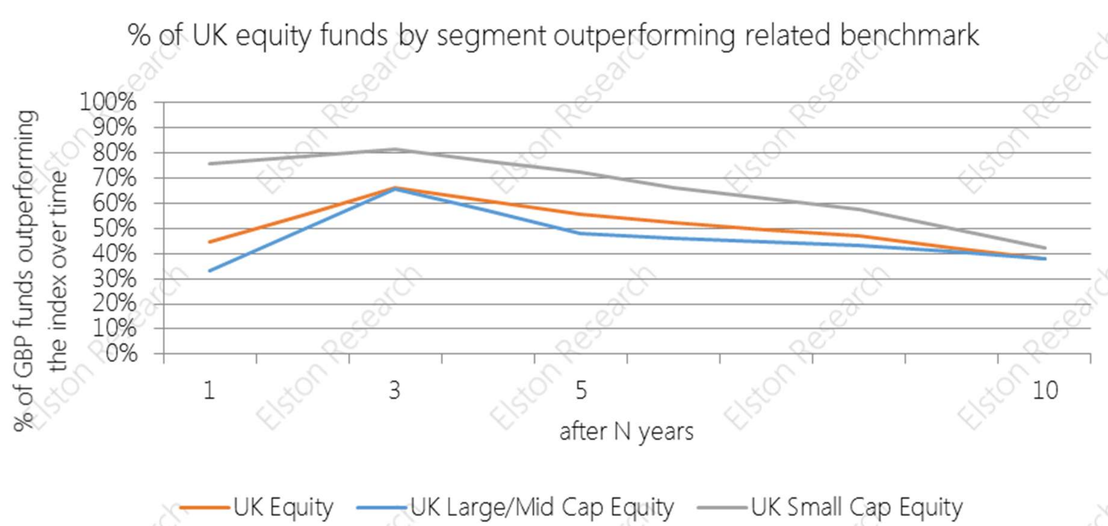
Fig.1. Percentage of equity funds by region outperforming related benchmark



Source: Elston research, S&P Dow Jones Indices SPIVA Europe scorecard data as at December 2021 (GBP denominated funds). Includes interpolated data between 1&3 and 5&10 years for illustration only

As illustrated by the chart above, we can see that there is greater evidence of outperformance in the UK market over 3, 5 and 10 years, than there is in the Global or US markets. The overall trend over time is, however, clear. Looking within the UK equity market, we can see that there is greater evidence of outperformance in the small-cap sector than there is for large/mid cap, suggesting that looking to a specialist active manager could make sense in this segment.

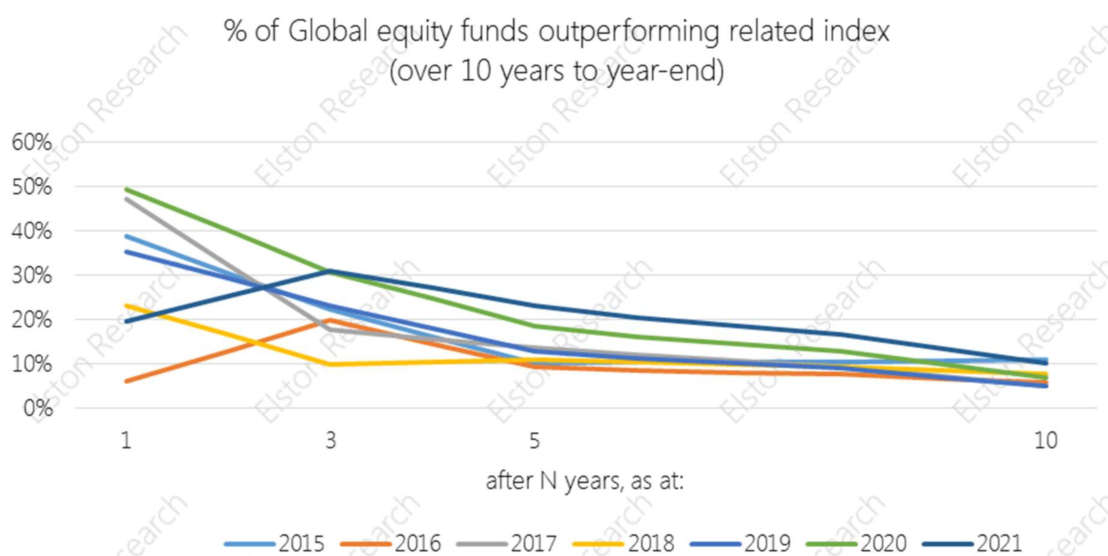
Fig.2. Percentage of UK equity funds by segment outperforming related benchmark



Source: Elston research, S&P Dow Jones Indices SPIVA Europe scorecard data as at December 2021 (GBP denominated funds). Includes interpolated data between 1&3 and 5&10 years for illustration only

Finally, rather than looking at just the 10 years to 2021, we can look at the potential for alpha for each 10 year period going back the last few years both in the US market, and the UK market.

Fig.3 Percentage of Global equity funds outperforming related benchmark over rolling 10 year periods (as at year-end)



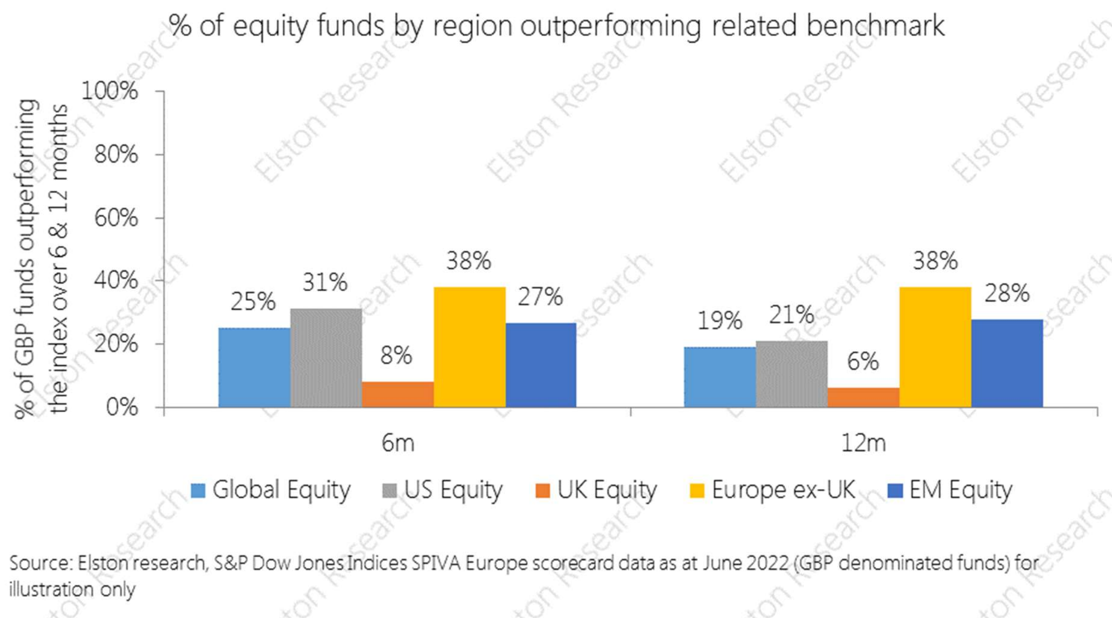
Source: Elston research, S&P Dow Jones Indices SPIVA Europe scorecard data as at December 2015-21 (GBP denominated funds). Includes interpolated data between 1&3 and 5&10 years for illustration only

The conclusion is clear: while there can be substantial dispersion over 1-3 years, the 10-year trend is fairly consistent with respect to fund underperformance.

In times of economic turmoil and market decline, when dispersion is high, active managers claim that they have greater potential to outperform. This is true, but the results are not guaranteed. In the first half of 2022[3], 25%, 31% and 8% of Global, US and UK active funds outperformed their respective index. Over the last 12 months to June 2022, the figures fall to 19%, 21% and 6% respectively.

[3] SPIVA Scorecard 1h22: https://www.spglobal.com/spdji/en/documents/spiva/spiva-europe-mid-year-2022.pdf

Fig.4. % of equity funds by region outperforming related benchmark 6 & 12 months to June 2022



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For more on this topic

Insights: 22nd October 2021: [Understanding SPIVA]

[CPD Webinar: Is Active Management a Zero-Sum Game?]

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Our Research & CPD focuses on multi-asset strategies, index funds and ETFs.

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