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Fewer active managers beat market than at any time in decade

Fewer fund managers are beating the market this year than at any time in over a decade, piling further misery on a profession that faces increasing investor scepticism.

Fewer than one in five active managers outperformed the stock market in the year to the end of October, according to figures compiled by Bank of America.

Some of the most widely held shares have been weak this year, amid an equity market rally powered by less well-loved blue-chip companies, and managers appeared to compound their poor decisions during last month's volatility.

The largest active fund managers have been losing market share to low-cost index trackers and exchange traded funds (ETFs) after academic studies showed them perennially underperforming the stock market after fees.

"It has been an abysmal year," said Savita Subramanian, head of US equity and quantitative strategy at Bank of America.

"Large-cap mutual funds have a chronic bias towards smaller stocks, since it is hard to overweight the very largest stocks, but these stocks have actually outperformed by a pretty large margin this year. The smaller-cap bias has hurt quite a bit."

In addition, widely held technology and energy stocks had a dismal October, amid concerns about global growth, potentially extended stock valuations and a sliding oil price.

BofA data cover all US large-cap equity funds, including those tilted towards value stocks or growth companies, that are actively managed. Only 17.7 per cent are beating the Russell 1000 index of large-cap stocks so far this year. That compares with 40.5 per cent for 2013 as a whole.

Since the bank began calculating performance from 2003, there has only been one year – 2007 – when a majority of active managers beat the market.

ETFs attracted a record $199bn in the US alone in the first three quarters of 2014, taking the total amount in these index-tracking products to $2.6tn, according to ETFGI research.

Meanwhile, low-cost tracker mutual funds have also gathered assets. The Vanguard Total Stock Market Index fund surpassed the Pimco Total Return Bond fund last year to become the world's largest mutual fund, and now has $370bn in assets.

Active managers have tried to counter the rise of passive funds by arguing that, while the average manager may underperform, it remains possible to identify fund managers and fund management companies that can consistently beat the market.

"People shouldn't stand for benchmark returns because there are alternatives out there that are much better," said Tim Armour, chairman of the management committee at Capital Group, which runs the American Funds suite of actively managed mutual funds.

The average active fund now lags behind the Russell 1000, which is up 9.6 per cent this year, by 2 percentage points, according to BofA.

“We frequently hear the argument for strong market gains in the fourth quarter based on active managers ‘buying risk’ in an attempt to catch up,” said Ms Subramanian. “But there is no discernible historical trend of flagging performance of active funds preceding strong year-end gains.”