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15 Years of SPIVA®, the De Facto Scorekeeper of the Active vs. Passive Debate

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Few people know the ins and outs of the SPIVA (S&P Indices Versus Active) Scorecard better than Aye Soe, Managing Director of Research & Design. A few months after SPIVA's 15th birthday, Emily Wellikoff, Indexology Magazine Editor-in-Chief, sat down with her to discuss how the report has grown over the last decade and a half, its most surprising findings, and what's changed since factor investing started blurring the lines between active and passive.

EMILY: Fifteen years, or one-and-a-half market cycles, since SPIVA launched, what's the most important lesson you've learned about active and passive investing?

AYE: The most important thing we've learned is that the average manager hasn't been able to beat the benchmark across most equity and fixed income categories over the long term.[1] There may be a small number of managers who are able to beat the benchmark in any given year, but the likelihood of those managers repeating the same success consistently in the years that follow is small, less than a random coin toss.

EMILY: What are some common misconceptions or myths about the active versus passive debate that you have come across in the last 15 years?

AYE: In equities, many people see small-cap and emerging markets as areas where market inefficiencies may provide opportunities for active management. However, near-, mid-, and long-term results for the two categories show that average active managers do not necessarily fare better than their benchmarks. In fact, over 1-, 3-, 5-, and 10-year periods, the majority of active managers in those two categories have overwhelmingly underperformed.[2] Market inefficiency may exist in those asset classes, but the results dispel the myth that an average active manager has historically been able to deliver higher relative returns than the benchmark.

[1] S&P Dow Jones Indices, (2017), https://spindices.com/documents/spiva/spiva-us-mid-year-2017.pdf.
[2] S&P Dow Jones Indices, (2017), https://spindices.com/documents/spiva/spiva-us-mid-year-2017.pdf.

Many people also consider fixed income an inefficient asset class because of its opaque pricing system, high degree of market segmentation, the vast majority of securities trading over the counter (OTC), and dealer-dependent inventory levels, which impact liquidity. And since a significant portion of bond returns are driven by systematic risk such as duration and credit, many people have seen index-linked investment vehicles as structurally inadequate to deal with interest rate changes or credit events.

Fixed income fund performance over 5-, 10-, and 15-year periods has revealed mixed results. Generally speaking over the five-year horizon, managers in certain categories such as short- and intermediate-term investment-grade corporate credit, and general municipal, have been able to outperform their benchmarks. But over longer-term 10- and 15-year horizons, the majority of funds across all the categories have failed to beat the benchmarks.[3]

EMILY: What's the most surprising thing you've encountered since SPIVA was first published?

AYE: How difficult it is to earn excess returns consistently over mid- and long-term horizons. That observation applies beyond the U.S. too. Our research has shown that most active managers across different regions, countries, and market segments have historically underperformed their benchmarks.

Another finding I find really striking is that active managers underperform even more sharply when they are managing assets outside their domestic market – as just one example, European managers of U.S. equity funds have historically struggled more to beat the benchmark than their counterparts investing in European equity funds.

I would also add that the high death rate of funds over a long time horizon is quite surprising. For that reason, it's important that any study looking at mutual fund performance correct for survivorship bias. Approximately 79% and 57% of all domestic funds survive over 5- and 10-year investment horizons, respectively. That number declines significantly to 42% when the measurement period extends to 15 years.[4] Not correcting for survivorship bias can lead to upwardly biased performance results. For example, roughly 18% of domestic funds outperformed the S&P Composite 1500 Index over the fifteen years ending December 2016. If we didn't account for survivorship bias, nearly 43% of domestic funds would have outperformed the same benchmark. That's a pretty big difference.

EMILY: It seems like there's a lot of variability in the one-year percentage of active funds outperforming from year to year. What do you attribute that to?

AYE: One-year results can fluctuate widely depending on market conditions and investor sentiment. The numbers provide a general sense of how active managers as a group have fared in any given year, but it's not a good idea to reach definitive conclusions about the performance of active managers as a group based on those figures since they may change drastically come next year. For example, 38% of large-cap growth managers lagged the S&P 500 Growth Index in 2005, but nearly 94% of them underperformed in the following year, 2006. The percentage then dwindled again to 27% in 2007. Results are inconsistent when we look at short periods.

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[3] S&P Dow Jones Indices, (2017), https://spindices.com/documents/spiva/spiva-us-mid-year-2017.pdf.
[4] S&P Dow Jones Indices, (2017), https://spindices.com/documents/spiva/spiva-us-mid-year-2017.pdf.

EMILY: What do you think is the most significant factor preventing more active managers from beating their benchmark over longer-term periods?

AYE: I think there are a number of contributing factors. Fees definitely play a role but it's not necessarily as large as many believe it is. In fact, our research shows that most actively managed equity funds trail their benchmarks even when gross-of-fees returns are used.[5] The secular equity bull market we've experienced over the last eight years has also made it difficult for active managers to outperform. My colleague and coauthor of the SPIVA U.S. Scorecard, Ryan Poirier, pointed out that the S&P 500 has had 65 up months and only 31 down months from January 2009 to December 2016.[6] That means any degree of wrong security selection, insufficient market beta exposure, or just having allocation to cash may have resulted in underperformance. Another factor that may play a role is this relatively low cross-sectional volatility, or low dispersion, environment we've been seeing. My colleagues on our Index Investment Strategy team have done quite a bit of research on the topic, linking managers' performance and the availability of alpha-generating opportunities.[7]

One more key factor that may contribute to managers' underperformance is portfolio construction, and more specifically, the type of bets managers take on, and whether those bets are compensated. We intend to explore that more in upcoming research.

EMILY: The rise of factor investing has blurred the previously clearer lines between active and passive. In fact, it's now possible for an investor to use passive vehicles to invest in an otherwise tactical, "active" way. Is that shifting the way we frame the debate?

AYE: Absolutely. Investors are realizing that a manager's sources of returns can be broken down into a series of factor returns, and those factors can be partially or wholly captured in a rules-based, systematic process. At the same time, the availability of low-cost, passive factor investment products has democratized the way an average investor can gain access to those exposures. That means alpha can no longer be defined just as the excess returns over the benchmark. The debate then shifts to whether a manager is able to outperform the benchmark after adjusting for factor exposures.

EMILY: The scorecard has expanded beyond the U.S. to Canada, Mexico, Brazil, Chile, Europe, South Africa, India, Japan, and Australia, and now looks at not just equity but also fixed income in some regions. What's next?

AYE: We continue to enhance the scorecard and extend its scope. In 2016, we introduced the SPIVA Institutional Scorecard in which we examined the impact of fees on institutional managers' performance. We published the report in 2017[8] as well, and will be releasing the report on an annual basis. This year, we also conducted a study linking the SPIVA and the Persistence Scorecards[9] by examining the average performance persistence of funds that beat the benchmark in a given year. And we added the 15-year performance figures to the SPIVA U.S. Scorecard, which provides a more stable narrative across multiple business cycles.

In Q1 2018, we will publish a study looking at whether fund characteristics such as volatility, concentration level, tracking error, information ratio, or active share lead to outperformance.

*For more information about SPIVA and to get the latest results for markets around the world, please visit **spdji.com/spiva**.*

[5] S&P Dow Jones Indices, (2017), https://spindices.com/documents/spiva/research-spiva-institutional-scorecard-how-much-do-fees-affect-the-active-versus-passive-debate-year-end-2016.pdf.
[6] S&P Dow Jones Indices, (2017), http://www.indexologyblog.com/2017/05/18/three-takeaways-from-the-spiva-u-s-year-end-2016-scorecard/.
[7] S&P Dow Jones Indices, (2013), https://us.spindices.com/documents/research/research-dispersion-measuring-market-opportunity.pdf?force_download=true.
[8] S&P Dow Jones Indices, (2017), https://spindices.com/documents/spiva/research-spiva-institutional-scorecard-how-much-do-fees-affect-the-active-versus-passive-debate-year-end-2016.pdf.
[9] S&P Dow Jones Indices, (2017), https://spindices.com/documents/research/research-fleeting-alpha-evidence-from-the-spiva-and-persistence-scorecards.pdf.