

The Challenge of Strong Returns

Through the end of August, a simple portfolio of 60% global equities and 40% U.S. bonds generated an annualized three-year return of 14%. This was an inarguably strong period of investment performance with returns well above the requirements of most endowments, foundations, and pension plans.¹

Despite such strong portfolio performance, investment committees may find themselves under pressure. Why?

The answer lies in relative returns. While a basic balanced portfolio approached a 15% annualized return, many institutional portfolios likely fell short. The culprit was often active management. By definition, active strategies differ from their benchmarks, and many struggled to keep pace with a market led by a narrow group of winners. According to Morningstar, only 38% of actively managed strategies outperformed their passive counterparts over the past 12 months ending this June.² Instead of generating excess returns, many active managers produced negative relative returns, casting a pall over what were otherwise very strong absolute results.

Faced with this reality, investment committees inevitably begin asking questions. Is the manager broken? Should we make a change? Are we falling behind peers?

Reasonable questions, but often asked at exactly the wrong moment. The problem is a false premise: that investing is a winner's game.

Charles Ellis famously argued that investing is, in fact, a loser's game. Successful outcomes come not from making the most brilliant decisions but from making the fewest mistakes. The analogy applies equally well to golf. The winner is rarely the player who attempts the most difficult shots. More often, it is the player who consistently avoids the hazards. The golfer who looks at a tree and thinks, "It's 90% air," usually discovers why that was a bad idea.

Investment committees face a similar temptation. When active managers underperform, the intuitive response is to fire the laggards and hire the winners. While understandable, that decision often becomes an unforced error.

In their *Journal of Portfolio Management* article, "The Folly of Hiring Winners and Firing Losers," Rob Arnott, Vitali Kalesnik, and Lillian Wu found that managers who underperformed peers over a trailing three-year period subsequently outperformed by more than 1% annually over the next three years. Investors who fire underperforming managers often sell assets that have become relatively cheap and reallocate capital to assets that have become relatively expensive. In effect, they institutionalize the mistake every investor knows to avoid: selling low and buying high.

This is not to suggest that performance is irrelevant. Persistent underperformance, organizational instability, or style drift may justify a change. But overreliance on recent performance can lead committees to mistake discomfort for evidence.



Gavin W. Stephens
CFA

Chief Investment Officer
 gstephens@goelzerinc.com
 (317) 264-2619



That is where governance becomes valuable.

A well-functioning investment committee may be an institution's most reliable source of alpha. By setting clear objectives, establishing evaluation standards, defining decision-making processes, and adhering to a sound investment policy statement, a committee creates value through sound governance—not forecasting skill or manager selection prowess. Conversely, a committee can become its own worst enemy through impatience, overconfidence, and an appetite for action.

In the loser's game of investing, the advantage belongs to the committee that makes the fewest mistakes.

¹ Bloomberg. Global equities represented by the MSCI All World Equity Index. Bonds represented by the U.S. Aggregate Bond Index. Returns are three-year annualized total returns, which include price appreciation and income.

² "Active Passive Barometer." Morningstar. June 30, 2026.

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