Harpswell
CAPITAL ADVISORS, LLC

Active Equity Managers Performance vs. Index Funds

Overview

Over the years, there has been much discussion regarding the value added by Active Equity Managers compared to simply investing in index or passive funds[1].

At Harpswell, we believe that there is a role for both active and passive management when building investment portfolios. However, the challenge for any investment advisor is determining when and where each can add the most value in crafting a portfolio.

To provide some insight into our evaluation process and how we developed our investment approach, we prepared a historical review where Active Equity Managers' results were compared to a relevant index. We looked at returns over the past 10 years but also included a risk measure, Standard Deviation, which is an important consideration when identifying suitable managers. Active managers are more concentrated than index funds and will over/under weight sectors and individual securities to add value. This results in added layers of risk associated with sector and security selection. Index funds, by contrast, only have the Systematic Risk of the market or underlying segment that they represent.

Since Harpswell utilizes mutual funds for our clients, we used Morningstar data in our review. Morningstar publishes manager universes by asset class representing peer groups of investment managers with a similar investment philosophy. We recognize that there are some shortcomings with the compositions of the universes, but the large number of constituents should provide suitable results.

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[1] Active Equity Managers evaluate individual securities based on qualitative and quantitative research. They try to identify those companies that have the highest probability for adding value to a portfolio in both absolute terms and on a relative basis when compared to a relevant benchmark.
Passive Funds are designed to closely track or mirror the returns and risk of a specific benchmark or index. These funds can hold all the securities associated with an index, which is often the case for the S&P 500 Index funds, or use statistical sampling to track the index's characteristics while holding only a portion of the securities.

The review covered four asset classes: Domestic Large Core; Domestic Small Cap Core; Developed International; and Emerging Markets. Each asset class is represented by a familiar index. Although mutual fund results are net of fees, we did not adjust the indices' results for fees since the amounts are nominal.

Results

The results of the review are summarized in Appendix 1. The four asset classes are presented showing how the various indices performed versus the associated peer universes.

In general, the results show that it is difficult for active management to outperform an index over time. In almost all timeframes presented, the indices' returns ranked better that the median manager (50^{th} percentile). Domestic equity managers fared the worst where both indices, the S&P 500 and the Russell 2000, consistently presented in the top quartile of the return rankings.

In addition to ranking high in performance, the S&P 500 index's risk ranked well below the median for all ten years. Even the Russell 2000 small cap index had a lower risk ranking over three years and just above the median over five and ten years.

In summary, domestic equity indices present a significant hurdle for active equity managers to add value. The domestic markets are very efficient and research is readily available. There are Active Domestic Equity Managers that do outperform indices over time—although the vast majority do not—and the associated risk levels are much higher due to portfolio concentrations.

The international markets present somewhat different results. Although we still see both the EAFE and Emerging Markets indices rank high in Returns and low in Risk, the results are not as striking as in the domestic markets. Overseas markets span numerous countries and currencies complicating the decision-making process involved in portfolio construction. The results certainly show that many international managers fail to outperform the indices, but thorough due diligence can identify managers that consistently add value at acceptable levels of risk. Appendix 1 includes several managers in each international asset class that have favorable results versus the indices over time.

Conclusion

Index funds provided attractive returns throughout the review period when compared to Active Equity Managers, especially on a risk-adjusted basis. Low fees contributed to the outperformance on a relative basis as well. There are Managers that have performed well over time versus the Indices but identifying those firms requires significant time and effort. The results of our review certainly suggest that focusing this effort on Active International Equity Managers offers the best opportunity for success.

This review is an analysis of historical results and provides insight into the relationship between active and passive management over time. However, it is not a forecast of future behavior and is presented to provide guidance into the decision-making process going forward.

Harpswell Disclosure

General
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Risks
Harpswell invests in stocks, bonds, mutual funds and sometimes alternative investments. Each asset class, along with each individual investment, carries varied degrees of risk of loss. Harpswell analyses investments from a long-term fundamental perspective and aims to engineer portfolios that have an attractive risk and reward balance. Despite a strong bias for diversification, all Harpswell portfolios do carry risks of losses, particularly in times of escalated market volatility. Harpswell does focus on capital preservation yet extraordinary markets can potentially generate material losses.

Our investment decisions and recommendations are based upon our professional judgment. We do not guarantee the results of any of our investment decisions or recommendations, the future performance of your Assets or Accounts, any specific level of performance, the success of any Independent Manager, investment decision, strategy or recommendation made by an Independent Manager, or the overall success of the Account. Past performance is not indicative of future results. Investments in your Account may go up or down in value depending on market conditions.

Alternative investments are designed only for sophisticated investors who are able to bear the economic risk of losing all of their investment. Alternative investments: (1) often engage in leveraging and other speculative investment practices that may increase the risk of investment loss; (2) can be highly illiquid; (3) are not required to provide periodic pricing or valuation information to investors; (4) may involve complex tax structures and delays in distributing important tax information; (5) are not subject to the same regulatory requirements as mutual funds; and (6) often charge high fees.

Current Information
Opinions expressed are current opinions as of the date appearing in this material only. While the data contained herein has been prepared from information that Harpswell Capital Advisors believes to be reliable, Harpswell Capital Advisors does not warrant the accuracy or completeness of such information.

Use of Indices
Market index information shown herein, such as that of the S&P 500 Stock Index, is included to show relative market performance for the periods indicated and not as standards of comparison, since these are unmanaged, broadly based indices which differ in numerous respects from the portfolio composition of the Fund. Market index information was compiled from sources that Harpswell Capital Advisors believes to be reliable. No representation or guarantee is made hereby with respect to the accuracy or completeness of such data.

Index Definitions
The S&P 500 Stock Index is an unmanaged market capitalization index of 500 US equities generally considered to be representative of US stock market activity. The Morgan Stanley Capital International World Index is a market capitalization-weighted equity index of over 1,500 stocks traded in 22 world markets. The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on the NASDAQ Stock Market. The Index is market value-weighted. The SB World Bond Index is a market capitalization weighted index of 18 Government bond markets composed of sovereign debt denominated in the domestic currency. The Lehman Aggregate Index is a benchmark index made up of the Lehman Brothers. The Hennessee Hedge Fund Indices® are calculated from performance data obtained from publicly available information, internally developed data and other third party sources believed to be reliable. MSCI EAFE is a stock market index that is commonly used as a benchmark for the performance of major international equity markets. The MSCI Emerging Market Index is an index created by Morgan Stanley Capital International (MSCI) that is designed to measure equity market performance in global emerging markets. The Russell 1000 seeks to track the investment results of an index composed of large- and mid-capitalization U.S. equities. The Russell 2000 seeks to track the investment results of an index composed of small-capitalization U.S. equities. The Russell 2500™ Index measures the performance of the small to mid-cap segment of the U.S. equity universe, commonly referred to as "smid" cap. The Barclays Capital Global Aggregate Bond Index is designed to be a broad based measure of the global investment-grade, fixed rate, fixed income corporate markets outside the United States. The Barclays Capital US Gov/Credit bond Index measures the performance of U.S. Dollar denominated U.S. Treasuries, government-related and investment grade U.S. corporate securities that have a remaining maturity of greater than one year.

Index Funds versus Manager Universe Comparisons

Appendix 1

Percentiles

July 2010 - June 2020

	Return Rankings[2] 1 year	3 years	5 Years	10 years	Standard Deviation Rankings[3] 1 year	3 years	5 Years	10 years
S&P 500 Index vs Large Blend Manager Universe [4]								
Manager Universe[1] - Large Core	1397	1298	1199	1029				
S&P 500 Index	18.7%	16.6%	9.9%	10.7%	65.4%	63.6%	66.0%	77.6%
Russell 2000 Index vs Small Core Managers [4]								
Manager Universe - Small Core	634	626	582	487				
Russell 2000 Index	18.9%	18.3%	20.0%	20.4%	62.6%	61.6%	46.0%	43.1%
EAFE Index vs Developed Markets Manager Universe [4]								
Manager Universe - Developed International	705	655	588	496				
Developed International Mgr 1	0.2%	0.0%	0.0%	N/A	78.4%	78.8%	82.8%	N/A
Developed International Mgr 2	0.7%	0.0%	0.9%	0.0%	89.2%	93.6%	95.4%	46.1%
MSCI EAFE Index	55.4%	28.0%	24.5%	18.3%	78.6%	79.4%	64.0%	64.2%
Managers vs Emerging Markets Manager Universe [4]								
Manager Universe - Emerging Core Managers	754	700	648	345				
Emerging Markets Mgr 1	4.3%	1.0%	0.5%	N/A	50.7%	52.1%	26.7%	N/A
Emerging Markets Mgr 2	73.3%	24.6%	2.4%	22.5%	14.6%	6.8%	16.7%	54.8%
MSCI Emerging Markets Index	53.7%	42.4%	43.2%	48.4%	76.6%	71.2%	51.3%	46.6%

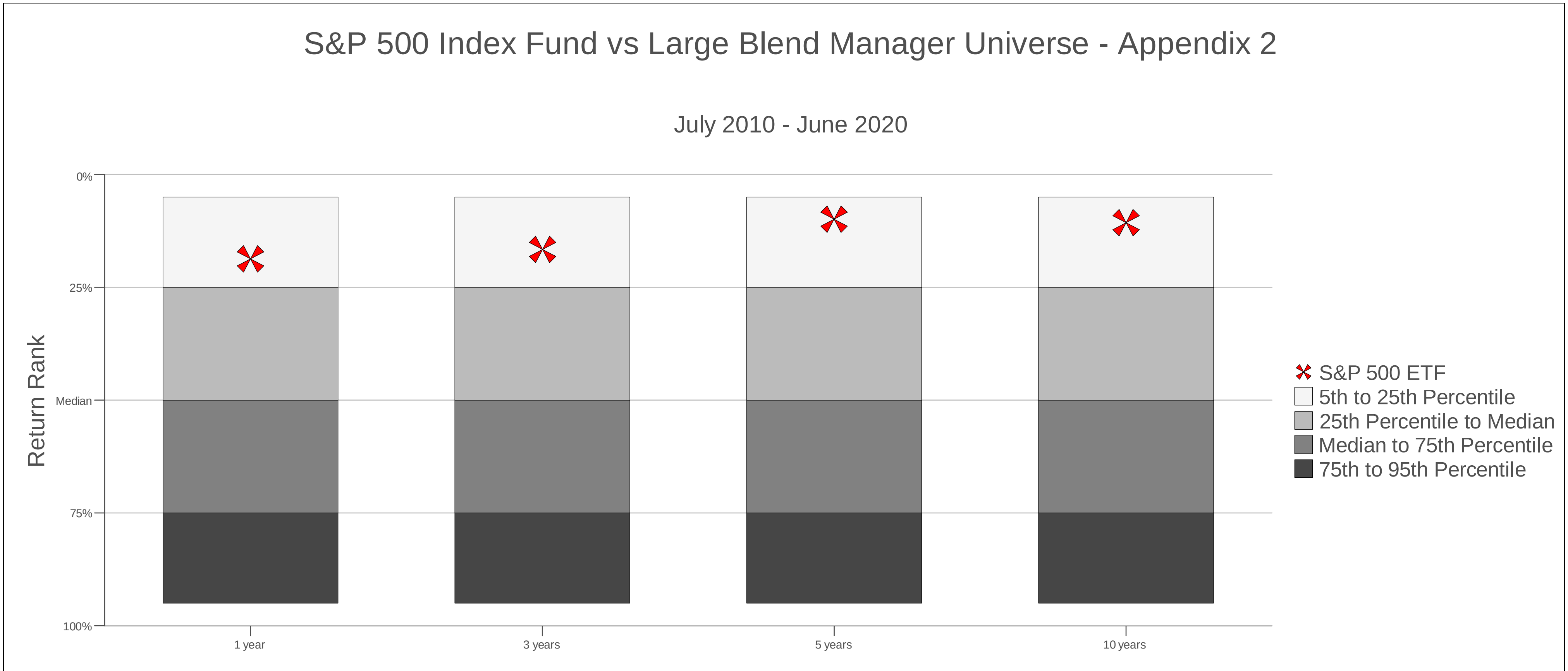
Notes

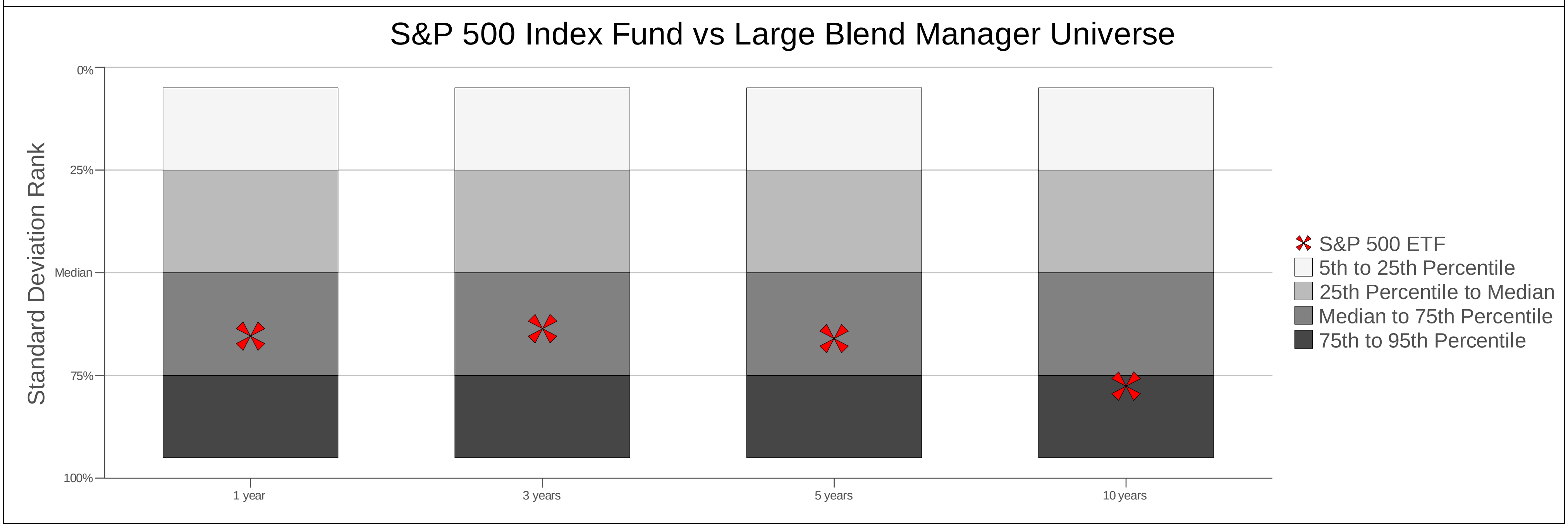
[1] Number of managers included in the universe. The numbers are larger in the shorter time frames as new products are launched. There is also an element of survivorship bias where funds close and are eliminated from the universe

[3] Standard Deviation Rankings, similar to Returns, are presented in percentiles. The 1 year S&P 500 index rank is 65% representing a risk level well below the median of the universe. Only 35% (100 - 65%) had lower Risk. For this measure, the higher the rank, the better.

[2] Return Rankings are presented in percentiles. For example, the 1 year S&P 500 index rank is 18.7% in comparison to the Large Core universe. In other words, the return of the index was better than 81.3% (100 -18.7%) of the universe.

[4]-Appendices 2,3,4 & 5 present charts showing the quartile rankings within each asset class





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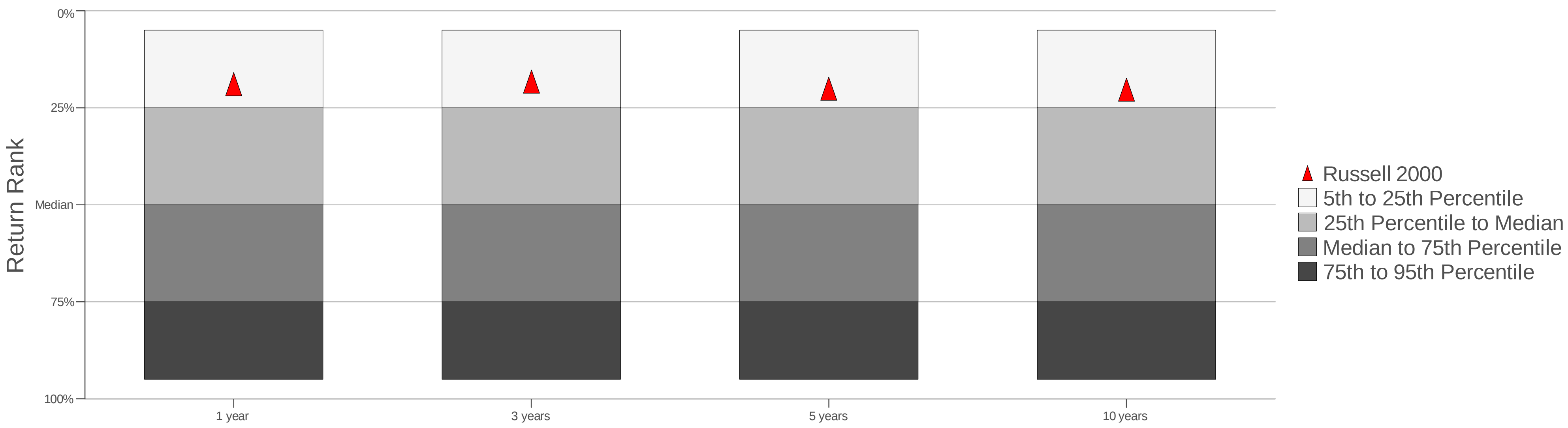
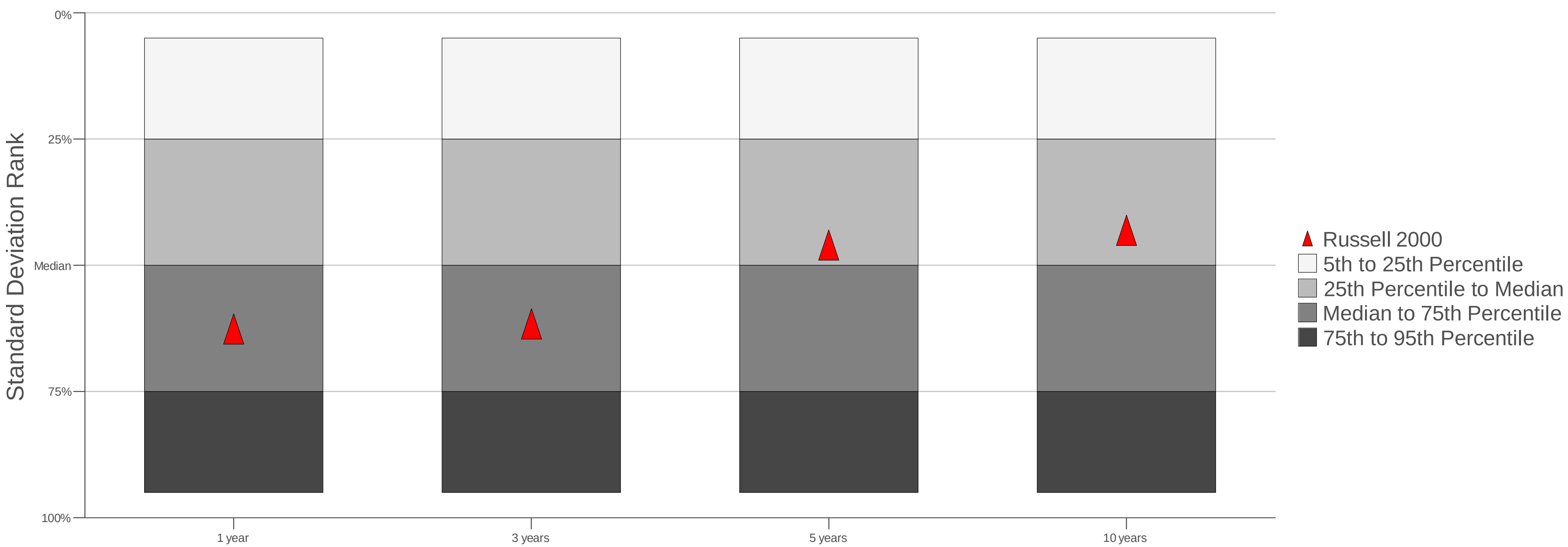
Russell 2000 Index vs Small Cap Manager Universe - Appendix 3

July 2010 - June 2020



Russell 2000 Index vs Small Cap Manager Universe



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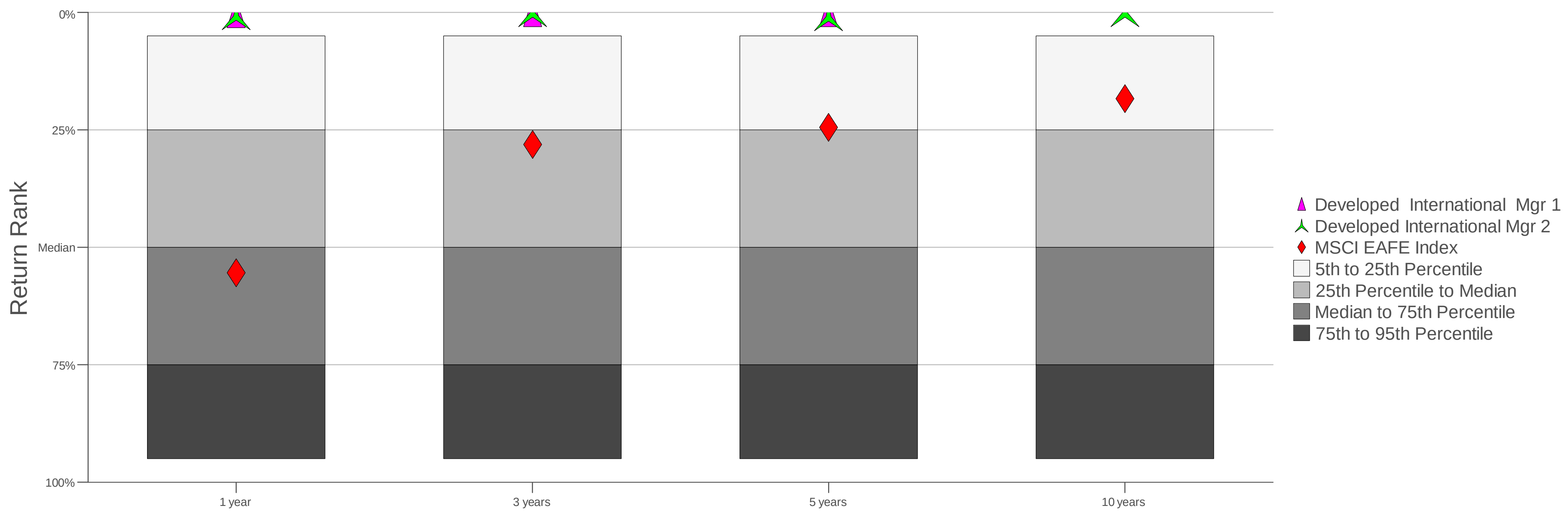
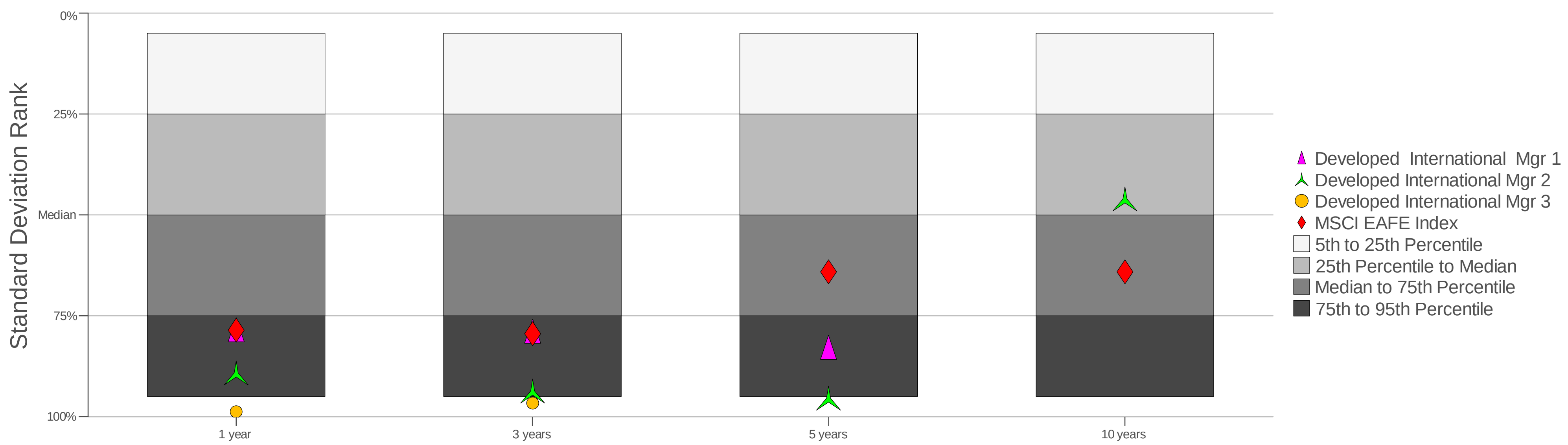
EAFE Index vs Developed Markets Manager Universe - Appendix 4

July 2010 - June 2020

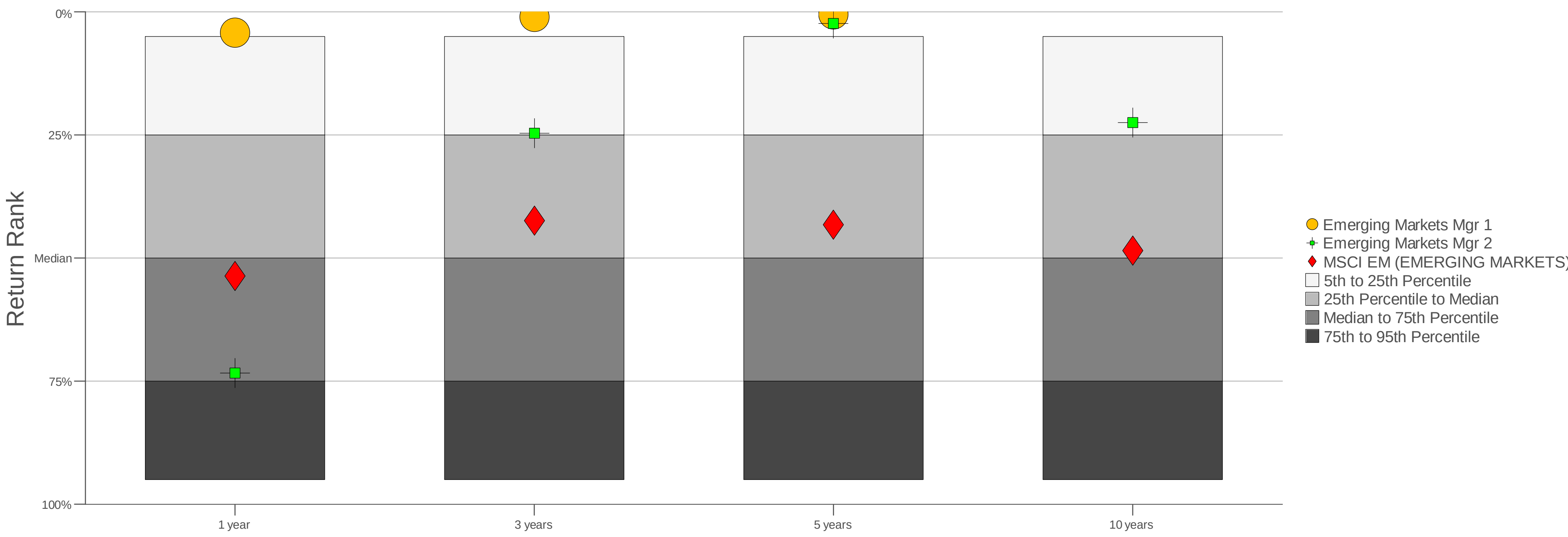


EAFE Index vs Developed Markets Manager Universe

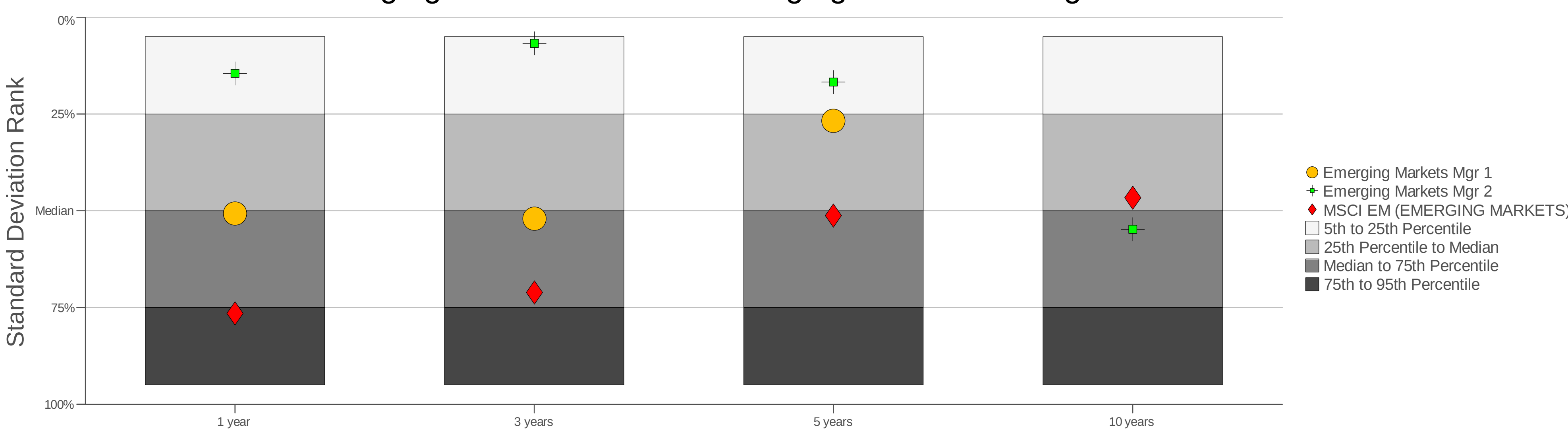


Emerging Markets Index vs Emerging Markets Manager Universe - Appendix 5

July 2010 - June 2020



Emerging Markets Index vs Emerging Markets Manager Universe



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