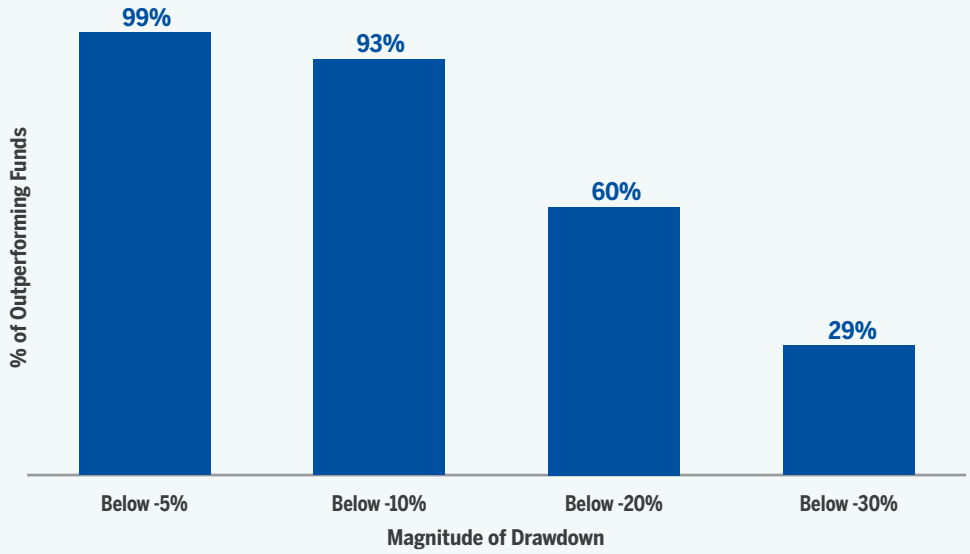
ALGER

Alger On the Money

Par for the Course?

For anyone in a results-focused occupation — from athletes to sales professionals — periods of performance setbacks are common. The same can happen with professional investors, given the inevitable ebbs and flows of the market environment. How often do investment managers experience relative drawdowns — the maximum loss in performance compared to their benchmark — and how severe have they been in the past?

% of Outperforming Funds Experiencing Various Drawdowns Relative to Their Benchmark



Source: Chris Tidmore and Andrew Hon, "Patience with Active Performance Cyclicality: It's Harder Than You Think," Journal of Investing, June 2021. The researchers evaluated all US-domiciled, Morningstar nine-style-box US active equity, emerging markets, and developed market foreign funds with a minimum of 10 years of performance data over the period from January 1, 1995, to December 31, 2019, relative to their style benchmark and identified all net outperforming funds (1,173 funds).[1] The data in the chart above indicates the worst drawdown of each outperforming fund over the sample period, relative to its style benchmark.

- In a recent study in the Journal of Investing, the authors analyzed equity fund performance, net-of-fees, and calculated the periods of relative underperformance by equity funds with at least a 10-year track record that outperformed their benchmark from 1995 through 2019 ("the sample period").[1] In the chart above, the magnitude of drawdown for each fund refers to the cumulative peak-to-trough loss in performance relative to its benchmark
- Their findings reveal that nearly all of the funds that outperformed during the sample period, experienced drawdowns of at least 10% relative to their benchmark. In fact, more than half experienced drawdowns of at least 20%, and almost a third of managers experienced a drawdown in excess of 30%. Moreover, the study also found that these drawdowns can be lengthy, with managers experiencing, on average, one continuous drawdown lasting two years or more.
- While periods of relative underperformance can be frustrating to investors, they are common, as evident in the chart above. We have written that evaluating managers based on short-term performance may not be prudent. We believe that investors may be well served by assessing specific fund characteristics, such as long-term performance[2] and manager independence[3] (i.e., lack of affiliation with investment banks, reducing potential conflicts of interest in holding a disproportionate amount of a company's shares).

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[1]The study took the oldest share class for all US-domiciled actively managed open-end equity funds in the Morningstar Direct database (including surviving and obsolete funds) during the 25 years ended December 31, 2019. The study then removed any fund with fewer than 10 holdings or less than 10 years of returns, along with any fund not categorized in the traditional US Morningstar nine-box style factors, emerging markets, foreign large capitalization, or foreign small-/mid-cap categories during the sample period, which produced a sample of 2,593 funds. Next, using each fund's relevant Morningstar style benchmark, each fund's cumulative net excess return over the sample period was calculated. Funds with a positive cumulative return, net of expense ratio, were labeled "outperformers," resulting in 1,173 funds that outperformed. By category, the sample was made up of 83 US large-cap blend, 192 US large-cap growth, 88 US large-cap value, 27 US mid-cap blend, 85 US mid-cap growth, 24 US mid-cap value, 97 US small-cap blend, 156 US small-cap growth, 61 US small-cap value, 235 foreign large-cap, 48 foreign small-/mid-cap, and 77 diversified emerging market funds.

[2]Donoho, Crenian, Scanlan, 2010.

[3]Hao, Q., and X. Yan. "The Performance of Investment Bank-Affiliated Mutual Funds: Conflicts of Interest or Informational Advantage?" Journal of Financial and Quantitative Analysis, 2012.

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