

SPIVA® Australia Scorecard

MID-YEAR 2014

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Summary

- The SPIVA Australia Scorecard reports on the performance of actively managed Australian mutual funds versus that of their benchmarks, showing equal- and asset-weighted peer averages.
- The index versus active debate has been a contentious subject for decades, and there are strong opinions on both sides. The SPIVA Australia Scorecard is the de facto scorekeeper of this debate.
- There are no consistent trends to be found in annual active versus index figures. The only consistent data point we have observed over a five-year horizon is that the majority of active equity funds in most categories fail to beat their comparable benchmark indices.
- The majority of funds in all categories, except Australian small-cap funds, were outperformed by their respective index benchmark over the one-, three- and five-year periods as of June 2014. International equity and Australian bond funds had the lowest relative performances over the one-year period, with close to 80% of funds underperforming the S&P Developed Ex-Australia LargeMidCap and S&P/ASX Australian Fixed Interest Index.
- **Australian General Equities:** The majority (66.1%) of Australian large-cap equity funds underperformed the S&P/ASX 200 Accumulation Index in the one-year period, which has been consistent for the past three- and five-year periods (65.6% and 74.9%, respectively). The return for the S&P/ASX 200 Accumulation Index exceeded both the equal- and asset-weighted average fund returns for the past one-year period.
- **Australian Small-Cap Equities:** Australian small-cap funds delivered remarkable returns over the one-year period, with both the equal- and asset-weighted average returns exceeding the S&P/ASX Small Ordinaries return. The majority of active funds in this category outperformed the benchmark, with only 8.2%, 7.7% and 17.1% of funds failing to beat the benchmark in the past one-, three- and five-year periods, respectively.
- **International Equities:** Only around one-fifth of international equity funds enjoyed equal or higher returns compared with the S&P Developed Ex-Australia LargeMidCap, and the majority of active funds in this category underperformed the index in the past one-year period. This observation has also been consistent over the past three and five years.
- **Australian Bonds:** In the one-year period, 80% of Australian bond funds underperformed the S&P/ASX Australian Fixed Interest Index. The S&P/ASX Australian Fixed Interest Index returns outpaced the equal-weighted average returns of funds in this peer group across all observed periods.

- **Australian A-REITs:** The S&P/ASX 200 A-REIT outperformed 54% of A-REIT funds in the one-year period, and both the equal- and asset-weighted average returns exceeded the index return over the same period. However, performance of A-REIT funds was less promising over the longer periods. In this category, 80% and 78.8% of active funds underperformed the index over the three- and five-year periods, respectively, and their equal- and asset-weighted average returns failed to exceed benchmark returns for both periods.
- **Fund Survivorship:** Over 97% of active funds in each of the peer groups observed in this report survived more than one year. However, all fund categories had survivorship rates below 84% when extending the observation period to five years. Australian small-cap funds had the highest survivorship rate, while international equity funds had the lowest rate among all categories over the five-year period.
- **Equal-Weighted Average Fund Returns:** Australian general equity, international equity and Australian bond funds recorded lower equal-weighted average returns than the benchmark across all observed periods. Australian small-cap funds, on the other hand, consistently delivered higher equal-weighted average returns than the benchmark across the one-, three- and five-year periods.
- **Asset-Weighted Average Fund Returns:** Asset-weighted average returns in all fund categories exceeded their respective equal-weighted average returns over the three- and five-year periods, showing that larger funds delivered higher returns than smaller funds across all of the measured peer groups.

Introduction

The SPIVA Australia Scorecard provides a semiannual update on the active vs. index debate in Australia. The SPIVA Australia Scorecard shows the performance of actively managed Australian mutual funds compared with S&P Dow Jones Indices in their respective categories. Although many such reports are available, the SPIVA Australia Scorecard is unique in that it offers the following.

- **Apples-to-apples comparison:** Fund returns are often compared with a popular benchmark regardless of their investment category. SPIVA Australia Scorecards make an appropriate comparison by measuring a fund's returns against the returns of a benchmark that reflects the fund's investment category.
- **Asset-weighted returns:** Average returns for a fund group are often calculated using only equal weighting, which results in the returns of an Australian dollar (AUD) 10 billion fund affecting the average in the same manner as the returns of an AUD 10 million fund. However, the SPIVA Australia Scorecard shows both equal- and asset-weighted averages. Equal-weighted returns are a measure of average fund performance, while asset-weighted returns are a measure of the performance of the average invested dollar.

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SPIVA Methodology

Data

We obtain a data feed of monthly fund data from Morningstar® Australia for all managed funds for which data are available for a given month-end date during the performance period. The data feed includes the most comprehensive Australian data on active, closed and finalized (merged or liquidated) funds over the chosen period. S&P Dow Jones Indices applies the following filters to ensure that an equitable comparative analysis is made.

- Only open-end unlisted retail unit trusts are selected.
- Small funds with less than AUD 5 million in market capitalization are excluded in an effort to report on fund performance that predominantly relates to investor experience. To this end, we remove as many versions, or share classes, of a fund as possible.

The following identifiers are available on a monthly basis.

- Fund name
- Fund identifier
- Month and year
- Fund returns for the month, including distributions
- Fund assets under management in that month
- Fund categorization in that month
- Management type, i.e., whether the fund is indexed or actively managed

We then limit our subset using the following filters.

- We choose funds that are actively managed, excluding index funds.
- We remove funds that lack information on assets under management for any three-month range within the previous 60 months. Therefore, if a fund is missing net asset data for a given month, a search is conducted over three months in an effort to populate that data field. Should a three-month search fail to yield net asset data, the fund is then removed from the analysis. We remove these funds because the report on asset-weighted returns cannot be computed without fund asset information, and we wish to use a consistent data set across the four main reports provided in the SPIVA Australia Scorecard.

Fund Categories

We choose funds that have, at any point in the previous 60 months, been classified in at least one of the following five categories.

- Australian Equity General
- Australian Equity Small-Cap
- International Equity General
- Australian Bonds
- Australian Equity A-REIT

These categories, we believe, represent the primary categories of interest for Australian fund investors and were derived from the Morningstar Australia fund classification policy. The Morningstar classification system produces narrow, style-based classifications for funds, particularly in relation to Australian and international equities.

S&P Dow Jones Indices has consolidated the style-based categories in order to generate a larger sample size and develop a broad-market comparison to market-based benchmarks. A narrow, style-based comparison would yield a limited sample size given that distinct value and growth style segments are not consistently discernible over the past five years.

Morningstar categories have been mapped to SPIVA peer groups in the following manner.

Exhibit 1: SPIVA and Morningstar Categories	
SPIVA Category	Morningstar Category
Australian Equity General	Equity Region Australia Large Value
	Equity Region Australia Large Growth
	Equity Region Australia Large Blend
Australian Equity Small-Cap	Equity Region Australia Mid/Small Value
	Equity Region Australia Mid/Small Growth
	Equity Region Australia Mid/Small Blend
International Equity General	Equity Region World Large Value
	Equity Region World Large Growth
	Equity Region World Large Blend
Australian Bonds	Australian Bonds
Australian Equity A-REIT	Equity Sector Australia–Real Estate

It is unlikely that funds will change from one category to another due to the broad nature of the groups that have been selected, which allows the SPIVA Scorecards to provide consistent comparisons over time.

Benchmarks

The chosen benchmarks are shown in the table below. All index returns are total returns (i.e., include dividend reinvestment) in Australian dollars. There has been no deduction from index returns to account for fund investment expenses. It is important to note that active fund returns are after expenses, but they do not include loads and entry fees.

Exhibit 2: SPIVA Categories and Their Benchmarks	
SPIVA Category	Benchmark Index
Australian Equity General	S&P/ASX 200 Accumulation Index
Australian Equity Small-Cap	S&P/ASX Small Ordinaries
International Equity General	S&P Developed Ex-Australia LargeMidCap
Australian Bonds	S&P/ASX Australian Fixed Interest Index
Australian Equity A-REIT	S&P/ASX 200 A-REIT

The benchmarks chosen are the most commonly adopted benchmarks for funds that fall into the respective fund peer groups. In some instances, a fund may not adopt the benchmarks stipulated above. However, a vast majority do set their performance hurdle based on the assigned benchmarks in this report, ensuring that the study is robust and fair.

Scorecard Results

Australian Equity General Funds: Majority of Active Funds Underperformed

The Australian equity market is significantly concentrated in that almost two-thirds of the market is allocated between resources and financials, and the top 50 stocks account for nearly 70% of the capitalization of the S&P/ASX 200 Accumulation Index. As a result, a large majority of the tradable opportunity set in Australia is heavily researched and considered highly efficient.

The S&P/ASX 200 Accumulation Index finished with an increase of 17.4% in the 12-month period ending June 2014. The majority of Australian large-cap equity funds underperformed the index during this period, which has been consistent for the past three- and five-year periods. Report 1 shows that 66.1%, 65.6% and 74.9% of actively managed funds were outperformed by the index in the past one-, three- and five-year periods, respectively. The S&P/ASX 200 Accumulation Index return surpassed both the equal- and asset-weighted average fund returns for the past one-year period. The asset-weighted average returns of active funds in this category exceeded the equal-weighted average returns across all observed periods, suggesting large funds tended to perform better than smaller funds. Of the active funds in this category, 100% survived the one-year period, although only 80.7% survived through the five-year period.

Australian Equity Small-Cap Funds: Strong Active Performance

When compared with large-cap stocks, stocks within the small-cap opportunity set tend to be relatively underresearched, which could allow active asset managers to take advantage of any mispricings in the market. This notion has panned out in the Australian market, where the large majority of active Australian equity small-cap funds have outperformed the S&P/ASX Small Ordinaries across all observed time periods.

Despite small corrections in the first half of 2014, the S&P/ASX Small Ordinaries recorded an annual gain of 13.1% as of June 2014. Australian small-cap funds delivered remarkable returns, with equal- and asset-weighted averages of 20.4% and 20% over the same period, respectively. The large majority of active Australian small-cap funds outperformed the benchmark, with only 8.2%, 7.7% and 17.1% of funds failing to beat the benchmark in the past one-, three- and five-year periods, respectively. The funds' equal- and asset-weighted average returns outpaced the benchmark by significant margins as well (see Reports 3 and 4). The five-year survivorship rate of this peer group is 83%, which is the highest among all peer groups.

International Equity General Funds: Investors Find Quality Among Poor Returns

In addition to equity risk, many international equity funds carry currency risk. Foreign exchange markets can have a profound effect on the risk profile of international equity funds and, therefore, can influence comparative fund returns within the peer group.

International equities moderately outperformed Australian domestic equities over the 12-month period ending June 2014, with the S&P Developed Ex-Australia LargeMidCap recording a return of 20.9%. However, the majority of active international equity funds underperformed the benchmark in the past one-year period, which was also consistent over the past three and five years. Across the category, only approximately one-fifth of active funds enjoyed returns equal to or higher than the S&P Developed Ex-Australia LargeMidCap over the past one year. On average, by either equal or asset weighting, returns of funds in this peer group trailed the benchmark return for all observed periods. Also, only 78.3% of funds in this category survived the five-year period, which was the lowest rate we observed among all categories.

Australian Bond Funds: Benchmark Outperformance With a Nuance

The performance of Australian bonds improved in the first half of 2014, moving the S&P/ASX Australian Fixed Interest Index higher to achieve a gain of 6.3% over the one-year period ending June 2014. Active Australian bond funds, on average, recorded slightly lower returns over the same period, and close to 80% of active funds in this category underperformed the index. The S&P/ASX Australian Fixed Interest Index return outpaced the equal-weighted average return of funds in this peer group across all observed periods. However, Australian bond funds had a survivorship rate that was higher than 98% for the one- and three-year periods and close to 82% for the five-year period. Asset-weighted average returns exceeded equal-weighted average returns of funds in this peer group for all observed periods, suggesting smaller funds suffered from lower returns than larger funds in this category.

Before drawing sweeping conclusions about the merits of bond-based indices and active bond funds, it is important to consider that unlike a stock index, a broad bond index is not truly replicable; it is a measure of the market, rather than a replicable passive portfolio. Typically, passive bond portfolios hold only a small fraction of an index's securities and use optimization algorithms to match benchmarks, not unlike active funds' use of quantitative screens to beat benchmarks.

Australian Equity A-REIT Funds: Survival of the Fittest?

The S&P/ASX 200 A-REIT gained 11.1% for the 12-month period ending June 2014, outperforming 54% of A-REIT funds. Both the equal- and asset-weighted average returns were higher than the index return over the one-year period. In contrast, A-REIT fund performance was less promising over the longer periods. Equal- and asset-weighted average returns were lower than the benchmark over the three- and five-year periods for this category, and 80% and 78.8% of active funds underperformed the index over the same periods, respectively. Asset-weighted average returns of A-REIT funds were above their respective equal-weighted average returns over all observed periods, showing the tendency of larger A-REIT funds to outperform smaller A-REIT funds. Over a five-year period, the survivorship rate of A-REIT funds was 78.5%, which was lower than the rates of Australian domestic equity and bond funds.

Report 1: Percentage of Funds Outperformed by the Index

This report shows the percentage of funds that were outperformed by the comparison benchmark index over the one-, three- and five-year periods. We begin with the funds listed in a category at the beginning of the period and report the percentage of funds that have underperformed the index. The fund's category at the end of the period is not considered, since the category of interest is the one at the beginning of the holding period. Therefore, fund category changes do not unduly affect the results in this report.

Exhibit 3: Percentage of Funds Outperformed by the Index				
Fund Category	Comparison Index	One-Year (%)	Three-Year (%)	Five-Year (%)
Australian Equity General	S&P/ASX 200 Accumulation Index	66.13	65.57	74.94
Australian Equity Small-Cap	S&P/ASX Small Ordinaries	8.18	7.69	17.12
International Equity General	S&P Developed Ex-Australia LargeMidCap	79.36	87.62	85.97
Australian Bonds	S&P/ASX Australian Fixed Interest Index	79.69	86.54	67.24
Australian Equity A-REIT	S&P/ASX 200 A-REIT	54.74	80.00	78.50

Source: S&P Dow Jones Indices LLC, Morningstar. Data as of June 30, 2014. Charts and tables are provided for illustrative purposes. Past performance is no guarantee of future results.

Report 2: Survivorship

This report shows the number of funds that existed in a particular category at the beginning of the period in question, as well as the percentage of funds that survived until the end of the period. Once again, the fund's category at the end of the period is not considered, since the category of interest is the one at the beginning of the holding period.

Exhibit 4: Survivorship

Fund Category	No. of Funds at Start	Survivorship (%)
One-Year		
Australian Equity General	379	100
Australian Equity Small-Cap	110	100
International Equity General	220	97.73
Australian Bonds	65	98.46
Australian Equity A-REIT	94	97.87
Three-Year		
Australian Equity General	373	90.62
Australian Equity Small-Cap	105	93.33
International Equity General	208	88.46
Australian Bonds	55	98.18
Australian Equity A-REIT	95	89.47
Five-Year		
Australian Equity General	410	80.73
Australian Equity Small-Cap	112	83.04
International Equity General	226	78.32
Australian Bonds	61	81.97
Australian Equity A-REIT	107	78.50

Source: S&P Dow Jones Indices LLC, Morningstar. Data as of June 30, 2014. Charts and tables are provided for illustrative purposes.

Report 3: Equal-Weighted Fund Returns

This report shows the equal-weighted average returns of funds in a particular category for the one-, three- and five-year periods. The eligible population in a given category is determined on a monthly basis.

For every month in the period, we calculated the simple average return of all the existing funds in each category. We then compound the returns from all the months in the period. These returns are compared to their respective benchmark's index returns. Note that the population of funds used in the averaging process one month might differ from those used the next month because some funds could have merged or liquidated, new funds could have been formed and some funds could have switched categories.

Most reports that purport to show average active fund performance report on the funds in a category at the end of the period, and then take the average of their historical returns. The SPIVA methodology offers a more accurate picture of active fund performance by calculating the average performance of the active funds in existence in a given category each month—not just at the end of the period.

Exhibit 5: Equal-Weighted Fund Returns

Index/Peer Group	One-Year (%)	Three-Year Annualized (%)	Five-Year Annualized (%)
S&P/ASX 200 Accumulation Index	17.41	10.37	11.19
Australian Equity General	16.83	10.17	10.59
S&P/ASX Small Ordinaries	13.12	-2.94	3.43
Australian Equity Small-Cap	20.4	7.93	13.38
S&P Developed Ex-Australia LargeMidCap	20.85	17.23	12.12
International Equity General	18.39	14.69	10.46
S&P/ASX Australian Fixed Interest Index	6.33	7.27	7.12
Australian Bonds	5.62	6.37	6.99
S&P/ASX 200 A-REIT	11.05	15.27	14.32
Australian Equity A-REIT	11.26	14.48	13.42

Source: S&P Dow Jones Indices, Morningstar. Data as of June 30, 2014. All returns in AUD. Charts and tables are provided for illustrative purposes. Past performance is no guarantee of future results.

Report 4: Asset-Weighted Fund Returns

This report shows the asset-weighted average returns of funds in a particular category for one-, three- and five-year periods. The eligible population in a given category is determined on a monthly basis.

For every month in the period, we calculated the average return by weighting each fund's return by its month-end assets. We then compounded the returns from all the months in the period and compared them to the benchmark returns. Note that the funds used in the averaging process one month might not be the same as those used the next month since some funds could have merged or liquidated, new funds could have been formed and some funds could have switched categories.

Exhibit 6: Asset-Weighted Fund Returns

Index/Peer Group	One-Year (%)	Three-Year Annualized (%)	Five-Year Annualized (%)
S&P/ASX 200 Accumulation Index	17.41	10.37	11.19
Australian Equity General	17.21	11.13	11.40
S&P/ASX Small Ordinaries	13.12	-2.94	3.43
Australian Equity Small-Cap	20.00	8.75	13.71
S&P Developed Ex-Australia LargeMidCap	20.85	17.23	12.12
International Equity General	18.38	15.83	10.92
S&P/ASX Australian Fixed Interest Index	6.33	7.27	7.12
Australian Bonds	5.79	6.85	7.35
S&P/ASX 200 A-REIT	11.05	15.27	14.32
Australian Equity A-REIT	12.52	14.96	13.86

Source: S&P Dow Jones Indices LLC, Morningstar. Data as of June 30, 2014. All returns in AUD. Charts and tables are provided for illustrative purposes. Past performance is no guarantee of future results.

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