



Benchmark Battles

Response to:

Loeper and Apt Letters

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The following is in response to two Letters to the Editor which appeared last week: Dave Loeper's article "[Howard is Right. The World is Flat](#)" and Adam Apt's article "[Luck versus Skill and the Analogy to Astronomy](#)."

I am happy to read that Dave Loeper agrees with many of my points in the "[New Ptolemians](#)" article. As he states, "the notion that all of this slicing and dicing of the markets into style and market cap boxes is not really creating new asset classes and is just manufacturing non-diversified pieces of markets and thus it is worthy of skepticism." He goes on to agree with me that a market benchmark is the correct one to use when assessing average performance across all equity mutual funds. He however challenges my use of the S&P 500 for this purpose. This seems a reasonable question and I appreciate his challenge.

Loeper argues that the Russell 3000 is a better measure of the market since it represents 98% of market capitalization as compared to 75% for the S&P 500. So I estimated 1984 (the year that the Russell 3000 was launched) through 2007 average fund alphas using the Russell 3000 as the market benchmark. First, since small-cap stocks underperformed large stocks, the Russell 3000 underperformed the S&P 500 over this time period by roughly 40bp annually. So it turns out that the S&P 500 was a more difficult benchmark to beat than was the Russell 3000. Second, the correlation between the two indices is 0.99 and the time trend of Russell 3000 alphas is positive but shallower than is the time trend for S&P 500 alphas. So my conclusion is the same: average fund alphas are increasing over time.

Adam Jared Apt points out that my Ptolemy-Copernicus analogy is not completely accurate. I recently read Copernicus' *On Revolutions* and other scientific works of the time and Apt has painted a correct picture of the 16th century scientific debate. Taking poetic license, I gave readers a context for



understanding the current problems that surround performance benchmarking. I suggest Apt let the analogy wash over him and not get caught up in the details.

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