Active Managers Did Poorly Last Year. Can Volatility Save Them?

By Aziza Kasumov April 8, 2020

Active management had a not-so-great year in 2019, with U.S. equity managers, in particular, failing to beat their respective benchmarks, according to new research by Wilshire Consulting. Now that volatility is back, induced by the global coronavirus pandemic, the pressure is on for active managers to prove their worth.

"It's a challenging period, … there's certainly going to be winners and losers," says **Steven Foresti**, CIO at Wilshire Consulting. "And it will be a difficult environment for [active managers] because they already came into this market with a business model challenged a bit."

In its report, Wilshire found that most U.S. equity managers were unable to generate excess gross-of-fees returns relative to their benchmarks, with REITs serving as the only exception. While REITs generated a median 1.86% in excess returns relative to their benchmark, U.S. small and large-value, core and growth all generated less. Growth-oriented strategies overall did the worst compared to their respective benchmarks, Wilshire found.

For active managers focusing on non-U.S. markets, the picture looked a bit rosier, with emerging markets equities generating close to 1.5% in median excess return. In the fixed income category, however, median returns were at least 1% lower than the relative benchmarks for both U.S. core and U.S. high-yield strategies.

The smooth-sailing market environment last year, consultants say, played some role in those results.

"Even a manager with skill will have a hard time outrunning their costs or their fees in a very low-risk market, … where there's not much price difference," says Foresti. That's also why active managers in less efficiently priced and researched spaces – such as emerging or developed ex-U.S. markets – had a bit of a leg up, he adds.

Some active U.S. equity managers felt the pain through institutional outflows. A few the worst performing strategies in the Wilshire study — U.S. large-cap value and U.S large-cap growth — saw institutional outflows of more than $30 billion and close to $10 billion, respectively, in the fourth quarter of last year alone, according to an eVestment report from last month.

Now that markets are significantly more volatile than last year, however, there might be an opportunity to make up for some of the damage.

“Particularly in these markets, these challenging times, the active manager can actually use his research to change the portfolio to do different things, to reduce the volatility — and an index can’t do that,” says **Sondhelm Partners** CEO **Dan Sondhelm**. “For a lot of active managers, this is their time to shine if they want to, and it’s not just about performance, it’s about the story and the strategies doing what they’re supposed to do,” he adds.

Wilshire’s Foresti notes that, while the managers he’s spoken to aren’t taking any radical positions, there is an expectation that the current market environment is “more suitable” for their investment processes to work.

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Ben Johnson
Morningstar

“As you move toward more volatile markets, which clearly we’re in right now, that’s a condition that theoretically an active manager should be able to exploit,” Foresti says.

Foresti however warns that in-depth data on how active strategies managed the markets throughout this period will not be available for months, if not quarters.

On the actively managed mutual fund side, however, that thesis has already proven difficult to realize, research from Morningstar shows.

Slightly more than half — about 52% — of actively managed U.S. stock mutual funds beat their indices between Feb. 20 and March 12. While that success rate is almost twice as high as the percentage that beat their benchmarks between Dec. 14, 2018 and Feb. 19, 2020, it still puts the thesis that active institutional managers could shine right now into question.

“The idea that active managers as a group will on average outperform the market during bear markets belongs in the same category as the Easter Bunny and Santa Claus,” says **Ben Johnson**, director of global exchange-traded fund (ETF) research for Morningstar. “It’s something we all want to believe in, and to some degree take comfort in, but ultimately, it’s fiction.”

Johnson’s research found that, over the past 10 years, actively managed U.S. large-cap blend ETFs and mutual funds have failed to outperform their passive counterparts. And Johnson says he doesn’t expect those findings to change during a down-market.

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