PRIVATE WEALTH MANAGEMENT

CIBC WOOD GUNDY
HUMMEL FINANCIAL GROUP

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THE SCIENCE BEHIND THE NUMBERS: HOW TO ACHIEVE CONSISTENT LONG-TERM PERFORMANCE

The core of our portfolios are built using a diversified mix of index based ETF's. This has been our approach to managing clients wealth since ETF's were in their infancy. As the popularity of our approach has gained traction, a narrative has arisen that index investing is boring, or the lazy way. It is far more entertaining to feel that we are privy to special information, and it is easy to be drawn to a good story. In reality however, statistical evidence suggests that actively managed strategies lack long-term performance persistence, whereas index investments perform better and generate further diversification benefits. This results in lower risk, lower volatility, and potentially higher returns, leading to a better long-term investment experience.

S&P Dow Jones Indices LLC is an international firm that produces and maintains stock market indices. (E.g. the S&P 500 and the Dow Jones Industrial Average.) The firm also tracks index and mutual fund performance, and publishes studies on actively managed under/over-performance relative to the indices.

1) The first study identifies funds that beat their benchmarks indices, based on three-year annualized returns net of fees.
2) The second study identifies the persistence in which these "winning" actively managed funds continue to beat their benchmark indices during the next three one-year-periods.

THE RESULTS…

Exhibit 1 depicts the results of these studies:

- Over a rolling quarterly three year period, **32.70%** of actively managed mutual funds beat their benchmark indices (700 of a total 2401 mutual fund universe in the United States).

- Of these 700 winning funds, only:
  - **39.81%** (229 funds) continued to outperform their benchmark the following year
  - **15.57%** (109 funds) continued to outperform their benchmark for the following two years
  - **5.26%** (37 funds) continued to outperform their benchmark for the following three years

- This data suggests that the persistence of fund performance is worse than what would be expected from luck. If the ability of managers to beat their benchmarks arose by chance, we would expect 12.50% of the winners to maintain their status for the next three years, not 5.26%.

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What this tells us is that the "winner group" changes over time. It is statistically unlikely to beat the benchmark index using mutual funds, and even more challenging to hold the lead. This is why almost all mutual funds underperform in the long run, and why ETF's that track the index provide the highest probability of long- term investment success.

Exhibit 1: Rolling Quarterly Outperformance Persistence over Three Consecutive Years

(March 31, 2003 to Sept 30, 2018)

Mutual Fund Category	Total Number of Funds	# of Funds Outperforming the Benchmark	% of Funds Outperforming the Benchmark	Percentage Outperforming the Benchmark (Period End)		
		Current Period		Year 1	Year 2	Year 3
All Domestic Funds	2401	700	32.70 %	39.81 %	15.57 %	5.26 %
Large-Cap Funds	845	198	26.47 %	33.13 %	11.72 %	3.64 %
Mid-Cap Funds	393	86	24.35 %	30.25 %	9.36 %	2.40 %
Small-Cap Funds	527	115	25.26 %	32.57 %	11.54 %	3.70 %
Multi-Cap Funds	670	177	30.69 %	28.42 %	10.25 %	3.27 %

Source: S&P Dow Jones Indices LLC and CRSP. Data as of Sept. 30, 2018. Past performance is no guarantee of future results. Table is provided for illustrative purposes.

CONCLUSION

We create a diversified mix of index ETF's that captures growth wherever it is in the market, while also being resilient to volatility in specific markets. Rather than basing investment decisions on predictions of which way markets are headed, a wiser strategy is to hold a range of investments that focus on systematic drivers of future returns.

We focus on creating an investment process for our clients that creates strong investment behaviors and prevents emotional biases from taking control. Regular review of family goals and liquidity needs, and the regular calls we make during good and bad markets. These actions are part of the process developed to summon the discipline needed in stressful times. Just as a great athlete navigates through the moments of pressure in any athletic event, consistent investment actions are part of the routine that allows the individual to navigate through a chaotic market.

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Sources:

1) S&P Dow Jones Indices LLC, a part of S&P global. (2019). Fleeting Alpha: The Challenge of Consistent Outperformance. Retrieved from S&P Dow Jones Indices (https://us.spindices.com/search/?query=fleeting+alpha%3A+the+challenge+of+consistent+outperformance&Search=Go&Search=Go)

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