RVK

Performance Trends: US Equity Active Management

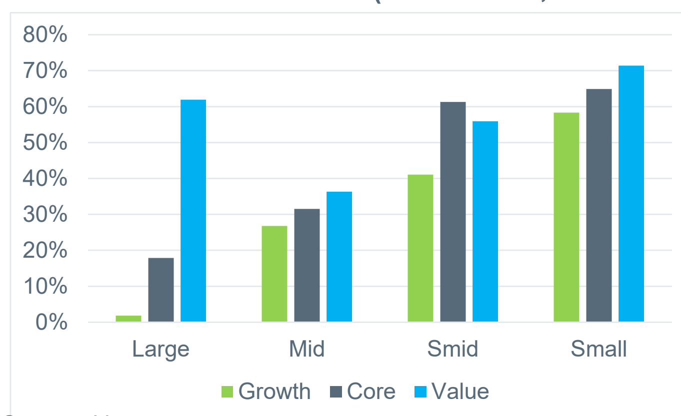
The following is an overview of recent and longer-term active management trends in US equity markets. Over the past 20 years, large- and mid-cap managers, primarily in the growth and core spaces, have struggled to generate excess returns relative to their respective benchmarks over rolling three-year periods (**Figure 1**). The most attractive space for active management has been in small-cap equity; however, the spread between top and bottom quartile performance tends to be wider in small-cap peer groups, emphasizing the need for successful manager selection.

Figure 1: US Active Manager Rolling 3-Year Excess Returns (Net of Fees, 2003-2022)

Source: eVestment.

Poor relative performance among active large-cap growth managers dates back to the Great Financial Crisis (GFC) and the beginning of quantitative easing by the US Federal Reserve (see "The Fed Balance Sheet and Active Public Equity Management", RVK Insights). Since 2009, median large-cap growth excess returns have been positive in less than 2% of observed rolling three-year periods. By comparison, small-cap growth and large-cap value managers have produced positive excess returns in 58% and 62% of the same periods, respectively (**Figure 2**). Prior to 2009, median large-cap growth excess returns were positive in every rolling three-year period dating back to October of 2000.

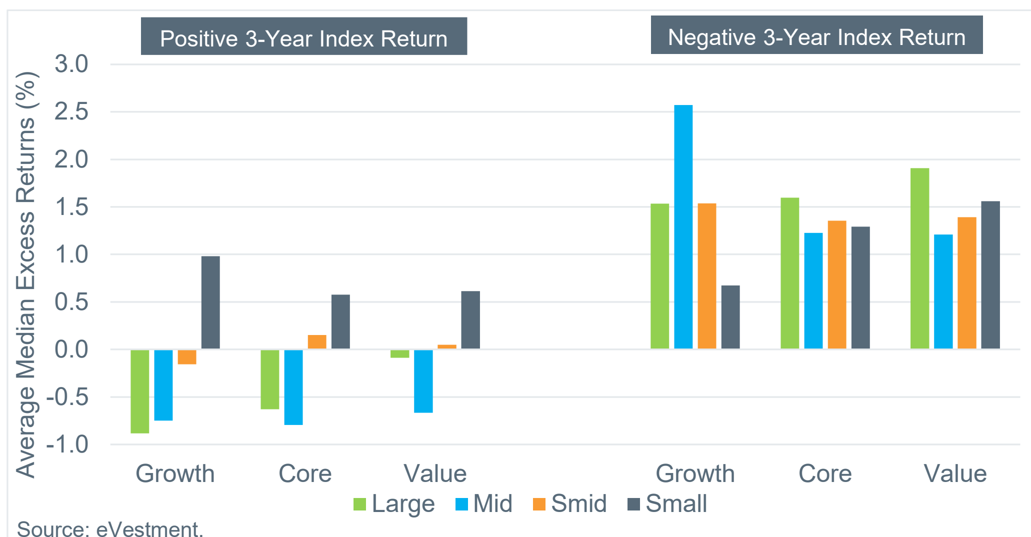
Figure 2: Percent of Rolling 3-Year Periods with Positive Excess Returns (Net of Fees, 2009-2022)



Source: eVestment.

A potential explanation for the disparity exhibited in active management performance in US equities between small-cap managers and the rest of the universe can be seen in performance patterns in up and down markets. The average median excess returns were positive across all small-cap styles in both positive and negative three-year index return periods. Conversely, large-, mid-, and smid-cap managers have generally exhibited a stronger negative correlation with their respective benchmark returns, underperforming in up markets and outperforming in down markets (**Figure 3**). Large-cap value and smid-cap managers stand out from non-small-cap peers, exhibiting strong downside protection while remaining relatively in line with their benchmark in up markets.

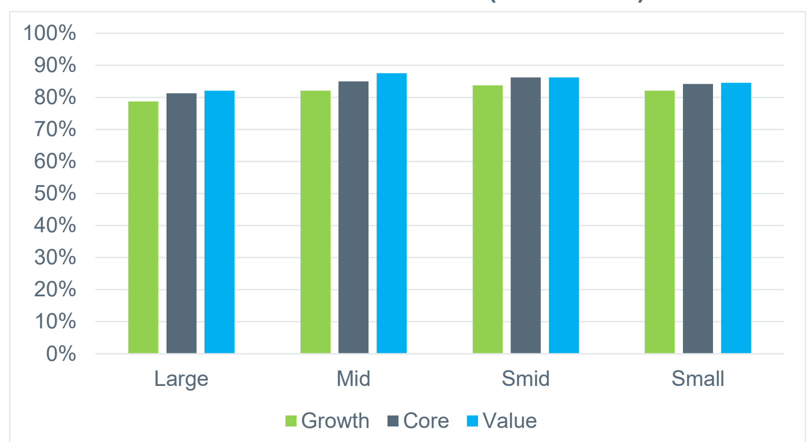
Figure 3: Average Median Rolling 3-Year Performance in Up/Down Markets (Net of Fees, 2003-2022)



Source: eVestment.

While active managers have tended to generate more significant excess returns in down markets, periods with positive index returns have accounted for greater than 78% of rolling three-year periods over the last 20 years (**Figure 4**). Intuitively, this implies active management in sub-asset classes that have been successful in generating excess returns in up markets (i.e., small- and smid-cap) have generally outperformed others in terms of excess returns relative to their respective benchmarks over longer-term periods.

Figure 4: Percent of 3-Year Rolling Periods with Positive Index Returns (2003-2022)



Source: eVestment.

Figure 5: US Active Manager 2022 Excess Returns

Source: eVestment.

The negative correlation between active management excess returns and index returns seen over longer-term periods was on display in 2022. Active management in US equities was broadly successful with the exception of growth managers (**Figure 5**). Value and core managers protected capital well relative to their respective benchmarks, with managers across the market cap spectrum providing median excess returns of greater than 2%. Small-cap growth managers had a rare period of poor performance after producing average median excess returns of nearly 5% in the preceding five calendar years. This, in large part, can be attributed to headwinds for growth stocks due to rising interest rates, which has led to increased discounting of future cash flows and has weighed on valuations. These factors, along with declining investor sentiment and the risk-off environment in 2022, led to a broad, undifferentiated sell-off of growth stocks resulting in factor and style headwinds that overshadowed quality, fundamental stock picking.

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