

Financial Analysts Journal >

Volume 69, 2013 - [Issue 4](#)

2,088 Views | 207 CrossRef citations to date | 64 Altmetric

Equity Investments


# Active Share and Mutual Fund Performance

Antti Petajisto

Pages 73-93 | Published online: 28 Dec 2018

 Cite this article  <https://doi.org/10.2469/faj.v69.n4.7>

Sample our  
Law  
Journals  
>> [Sign in here](#) to start your access  
to the latest two volumes for 14 days



 References  Supplemental  Citations  Metrics  Reprints & Permissions

[Read this article](#)

[Share](#)

## Abstract

Using Active Share and tracking error, the author sorted all-equity mutual funds into various categories of active management. The most active stock pickers outperformed their benchmark indices even after fees, whereas closet indexers underperformed. These patterns held during the 2008-09 financial crisis and within market-cap styles. Closet indexing has increased in both volatile and bear markets since 2007. Cross-sectional dispersion in stock returns positively predicts performance by stock pickers.

Should a mutual fund investor pay for active fund management? Generally, the answer is no. A number of studies have all concluded that the average actively managed fund loses to a low-cost index fund, net of all fees and expenses. However, active managers are not all equal: They differ in how active they are and what type of active management they practice. These distinctions allow us to distinguish different types of active managers, which turns out to matter a great deal for investment performance.

I divided active managers into several categories on the basis of both Active Share, which measures mostly stock selection, and tracking error, which measures mostly exposure to systematic risk. Active stock pickers take large but diversified positions away from the index. Funds that focus on factor bets generate large volatility with respect to the index even with relatively small active positions. Concentrated funds combine very active stock selection with exposure to systematic risk. Closet indexers do not engage much in any type of active management. A large number of funds in the middle are moderately active without a clearly distinctive style.

Focusing on closet indexing, I started by looking at examples of different types of funds and then examined two famous funds in detail. I also investigated general trends in closet indexing over time and the reasons behind them. I then turned to fund performance, testing the performance of each category of funds through December 2009. I separately explored fund performance in the financial crisis of January 2008–December 2009 to see whether historical patterns held up during this highly unusual period. Finally, I tried to identify when market conditions are generally most favorable to active stock pickers.

I found that closet indexing has been increasing in popularity since 2007, currently accounting for about one-third of all mutual fund assets. Over time, the average level of active management is low when volatility is high, particularly in the cross-section of stocks, and also when recent market returns have been low, which also explains the previous peak in closet indexing in 1999–2002.

The average actively managed fund has had weak performance, losing to its benchmark by  $-0.41\%$ . The performance of closet indexers is predictably poor. They largely just match their benchmark index returns before fees, and so after fees, they lag behind their benchmarks by approximately the amount of their fees. Funds that focus on factor bets have also lost money for their investors. However, one group has added value for investors: the most active stock pickers, who have beaten their benchmarks by  $1.26\%$  a year after fees and expenses. Before fees, their stock picks have even beaten the benchmarks by  $2.61\%$ , displaying a nontrivial amount of skill. High Active Share is most strongly related to future returns among small-cap funds, but its predictive power within large-cap funds is also both economically and statistically significant.

The financial crisis hit active funds severely in 2008, leading to broad underperformance in 2008 and a strong recovery in 2009. The general patterns were similar to historical averages. The active stock pickers beat their indices over the crisis period by about 1%, whereas the closet indexers continued to underperform.

Cross-sectional dispersion in stock returns positively predicts benchmark-adjusted returns on the most active stock pickers, suggesting that stock-level dispersion can be used to identify market conditions favorable to stock pickers. Other related measures, such as the average correlation with the market index, do not predict returns equally well.

Author's Note: This article was written when the author was a finance professor at the NYU Stern School of Business.

## Related research

People also read

Recommended articles

Cited by  
207

[Active Share and the Three Pillars of Active Management: Skill, Conviction, and Opportunity >](#)

Martijn Cremers

Financial Analysts Journal

Published online: 26 Dec 2018

[Deactivating Active Share >](#)

Andrea Frazzini et al.

Financial Analysts Journal

Published online: 27 Dec 2018

[Challenging the Conventional Wisdom on Active Management: A Review of the Past 20 Years of Academic Literature on Actively Managed Mutual Funds >](#)

K.J. Martijn Cremers et al.

Financial Analysts Journal

Published online: 18 Jul 2019

## Information for

- Authors
- R&D professionals
- Editors
- Librarians
- Societies

## Opportunities

- Reprints and e-prints
- Advertising solutions
- Accelerated publication
- Corporate access solutions

## Open access

- Overview
- Open journals
- Open Select
- Dove Medical Press
- F1000Research

## Help and information

- Help and contact
- Newsroom
- All journals
- Books

## Keep up to date

Register to receive personalised research and resources by email

 Sign me up



Copyright © 2026 Informa UK Limited [Privacy policy](#)

[Cookies](#) [Terms & conditions](#) [Accessibility](#)

Registered in England & Wales No. 01072954  
5 Howick Place | London | SW1P 1WG