# The Case for Active Management: A Look Beyond the Headlines

Christopher Davis

## Active May Be Poised to Outperform

A Google search for "the death of active management" produces 1.8 million results. With more than $1 trillion flowing into passive funds and ETFs and $1.1 trillion removed from active managers over the last decade, the tide of investors shifting from active to passive investment strategies has become a tsunami.[1] This wave has been driven by the widespread acceptance of data showing the S&P 500 Index has outperformed the average active manager over the long term. While the data itself is true, the results are misleading in three important ways.

First, active and passive strategies have historically moved in a cycle. During parts of this cycle such as in the last decade or so, passive strategies have tended to outperform active management. However, during other parts of the cycle, even average active managers outperform the index. For example, the chart below tracks the percentage of large cap active managers that outperformed the S&P 500 Index over five-year time periods since 1975. The gold circles represent inflection points where the number of active managers outperforming the market began to increase. If the cycle were to continue, this may point to potential wisdom of moving toward active management.

### Active vs. Passive Has Been Cyclical[2]

Percentage of Large Cap Funds that Outperform S&P 500 Index

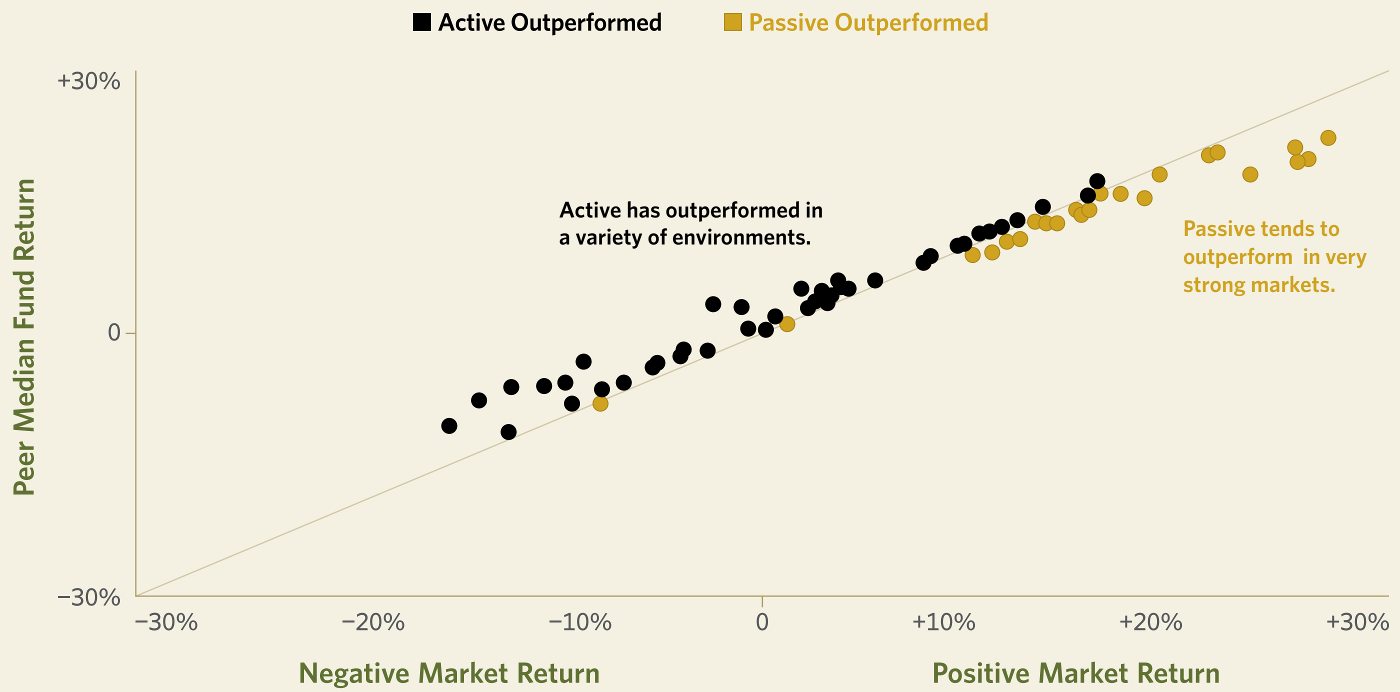

**1.** Source: Morningstar. U.S. domestic equity funds including open end index funds and ETFs. Date range: 1/1/07–12/31/17. **2.** Source: Morningstar Direct. Universe: Large Value, Large Blend and Large Growth. There is no guarantee that the number of active managers outperforming the market will continue to increase or that active and passive managers will continue to move in cycles.

## Active and Passive Outperform in Different Environments

While active managers have historically tended to underperform when the S&P 500 Index has galloped ahead, they have tended to outperform when market returns moderate. In the chart below, each black dot represents a period in which the average manager outperformed the index, while each yellow dot represents a period in which the index outperformed.

As is clearly shown, the lower the market return, the more active managers outperform. While the direction of the market is unknowable in the short term, the fact the index has more than doubled in the last five years and the market has gone more than seven years without a 20% correction versus an historical average of two-and-a-half years leads us to expect more moderate returns in the years ahead. Active management could be poised for a period of relatively strong results compared to the index.

### Active and Passive Outperform in Different Environments[3]




**3.** Sources: AMG Funds, Morningstar. Chart plots median actively managed large-cap funds, with manager tenure of greater than 10 years (longest-tenured portfolio manager), annualized three-year rolling returns (with a quarterly frequency) over the 20-year period ending March 31, 2016 against the S&P 500 Index returns. Black plot points indicate periods of outperformance and yellow plot points represent underperformance. The distance of the points from the diagonal line indicates the degree of over- or underperformance. The fund category used is the Morningstar large-cap fund universe, including growth, value and blend categories. Performance is net of fees. **Past performance is not a guarantee of future results.**

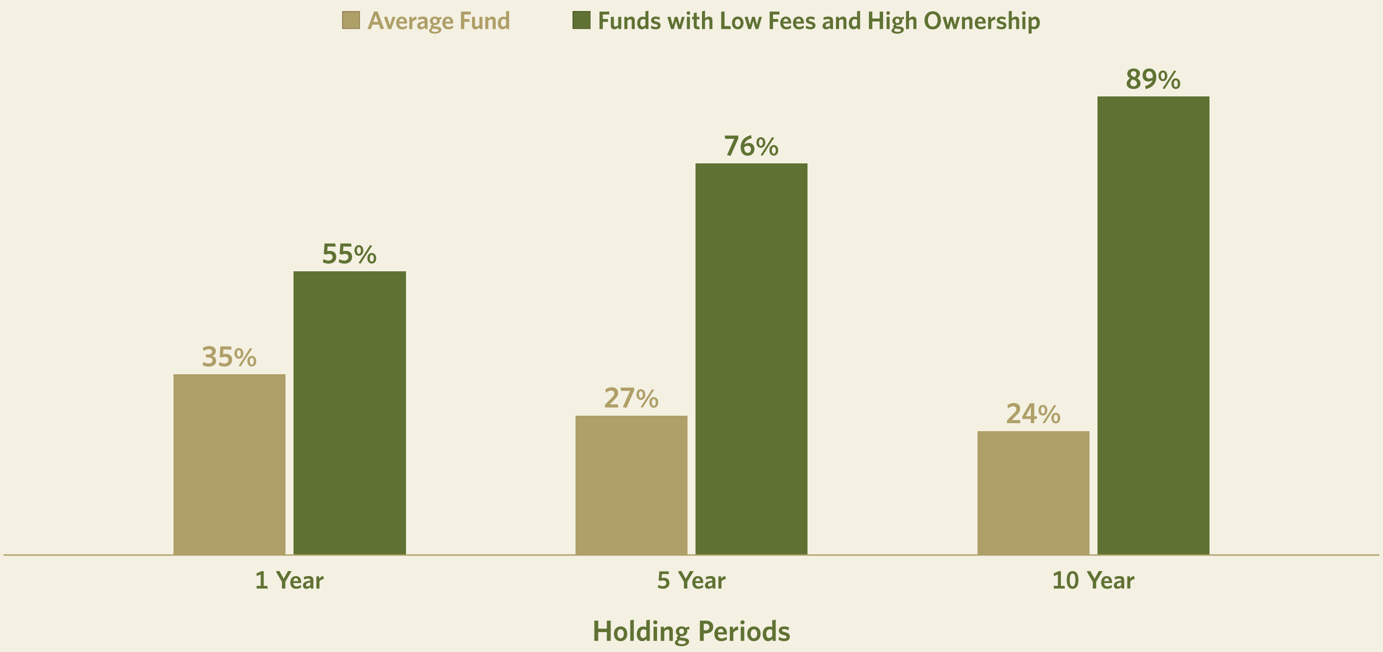
## Funds with Low Fees and High Ownership Outperform the Index

Finally, certain active funds including Selected American Shares have outperformed in the vast majority of rolling 10 year periods. As a result, while the data shows the *average* active manager has underperformed, investors need not choose an average manager. In fact, data suggests active managers with certain identifiable characteristics such as low fees, low turnover, proper incentives, an experienced team, and a differentiated portfolio have historically been more likely to outperform both the index and the average active manager. For example, the chart below shows managers with low fees and a high investment in their own funds have outperformed in 89% of all rolling 10 year periods.

Putting these thoughts together, we believe the head-winds active managers have faced in recent years could well become tailwinds in the years ahead. If so, this would not be the first time the herd mentality proved wrong. After all, not so long ago everyone was buying residential real estate based on the then true but ultimately misleading fact single family real estate prices had never declined nationwide.

### Funds with Low Fees and High Ownership Outperform the Index[4]

Percentage of Time Outperformed the S&P 500 Index




**4.** Source: Capital Group, based on Morningstar data. Based on monthly rolling periods from January 1997 to December 2016. Funds in the "Average Fund" group are those U.S. domestic equity funds in the Morningstar Large Value, Large Blend and Large Growth categories. "Funds with Low Fees and High Ownership" group are those U.S. domestic equity funds in the Morningstar Large Value, Large Blend and Large Growth categories filtered for the quartile with the lowest net expense ratios (NER) and the quartile with the highest manager ownership. U.S. index is S&P 500 Index. The index is unmanaged and, therefore, has no expenses. Investors cannot invest directly in an index. For live funds, only the oldest share class was used. For dead funds with multiple share classes, the median monthly returns were used. **Past performance is not a guarantee of future results.**

## Selected Funds

We are further encouraged by data indicating identifiable factors such as relatively low expenses, alignment of interest and a willingness to look different from other investment managers, all of which are central to our firm's investment culture, have historically been durable hallmarks of long-term outperformance.

In investing, as in any other profession, skill matters. Since we assumed management of Selected American Shares in 1993, we have demonstrated the value of that skill by building wealth for our shareholders and generating results that exceeded the market averages. With the vast majority of our net worth invested alongside our shareholders, we have every incentive and intention to build on this record in the years and decades ahead.

*This report is authorized for use by existing shareholders. A current Selected American Shares prospectus must accompany or precede this material if it is distributed to prospective shareholders. You should carefully consider the Fund's investment objective, risks, fees, and expenses before investing. Read the prospectus carefully before you invest or send money.*

**Objective and Risks.** Selected American Shares' investment objective is capital growth and income. In the current market environment, we expect that income will be low. There can be no assurance that the Fund will achieve its objective. Selected American Shares invests primarily in equity securities issued by large companies with market capitalizations of at least $10 billion. Some important risks of an investment in the Fund are: **common stock risk:** an adverse event may have a negative impact on a company and could result in a decline in the price of its common stock; **depositary receipts risk:** depositary receipts may trade at a discount (or premium) to the underlying security and may be less liquid than the underlying securities listed on an exchange; **emerging market risk:** securities of issuers in emerging and developing markets may present risks not found in more mature markets; **fees and expenses risk:** the Fund may not earn enough through income and capital appreciation to offset the operating expenses of the Fund; **financial services risk:** investing a significant portion of assets in the financial services sector may cause the Fund to be more sensitive to systemic risk, regulatory actions, changes in interest rates, non-diversified loan portfolios, credit, and competition; **foreign country risk:** foreign companies may be subject to greater risk as foreign economies may not be as strong or diversified. As of December 31, 2017, the Fund had approximately 18.5% of assets invested in foreign companies; **foreign currency risk:** the change in value of a foreign currency against the U.S. dollar will result in a change in the U.S. dollar value of securities denominated in that foreign currency; **headline risk:** the Fund may invest in a company when the company becomes the center of controversy. The company's stock may never recover or may become worthless; l**arge-capitalization companies risk:** companies with $10 billion or more in market capitalization generally experience slower rates of growth in earnings per share than do mid- and small-capitalization companies; **manager risk:** poor security selection may cause the Fund to underperform relevant benchmarks; **mid- and small-capitalization companies risk:** companies with less than $10 billion in market capitalization typically have more limited product lines, markets and financial resources than larger companies, and may trade less frequently and in more limited volume; and **stock market risk:** stock markets have periods of rising prices and periods of falling prices, including sharp declines. See the prospectus for a complete description of the principal risks.

Davis Selected Advisers, L.P., began managing Selected American Shares on May 1, 1993. Prior to that date, the Fund was managed by a different investment advisor.

We gather our index data from a combination of reputable sources, including, but not limited to, Thomson Financial, Lipper and index websites.

The S&P 500 Index is an unmanaged index of 500 selected common stocks, most of which are listed on the New York Stock Exchange. The Index is adjusted for dividends, weighted towards stocks with large market capitalizations and represents approximately two-thirds of the total market value of all domestic common stocks. Investments cannot be made directly in an index.

**Shares of the Selected Funds are not deposits or obligations of any bank, are not guaranteed by any bank, are not insured by the FDIC or any other agency, and involve investment risks, including possible loss of the principal amount invested.**

**Davis Distributors, LLC**
**2949 East Elvira Road, Suite 101, Tucson, AZ 85756**
**800-243-1575, selectedfunds.com**

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