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Market Facts

Why Value Managers Will Collect The Trophies

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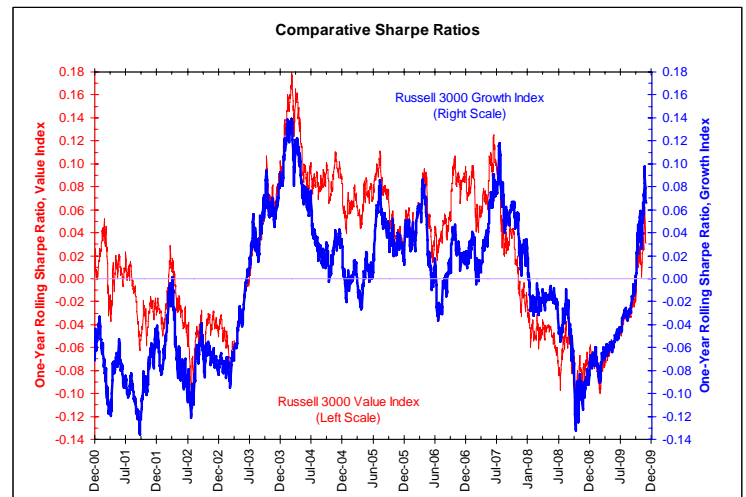
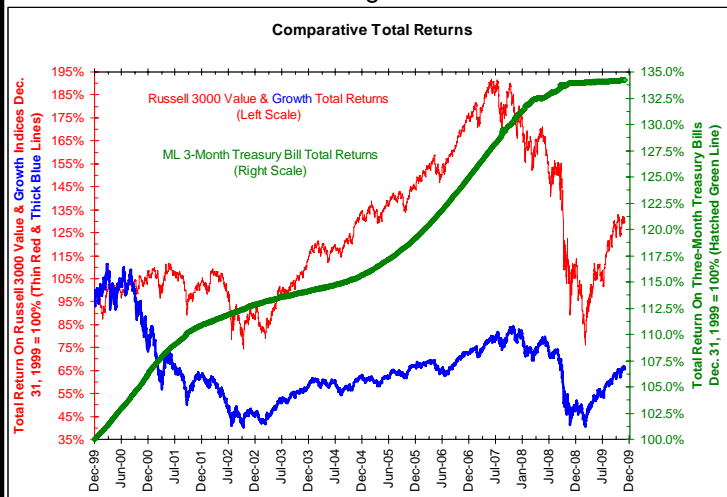
Morningstar announced its [Fund Manager of the Decade Finalists](#) yesterday, and the domestic equity list was dominated, unsurprisingly, by value managers. This is a coveted award, and marketing departments already are jockeying for Fund Manager of the Century and Fund Manager of the Millennium awards as consolation prizes. Their senses of duty are admirable.

As their value managers were having a great deal of trouble retaining their positions and assets under management during the previous decade, a reasonable inquiry might be whether their present status is a function of underlying market conditions.

The average annual return for the Russell 3000 value index (red line, left-hand chart) for this decade has been 2.64%. This is far greater than the Russell 3000

growth index' average annual return of -4.24% (blue line), but less than the average annual return for the Merrill Lynch index of three-month Treasury bills (green line). As the daily returns of the value and growth indices are identical at only 51.48% confidence, we should expect superior fund management from value managers over this sample period.

The same applies to risk-adjusted returns. The one-year rolling Sharpe ratios for the growth and value indices (blue and red lines, respectively, right-hand chart) indicate long periods of dominance by the value indices. This has changed recently; the one-year rolling Sharpe ratio for the growth index has been higher continuously since August 31, 2009...and continuously positive since October 2, 2009.



Conclusion

Reversion to the mean is a powerful force in investment performance. Who at the Y2K moment was willing to predict three-month Treasury bills would outperform U.S. stocks over the ensuing decade? Nine years, actually: The total return for the three-month Treasury bills this year has been 0.196%.

This decade's value managers, the *Morningstar* nominees included, should take their bows and skip the touchdown dance. The same applies to fixed-

income managers who have outperformed their equity brethren; the tyranny of fixed-income mathematics makes a similar decade of outperformance difficult to conceive starting from this level of interest rates.

No one gets paid simply for being aggressive or simply for assuming greater risk. That is a given. What is equally true is avoiding risk, avoiding diversification and chasing recent winners is not a strategy for long-term success.

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