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# FLIP FEATURE

***Wall Street's Dirty Big Secret:  
Investors Pay Higher Fees for Lower Returns***

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# Wall Street's Dirty *Big Secret*: Investors Pay Higher Fees for Lower Returns

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When it comes to investing, one of the biggest questions has always been: should you try to “beat the market” or just ride it? This is the core of the active versus passive investing debate. Active management is the art of trying to outperform the market, where a fund manager hand-picks investments, tries to time the market, and shifts things around to get an edge. Passive investing, on the other hand, is about simply matching the market by building a portfolio that mirrors a major index, like the S&P 500.

For the last twenty years, we’ve had a powerful tool to help settle this debate: the SPIVA Scorecard. SPIVA (Standard and Poor’s Indices Versus Active) reports are published by S&P Dow Jones Indices, and they act as a referee, comparing how actively managed funds actually perform against their benchmarks. What makes the SPIVA scorecards so reliable is that they’re designed to be fair and avoid common statistical traps. For instance, they account for “survivorship bias.” Many poorly performing funds simply shut down or merge with others over time. If you only look at the funds that are still around, it makes active managers look better than they really are. SPIVA includes these “dead” funds in its analysis, giving us a much more honest picture.

And what does this picture show? After more than two decades of data, the trend is undeniable: the vast majority of active fund managers fail to beat their benchmarks, especially over the long haul. This isn’t just an academic finding; it’s a key reason why so many people, from regular investors to huge institutions, are moving their money into passive strategies.

## What is Active Investing, Anyway?

At its heart, active investing is about a manager making hands-on decisions to try and earn better returns than the overall market. They use a combination of deep financial analysis, economic predictions, and research to spot opportunities. Active managers have a few tools in their toolbox:

- *Stock Picking*: Trying to find undervalued companies they believe are poised for growth.
- *Market Timing*: Attempting to get in and out of the market at just the right moments.
- *Sector Bets*: Overloading the portfolio with industries they think will soar and avoiding ones they expect to slump.
- *Risk Management*: Adjusting the portfolio to protect against losses when the market gets choppy.

All this research and frequent trading doesn’t come free. Actively managed funds charge higher fees than their passive cousins, and as we’ll see, that cost is a major hurdle to their long-term success.

## And What About Passive Investing?

Passive investing flips that whole idea on its head. Instead of trying to beat the market, the goal is to *be* the market. A passive fund tracking the S&P 500, for example, simply buys and holds all 500 companies in the index, in the same proportions.

The growing popularity of passive investing comes down to a few simple, powerful advantages:

- *Lower Costs*: Since there's no team of analysts to pay or constant trading to execute, the management fees are dramatically lower.
- *Broad Diversification*: By owning a piece of every company in an index, you're not overly exposed to the fate of any single one.
- *Simplicity and Transparency*: The strategy is straightforward and rules-based, making it easy for anyone to understand what they own.
- *Tax Efficiency*: Passive funds buy and sell far less often, which means investors typically face fewer capital gains taxes along the way.

The objective is clear: capture the market's overall return as cheaply and efficiently as possible.

### Let's Talk About the SPIVA Scorecards

The SPIVA reports give us a detailed, no-nonsense look at how active funds stack up against passive benchmarks across all different types of investments and timeframes, from a single year to two decades. A key reason these reports are so respected is how they handle survivorship bias. It's like judging a singing competition by only listening to the finalists—you'd miss all the people who got voted off in the early rounds. By including the funds that failed and closed-up shop, SPIVA ensures we're seeing the full, unvarnished truth about active management's performance.

The scorecards also show us performance over many different time horizons. While a few managers might get lucky and beat the market for a year or two, the data clearly show that the longer the timeframe, the harder it is to stay on top. The long-term evidence from SPIVA is pretty damning for active management. Across almost every category of the stock market, most active funds just don't keep up with their benchmarks. Here's a snapshot of what the typical 20-year results look like for U.S. stock funds (stock is also called "equities" in finance):

**Table 1: Percentage of Active Funds Underperforming Benchmarks (20-Year Horizon)**

<b>Fund Category</b>	<b>Benchmark Index</b>	<b>% Underperforming</b>
U.S. Large-Cap Funds	S&P 500	~94%
U.S. Mid-Cap Funds	S&P MidCap 400	~95%
U.S. Small-Cap Funds	S&P SmallCap 600	~93%

*Source: SPIVA U.S. Scorecards, S&P Dow Jones Indices.*

To put it bluntly, over a 20-year stretch, over nine out of ten active managers fail to beat their passive index (benchmark). This means if you were to pick an active fund at random, your odds of choosing one that will beat the market over the long run are incredibly low. And it's not just a long-term problem.

The SPIVA data also show that even in the short-term, beating the market is tough. Here's a look at how U.S. large-cap funds did against the S&P 500 in recent years:

**Table 2: Annual Underperformance of Active Large-Cap Funds vs. the S&P 500**

<b>Year</b>	<b>% of Active Managers Underperforming</b>
2016	66%
2017	64%
2018	64%
2019	71%
2020	60%
2021	85%
2022	51%
2023	60%
2024	65%
2025	79%

*Source: SPIVA U.S. Scorecards, S&P Dow Jones Indices.*

Even in the best years for active managers (e.g. 2022), a majority still lagged behind the index.

Another way to look at the SPIVA results is to think about your chances of picking an outperforming fund, out of the thousands of funds available, over different periods.

**Table 3: The Shrinking Probability of an Active Fund Beating the Market**

<b>Time Horizon</b>	<b>% of Active Managers Beating the Market</b>
1 Year	~35–40%
5 Years	~25%
10 Years	~15%
15 Years	~10%
20 Years	~5–7%

*Source: SPIVA U.S. Scorecards, S&P Dow Jones Indices*

The takeaway is clear: the longer you invest, the less likely your active fund is to come out on top.

## **So, Why Do Most Active Managers Fall Short?**

It's not that active managers aren't smart or hardworking. There are a few powerful forces working against them. Active funds charge higher fees to pay for their research and trading. An active fund might charge 1% per year, while a passive index fund might charge just 0.05%. That 0.95% difference might not sound like much, but over 20 or 30 years, compounding turns that small drag into a massive chunk of your potential wealth.

In addition to significantly higher fees, the stock market itself is pretty smart. In today's world, information travels instantly. Thousands of professional analysts are constantly digging into companies, and any new piece of information—good or bad—is usually reflected in a stock's price in a matter of seconds. In such an *efficient* market, finding truly undervalued gems is incredibly difficult.

Nobel laureate William Sharpe explained this with what he called the “arithmetic of active management.” In short, since all active managers in total *are* the market, their average return, before fees, must be the market's return. Once you subtract their higher fees and trading costs, their average return is guaranteed to fall below the market. Active managers trade a lot, and every trade comes with costs like commissions; these little “frictions” add up and eat into returns. Passive funds, which buy and hold, largely avoid these costs.

## **Can You Just Pick Yesterday's 'Active' Winners?**

You might think you can just find an active fund that did great last year and invest in it. Unfortunately, SPIVA research shows that performance rarely lasts. A manager who has a fantastic year is just as likely to have a mediocre or poor one the next. This suggests that much of the short-term outperformance we see is often due to luck, not repeatable skill, making it nearly impossible to consistently pick future winners based on their past.

Given all this evidence, it's no surprise that passive investing has exploded in popularity. Index funds and ETFs have seen massive inflows of cash from investors who want lower costs and reliable market returns. Today, passive strategies make up a huge slice of the investment pie, especially in retirement plans and large institutional portfolios.

While the case for passive is strong, active management isn't completely irrelevant. In some less-trafficked corners of the market, there may be more opportunities for skilled managers to find an edge. These might include emerging or frontier markets, very small companies, and specialized or alternative asset classes (not stocks and bonds). However, even in these areas, the challenge of finding a manager who can consistently deliver remains.

## **What All of This Means for You**

For most individual investors, the lessons from SPIVA are clear and powerful. The less you pay in fees, the more of your money you get to keep. Over a lifetime of investing, this can make a life-changing difference. Further, broad market index funds give you a stake in hundreds or even thousands of companies, protecting you from the risk of any single one blowing up. Trying to time the market or chase hot funds is often a losing strategy. A steady, long-term approach is far more likely to succeed. For these reasons, many financial advisors recommend building the core of your portfolio around low-cost index funds.

After looking at two decades of hard data, the debate over active versus passive investing isn't much of a debate anymore. The SPIVA Scorecards have shown, year after year, that the majority of active managers in nearly every category fail to beat their benchmarks over the long term. This isn't an opinion; it's a conclusion driven by the math of higher fees, trading costs, and

the simple difficulty of outsmarting an efficient market. While some active managers may still find success in niche areas, for most people, a simple, low-cost passive indexing strategy is the most reliable path to building long-term wealth.