

First Quarter 2010 Knowledge College

Active Manager Performance, Consistency and Persistency

We recently updated our 2007 study of active manager performance, consistency and persistency. The work focused on top quartile mutual funds over the ten-year period ending December 31, 2009.

- Of those top quartile funds, 85% were unable to avoid a three-year stretch below median.
- 62% were unable to avoid the bottom half in any five-year period.

Ten-year top quartile funds that fell below median during one or more three- and five-year periods (ending December 31, 2009)¹

Category	Number of funds with 10-year records ¹	Number of 10-year top quartile funds	Number of 10-year top quartile funds below median for a 3-year period	Percent of 10-year top quartile funds below median for a 3-year period	Median consecutive years spent in bottom half	Percent of 10-year top quartile funds below median for a 5-year period
Intermediate Bond	222	56	49	88%	1.00	64%
High Yield Bond	88	22	20	91%	1.50	73%
International Bond	48	12	11	92%	1.00	50%
Large Cap Value	183	46	44	96%	1.75	74%
Large Cap Core	315	79	64	81%	1.00	61%
Large Cap Growth	281	70	59	84%	1.25	60%
Mid Cap Value	37	9	9	100%	0.75	67%
Mid Cap Core	79	20	17	85%	1.38	75%
Mid Cap Growth	139	35	29	83%	1.25	66%
Small Cap Value	55	14	13	93%	2.00	57%
Small Cap Core	116	29	22	76%	1.00	41%
Small Cap Growth	138	35	30	86%	1.50	74%
Real Estate	42	11	9	82%	1.00	36%
International Value	57	14	13	93%	0.75	50%
International Core	107	27	18	67%	0.25	33%
International Growth	34	9	9	100%	1.25	89%
Emerging Markets	55	14	13	93%	1.13	64%
Total	1,996	502	429	85%	1.13	62%

- Categories where more top quartile funds fell below median (over both three- and five-year windows) typically spent more consecutive periods there.
- The smaller the peer group, the more difficult it was for top quartile funds to avoid the bottom half over a three-year stretch.
- *International core* had the fewest top quartile funds dip below median during a three- or five-year period (67% and 33%, respectively).
- Not one *international growth* or *mid cap value* top quartile fund avoided the bottom half during a three-year span.

¹Distinct Portfolio Only: Many fund families offer multiple versions of the same fund, but with variations on the sales fees that are charged and/or investor qualifications. The "distinct portfolio only" feature removes all but one of these options. Morningstar normally designates the oldest share class as the distinct portfolio, which is often, but not always, the 'A' share class.

²Morningstar mutual fund data was used because it is less prone to some reporting biases compared to other databases. For example, poorly performing managers frequently stop reporting to manager databases during poor performance stretches. While the Morningstar data is not immune to survivorship bias, each mutual fund that survived the ten-year stretch was captured regardless of performance. In addition, the Morningstar data generates returns net of expenses. Many other databases show returns gross of fees. Since fees for institutional investors are often tiered based on asset size, and trading costs are not uniform, it is problematic to calculate objective after-expense returns.

Average percent of three-year and five-year periods spent in the bottom half by ten-year top quartile funds (ending December 31, 2009)

Category	Average percent of 3-year periods spent in bottom half	Average percent of 5-year periods spent in bottom half
Intermediate Bond	21%	15%
High Yield Bond	30%	29%
International Bond	20%	12%
Large Cap Value	28%	23%
Large Cap Core	22%	20%
Large Cap Growth	25%	22%
Mid Cap Value	22%	17%
Mid Cap Core	31%	33%
Mid Cap Growth	23%	22%
Small Cap Value	31%	31%
Small Cap Core	19%	12%
Small Cap Growth	29%	27%
Real Estate	17%	3%
International Value	19%	14%
International Core	15%	13%
International Growth	26%	15%
Emerging Markets	19%	12%
Average	23%	19%

- On average, top quartile funds spent about 23% of all rolling three-year periods in the bottom half of their peer group.
- Top quartile funds spent approximately 19% of all rolling five-year periods in the bottom half of their peer group (on average).

Conclusion

Investors should decide to be patient before hiring active managers or they should seek a passively managed alternative. Our research continues to show that the vast majority of long-term top performing managers will experience periods of lousy performance. Impatience invariably leads to a self-defeating cycle.

For more information, visit the DiMeo Schneider & Associates, L.L.C. [research page](#) to view our most recent white paper, “[The Next Chapter in the Active versus Passive Debate \(2010 Update\)](#).”