Dimensional

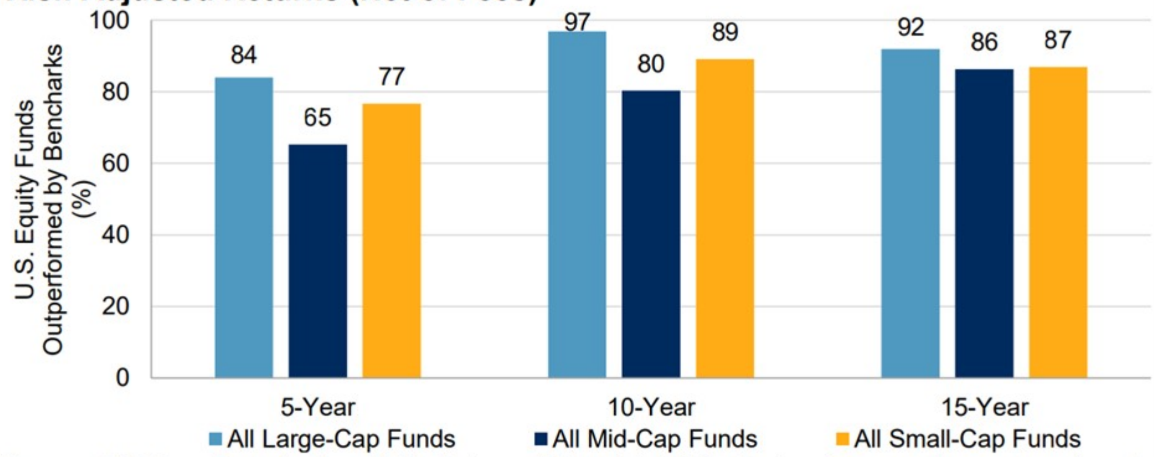
CLIENT QUESTION OF THE MONTH: Do you see any sectors or companies that might be well positioned to outperform the market going forward?

- The past 12 months have taught us many lessons and reinforced a few timeless principles, one of which is the difficulty of making accurate forecasts. The headlines below should serve as a reminder of the importance of following an investment approach based on discipline and diversification rather than prediction and timing:
  - *“Dow Closes at Record as Worries Abate”*
  - *“Oil Prices Collapse After Saudi Pledge to Boost Output”*
  - *“Coronavirus Declared Pandemic by World Health Organization”*
  - *“Dow Soars More Than 11% In Biggest One-Day Jump Since 1933”*
  - *“Record Rise in Unemployment Claims Halts Historic Run of Job Growth”*
  - *“US Stocks Turn in Worst Quarter Since 2008”*
  - *“US Stocks Close Out Best Quarter Since 1998”*
  - *“US Debt Hits Postwar Record”*
- The global financial markets process millions of trades worth hundreds of billions of dollars each day. These trades reflect the viewpoints of buyers and sellers who are voluntarily transacting at current prices and putting their capital to work. Using these trades as inputs, the market functions as a powerful information-processing mechanism, aggregating vast amounts of information into prices and driving them toward fair value. Investors who attempt to outguess prices are pitting their knowledge against the collective wisdom of all market participants.
- If markets were not effectively incorporating information into securities prices, then opportunities would arise for professional managers to identify stocks/sectors that are “mispriced” and take advantage of those dislocations before being “corrected”. However, the prediction game may be a losing one for many investors, and each year there are published reports that highlight the difficulties conventional managers face.
- Dimensional’s 2020 Mutual Fund Landscape report evaluated 4,279 US-based mutual funds, which account for more than $10.9 trillion, to assess the performance of managers relative to benchmarks.[1] Across thousands of funds covering a broad range of manager philosophies, objectives, and styles, a majority of the funds evaluated did not outperform benchmarks after costs**.** According to the report, **for the 20-year period through 2020, 19% of equity funds and 11% of fixed income funds survived and outperformed their benchmarks.**
- While there are a select number of fund managers that outperform, sometimes good track records happen by chance, and outperformance fails to repeat. Dimensional’s report shows that among funds ranked in the top quartile based on previous five-year returns, on average, a dismal 21% of equity funds also ranked in the top quartile of returns over the following five-year period. **This lack of persistence casts further doubt on the ability of managers to consistently gain an informational advantage on the market.**
- Claims have been made that active managers provide better risk-adjusted returns; however, this has also been refuted. The S&P Indices Versus Active (SPIVA) scorecard recently published a risk-adjusted report and found that after adjusting for risk, the majority of actively managed domestic funds in all categories underperformed their benchmarks on a net-of-fees basis over mid-and long-term investment horizons.[2] The results are shown in Exhibit 1 below.
- Stock pickers may also postulate that during times of heightened volatility they have an edge. Chicago Booth’s Lubos Pastor and Booth PhD candidate M. Blair Vorsatz analyzed returns from

3,626 equity funds between February 20th – April 30th, 2020 and found that net of fees, a large majority of actively managed funds lagged behind their respective benchmark indexes.[3] Meaning, right when investors would lean on active managers to protect downside risk, they were nowhere to be found.

- The results of these studies suggest that investors are best served by relying on market prices. Investment approaches based on a manager's efforts to outguess market prices have resulted in underperformance for the vast majority of mutual funds. At Dimensional, our commitment to one investment philosophy, our robustness in portfolio design, and our efficiency in portfolio management and trading has enabled us to deliver an outstanding investment experience.

Exhibit 1: Percentage of U.S. Equity Funds Outperformed by Benchmarks – Risk-Adjusted Returns (Net of Fees)



Source: S&P Dow Jones Indices LLC. Data as of Dec. 31, 2019. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

[1] In the study results, "benchmark" refers to the primary prospectus benchmark used to evaluate the performance of each respective mutual fund in the sample where available.
[2] https://www.indexologyblog.com/2020/05/19/risk-adjusted-spiva-year-end-2019-scorecard-most-active-managers-still-lagged/
[3] https://review.chicagobooth.edu/finance/2020/article/mutual-fund-managers-didn-t-shine-during-covid-19-crisis?source=ic-em-2020505&mkt_tok=eyJpIjoiWWprMlpURmxOR0U1TmpndyIsInQiOiJBMWdWOW42TXRIZ0dGNG5rRDlQeWI3a28xQ29pbFFCXC9JNFpEQmFQRVZnanhicERKejVLRm5cLzlEczFGSE9UYWw2ZFRES1hOdmVNZm9nbUlPMkt4YWhuZTU0ekZlYSt0MkY5d1pXUngyUUtBMVpneW5wU3dhUzB2NHR5bDc2elVRIn0%3D