

February 5, 2020

Benchmark(s): A Necessity, a Standard, or An Absolute?

Mutual Fund Directors Forum Webinar

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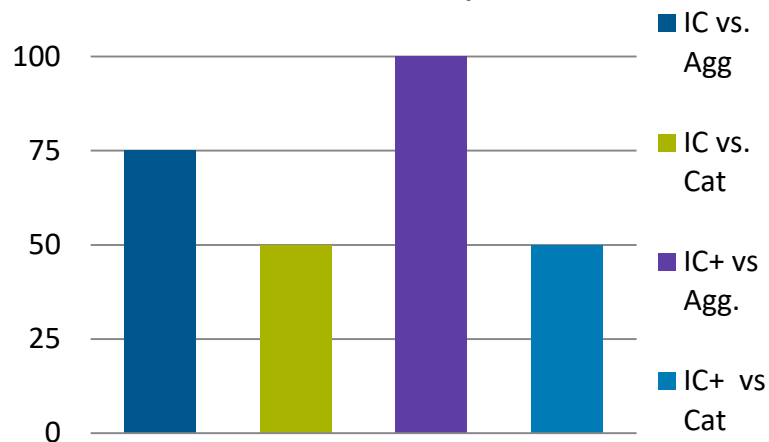
The Benchmark Trilemma

- Directors often ask “To evaluate performance, should we focus on the benchmark, the category, or the peer group?”
- The answers are:
 - Yes...
 - This one but...
 - This one and the other one...
 - None of the above...
- Why “beating the benchmark” is not self-evidently good: Three Examples
 - Bonds
 - Stocks
 - Alts

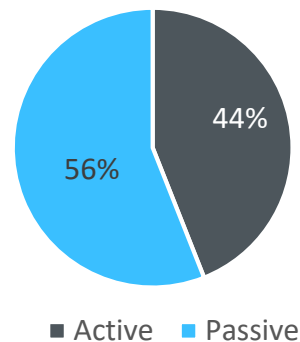
Core Bonds: Does Alpha Matter?

Core and Core+ [Gross Returns, 10 Year] versus BBgBarCap “Agg”

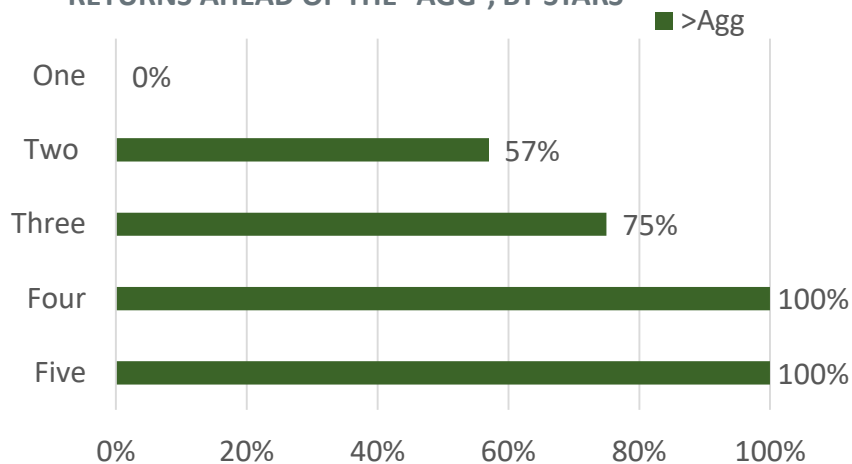
RETURNS AHEAD OF THE “AGG”... | CAT AVG.



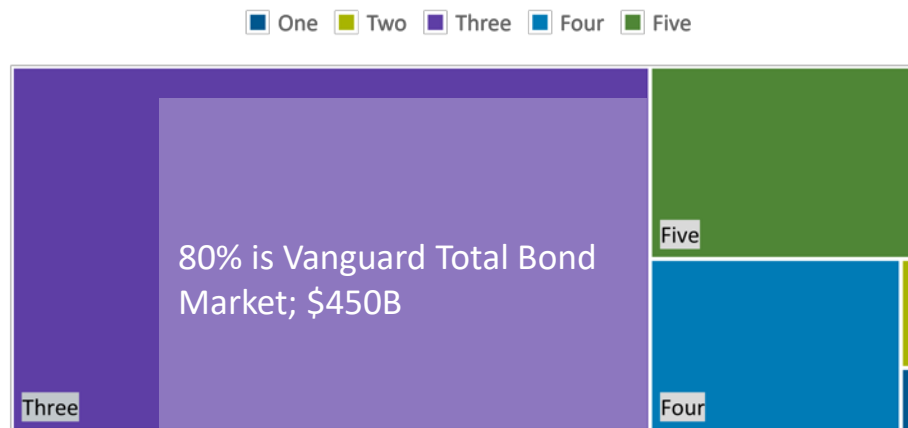
BUT PASSIVE DOMINATING



RETURNS AHEAD OF THE “AGG”, BY STARS



ASSETS BY STARS



Giants, Still?

Name	Fund Size Base Currency
Metropolitan West Total Return Bd	82,587,492,183
PIMCO Total Return	67,096,164,562
Dodge & Cox Income	63,545,561,555
DoubleLine Total Return Bond	56,235,164,319
PGIM Total Return Bond	54,842,123,759
American Funds Bond Fund of Amer	52,013,261,748
[Fidelity] Strategic Advisers® Core Income	42,984,247,835
Fidelity® Series Investment Grade Bond	34,866,771,187
JPMorgan Core Bond	32,906,060,275
Western Asset Core Plus Bond	32,059,569,158
Fidelity® Total Bond Fund	26,621,557,205
T. Rowe Price New Income	25,420,343,931
Baird Core Plus Bond	25,215,280,313
Baird Aggregate Bond	23,633,838,498
[Fidelity] Strategic Advisers® Fidelity® Core Inc	22,555,676,732
Bridge Builder Core Plus Bond	19,554,039,700
BlackRock Total Return	16,707,103,731
Bridge Builder Core Bond	16,078,642,756
JPMorgan Core Plus Bond	15,094,810,838
Western Asset Core Bond	14,609,826,735
Fidelity SAI Total Bond	14,520,940,936
DoubleLine Core Fixed Income	12,965,582,456
DFA Investment Grade	10,284,280,384

Core and Core+ ETFs with >\$1B in Assets (96% of market)

MAINLY PASSIVE

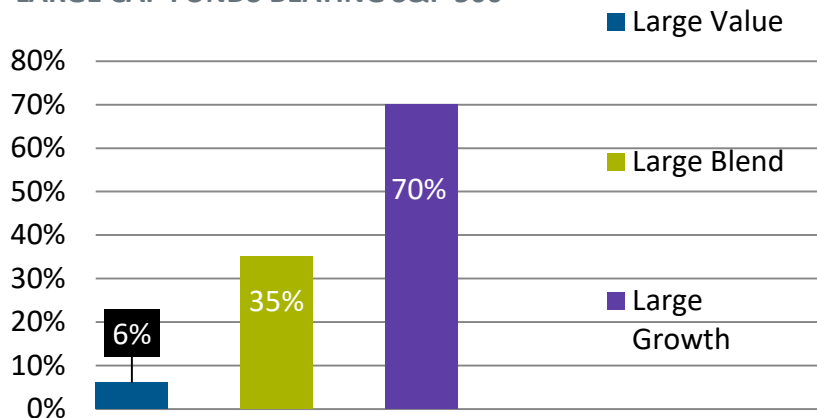
- iShares Core US Aggregate Bond ETF
- Vanguard Total Bond Market Index Fund
- Vanguard Intermediate-Term Bond Index Fd
- Schwab US Aggregate Bond ETF™
- SPDR® Portfolio Aggregate Bond ETF
- iShares Core Total USD Bond Market ETF
- SPDR® DoubleLine Total Return Tact ETF
- PIMCO Active Bond ETF
- iShares Intermediate Govt/Crdt Bd ETF
- First Trust TCWOppportunistic Fxd Inc ETF
- WisdomTree Yield Enhanced US Aggt Bd Fd



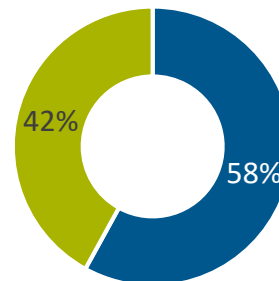
Domestic Equity: Factors Dominate “The Market”

Large Value, Blend and Growth Returns [Gross; 10 Years] vs Indexes

LARGE CAP FUNDS BEATING S&P 500

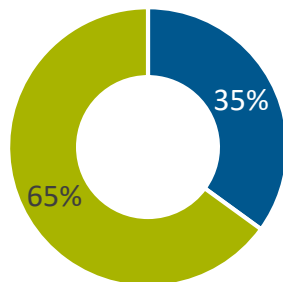


LARGE VALUE



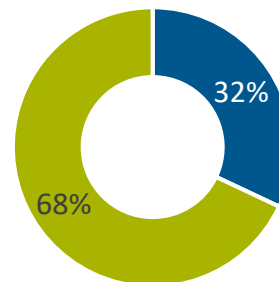
■ > Russell 1000 Value ■ < Russell 1000 Value

LARGE BLEND



■ > S&P 500 ■ < S&P 500

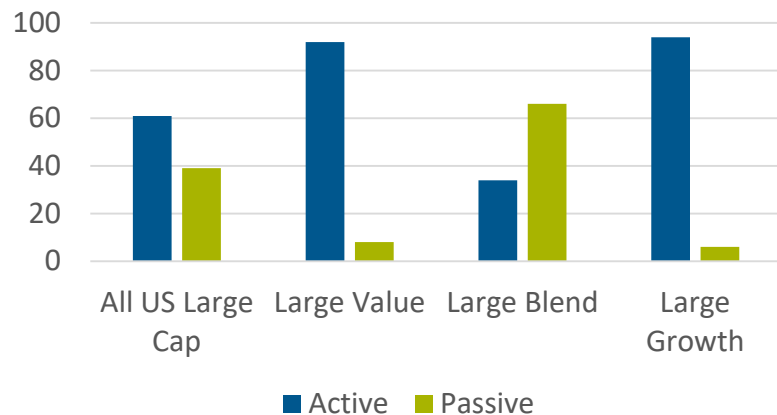
LARGE GROWTH



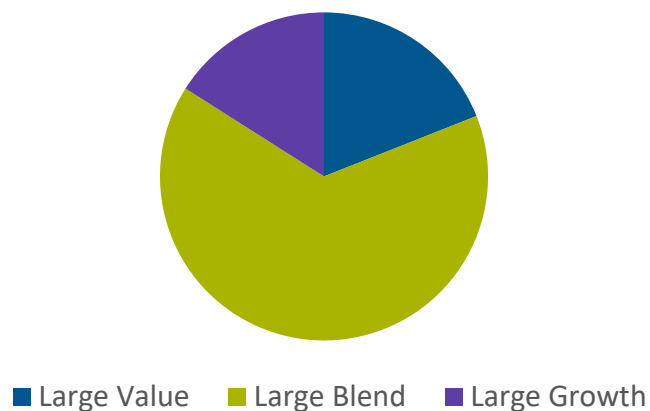
■ > Russell 1000 Growth ■ < Russell 1000 Growth

What about ETFs and allocators?

ASSETS: DOMESTIC LARGE CAP, OPEN END



ETF SHARE (>99% PASSIVE)



Typical 60/40 Allocation

Bonds	40%				
Equity	60%				
US Equity	36%	Blend		Value	Growth
Large Cap	24%	24%	or	12%	12%
SMID	12%				
Non-US Equity	24%				

Fund

Current assets

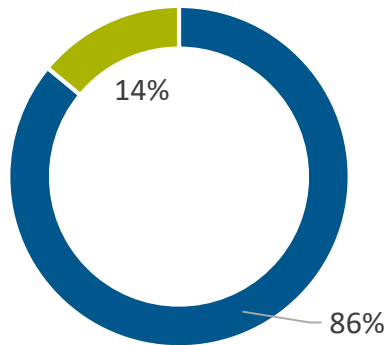
SPDR® S&P 500 ETF Trust	307,394,595,332
iShares Core S&P 500 ETF	201,408,690,621
Vanguard Total Stock Market Index Fund	138,114,075,640
iShares Russell 1000 ETF	22,357,545,992
Schwab US Large-Cap ETF™	19,803,632,668
Vanguard Large Cap Index Fund	16,266,674,289
SPDR® Portfolio Large Cap ETF	3,487,109,630

>50% of all ETF Large Cap Value, Blend, and Growth fund assets are in these 8 market tracking 'core' or blend funds.

Alternatives: Is the Benchmark a Goal?

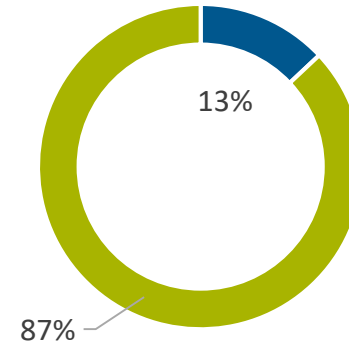
Multialternative Funds versus Benchmarks Plus... [Gross; 5 Years]

BEATING CASH...



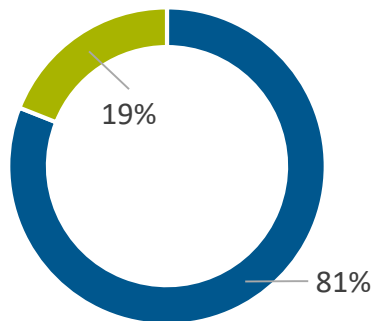
■ > ICE Bof A 3M Tr Bd ■ < ICE Bof A 3M Tr Bd

BUT NOT SHARPE



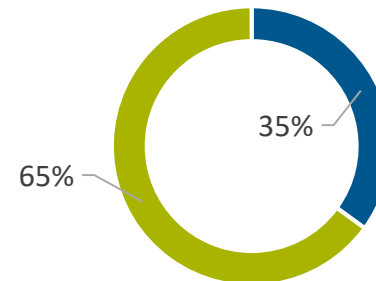
■ Sharpe Ratio > 1 ■ Sharpe Ratio < 1

HIGH CORRELATION...



■ Corr. To Mstar Mod Risk > 33%
■ Corr. To Mstar Mod Risk < 33%

...AND HIGH AVERAGE DRAWDOWN



■ Avg. Drawdown < 3% ■ Avg. Drawdown > 3%

Potential Solutions

- In cases where all or most managers beat “the market”, and more and more investors are satisfied with an index set and index + benchmark; focus on the category/classification median
- In cases where a single factor is decisive in terms of whether a fund beats the market, use a benchmark that reflects that factor
- In cases where beating the benchmark is index is assumed, use non-index criteria to assess performance, e.g., Sharpe ratio, non-correlation, drawdown, downside volatility, etc.

Things to consider:

- Specifying risk budget (e.g., tracking error) / expected returns (alpha) necessary to outperform
- Accounting for costs [new Morningstar analyst rating methodology]: is strategy capable of overcoming expense ratio to beat benchmark?
- Using peers to establish “degree of difficulty” for beating a given benchmark

Which is more/most important?

AUDIENCE	BENCHMARK	CATEGORY / CLASSIFICATION	PEER GROUP	PRIMARY CONCERN
Investor				Returns
Intermediary				Ratings
Distributor				Cost
Gatekeeper				Performance consistency
Regulator				Active share
Asset Allocator				Style correlation
Product Manager				Market concerns
Portfolio manager				Compensation
Board Members				Oversight



Uses of a benchmark

- Goal- to be surpassed
- Constraint– limiting bets
- Target– esp. for index+

- Timing
 - Market cycle?
 - Rolling periods?
 - 1/3/5/10
- Portfolio efficiency
- Risk-adjusted?



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