

SPIVA[®] Australia Scorecard

YEAR-END 2013

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Summary

- The SPIVA Australia Scorecard reports on the performance of actively managed Australian mutual funds vs. that of their benchmarks, showing equal- and asset-weighted peer averages.
- The index vs. 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.
- 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 vs. index figures. The only consistent data point we have observed over a five-year horizon is that a majority of active equity funds in most categories fail to beat the comparable benchmark indices.
- **Australian General Equities:** The market environment of 2013 was less volatile than it had been in recent years, and 68% of funds outperformed the S&P/ASX 200 Accumulation Index. However, over the three- and five-year periods, only 37% and 30% of funds in this category managed to outperform the benchmark, respectively.
- **Australian Small-Cap Equities:** The majority of active Australian small-cap funds outperformed the S&P/ASX Small Ordinaries Index consistently over the past one, three and five years. Active funds in this peer group delivered remarkable returns in 2013, with only 5.4% failing to beat the benchmark. Over the past five years, Australian small-cap funds had a survivorship rate of 83%, the highest among all observed fund categories.
- **International Equities:** Less than a quarter of active international equity funds managed to outperform the S&P Developed Ex-Australia LargeMidCap in the past one- and five-year periods. The figure was even lower for the three-year period, with only 16% of funds in this category outperforming the benchmark.
- **Australian Bonds:** In the past year, 55% of Australian bond funds beat the S&P/ASX Fixed Interest Index, but the figures were lower for periods of three and five years, with only 16% and 45% outperforming the benchmark, respectively.
- **Australian A-REITs:** Almost 60% of Australian A-REIT funds failed to beat the S&P/ASX 200 A-REIT over the one- and five-year periods. The portion of funds underperforming the benchmark over the three-year period was even higher, exceeding 70%. Australian A-REIT funds had the lowest survivorship rate among all observed peer groups—78.3% over a five-year period.

- **Fund Survivorship:** Over 94% of active funds in each of the peer groups observed in this report survived more than one year. However, only the Australian small-cap and bond funds maintained a survivorship rate of over 90% for a three-year horizon. Extending the observation period to five years, none of the fund categories had a survivorship rate above 84%. The figures for international equity and A-REIT funds were below 80%. Australian small-cap funds had the highest survivorship rates among all categories across all observed periods.
- **Equal-Weighted Average Funds Return:** Australian small-cap funds consistently delivered higher equal-weighted average returns than the benchmark across one-, three- and five-year periods. International equity funds, on the other hand, recorded lower equal-weighted average returns than the benchmark across all observed periods.
- **Asset-Weighted Average Funds Return:** Asset-weighted average returns for most fund categories exceeded their respective equal-weighted average returns across all observed periods, showing that larger funds delivered higher returns than smaller funds in all of the measured peer groups. The Australian general equity, small-cap equity and A-REIT funds recorded higher asset-weighted average returns than their respective benchmarks over the past one-, three- and five-year horizons.

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:

- **Apples-to-apples comparison:** Fund returns are often compared with a popular benchmark regardless of its 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 a Australian dollar (AUD) 10 billion fund affecting the average in the same manner as the returns of a AUD 10 million fund. The SPIVA Australia Scorecard shows both equal- and asset-weighted averages. Equal-weighted returns are a measure of average fund performance. 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 SmallCap	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 Index
Australian Equity Small-Cap	S&P/ASX Small Ordinaries Index
International Equity General	S&P Developed Ex-Australia LargeMidCap Index
Australian Bonds	S&P/ASX Australian Fixed Interest Index
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/ASX 200 Accumulation Index. As a result, a large majority of the tradable opportunity set in Australia is heavily researched and considered highly efficient.

Domestic equity investors enjoyed a good year in 2013, with the S&P/ASX 200 Accumulation Index posting a gain of 20.2%. With a less volatile market environment, domestic equity managers delivered equally remarkable returns, as the majority of active Australian equity funds beat the benchmark. Report 1 shows that only 32.2% of funds underperformed the benchmark in 2013. Both the equal- and asset-weighted average fund returns marginally exceeded the benchmark return as shown in Report 3 and 4. However, looking at longer periods of three and five years, the picture is less rosy, with 62.8% and 69.7% of active funds underperforming the benchmark, respectively. Of the active funds in this category, 80.6% survived through a five-year period (see Report 2). The asset-weighted average return of active Australian equity funds marginally exceeded the equal-weighted average return across all observed periods, suggesting large funds tended to perform better than smaller funds.

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. The S&P/ASX Small Ordinaries Index is also much less concentrated when compared to the S&P/ASX 200 Accumulation 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 underresearched 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 Index across all time periods.

Unlike general equities in Australia, small-cap equities performed poorly in 2013, with the S&P/ASX Small Ordinaries Index recording a loss of 0.76% for the year. However, small-cap funds delivered remarkable returns, with 94.6% of funds outperforming the benchmark over the past year (see Report 1). The remarkable performance of Australian small-cap funds has been consistent for the past three- and five-year periods, with more than 89.4% and 82.9% of funds beating the benchmark, respectively. Both the equal- and asset-weighted average returns in Reports 3 and 4 show that active funds in this category outpaced the benchmark across one-, three- and five-year periods by significant margins. This peer group also had the highest survivorship rates among all peer groups across all observed periods, with a survivorship rate of 83% over the past five years. The asset-weighted average return was moderately higher than the equal-weighted average return over periods of one and three years.

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 performed strongly in 2013, with the S&P Developed Ex-Australia LargeMidCap Index recording a 47.8% return for the year. The majority (77.6%) of international equity funds failed to beat the benchmark in the past one-year period, consistent with our observations over the past three and five years with 84.3% and 75.7% of funds underperforming the benchmark, respectively. The equal- and asset-weighted average returns in Reports 3 and 4 underperformed that of the benchmark in most of the observed periods. Equal-weighted average returns trailed asset-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. The survivorship rate of funds in this peer group was only 78.6% for a five-year period—relatively low among all observed categories.

Australian Bond Funds: Benchmark Outperformance With a Nuance

The performance of Australian bonds was weak in 2013 relative to the previous year. The S&P/ASX Australian Fixed Interest Index posted a return of just 1.9% for the year. Of Australian bond funds, 44.6% underperformed the benchmark in the past year, which was lower than the 83.6% and 54.6% amounts observed over the past three and five years, respectively. Despite both the equal- and asset-weighted average returns of funds in this category exceeding the benchmark return over the past one-year period (as shown in Reports 3 and 4), neither of them showed a consistent margin above benchmark return over the past three and five years. However, survivorship rates of Australian bond funds were above 90% and 80% over the three- and five-year periods, respectively, which is relatively high among all fund categories (see Report 2). Asset-weighted average returns were consistently higher than equally weighted average returns for funds in this peer group—evidence that larger, active Australian bond funds tended to 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 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 posted a 7.1% gain in 2013, outperforming approximately 60% of active funds in this peer group, which is consistent with the observation across a five-year period. However, the portion of funds underperforming the benchmark increased to 73.7% over the three-year period. As shown in Reports 3 and 4, 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 only 78.3%, the lowest among all fund categories.

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 impact 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	32.21	62.83	69.67
Australian Equity Small-Cap	S&P/ASX Small Ordinaries Index	5.41	10.58	17.12
International Equity General	S&P Developed Ex-Australia LargeMidCap Index	77.63	84.31	75.69
Australian Bonds	S&P/ASX Australian Fixed Interest Index	44.62	83.64	54.55
Australian Equity A-REIT	S&P/ASX 200 A-REIT	59.60	73.68	59.05

Source: S&P Dow Jones Indices, Morningstar. Data as of Dec. 31, 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.

Exhibit 4: Survivorship

Fund Category	No. of Funds at Start	Survivorship (%)
One-Year		
Australian Equity General	391	97.95
Australian Equity Small-Cap	111	99.10
International Equity General	222	97.30
Australian Bonds	66	98.48
Australian Equity A-REIT	99	94.95
Three-Year		
Australian Equity General	383	88.25
Australian Equity Small-Cap	105	92.38
International Equity General	211	87.68
Australian Bonds	58	91.38
Australian Equity A-REIT	95	89.47
Five-Year		
Australian Equity General	408	80.64
Australian Equity Small-Cap	112	83.04
International Equity General	224	78.57
Australian Bonds	58	81.03
Australian Equity A-REIT	106	78.30

Source: S&P Dow Jones Indices, Morningstar. Data as of Dec. 31, 2013.

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 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 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	20.18	8.94	12.46
Australian Equity General	21.80	8.94	12.04
S&P/ASX Small Ordinaries Index	-0.76	-5.99	8.14
Australian Equity Small-Cap	16.25	6.38	17.00
S&P Developed Ex-Australia LargeMidCap Index	47.83	17.31	10.10
International Equity General	43.54	14.69	9.23
S&P/ASX Australian Fixed Interest Index	1.87	7.22	5.66
Australian Bonds	2.07	6.44	6.09
S&P/ASX 200 A-REIT Index	7.10	11.96	8.57
Australian Equity A-REIT	7.11	11.42	9.05

Source: S&P Dow Jones Indices, Morningstar. Data as of Dec. 31, 2013. All returns in AUD.

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 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.

Exhibit 6: Asset-Weighted Fund Returns

Index/Peer Group	One-Year (%)	Three-Year Annualized (%)	Five-Year Annualized (%)
S&P/ASX 200 Accumulation Index	20.18	8.94	12.46
Australian Equity General	22.90	10.00	12.94
S&P/ASX Small Ordinaries Index	-0.76	-5.99	8.14
Australian Equity Small-Cap	18.52	7.14	17.00
S&P Developed Ex-Australia LargeMidCap Index	47.83	17.31	10.10
International Equity General	46.34	15.84	10.29
S&P/ASX Australian Fixed Interest Index	1.87	7.22	5.66
Australian Bonds	2.32	6.91	6.46
S&P/ASX 200 A-REIT Index	7.10	11.96	8.57
Australian Equity A-REIT	8.32	12.07	9.40

Source: S&P Dow Jones Indices, Morningstar. Data as of Dec. 31, 2013. All returns in AUD.

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