Casey, Quirk & Associates

RESEARCH INSIGHT

November 2005

The Geeks Shall Inherit the Earth?
Quantitative Managers' Recent Edge

- **Quantitative managers have outperformed other managers.** Active U.S. large cap equity quantitative products have outperformed other active U.S. large cap equity products by 103 basis points over the three years through 2004.

- **Quantitative managers have grown faster.** Active quantitative products' assets have grown at over twice the rate of other products over the same period and represent over $150B in U.S. large cap products.

- **A select group of firms have reaped the most.** Among U.S. large cap equity quantitative managers, three firms—Barclays Global Investors, INTECH, and LSV Asset Management— manage 46% of active quantitative assets.

Summary

U.S. large cap equities are highly liquid and well understood, presenting a challenge to managers seeking to add alpha in this space. Our research shows that one subset of managers, quantitative managers, has been able to outperform other peers in large cap equity. A quantitative investment manager is one that *derives its primary value-added from quantitative signals*. Quantitative managers' performance advantage is even starker after taking into account their lower active risk. In addition, quantitative managers have capitalized on their investment performance, and consequently have grown their assets at a much faster rate than other large cap equity managers over the past two years. Three firms have been particularly successful at translating investment performance into commercial success: Barclays Global Investors, INTECH, and LSV Asset Management.

Research Methodology

We examined performance and asset data for active quantitative and 'other' products over the past five years. Our analysis is based on managers reporting active U.S. large cap equity track records for separate accounts and commingled funds through year-end 2004.

As a first step, index and low-tracking error (enhanced index) track records were eliminated. Relying on product name, product description, and on knowledge of the managers, we identified the quantitative products in this universe. This process yielded 70 quantitative product track records from 32 managers. The corresponding pool of 'other' products had 688 track records from 387 managers (Figure 1).

Figure 1

Research Universe

Manager/Product Categorization as of June 30, 2005

	Manager Count	Product Count	Total Assets ($M)
Quantitative Products	32	70	$157,000
'Other' Products	387	688	$925,000

SOURCE: *InvestorForce, CQA analysis*

Findings

1. QUANTITATIVE PRODUCTS HAVE HAD A DISTINCT PERFORMANCE ADVANTAGE

Comparing the performance of both subgroups of actively managed products reveals that quantitative products have consistently maintained substantially lower active risk (tracking error). Prior to 2003, quantitative products' lower active risk corresponded with lower returns, although quantitative products achieved higher risk-adjusted returns (information ratio). However, since 2003, the median quantitative product has outperformed 'other' products on an absolute basis as well.

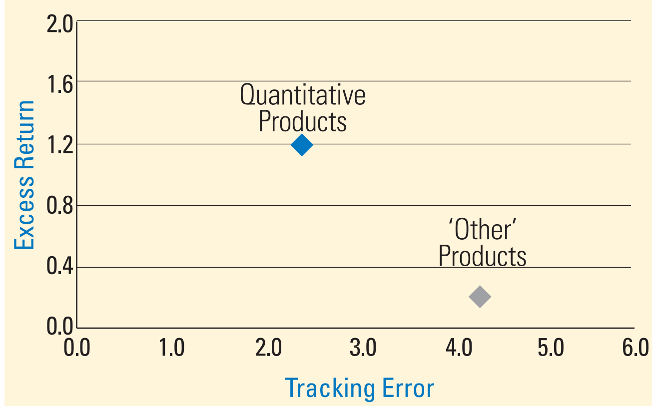
For the three years through 2004, for example, the median quantitative product had a three-year tracking error of 2.7% compared to 4.5% for the median 'other' product. Over the same timeframe, the median quantitative product returned an annualized 5.6% versus 4.5% for the median 'other' product, which resulted in a median information ratio of 0.37 for quantitative products versus 0.06 for all other products (Figure 2). The 100-bp spread in performance appears in the second quarter of 2003 and continues to persist. (Our latest data point is June 2005.) Additionally, outperformance is independent of investment style: the spread is replicated in the large cap core, large cap growth, and large cap value subsets, although it is most pronounced in large cap value (120 basis points) and least pronounced in large cap growth (70 basis points).

Figure 2

Returns &Tracking Error

Quantitative Products vs. 'Other' Products

Three Years Ending December 31, 2004



SOURCE: *InvestorForce, CQA analysis*

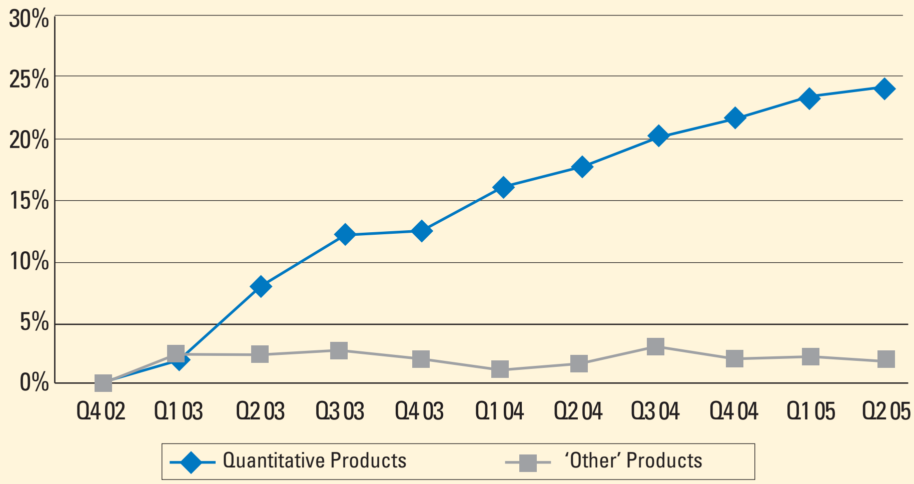
2. QUANTITATIVE PRODUCTS HAVE HAD MUCH GREATER ASSET GROWTH

We examined the assets under management for quantitative and 'other' strategies by studying two primary data points: total assets and net asset flows. Both analyses revealed that beginning in 2003, quantitative products' assets grew at a significantly faster rate than 'other' products. As of year-end 2004, our universe of 70 quantitative products managed in total $157B—nearly double the assets from three years earlier—when quantitative assets stood at about $88B. By comparison, the assets in our 'other' universe grew from $720B to $925B. Stated another way, quantitative assets grew at an annualized rate of 21% over the three years through 2004, versus 9% for 'other' active products.

Figure 3

Cumulative Net Flows as a Percentage of Total Assets

December 31, 2002 - June 30, 2005



SOURCE: *InvestorForce, CQA analysis*

Simply looking at assets under management can be deceptive, however, since product performance can have a far larger impact on total assets than new flows. To address this, we also examined net asset flows, a metric we calculate on a quarterly basis by netting out capital appreciation from reported product assets—the difference is attributed to flows into or out of each product.

As illustrated in Figure 3, as a percentage of total assets under management, quantitative products have received substantially higher flows versus 'other' products since the end of 2002.

3. THREE FIRMS HAVE REAPED QUANTITATIVE PRODUCTS' SUCCESS

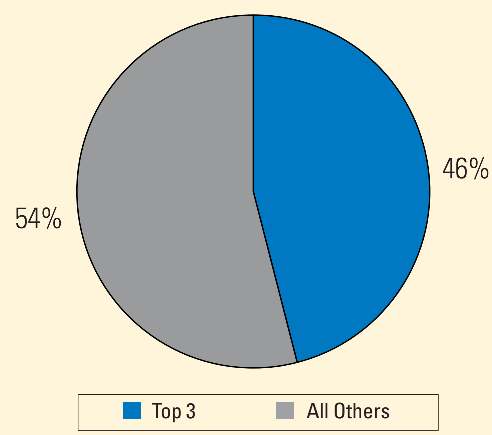
Of the 32 managers identified with quantitative offerings, three account for the majority of new assets: Barclays Global Investors, LSV Asset Management, and INTECH (Figure 4). Barclays Global Investors' quantitative offerings are the most risk-controlled and focused in the large cap core space. LSV Asset Management employs relatively higher risk levels, and all of their offerings are characterized by a deep value style of investing. INTECH's offerings are at a median risk level and are primarily in the growth style.

While these three firms are not the only quantitative managers with strong performance track records, we surmise that these three managers have capitalized on their good performance in part with a consistent and dedicated distribution effort.

Figure 4

Quantitative Manager Asset Concentration

As of June 30, 2005



SOURCE: *InvestorForce, CQA analysis*

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Casey, Quirk & Associates

John F. Casey, Chairman

David J. Bauer, Managing Director

Jeb B. Doggett, Managing Director

Kevin P. Quirk, Managing Director

Casey, Quirk & Associates (CQA) provides management consulting services exclusively to investment management firms. CQA specializes in developing business strategy, enhancing investment practices, and crafting distribution plans. CQA draws on 35 years of experience in delivering value to its clients and partners through a unique combination of deep industry knowledge and experience, solutions-oriented thought leadership, and a proven ability to create change within organizations.

Casey, Quirk & Associates periodically publishes *Research Insight* on topics of interest generated by its ongoing industry research. To discuss this CQA *Research Insight*, please contact:

Daniel Celeghin
d.celeghin@cqallc.com
203-899-3003

Jeb B. Doggett
j.doggett@cqallc.com
203-899-3034

Kevin P. Quirk
k.quirk@cqallc.com
203-899-3033

Casey, Quirk & Associates
19 Old King's Highway South
Darien, CT 06820
(T) 203-899-3000
(F) 203-656-8124
www.cqallc.com