

Standard & Poor's Indices Versus Active Funds Scorecard (SPIVA®)

Summary

- Over the five-year period ending December 31 2010, a majority of active funds (across most of the peer groups in this study) have failed to beat their respective benchmarks. With the exception of active Australian small-cap equity funds, more than 60% of all active funds underperformed relative to their benchmarks over a five-year period. The results are mixed for shorter time periods studied in this SPIVA® Scorecard.
- The S&P/ASX 200 Accumulation Index has outperformed active Australian equity funds over every time period studied. The S&P/ASX 200 Accumulation Index has outperformed approximately 71% of active Australian Equity General Funds over the last 5 years, increasing to approximately 81% over the last year. In spite of this result, Australian Equity funds enjoy the 2nd highest survivorship rate, relative to other peer groups, over periods of a minimum of one year.
- A large majority of active Australian equity small-cap funds have beaten the S&P/ASX Small Ordinaries Index across most of the time periods studied. Over 70% of Australian equity small-cap funds beat the S&P/ASX Small Ordinaries Index over a five-year period. However a similar majority underperformed relative to the benchmark over the last quarter.
- The percentage of active international equity funds that failed to beat the MSCI World ex Australia Index is generally consistent across all periods studied in this report. At least 60% of active international equity funds underperformed relative to the benchmark over every time horizon. Over a five-year period, the index has outperformed approximately 74% of actively managed international equity funds.
- A majority of Australian Bond funds have underperformed relative to the UBS Composite Bond Index across all time periods. At least 80% of active Australian Bond funds have failed to beat the benchmark over periods of three years or more. Correspondingly, this peer group suffered the lowest survivorship rate of the same period.
- The asset-weighted returns of most peer groups observed in this report are higher than the simple equal-weighted returns of their respective peer groups over a 3-year and 5-year period, indicating that larger funds perform better in each of these peers groups over the medium to long-term. However, a study of shorter time horizons shows mixed results across different peer groups.

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**S&P
INDICES**

A Unique Scorecard for the Active Versus Passive Debate

The Standard & Poor's Indices Versus Active Funds (SPIVA) Scorecard presents the performance of actively managed mutual funds as compared to relevant benchmark indices. Covering funds in Australia and comparing them to various Australian market indices in their respective categories, the popularity of SPIVA stems from a few unique attributes:

- **Survivorship bias correction:** Many funds might be liquidated or merged during a period of study. However, for someone making an investment decision at the beginning of the period, these funds are part of the opportunity set. Unlike other commonly available comparison reports, SPIVA removes survivorship bias.
- **Apples-to-apples comparison:** Fund returns are often compared to those of popular benchmarks regardless of their investment category.* SPIVA Scorecards avoid this pitfall by measuring a fund's returns against the returns of a benchmark appropriate for that particular 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 A \$10 billion fund affecting the average in the same manner as the returns of an A \$10 million fund. Equal-weighted returns are a measure of average fund performance, while asset weighted returns measure the performance of the average invested dollar. The SPIVA Scorecard shows both equal- and asset-weighted averages.

SPIVA Australia builds upon the reputation and success of the SPIVA Scorecard in the United States and Canada, where it has been widely recognized among financial advisors, institutional investors, and the media. Like its global counterparts, SPIVA Australia does not make investment recommendations or offer comments on the suitability of either index or active investing. The Scorecard simply reports periodic data according to the SPIVA methodology and provides a brief analysis. To better understand how the data is derived, please see the methodology beginning on page 5 of this document.

SPIVA Scorecards are the only comprehensive, periodic and publicly available sources of such data and can be found online at www.spiva.standardandpoors.com.au.

Scorecard Results

Australian General Equity Funds: Active Funds Underperformed

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

Australian equity investors saw the domestic market settle somewhat throughout 2010, particularly towards the end of the year, as volatility moved toward a more steady state. Despite a positive final quarter and more tolerable levels of volatility, the market still struggled to deliver a positive return in 2010. While the year finished on a positive note, active Australian equity funds continue to struggle relative to the S&P/ASX 200 Accumulation Index. [Report 1](#) shows that over the last year, 80.94% of funds have failed to beat the benchmark index. Over a longer five-year period, the index beat 70.57% of active Australian equity funds – the largest percentage observed since the SPIVA[®] Scorecard was introduced in Australia in 2009. [Report 3](#) and [Report 4](#) illustrate some interesting results, with the asset-weighted returns of active Australian equity funds exceeding the equal-weighted returns over three or more years. The results over a shorter time horizon generally show equal-weight returns exceeding asset-weighted returns for the peer group. Therefore, there is no compelling evidence to suggest that larger funds are performing better than smaller funds, dismissing the view that investors are increasingly allocating money to stronger performers.

Despite the fact that a large majority of active funds failed to beat the benchmark over five years, as shown in [Report 2](#), active funds have displayed a 90.81% survivorship rate over this period. This is the second highest survivorship rate across each of the peer groups studied over a five-year period.

Australian Small-Cap Funds: Strong Active Outperformance

Stocks within the small-cap opportunity set are relatively under-researched when compared to large-cap stocks, better enabling asset managers to take advantage of any mispricing opportunities in the market. This theory has panned out in the Australian market where the S&P/ASX Small Ordinaries Index has failed to beat a majority of active Australian equity small-cap funds across all time periods, with the exception of 4Q 2010. At least 70% of all active small-cap funds have beaten the index over a 5-year period. However, a corresponding majority has failed to beat the benchmark over the last quarter. Equal- and asset-weighted average returns in [Report 3](#) and [Report 4](#) also show that active funds in this category have outperformed the index across all time periods, with the last quarter being the only exception. Equal-weighted returns are greater than asset-weighted returns over the 3-year and 5-year periods studied. This finding suggests that larger funds are also performing well in the small-cap segment of the market. Survivorship of active funds in this peer group suffered over the last year, exhibiting a 93.59% survival rate, which is the second lowest among all peer groups.

International Equity: Investors Find Quality Among Poor Performers

In addition to equity risk, many international equity funds also 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. The strength of the Australian dollar has eroded much of the gains that may have been delivered through global investments in 2010. As seen in [Report 1](#), at least 63% of funds failed to beat the MSCI World Accumulation Index over all of the periods studied in this report. Over five years, 73.68% of active international equity funds failed to beat the benchmark. [Report 3](#) shows that in equal-weighted terms, active funds in this peer group consistently underperformed relative to the index across all time periods, with a much larger magnitude over five years. [Report 4](#) shows asset-weighted returns of the international equity peer group substantially outperforming the index over a three- and five-year period. However, these results are reversed over periods of one year or less. The strong asset-weight return over longer time periods provides compelling evidence that suggest 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.

[Report 2](#) shows that the five-year survivorship rate for international equity funds is approximately 87%, which is the second lowest rate across the different peer groups in this report.

Fixed Income: Benchmark Outperformance with a Nuance

The UBS Composite Bond Index has outperformed a vast majority of the active diversified bond funds in the Australian market across all time periods. Looking closer at [Report 1](#), it shows that the index outperformed over 82% of active funds over the three- and five-year periods. Furthermore, [Report 3](#) and [Report 4](#) show that active Australian fixed income funds underperformed the index in both equal-weighted and asset-weighted terms for periods greater than one year. Before drawing sweeping conclusions about the merits of indices and active indexing in bonds, it is important to consider that unlike a stock index, a broad bond index is not truly replicable; it is only 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 bond funds also have the lowest survivorship rate across all asset classes, as illustrated in [Report 2](#), which shows an 82.5% survivorship rate over the last five years.

A-REIT: Mixed Results

As shown in [Report 1](#), the S&P/ASX 200 A-REIT Index outperformed approximately 76.47% of active funds in the last year. However, the proportion that was outperformed by the index decreased to approximately 62% over five years, with a majority of approximately 54% active funds outperforming over the last three years. Report 4 shows that the peer group outperformed the index on an asset-weighted basis over all periods studied in the report, illustrating a general allocation of assets toward listed property funds that outperform the index. The Australian equity A-REIT peer group enjoyed the highest survivorship rate over a period of three years or more.

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-weighted and equal-weighted peer averages.

S&P 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 on where to invest, and equally important, 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

SPIVA Methodology

Data

We obtain a data feed of monthly fund data from Morningstar[®] Australia for all managed funds whose 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 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 that are less than A \$5 million in size are excluded in an effort to report on fund performance that predominantly relates to investor experience, thereby removing as many versions – 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

¹www.stanford.edu/~wfs Sharpe/art/talks/indexed_investing.htm

We then limit our subset using the following filters:

- We choose funds that are actively managed, excluding index funds.
- We remove funds that do not have information on assets under management for a 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 we have a report on asset-weighted returns that cannot be computed without fund asset information, and we wish to use a consistent data set across the four main reports provided in SPIVA Australia.

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 major 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 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 comparative would yield a limited sample size given that distinct value and growth style segments are not consistently discernable over the last five years. Morningstar categories have been mapped to SPIVA peer groups in the following manner:

Morningstar Category	SPIVA Category Name
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 Bonds
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 comparator groups that have been selected. This allows for more consistent comparison over time for each of the SPIVA Scorecards.

Benchmarks

The benchmarks chosen are shown in the table below. All the index returns are total returns (i.e., include dividend reinvestment) in Australian Dollars. There has been no deduction of index returns to account for fund investment expenses. Active fund returns are after expenses, but do not include loads/entry fees.

SPIVA Category Name	Market Index Name
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 Bonds	UBS Composite Bond Index 0+Y
Australian Equity A-REIT	S&P/ASX 200 A-REIT Index

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

Reports

Report 1: Percentage of Funds Outperformed by the Index

This report corrects any survivorship bias and illustrates the percentage of funds that have been outperformed by the comparison benchmark over last quarter, one-year, three-year and five-year periods. We start off with the funds listed in a category at the beginning of the period. At the end of the period, we report the percentage of funds that have survived and outperformed 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, any potential fund category changes do not unduly impact the results in this report.

The report essentially shows what percentage of funds in the opportunity set, at the beginning of the period, failed and underperformed relative to the benchmark.

Most reports that purport to show the percentage of active funds outperforming an index start off with the funds in a category at the end of the period, and then compare their historical returns to the benchmark. SPIVA corrects for this survivorship bias by accounting for the funds present at the beginning of the period.

Report 1: Percentage of Funds Outperformed by the Index					
Fund Category	Comparison Index	Last Quarter (%)	One Year (%)	Three Year (%)	Five Year (%)
Australian Equity General	S&P/ASX 200 Accumulation Index	66.29	80.94	53.60	70.57
Australian Equity Small Cap	S&P/ASX Small Ordinaries Index	71.23	44.16	31.58	28.99
International Equity General	MSCI World Ex Australia Index	68.94	68.57	63.45	73.68
Australian Bonds	UBS Composite Bond Index 0+Y	55.56	62.16	82.93	82.50
Australian Equity A-REIT	S&P/ASX 200 A-REIT Index	39.51	76.47	45.68	62.50

Source: Standard & Poor's, Morningstar. Data as of December 31, 2010. Charts are provided for illustrative purposes only. Index returns do not include payment of any sales charges or fees an investor would pay to purchase the securities they represent. Such costs would lower performance. It is not possible to invest directly in an index. Past performance is not an indication of future results

Report 2: Survivorship

This report shows the count of funds that existed in a particular category at the beginning of last quarter, one-year, three-year and five-year time periods, and how many survived at the end of the period. Once again, the category of the fund at the end of the period is not considered, since the category of interest is the one at the beginning of the holding period. This report essentially shows what percentage of funds in the opportunity set at the beginning of the period has survived at the end of the period.

Report 2: Survivorship		
Fund Category	No. of Funds at Start	Survivorship (%)
Last Quarter		
Australian Equity General	274	99.27
Australian Equity Small Cap	74	98.65
International Equity General	133	98.50
Australian Bonds	36	100.00
Australian Equity A-REIT	82	100.00
One Year		
Australian Equity General	285	95.09
Australian Equity Small Cap	78	93.59
International Equity General	141	92.91
Australian Bonds	37	97.30
Australian Equity A-REIT	86	95.35
Three Year		
Australian Equity General	285	91.58
Australian Equity Small Cap	78	89.74
International Equity General	146	87.67
Australian Bonds	41	85.37
Australian Equity A-REIT	86	91.86
Five Year		
Australian Equity General	272	90.81
Australian Equity Small Cap	71	88.73
International Equity General	135	87.41
Australian Bonds	40	82.50
Australian Equity A-REIT	85	91.76

Source: Standard & Poor's, Morningstar. Data as of December 31, 2010. Charts and graphs are provided for illustrative purposes only.

Report 3: Equal-Weighted Fund Returns

This report shows the equal-weighted average returns of funds in a particular category for last quarter, one-year, three-year and five-year time periods, with the level of granularity for determining the eligible population in that category being monthly.

For every month in the time period, we take all funds that are in existence in a category and calculate the simple average return. We then compound the returns from all the months in the time period. These returns are compared 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 would have merged or liquidated, new funds would have been formed and some may have switched categories.

Most reports that purport to show average active fund performance start off with the funds in a category at the end of the period, and then take the average of their historical returns. SPIVA presents a more accurate picture of active fund performance in a category by calculating the average performance of the active funds in existence in a category each month.

Report 3: Equal-Weighted Fund Returns

Index/Peer Group	Last Quarter (%)	One Year (%)	Three Year Annualized (%)	Five Year Annualized (%)
S&P/ASX 200 Accumulation Index	4.38	1.57	-5.02	4.32
Australian Equity General	3.85	-0.41	-4.96	3.75
S&P/ASX Small Ordinaries Index	11.20	13.05	-5.89	5.54
Australian Equity Small Cap	10.21	14.05	-2.63	7.99
MSCI World Ex Australia Index	2.98	-1.52	-9.29	-3.93
International Equity General	2.39	-2.47	-9.52	-4.35
UBS Composite Bond Index 0+Y	-0.19	6.06	7.44	5.77
Australian Bonds	-0.19	6.11	6.66	4.95
S&P/ASX 200 A-REIT Index	-1.31	-0.41	-20.92	-9.50
Australian Equity A-REIT	-0.81	-1.12	-20.20	-9.71

Source: Standard & Poor's, Morningstar. Data as of December 31, 2010. Charts are provided for illustrative purposes only. Index returns do not include payment of any sales charges or fees an investor would pay to purchase the securities they represent. Such costs would lower performance. It is not possible to invest directly in an index. Past performance is not an indication of future results.

Report 4: Asset-Weighted Fund Returns

This report shows the asset-weighted average returns of funds in a particular category for year-to-date, one-year, three-year and five-year time periods, with the level of granularity for determining the eligible population in that category being monthly. For every month in the time period, we take all funds that are in existence in a category and 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 time period and these returns are compared 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 would have merged or liquidated, new funds would have been formed and some might have switched categories.

Most fund reports do not show asset-weighted returns. SPIVA presents an accurate picture of asset-weighted active fund performance in a category by calculating the asset-weighted average performance of the active funds in existence in a category each month.

Report 4: Asset-Weighted Fund Returns

Index/Peer Group	Last Quarter (%)	One Year (%)	Three Year (Annualized %)	Five Year (Annualized %)
S&P/ASX 200 Accumulation Index	4.38	1.57	-5.02	4.32
Australian Equity General	3.64	-0.62	-4.48	3.87
S&P/ASX Small Ordinaries Index	11.20	13.05	-5.89	5.54
Australian Equity Small Cap	9.66	14.08	-2.23	7.51
MSCI World Ex Australia Index	2.98	-1.52	-9.29	-3.93
International Equity General	1.22	-3.25	-6.23	-2.02

UBS Composite Bond Index 0+Y	-0.19	6.06	7.44	5.77
Australian Bonds	0.02	6.73	7.17	5.39
S&P/ASX 200 A-REIT Index	-1.31	-0.41	-20.92	-9.50
Australian Equity A-REIT	-0.53	-0.19	-19.36	-8.97

Source: Standard & Poor's, Morningstar. Data as of December 31, 2010. Charts are provided for illustrative purposes only. Index returns do not include payment of any sales charges or fees an investor would pay to purchase the securities they represent. Such costs would lower performance. It is not possible to invest directly in an index. Past performance is not an indication of future results

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