

PERSPECTIVES

Active Management Hasn't Shined in Volatile Markets

Wes Crill, PhD
Head of Investment Strategists and Vice President

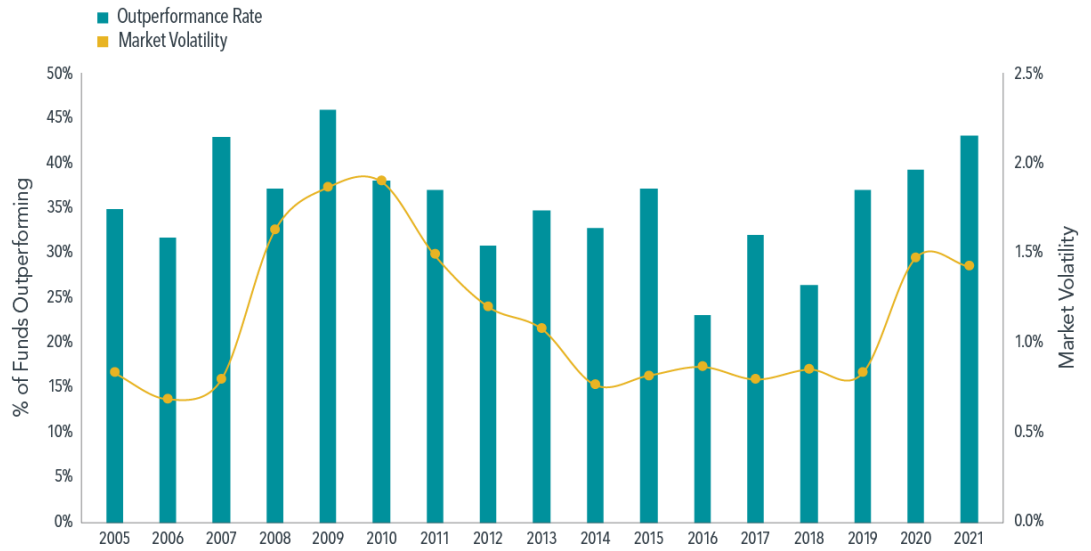
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Many investors have likely heard the adage that active management performs better in times of market turbulence. This may sound like an emotional hedge for market stress akin to betting against your favorite sports team to balance an adverse outcome with financial compensation. However, a historical analysis of active US-domiciled equity funds finds no meaningful relation between market volatility and managers' success rates; the implication is that traditional active investments may compound your concerns during times of market uncertainty.

The rolling three-year standard deviation for US stock market returns, illustrated by the orange line in **Exhibit 1**, shows recent volatility has been at its highest since the 2008 financial crisis. Whether this portends success by active managers is doubtful. The rolling three-year outperformance rates by active US equity funds (blue bars) imply very little relation with volatility levels. The year-to-year variation in success rates does not consistently track market volatility. For example, rolling averages of daily volatility from 2014 to 2019 were consistent in level and yet the percent of funds outperforming during these rolling periods was not, ranging from 23% to 37%.

Exhibit 1 Active Imagination

Rolling three-year outperformance rates for active US equity funds vs. stock market volatility, January 2005–December 2021



Market volatility computed each month using standard deviation of Fama/French Total US Market Research Index daily returns. Monthly volatility observations are then averaged over rolling three-year periods formed at the end of each year. Outperformance rates are computed over the same rolling three-year periods and are calculated as the percentage of active US-domiciled equity funds that survive the period and outperform their respective Morningstar category index net of all fees and expenses. Sample of active managers consists of funds categorized as active US equity by Morningstar. Fund returns are average returns computed each month, with individual fund observations weighted in proportion to their assets under management (AUM). Index benchmarks are those assigned by Morningstar based on the fund's Morningstar category.

Past performance is no guarantee of future results.

Volatile market environments give us enough to worry about—investors can do without unpredictable outcomes from traditional active management.

Active management: A portfolio management approach that aims to outperform a market rate or return, or a specific benchmark, by choosing investments that deviate from the market portfolio or benchmark.

Standard deviation: A measure of the variation or dispersion of a set of data points. Standard deviations are often used to quantify the historical return volatility of a security or portfolio.

Fama/French Total US Market Research Index: The value-weighted US market index is constructed every month, using all issues listed on the NYSE, AMEX, or Nasdaq with available outstanding shares and valid prices for that month and the month before. Exclusions: American depositary receipts. Sources: CRSP for value-weighted US market return. Rebalancing: Monthly. Dividends: Reinvested in the paying company until the portfolio is rebalanced.

The Fama/French Indices represent academic concepts that may be used in portfolio construction and are not available for direct investment or for use as a benchmark. Index returns are not representative of actual portfolios and do not reflect costs and fees associated with an actual investment. See "Index Description" above for a description of the Fama/French index data. Results shown during periods prior to each index's index inception date do not represent actual returns of the respective index. Other periods selected may have different results, including losses. Backtested index performance is hypothetical and is provided for informational purposes only to indicate historical performance had the index been calculated over the relevant time periods. Backtested performance results assume the reinvestment of dividends and capital gains. Profitability is measured as operating income before depreciation and amortization minus interest expense scaled by book. Eugene Fama and Ken French are members of the Board of Directors of the general partner of, and provide consulting services to, Dimensional Fund Advisors LP.

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