WERBA RUBIN PAPIER
WEALTH MANAGEMENT

August 2017

So You're Telling Me There's a Chance

Alan Werba, CPA, CFP®
Member

Jason Papier
Managing Member

Aaron Rubin, JD, CPA, CFP®
Member

Werba Rubin Papier
Wealth Management, LLC

10 Almaden Blvd.
15th Floor
San Jose, CA 95113

wrpwealth.com

408.260.3138

Every spring those of us in the investment management industry keep our eyes peeled for the Standard & Poors Index vs Active report, basically the industry scorecard for how well active managers have done compared to their respective benchmarks. This year's report card would make even the biggest underachiever blush.

During 2016, 66% of Large Cap actively managed funds failed to keep pace with the S&P 500. 2016 was an interesting year, with markets falling quickly to start and then rallying significantly the remainder of the year. Perhaps it was just bad luck that 2/3 of active managers couldn't keep up? After all, many predictions were wrong last year: Markets quickly reversed course after RBS told clients to sell early on, the Brexit vote was a simple blip on the screen for most global stocks, markets rallied significantly following Donald Trump's election win in November, and even the Cubs won the World Series — so surely 2016 must have been an aberration?

Well, as you start to look over longer periods, the numbers don't get much better. Over the last five years 88% of those same Large Cap managers trailed the S&P 500.

The common thinking in the investment world is that active managers show their value during down markets, since they are able to shield their clients from the worst of index losses. Yet, over the past 10 and 15 years, when the market saw the Financial Crisis, 84.60% and 92.15% of Large Cap managers failed to match the S&P 500. Even in 2008, when the S&P fell 37%, only 44.05% of active managers could do better.

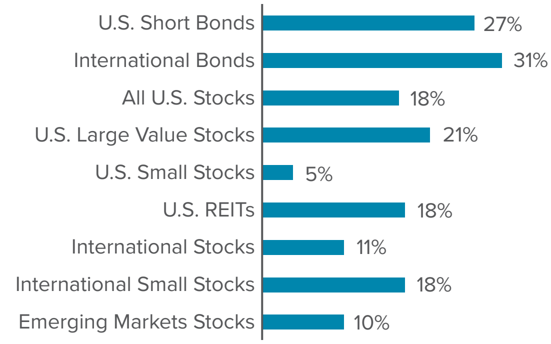
We've covered this story before in two previous blogs:

In The Last Redoubt of Active Management – Down Markets?, we looked at why "the belief that bear markets favor active management is a myth"

In Another Blow to Active Management, we evaluated the previous time SPIVA expanded their time horizon and found similar results

Perhaps it's just tough to shine in the highly competitive, liquid and well researched US Large Cap space. Surely in those "less competitive" asset classes like US Small, International or Emerging Markets active managers would beat their benchmarks on average? Not so according to the results in the table below.

Percent of Active Managers Who Beat Their Asset Class Benchmark 2002 – 2016



Source: SPIVA US Scorecard Year-End 2016

What you'll notice across these nine asset classes is that fewer than 50% of the active managers outperformed their asset class benchmark, meaning that at the start of the period you were more likely to invest with a manager who underperformed than outperformed. In fact, if you look at the combined percentages, the odds of selecting an active manager who outperformed the index in each of these nine categories would be worse than one in 16 million.

Potentially you look at those numbers, channel your inner Lloyd Christmas and think, "So you're telling me there's a chance." But are those numbers you can be comfortable with?

All investments involve costs, but the costs incurred by active management have shown time and time again to be a bad deal for investors.

Long-term investment plans already contain many variables and unknowns, why introduce additional ones which historically have a low probability of helping your plan?

Past performance does not guarantee future results. Implementing a passive investing strategy cannot guarantee a gain or protect against a loss.

Comparison Indexes as follows: Large Cap (S&P 500), US Short Bonds (Barclays US Government/Credit 1-3 Year), International Bonds (Barclays Global Aggregate), All US Stocks (S&P 1500), US Large Value Stocks (S&P 500 Value), US Small Stocks (S&P SmallCap 600), US REITs (S&P BMI US REITs), International Stocks (S&P International 700), International Small Stocks (S&P Developed Ex US Small Cap), Emerging Markets Stocks (S&P/IFCI Composite). It is not possible to invest directly in an index.

Battle of Guadalcanal

history.com

This August marks the 75th anniversary of Guadalcanal, the first major offensive battle of WWII. With Japanese troops stationed in this section of the Solomon Islands, U.S. marines launched a surprise attack in August 1942 and took control of an air base under construction. Reinforcements were funneled to the island as a series of land and sea clashes unfolded, and both sides endured heavy losses to their warship contingents. However, the Japanese suffered a far greater toll of casualties, forcing their withdrawal from Guadalcanal by February 1943.

When Japanese troops arrived on Guadalcanal on June 8, 1942, to construct an air base, and then American marines landed two months later to take it away from them, few people outside of the South Pacific had ever heard of that 2,500-square-mile speck of jungle in the Solomon Islands. But the ensuing six-month Guadalcanal campaign proved to be the turning point of the Pacific war.

Strategically, possession of a Guadalcanal air base was important to control of the sea lines of communication between the United States and Australia. Operationally, the Battle of Guadalcanal was notable for the interrelationship of a complex series of engagements on the ground, at sea, and in the air. Tactically, what stood out was the resolve and resourcefulness of the U.S. Marines, whose tenacious defense of the air base dubbed Henderson Field enabled the Americans to secure air superiority.

By the end of the battle on February 9, 1943, the Japanese had lost two-thirds of the 31,400 army troops committed to the island, whereas the U.S. Marines and the U.S. Army had lost less than 2,000 soldiers of about 60,000 deployed. The ship losses on both sides were heavy. But by far the most significant loss for the Japanese was the decimation of their elite group of naval aviators. Japan after Guadalcanal no longer had a realistic hope of withstanding the counteroffensive of an increasingly powerful United States.