

# IS YOUR ACTIVE MANAGER BEATING THE BENCHMARK INDEX?

Luciano Siracusano — Chief Investment Strategist

07/02/2014

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.<sup>1</sup> 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.<sup>2</sup> 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,

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.

according to Morningstar.

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." <sup>1</sup>Source: Morningstar. <sup>2</sup>Market capitalization data as of 3/31/2014.

#### Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Investments focusing on certain sectors and/or smaller companies increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. 2014 Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance, rankings and ratings are no guarantee of future results.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

## **IMPORTANT INFORMATION**

**U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.**

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages ([www.msci.com](http://www.msci.com))

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

## **DEFINITIONS**

**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.

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