

SPIVA[®] Australia Scorecard

MID-YEAR 2013

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SUMMARY

- The SPIVA[®] Australia Scorecard reports on the performance of actively managed Australian mutual funds, corrected for survivorship bias, and shows equal- and asset-weighted peer averages.
- There is nothing novel about the index versus active debate. It 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.
- Beyond the SPIVA Australia Scorecard's widely cited headline numbers is a rich data set that addresses issues related to measurement techniques, universe composition and fund survivorship that are far less frequently discussed, but are often far more fascinating.
- There are no consistent or useful 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 a majority of active equity managers in most categories lag comparable benchmark indices.
- Domestic Equities: Over the past 12 months ending June 30, the S&P/ASX200 Accumulation Index has been outperformed by more than 60% of active Australian equity funds studied in the SPIVA Australia Scorecard. However, over a five-year horizon, the S&P/ASX200 Accumulation Index has outperformed over 60% of active Australian equity general funds. The figures are equally unfavorable for active funds when measured over a three-year period, during which nearly 68% of the fund performance again lagged their benchmarks.
- Active Australian equity small-cap funds have significantly outperformed the benchmark across all periods studied in this report. Over the last five years, approximately 82% of active Australian equity small-cap funds have outperformed the S&P/ASX Small Ordinaries Index, with this majority increasing to roughly 93% over the last year. Both the equal- and asset-weighted average returns of the active fund category have far outperformed the S&P/ASX Small Ordinaries Index across all periods studied.
- Foreign Equities: Over 75% of active international equity general funds underperformed relative to the benchmark over the last year. The figures are equally unfavorable when viewed over both three- and five-year periods, with 88.04% and 78.97% of international equities general funds underperforming relative to the benchmark.
- Over the last five years approximately 64% of active Australian bond funds have failed to beat the index. When measured over the trailing three years, the underperforming percentage rises to approximately 68%. It should be noted that active Australian bond funds have the highest survivorship rate across the universe of funds studied in this report.

- Nearly 60% of active Australian A-REIT funds have failed to beat the benchmark over the last five years, increasing to an even larger majority of 87% when taking into account only the last year.
- The asset-weighted returns of most peer groups observed in this report are higher than their respective equal-weighted returns over the three- and five-year periods, indicating that larger funds perform better in each of these peer groups over medium- to long-term horizons. However, a study of shorter time horizons shows mixed results across different peer groups.
- Over the last year, survivorship rates across all categories have been greater than 95%. As expected, the figure declines to an average of 80.72% when viewed over the longer-term five-year period. The report also shows that while active funds in a particular category may be able to outperform the benchmark over the one-year period, there is no consistency when viewed over a five-year period. Australian equity small-cap funds are the only exception to this finding. With the exception of active Australian Equity Small-Cap funds, a majority of funds across all categories have failed to beat their respective indices over three- and five-year periods studied in the report.

UNDERSTANDING BEFORE INVESTING

Like all forms of investing, managed fund investing must begin with understanding not only the funds, but also the fund categories being considered. SPIVA Scorecards go beyond providing simple performance data for each fund category to offer detailed apples-to-apples comparisons corrected for survivorship bias, as well as asset- and equal-weighted peer averages.

S&P Dow Jones Indices believes that planners, brokers and investors should be aware of the overall objectives and costs of their actively managed funds, and should understand the experience, investment styles and strategies of their fund managers. They should also understand the strengths and weaknesses of the funds' performance benchmarks and available passive investment vehicles. The SPIVA Scorecards serve as clean, unbiased reports on the ongoing active versus passive debate. Readers will need to make their own judgments about where to invest, and just as importantly, where not to invest. The Nobel Prize-winning professor, William F. Sharpe, sums it up:

Should everyone index everything? The answer is resoundingly no. In fact, if everyone indexed, capital markets would cease to provide the relatively efficient security prices that make indexing an attractive strategy for some investors. All the research undertaken by active managers keeps prices closer to values, enabling indexed investors to catch a free ride without paying the costs. Thus there is a fragile equilibrium in which some investors choose to index some or all of their money, while the rest continue to search for mispriced securities.

Should you index at least some of your portfolio? This is up to you. I only suggest that you consider the option. In the long run, this boring approach can give you more time for more interesting activities such as music, art, literature, sports, and so on. And it very well may leave you with more money as well.

William F. Sharpe, 20021

¹ www.stanford.edu/~wfsarpe/art/talks/indexed_investing.htm

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 sixty 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
- Australian Equity Real Estate
- International Equity General
- Australian Fixed Income

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 last five years.

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

Morningstar Category	SPIVA Category
Equity Region Australia Large Value	Australian Equity General
Equity Region Australia Large Blend	
Equity Region Australia Large Growth	
Equity Region Australia Mid/Small Value	Australian Equity Small-Cap
Equity Region Australia Mid/Small Blend	
Equity Region Australia Mid/Small Growth	
Equity Region World Large Value	International Equity General
Equity Region World Large Blend	
Equity Region World Large Growth	
Australian Bonds	Australian Bond
Equity Sector Australia - Real Estate	Australian Equity A-REIT

It is very 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. Active fund returns are after expenses, but do not include loads and entry fees.

SPIVA Category	Market Index
Australian Equity General	S&P/ASX 200 Index
Australian Equity Small-Cap	S&P/ASX Small Ordinaries Index
International Equity General	MSCI World Ex Australia Index
Australian Bond	UBS Composite Bond Index 0+Y
Australian Equity A-REIT	S&P/ASX 200 A-REIT Index

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: Active Funds Underperform

The performance of Australian equity funds is of particular interest to Australian investors, who generally allocate a large portion of their fund investments to domestic equities. 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/ASX200. As a result, a large majority of the tradable opportunity set in Australia is heavily researched and considered highly efficient.

Over the past 12 months ended June 30, the S&P/ASX Accumulation Index posted double digit gains of 22.75%. Domestic equity managers delivered equally remarkable returns, as the majority of the active funds beat the benchmark. According to Report 1, only 36.42% of managers failed to outpace the benchmark. However, the longer-term five-year figure paints a less rosy picture, as 60.41% of funds underperformed the benchmark. Report 3 and 4 show that the asset-weighted returns of active Australian equity funds (indicating the average return of an invested dollar) exceeded the equal-weighted returns (indicating the average return of a fund) over all the periods studied, though only marginally. As shown in Report 2, active funds have displayed an 80.55% survivorship rate over the five-year period, which is largely consistent with other peer groups observed in this report.

Australian Equity Small-Cap Funds: Strong Active Performance

Stocks within the small-cap opportunity set are relatively under-researched when compared to large-cap stocks, better enabling active asset managers to take advantage of any mispricing opportunities in the market. The S&P/ASX Small Ordinaries Index is also much less concentrated when compared to the S&P/ASX200 Index, meaning that the market is not holding a large portion of funds within relatively few securities. The notion that small-cap stocks are relatively under-researched has panned out in the Australian market, where the S&P/ASX Small Ordinaries Index has failed to beat a very large majority of active Australian Equity Small -Cap funds across all time periods.

More than 80% of all Australian equity small-cap funds have beaten the index over periods of one year or more. The results over the last year are quite remarkable, with almost every active small-cap fund outperforming the index; approximately 93% of active small-cap funds beat the index. Equal- and asset-weighted average returns in Reports 3 and 4 also show that active funds in this category have outperformed the index across all time periods by a significant margin. Asset-weighted returns are moderately higher when compared to equal-weighted returns over periods of one year or more. Survivorship of active funds in this peer group is relatively robust, at 82.08% over the five-year period, ranking second highest among other peer groups over the same period.

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 impact on the risk profile of international equity funds, and therefore, influence the comparative fund returns within the peer group. As shown in Report 1, over 75% of international equity funds failed to beat the MSCI World Accumulation Index over the last year, increasing to nearly 79% that have failed to beat the benchmark over the last five years. Report 3 shows that in equal-weighted terms, active funds in this peer group consistently underperformed relative to the index across all time periods. Report 4 shows that the asset-weighted returns of the International Equity General peer group outperformed the index over the one- and five-year periods. However, these results are reversed over a period of three years. The strong asset-weighted return over longer-time periods provides compelling evidence suggesting that investors are allocating money to the better performing funds and that the largest funds are performing much better than the smaller funds in this asset class.

Australian Bond Funds: Benchmark Outperformance with a Nuance

A vast majority of the active diversified bond funds in the Australian market outperformed the UBS Composite Bond Index over the past year. However, as shown in Report 1, the index outperformed 67% and 64% of active funds over the three- and five-year periods, respectively. Australian bond funds also have the highest survivorship rate of all the asset classes, as illustrated in Report 2, which shows an 82.46% survivorship rate over the last five years. Reports 3 and 4 show asset-weighted returns consistently higher than equally-weighted returns, offering some evidence that larger active Australian bond funds perform better than smaller Australian bond funds. 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 the 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?

As shown in Report 1, the S&P/ASX 200 A-REIT Index outperformed approximately 87% of active funds in the last year. However, the proportion that was outperformed by the index decreased to approximately 60% over five years. Report 4 shows that the asset-weighted weighted returns for the peer group are higher than the equal weighted returns across all the periods studied in the report, illustrating a tendency to allocate assets toward listed property funds that outperform the index.

Report 1: Percentage of Funds Outperformed by the Index

This report corrects for any survivorship bias and shows the percentage of funds that were outperformed by the comparison benchmark index over the quarter, as well as 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 impact the results in this report.

Report 1: 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	36.42	67.63	60.41
Australian Equity Small Cap	S&P/ASX Small Ordinaries Index	6.12	11.54	18.10
International Equity General	MSCI World Ex Australia Index	75.52	88.04	78.97
Australian Bonds	UBS Composite Bond Index 0+Y	37.74	67.27	64.29
Australian Equity A-REIT	S&P/ASX 200 A-REIT Index	86.96	79.80	59.22

Source: S&P Dow Jones Indices, Morningstar. Data as of June 30, 2013.

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.

Report 2: Survivorship		
Fund Category	No. of Funds at Start	Survivorship (%)
One-Year		
Australian Equity General	352.00	97.73
Australian Equity Small Cap	98.00	98.98
International Equity General	194.00	95.88
Australian Bonds	54.00	100.00
Australian Equity A-REIT	93.00	96.77
Three-Year		
Australian Equity General	387.00	87.60
Australian Equity Small Cap	104.00	90.38
International Equity General	212.00	86.79
Australian Bonds	56.00	92.86
Australian Equity A-REIT	100.00	90.00
Five-Year		
Australian Equity General	401.00	80.55
Australian Equity Small Cap	106.00	82.08
International Equity General	216.00	78.70
Australian Bonds	57.00	82.46
Australian Equity A-REIT	109.00	79.82

Source: S&P Dow Jones Indices, Morningstar. Data as of June 30, 2013.

Report 3: Equal-Weighted Fund Returns

This report shows the equal-weighted average returns of funds in a particular category for the quarter, as well as 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 calculate 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 the respective benchmark index returns. Note that the population of funds used in the averaging process one month might differ from that 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.

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.

Report 3: Equal-Weighted Fund Returns

Index/Peer Group	One-Year (%)	Three-Year Annualized (%)	Five-Year Annualized (%)
S&P/ASX 200 Accumulation Index	22.73	8.56	2.94
Australian Equity General	23.44	8.05	3.32
S&P/ASX Small Ordinaries Index	-5.32	-2.01	-5.66
Australian Equity Small Cap	12.46	8.62	4.18
MSCI World Ex Australia Index	34.18	11.51	4.35
International Equity General	31.78	9.01	2.97
UBS Composite Bond Index 0+Y	2.77	6.83	7.83
Australian Bonds	3.19	6.49	7.68
S&P/ASX 200 A-REIT Index	24.22	13.45	0.3
Australian Equity A-REIT	22.53	12.62	0.63

Source: S&P Dow Jones Indices, Morningstar. Data as of June 30, 2013.

Report 4: Asset-Weighted Fund Returns

This report shows the asset-weighted average returns of funds in a particular category for the quarter as well as 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 calculate the average return by weighting each fund's return by its month-end assets. We then compound the returns from all the months in the period and compare the returns to the benchmark returns. Note that the funds used in the averaging process in 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.

Report 4: Asset-Weighted Fund Returns

Index/Peer Group	One-Year (%)	Three-Year Annualized (%)	Five-Year Annualized (%)
S&P/ASX 200 Accumulation Index	22.73	8.56	2.94
Australian Equity General	24.53	8.87	4.33
S&P/ASX Small Ordinaries Index	-5.32	-2.01	-5.66
Australian Equity Small Cap	15.03	9.17	4.61
MSCI World Ex Australia Index	34.18	11.51	4.35
International Equity General	34.86	9.45	4.73
UBS Composite Bond Index 0+Y	2.77	6.83	7.83
Australian Bonds	3.77	6.92	8.01
S&P/ASX 200 A-REIT Index	24.22	13.45	0.30
Australian Equity A-REIT	22.80	13.06	0.81

Source: S&P Dow Jones Indices, Morningstar. Data as of June 30, 2013.

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