



## June 2008 – Good Money Managers Can Help Offset Uneven Returns

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In theory, stocks consistently perform the best over the long term. In practice, no one has a long enough time frame. Even 10-year returns are scattered all around the mean. This means you have to find money managers with talent and skill who can minimize the effects of uneven performance.

When asked about the long-term return on equities, most reasonably well-informed advisors cite the double-digit returns achieved over decades—frankly, generations—of market experience. Such long-term performance records have explored periods dating back to the 19th century. Dating back to the 1920s, the most recognized researcher of domestic equity performance has been Ibbotson Associates.

These references to history are often cited despite the fact that all of today's advisors have no firsthand professional experience over such time frames. In addition, they likely do not even have clients with such long investment horizons. As an early baby boomer, I have nearly 30 years of experience in the industry, but that takes me back no further than the early 1980s, when the Dow hovered around 800.

The moral is that while really long-term track records result in consistent-looking mean returns, even 10-year periods can have significant variance from the results achieved over a greater number of 10-year holding periods stretching out over generations. From the client perspective, the only 10-year periods that matter are the ones that impact their future consumption needs at retirement.

### **The vagaries of the market**

As the chart below demonstrates, there has been significant dispersion in decade-long results in large-, mid-, and small-cap domestic capitalizations over the last generation alone. Not all investors enjoyed the same results at the moment they most needed historic high returns, while others benefited from timing and luck.



Figure 1: 10-Year Rolling Returns



Source: CMC EResearch

So while we are in a very strong sense bound by the directional flow of results when long-only investing in equities, it is important not to entirely discount the impact that superior investment results can have when fashioned by professional investors with talent and skill. This excess return—or more often consistency of returns—can soften to an extent the impact of poor-returning time periods and escalate the compounding of capital over time.

Identifying skilled managers is not purely quantifiable and is not merely limited to a positive relative historic track record. Rather, it is a complex value judgment that factors in performance but also considers the native talent of the managers, the quality of their decision-making processes, and the soundness of their business going forward.

Of course, past performance is certainly no guarantee of future results. Even those with established skill in managing money will have short periods when they are unlucky or just not quite up to par. But a good money manager can make a difference—particularly when your client's time frame is less than 100 years.



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