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Indexing vs. Active Fund Management - What Makes The Most Sense?

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SMS believes that an effective long-term investment strategy should involve the use of both index-oriented funds (a low cost approach whereby a fund tracks a broad market benchmark) as well as actively managed funds (funds seeking to beat an established benchmark through active security selection) and, in some cases, individual securities.

Over long periods of time, the majority of actively managed funds do not outperform their respective indexes, as illustrated by the chart below. One explanation for this is that most actively-managed funds are more costly to operate due to higher research, analysis and trading fees, thereby reducing their returns.

Percentage of Actively Managed Funds Outperformed by Their Index Benchmarks: 1986-2001

	Value	Blend	Growth
Large Cap*	80%	74%	66%
Mid Cap*	56%	67%	62%
Small Cap*	79%	56%	29%

*The table is based on data from Morningstar and the following Russell indexes: Russell 1000 Index (and its value and growth subsets); Russell Midcap Index (and its value and growth subsets); and the Russell 2000 Index (and its value and growth subsets). Source: Straight Talk On Investing, Jack Brennan, 2002.

The data in this table actually understates the advantages of indexing because it doesn't include data from actively-managed funds that ceased operations due to poor performance during the 15-year period.

There are select fund managers, however, that have delivered superior long-term performance records, even when taking into account taxes and fees. Still, past performance is no guarantee of future performance and strict reliance on these managers to continue to outperform their benchmarks would not be prudent. Therefore, a portfolio comprised of both index funds and proven actively-managed funds and, in some cases, individual securities, is an effective strategy for those investors seeking enhanced long-term performance.

Through its extensive and continuous research of the literally thousands of index-oriented and actively managed funds, SMS identifies the best funds that meet the particular needs of its clients.