Active versus passive 2018
A comparison of the key fund segments

Far fewer fund managers succeeded in outperforming their benchmarks in 2018 than in the previous year, according to an analysis of 15 key equity and bond fund segments conducted by Scope.

Scope's evaluation is based on the outperformance ratio, which measures by peer group the share of actively-managed funds that beat their respective benchmark over the period under analysis. Scope allocated a benchmark to each peer group.

This analysis is based on more than 3,000 investment funds (UCITS) authorized for distributing in Germany.

Just under a quarter of active equity funds beat benchmarks in 2018

Of the nearly 2,000 equity funds in the study, just 24% outperformed the benchmark in 2018, down from 53% in 2017. In fact, all eight equity segments saw their ratios worsen from 2017 to 2018.

The peer group with the largest decline was 'Equity Germany', where the ratio slumped from 87% in 2017 to 25% in 2018. The 'Equity Japan' ratio also fell sharply, from 74% to 15%.

Among equity categories, 'Equity Japan' had the lowest ratio: only one in seven of the 124 active funds outperformed the MSCI Japan index in 2018. 'Equity Asia Pacific ex. Japan' achieved the highest ratio, with 37% of the 59 active funds beating the index.

To put it in context: Japan has one of the most efficient equity markets worldwide, which makes it difficult for active fund managers to outperform. By contrast, other Asian equity markets have much greater inefficiencies and information asymmetries, which creates more opportunities for out-performance.

The 'Equity World' segment, the biggest in the study with over 700 funds, also had to contend with a sharp fall in the ratio. In 2018 only around 22% beat the MSCI World index. The previous year's figure was 56%.

See Figure 1 for details on the outperformance ratio of the equity fund peer groups.

Only 16% of bond funds outperformed

A mere 16% of the roughly 1,000 bond funds analysed outperformed their benchmarks in 2018, down from half in 2017.

'Bond EURO Corp. High Yield' achieved the highest ratio in 2018, with 29% of its 76 funds beating the benchmark. It was also the only peer group in the study whose ratio improved from 2017.

The lowest figure was for 'Bond European Currencies': only 7% beat the benchmark, down from 30% in 2017.

See Figure 2 for details on bond fund peer groups.

Analysts

Lead Analyst:
Martin Fechtner, CFA
+49 69 6677389 53
m.fechtner@scopeanalysis.com

Matthias Hahn
+49 69 6677389 36
m.hahn@scopeanalysis.com

Head of Investment Analysis

Said Yakhloufi, CEFA
+49 69 6677389 32
s.yakhloufi@scopeanalysis.com

Media

André Fischer
+49 30 27891 147
a.fischer@scopegroup.com

Business Development

Christian Michel
+49 69 6677389 35
c.michel@scopegroup.com

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Scope Analysis GmbH

Lennéstraße 5
10785 Berlin

Tel. +49 30 27891 0
Fax +49 30 27891 100
Service +49 30 27891 300

info@scopeanalysis.com
www.scopeanalysis.com

Bloomberg: SCOP

Why outperformance ratios worsened during 2018

In 2017, managers were able to demonstrate the benefits of active funds, with most funds across multiple segments outperforming their respective indices (see: Active versus Passive 2017). This was not the case in 2018; in fact none of the 15 peer groups in the study achieved an outperformance ratio exceeding 50%. One reason: 2017 was an exceptional year for active funds – also relative to 2016 (see below). To an extent, therefore, 2018 represented a normalisation of the outperformance ratio (mean reversion).

There were also reasons specific to each segment. Global equity funds, for instance, were affected by the discrepancy between European and American equities, which was extreme by historical standards. However, many equity funds were overweight Europe and underweight the US during 2018, which had a negative impact on performance. Moreover, numerous fund managers in Europe and Germany had high weights in cyclical export firms and were therefore hit the hardest when the trade war escalated.

With equity funds investing in Germany many fund managers were overweight German small and mid-caps, which had a disproportionately strong correction relative to blue chips, especially in the second half of 2018.

For bond funds, the long-standing boom in emerging markets versus developed markets came to an end last year. Many fund managers were overweight emerging markets, partly lured in by the positive spreads, and were caught on the wrong foot as a result.

Additionally, strong exposure to Italian bonds contributed to the under-performance of many bond funds. Italian bonds came under severe pressure when a dispute over the budget arose between the new populist government and the European Commission.

Even funds that counted on a narrowing of the record-high gap between US and German government bond yields were left disappointed and saw losses.

Figure 1: Outperformance ratio of the eight main equity peer groups – sorted by 2018

Peer group	Benchmark index	Number of funds*	Outperformance ratio		
			2016	2017	2018
Equities Asia Pacific ex. Japan	MSCI AC Asia Pacific ex Japan Standard Core (net) (USD)	59	24.1%	49.1%	37.3%
Equities North America	MSCI USA Standard Core (net) Index (USD)	266	26.8%	33.7%	29.7%
Equities Germany	MSCI Germany Standard Core (net) (EUR)	57	15.1%	87.3%	24.6%
Equities Eurozone	MSCI EMU Standard Core (net) Index (EUR)	118	25.5%	49.2%	24.6%
Equities Emerging Markets	MSCI Emerging Markets Standard Core (net) (USD)	244	28.6%	42.4%	23.8%
Equities Europe	MSCI Europe Standard Core (net) Index (EUR)	379	22.9%	55.3%	22.4%
Equities World	MSCI World Standard Core (net) Index (USD)	729	16.4%	56.2%	21.9%
Equities Japan	MSCI Japan Standard Core (net) Index (LC)	124	50.0%	74.4%	14.5%

*refers to the number of actively managed funds in a peer group. Source: Scope Analysis, As of 31.12.2018.

Figure 2: Outperformance ratio of the seven main bond peer groups – sorted by 2018

Peer group	Benchmark index	Number of funds**	Outperformance ratio		
			2016	2017	2018
Bonds EURO Corp. High Yield	BofA Merrill Lynch Euro High Yield TR Index	76	22.6%	10.7%	28.9%
Bonds USD	Barclays Capital US Aggregate Index (USD)	97	34.9%	37.2%	23.7%
Bonds Emerging Markets HC	JPMorgan EMBI Global Diversified	83	48.2%	48.9%	19.3%
Bonds Global Currencies	Barclays Capital Global Aggregate Index (USD)	361	34.3%	61.4%	16.1%
Bonds EURO	Barclays Capital Euro Aggregate Index (EUR)	219	22.8%	34.5%	13.2%
Bonds EURO Corp. Inv. Grade	FTSE EuroBIG Corporate Bonds Index	150	44.7%	72.2%	8.0%
Bonds European Currencies	Barclays Capital Euro Aggregate Index	41	11.9%	30.0%	7.3%

*refers to the number of actively managed funds in a peer group. Source: Scope Analysis, As of 31.12.2018.

Background

Scope's fund ratings assess a fund's quality compared with its peer group. The rating reflects, among other things, long-term profitability and stability of fund performance, as well as timing risk and risk of loss. For more details refer to the methodology.

Scope currently evaluates more than 6,000 investment funds (UCITS) authorised for distribution in Germany. The invested assets of these funds amount to more than EUR 2.5trn.

Further analyses and all fund ratings can be found on our online portal: https://funds.scopeanalysis.com/portal

Rating scale – Investment funds (UCITS)	
A	Very good
B	Good
C	Average
D	Below Average
E	Weak

Scope Analysis GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Tel. +49 30 27891 0

Frankfurt am Main
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Tel. +49 69 66 77 389 0

info@scopeanalysis.com
www.scopeanalysis.com

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