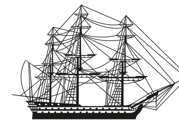

Defying conventional wisdom, indexes outperformed active managers

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Conventional wisdom holds that actively managed mutual funds outperform index funds during a bear market. This is based on the thinking that active managers have the discretion to move into cash or defensive sectors when markets take a downturn.

On the other hand, index funds, by mandate, are locked into holding the same securities as those in their benchmarks regardless of whether the market's bull or bear.

And, if there's a period when conventional wisdom should have been proven right, it would have been the 12 months through December 31, 2008, when the broad U.S. stock market (as measured by the Dow Jones Wilshire 5000 Index) plunged –37.3%. However, according to Lipper data, the average general equity fund performed even worse, returning –38.7%.

A mixed record for active managers

When separating out by investment styles, we found that the average return of actively managed funds in six of the nine investment style boxes lagged the return of the appropriate MSCI index in 2008, in one case by as much as 4 percentage points. Only in the mid-cap core and mid-cap growth areas did actively managed funds, on average, outpace the corresponding index for the 12-month period.

Active funds, on average, underperformed indexes, 12 months through December 2008

	Value		Blend/Core		Growth	
	Active	Index	Active	Index	Active	Index
Large	–37.4%	–35.8%	–37.2%	–36.1%	–40.7%	–36.5%
Medium	–38.3%	–36.5%	–38.5%	–41.8%	–44.5%	–47.1%
Small	–33.5%	–32.1%	–36.2%	–36.2%	–42.1%	–40.1%

Shaded areas denote style boxes where the average return of actively managed U.S. equity funds in the Lipper category lagged the return of the respective MSCI US index (Large Cap Value, Large Cap 300, Large Cap Growth, Mid Cap Value, Mid Cap 450, Mid Cap Growth, Small Cap Value, Small Cap 1750, Small Cap Growth). Past performance is no guarantee of future results. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

Sources: Derived from data provided by Lipper Inc. and MSCI.

The record of active managers against indexes in the previous six bear markets was also mixed.

"The majority of active managers failed to beat the broad market in half of those bear markets," said Christopher B. Philips, CFA, investment analyst in Vanguard Investment Strategy Group.

But when it came to bull markets, the record wasn't even close. The majority of active managers lagged the broad market in virtually every bull market that preceded or followed one of the bear markets analyzed in Vanguard's study.

Contrary to conventional wisdom, indexing has proven to have a solid track record relative to active management through both bull and bear markets.

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