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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