



Q2 2019 US Small Cap Growth Managers

Asset manager trading processes often significantly impact overall investment performance. To this end, managers have a fiduciary obligation to both obtain best execution (to minimize the impact their trading has on their clients' portfolio returns) and avoid paying excessive commissions. Asset owners, in turn, have a fiduciary obligation to monitor their managers to ensure these legal requirements are achieved.

In early 2014, Zeno AN Solutions ("Zeno"), then known as Zeno Consulting Group, introduced its trade cost Peer Group Universes. Unlike most other trade cost comparisons, Zeno's Peer Group Universes rank managers against other managers charged with the same investment mandate (e.g. Small Cap Growth, Large Cap Value, Non-US Developed, etc.). Further, the costs tracked in the universes include not just broker-related costs, but also the trading costs incurred by asset managers "working" their orders over multiple days. Equally important, the universes measure turnover rates, thereby enabling the quantification of how much each manager's trading process impacts their annual investment return.

As such, Zeno views these universes as the next step in the evolution of trade cost analysis; and an important tool in evaluating the degree to which a manager's trading process contributes or detracts from bottom-line performance. Just as fund fiduciaries use investment performance peer group universes to help identify managers with superior stock picking ability, Zeno's Peer Group Universes help evaluate the skill and efficiency with which managers implement those stock picks.

This newsletter highlights the range of trading costs, commissions, turnover, and impact to performance incurred by managers in Zeno's **US Small Cap Growth** Peer Group Universe.

US Small Cap Growth - Peer Group Universe

Consistent with historical averages, Small Cap Growth stocks tend to incur higher trading costs than larger cap and value securities. On a relative basis, Small Cap Growth stocks as of the end of the second quarter of 2019 had ticked up this time last year. Not only was the median trading cost more expensive, but the spread between the top and bottom quartile trading costs widened as well.

As shown in the table below, over the trailing four quarters ending June 30th 2019, the median trading costs incurred by US Small Cap Growth managers was -118 bp, 30+ bp more expensive than a year ago. At the same time, the difference between the most efficient and expensive trading processes (i.e. managers ranking in the 1st vs. 4th quartiles of the peer group), was 94 bp, a widening of almost 25 bp from a year ago.

Perhaps most importantly, from an investment perspective, given the turnover rates experienced by US Small Cap Growth managers (during the four quarter period ending June 30, 2019), the median impact to annual returns in this period was almost -1.5% (-146 bp); and managers ranking in the 4th quartile of Zeno's trade cost universe incurred a performance hit of almost -2.5% (-239 bp)!

To put these numbers into context, the median Small Cap Growth manager’s one-year net return during this period was approximately 5.5%, and the average net return over the trailing three years was 16.9%.¹ Clearly, trading costs can eat up a significant portion of the managers’ gross return – often ranging anywhere from 10-30% of a manager’s gross return. From a performance attribution analysis, this is an example of why we encourage clients not to ignore/underestimate the impact of trading on returns.

It should also be noted that the average commission rate paid during this period by US Small Cap Growth managers was -2.2¢, with 4th quartile commission rates averaging 2.75¢ or more. As Zeno has been alerting its clients over the past several years, MiFID II as well as other regulatory and market pressures, may be contributing to a drop in global commission rates (as some managers moved to execution-only rates). That in fact appears to have occurred. At this time last year, the median commission rate for US Small Cap Growth managers was -2.3¢, with 4th Quartile commission rates averaging over 3.0¢.

	US Small Cap Growth				
Ranking	Total Costs (bp)	Impact on Annual Returns (bp)	Turnover (%)	Commissions (¢)	Execution Price vs. VWAP (bp)
Top (25%)	-65	-83	61%	-1.55	-1
Median (50%)	-118	-146	75%	-2.22	-9
Bottom (75%)	-159	-239	90%	-2.75	-11

To review all of Zeno’s Peer Group Universes, key trends, and Glossary [click here](#).

Want to Learn More?

For more information about where your fund’s managers rank, please call us at (646)432-4000 or email info@abelnoser.com

¹ Based on Investment Metrics’ peer group data