

# Is Passive Small Cap Core Damaging Performance Relative to Peers?

December 2023

## Executive Summary

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- Passive performance in the US small cap core category has fallen in the bottom decile of its eVestment universe for the past ten years as of September 30, 2023\*
- We believe institutional portfolios choosing the passive option in US small cap core place themselves at risk of underperforming their peers. Anecdotally, we see institutions moving US small cap core allocations to active managers, but actual flows data vary month to month
- Our Diversified Small Cap Core strategy has outperformed the Russell 2000 for the past ten years as of September 30, 2023, and is available at attractive fees

*\*eVestment provides institutional investment data, analytics and market intelligence covering public and private markets. Cornerstone has an agreement with eVestment to provide Cornerstone's data on eVestment's Global Database. Cornerstone does not pay a fee to be included in eVestment's ranking.*

## Are Public Equity Benchmarks the Right Benchmarks for Institutional Allocators?

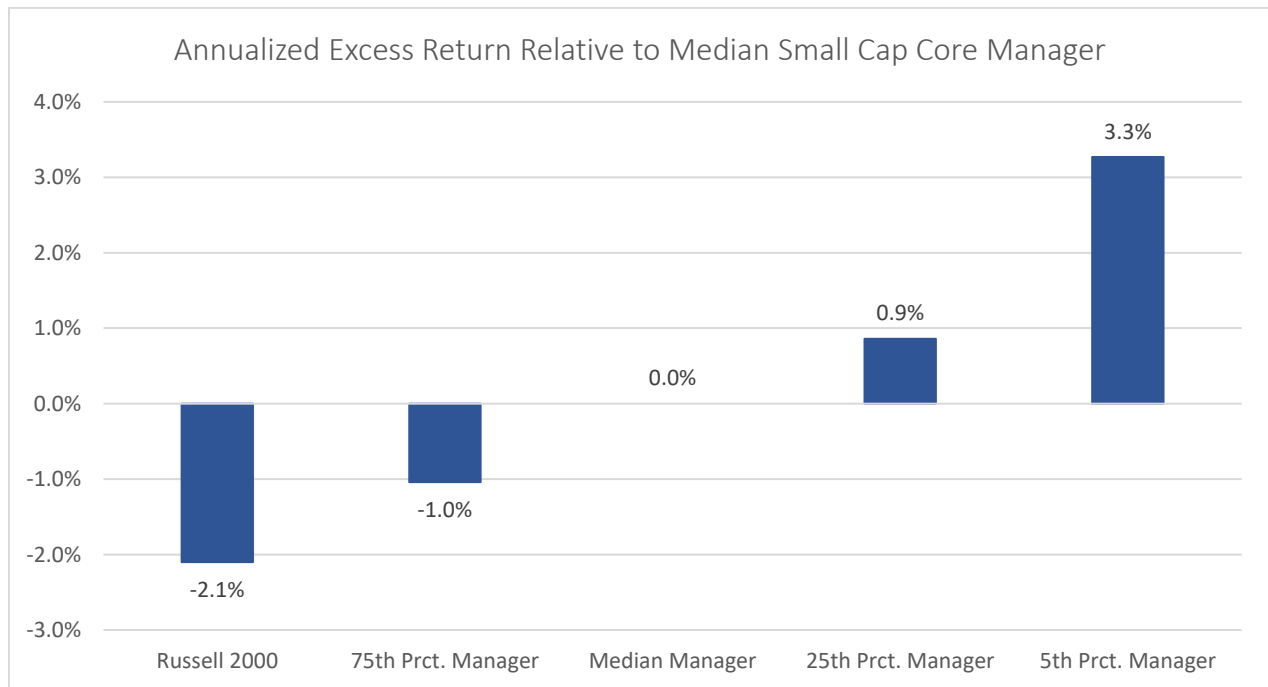
Many institutions evaluate the performance of their investment portfolios against their peer institutions, yet many institutions choose to allocate to passive indexes that have delivered performance well below that of the median active manager over the past ten years as of September 30, 2023. Nowhere has this trend been more visible than in the US small cap core universe. **We believe allocators choosing the passive option in US small cap core place themselves at material risk of underperforming their peers.**

### Passive Performance in Small Cap Core Has Been Poor

The long-term performance of the Russell 2000 Index in the eVestment small cap core universe has been poor, to say the least. Over the trailing 10-year period ending September 30, 2023, **the most popular passive small cap core index falls in the bottom decile of the universe, gross of fees, based on eVestment’s ranking.**

The annualized total return of the Russell 2000 Index trails the **median** active small cap core manager by over 200 basis points over the past ten years. A skilled active manager delivering a top quartile return has increased the annualized gap over the passive index by **at least** an additional 80 basis points during this period. We do not believe most allocators realize they may be giving up as much as 300 bps per year when they allocate to small cap core passively.

*10-Year Gross Excess Returns, relative to the median manager, for the eVestment U.S. Small Cap Core Universe and Russell 2000 Index (as of 9/30/2023)*

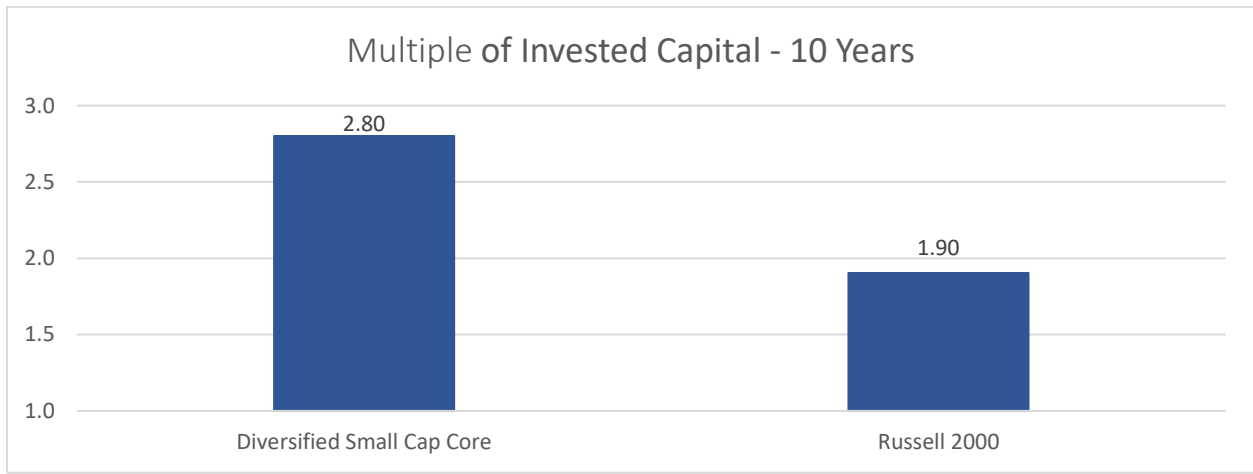


**Source: eVestment US Small Cap Core Universe & R2000 Index – 10 Yr. Gross Return as of 09/30/23**

The median fee (assuming a \$50mm account) in the eVestment US small cap core universe is 54 basis points. Applying this fee to the 75<sup>th</sup> percentile manager would still leave the Russell 2000 (which does carry a fee, in most cases) with a gross return below that of the 75<sup>th</sup> percentile manager. We also believe that active fees actually paid by many investors are below the standard fee schedules reported to eVestment. **Active managers have certainly more than earned their fees in the US small cap core category over the past decade.**

### *Cornerstone Has Delivered High-Caliber Performance*

Our Diversified Small Cap Core strategy has outperformed the Russell 2000 Index by a meaningful amount over the past decade. On a net basis, our strategy has outperformed the Russell 2000 Index by over 400 basis points, annualized. The chart below suggests the outperformance of our Diversified Small Cap Core strategy has resulted in a substantially higher multiple of invested capital relative to the Russell 2000 Index.



*Source: Cornerstone Investment Partners as of 09/30/23*

Our Diversified Small Cap Core strategy is open to new and existing investors for fees that are competitive within the active space. Our strategy is available at 30 basis points, which we believe is not materially higher than some passive fees for the Russell 2000 Index, for the first \$150 million invested in the strategy. We believe the performance more than justifies the net fee above the Russell 2000.

**To conclude, we ask those investors using passive vehicles in the small cap core category, is your passive allocation damaging your performance relative to your peer group? Can you afford to pass up the opportunity for 300 bps of relative outperformance?**

# CORNERSTONE

## investment results

## Diversified Small Cap Core Composite

	CORNERSTONE GROSS RETURNS	CORNERSTONE NET RETURNS	RUSSELL 2000	GROSS COMPOSITE 3 YR ST DEV	R2000 3 YR ST DEV	COMPOSITE ASSETS \$ MILLIONS	ACCOUNTS AT PERIOD END	PERCENT OF FIRM ASSETS	FIRM ASSETS \$ MILLIONS	GROSS COMPOSITE DISPERSION
2022	-18.41%	-18.62%	-20.44%	26%	26%	44.32	5 or fewer	2.601%	1,703.9	N.A.*
2021	44.80%	44.44%	14.82%	23%	23%	56.67	5 or fewer	2.933%	1,932.1	N.A.*
2020	22.37%	22.05%	19.96%	25%	25%	48.53	5 or fewer	2.650%	1,831.3	N.A.*
2019	18.75%	18.33%	25.52%	16%	16%	5.15	5 or fewer	0.224%	2,300.8	N.A.*
2018	-5.78%	-6.12%	-11.01%	16%	16%	4.40	5 or fewer	0.203%	2,169.9	N.A.*
2017	17.63%	17.21%	14.65%	13%	14%	4.67	5 or fewer	0.190%	2,458.6	N.A.*
2016	23.38%	22.94%	21.31%	15%	16%	2.56	5 or fewer	0.098%	2,609.7	N.A.*
2015	-1.17%	-1.52%	-4.41%	13%	14%	0.28	5 or fewer	0.008%	3,480.2	N.A.*
2014	4.25%	3.87%	4.89%	N.R.	N.R.	0.28	5 or fewer	0.003%	9,154.3	N.A.*
2013	48.81%	48.31%	38.82%	N.R.	N.R.	0.46	5 or fewer	0.006%	8,210.6	N.A.*
2012*	8.39%	8.21%	7.20%	N.R.	N.R.	0.31	5 or fewer	0.005%	5,725.4	N.A.*

\* Composite inception date is 6/30/2012

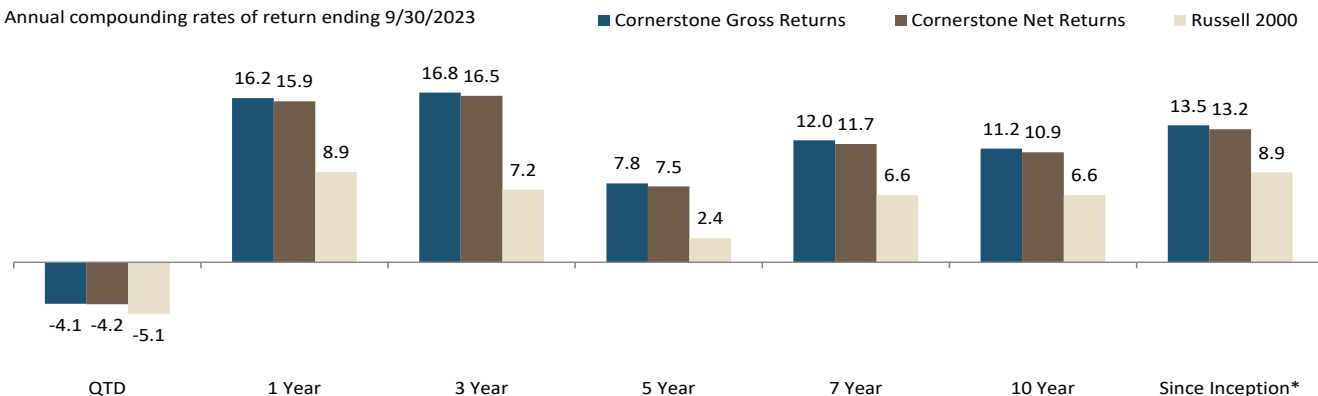
N.R. - Not Required

	CORNERSTONE GROSS RETURNS	CORNERSTONE NET RETURNS	RUSSELL 2000
QTD	-4.10%	-4.17%	-5.13%
1 Year	16.22%	15.91%	8.93%
3 Year	16.76%	16.46%	7.17%
5 Year	7.80%	7.49%	2.40%
7 Year	12.04%	11.69%	6.63%
10 Year	11.22%	10.86%	6.65%
Since Inception*	13.53%	13.16%	8.88%

Annual Compounding Rates of Return ending 9/30/2023

\* Composite inception date is 6/30/2012

Annual compounding rates of return ending 9/30/2023



Diversified Small Cap contains fully discretionary accounts that are comprised of around 230-250 securities that typically have capitalizations between \$250M and \$3B. For comparison purposes, the composite is measured against the Russell 2000 Index. Cornerstone Investment Partners is an independent, employee-owned investment advisory firm. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Past performance is not indicative of future results. The U.S. Dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all income. Net of fee performance was calculated using actual management fees. For non-fee-paying accounts, a model fee based on the standard investment advisory schedule was applied. The Diversified Small Cap Core composite was inception and created on June 30, 2012. N.A.\* The annual composite dispersion is an asset-weighted standard deviation calculated for the accounts in the composite for the entire year. This is not shown when there are 5 or fewer accounts in the composite for the entire year as it is not statistically meaningful. Cornerstone Investment Partners claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Cornerstone Investment Partners has been independently verified for the periods September 30, 2001 thru December 31, 2022. A firm that claims compliance with the GIPS standards must establish policies

and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The Diversified Small Cap Core composite has had a performance examination for the periods June 30, 2012 thru December 31, 2022. The verification and performance examination reports are available upon request. Benchmark returns are not covered by the report of independent verifiers. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request. To receive a list of composite descriptions and/or additional information, contact Cornerstone Investment Partners at 3438 Peachtree Rd, NE; Suite 900; Atlanta, GA 30326, 404-751-3850 or marketing@cornerstone-ip.com. The general fee schedule for accounts is as follows: 1.00% on the first \$10,000,000; 0.75% on the next \$40,000,000 and 0.50% on the balance. Actual investment advisory fees incurred by clients may vary. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Due to the marketing rule that went into effect on 11/4/22, the net returns were updated to comply with this regulation. Additional information is available upon request.

Source: Cornerstone Investment Partners