

IS YOUR ACTIVE MANAGER BEATING THE BENCHMARK INDEX?

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Many tools exist today for investors to screen databases for the best performing managers in any given asset class. But if you inadvertently exclude exchange-traded funds (ETFs) or index-based strategies, believing that they only provide the “market return,” you may be settling for sub-par active managers. Take U.S. mid-caps, for example. That asset class has come back in vogue this year, in part because of a first-half sell-off in some of the major small-cap indexes. If you are conducting a search for best-in-class mid-cap managers, know that a large majority of active managers have not beaten the major mid-cap indexes in their peer group over the past five years.¹ When we tap the Morningstar database to compare the performance of the [WisdomTree MidCap Earnings Index](#) to the universe of open-end fund peers in the U.S. mid-cap category, we find that over the last five years the WisdomTree Index beat 99% of all the open-end mid-cap funds competing for U.S. allocations. Interestingly, the cap-weighted [S&P MidCap 400 Index](#) beat 72% of the actively managed funds over this period—calling into question the premise that the market return merely makes you “average.”

Category: Morningstar Mid-Cap Blend

Percentage of Managers with Performance Lagging Index Performance as of March 31, 2014

	1-Year	3-Year	5-Year	2/1/07– 03/31/14*	10-Year
WisdomTree MidCap Earnings Index	89%	96%	99%	98%	N/A
S&P MidCap 400 Growth Index	35%	48%	74%	97%	95%
S&P MidCap 400 Index	40%	60%	72%	92%	91%
S&P MidCap 400 Value Index	42%	73%	70%	69%	82%
Number of Managers	415	363	332	259	200

Source: Morningstar. Past performance is not indicative of future results. You cannot invest directly in an index.

*2/1/2007 is the inception date of the WisdomTree Index.

For definitions of indexes in the chart, please visit our [glossary](#). Like the [WisdomTree SmallCap Earnings Index](#) does for its category, the WisdomTree MidCap Earnings Index includes essentially all the profitable publicly traded mid-cap companies in America and weights them annually based on the aggregate earnings each company has generated over the prior year. By including more than 600 stocks with an aggregate [market capitalization](#) of more than \$2.2 trillion, the WisdomTree MidCap Earnings Index is actually a broader and more representative barometer of the U.S. mid-cap asset class than the S&P MidCap 400 Index, whose 400 components have a combined market cap of just \$1.65 trillion.² Because WisdomTree’s [fundamentally weighted](#) approach to the U.S. mid-cap market is both representative of the mid-cap asset class and blessed with ample investment capacity, it could serve as the cornerstone for investors seeking core ["smart beta"](#) exposure for U.S. mid-caps stocks. Similarly, if you screen for small-cap managers and fail to include ETFs or index-based strategies, you may be unaware of the WisdomTree SmallCap Earnings Index, which beat 97% of its peer group over the past five years, according to Morningstar.

Category: Morningstar Small Blend

Percentage of Managers with Performance Lagging Index Performance as of March 31, 2014

	1-Year	3-Year	5-Year	2/1/07– 03/31/14*	10-Year
WisdomTree SmallCap Earnings Index	92%	87%	97%	90%	N/A
Russell 2000 Growth Index	80%	63%	70%	87%	58%
Russell 2000 Index	60%	56%	53%	55%	50%
Russell 2000 Value Index	34%	46%	37%	17%	36%
Number of Managers	701	625	564	459	340

Source: Morningstar. Past performance is not indicative of future results. You cannot invest directly in an index.

*2/1/2007 is the inception date of the WisdomTree Index.

For definitions of indexes in the chart, please visit our [glossary](#). In the next part of this series, we'll touch on one of the reasons why these excess returns may be occurring in the small- and mid-cap parts of the market, and what the ETF industry may not yet know about smart beta approaches to indexing. To learn more about smart beta, [click here](#) to read Luciano's recent Journal of Indexes article, "Considering Smart Beta."

¹Source: Morningstar. ²Market capitalization data as of 3/31/2014.

Important Risks Related to this Article

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WisdomTree MidCap Earnings Index : Fundamentally-weighted index that measures the performance of the top 75% of the market capitalization of the WisdomTree Earnings Index after the 500 largest companies have been removed.

S&P MidCap 400 Index : provides investors with a benchmark for mid-sized companies. The index covers over 7% of the U.S. equity market, and seeks to remain an accurate measure of mid-sized companies, reflecting the risk and return characteristics of the broader mid-cap universe on an on-going basis.

Market Capitalization : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

Earnings-weighted : Earnings for all constituents in an index are added together, and individual constituents are subsequently weighted by their proportional contribution to that total.

Smart Beta : A term for rules-based investment strategies that don't use conventional market-cap weightings.