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Performance persistency

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The purpose of this paper is to outline the history of value added by specialist managers operating in the Australian institutional market across three asset classes; Australian Equities, International Equities and Listed Property Trusts. It provides an update of analysis last conducted by SSgA Australia as at 30 June 2005.

The analysis, which uses data from the William M Mercer Performance Analytics software covering active managers and/or products, aims to explore value added after adjusting for distortions such as "survivorship bias". Given the underlying data is gross of tax and fees, an adjustment has also been made for higher tax and fee costs typically associated with actively managed products. This adjustment is reflected in a "performance threshold" for each asset class, calculated as an index return plus a margin of 0.9% for equities and 0.60% pa for listed property trusts.

There are a couple of conclusions that are common to all three asset classes considered;

- In each asset class, year-on-year measures indicate periods where the majority of managers have beaten the "performance threshold" as well as periods where the managers have generally underperformed.

- Persistency measures show that, of the managers who have beaten the "performance threshold" over a given 3 year period, only half are successful in beating the threshold in the subsequent 3 year period. The remainder either fail to beat the threshold, or no longer appear in the survey. This result was consistent across all three asset classes.

Over the last couple of years, performance in international equities and listed property has been fairly evenly divided between managers out- and under-performing the performance threshold. In Australian shares however, the last 12 months has seen more managers underperform than overperform, reflecting a difficult market environment. When combined with weak results in 2003 and 2004, this has seen the five year average value added for Australian equities managers drop 0.4% pa below the threshold. Figures for the average value added across the full history of each asset class remain modest; 0.6% pa above the threshold for Australian equities, 0.5% pa for international equities and close to "break even" for listed property trusts.

Introduction

Data and Assumptions

The data used in the analysis was taken from performance universes as compiled and maintained by William M Mercer. This dataset was selected in part because it includes discontinued managers and products and hence "survivorship bias" was less of a concern. Further comments on the data are contained in the Appendix.

Data to 30 June 2007 was used in the analysis, being the latest quarter end data available at the time. For convenience, a common benchmark has been assumed for all past and present participants in each universe.

In a number of the charts that follow, a performance "threshold" has been adopted. This reflects the fact that the data is gross of investment management fees and tax. However, when considering the merits of active versus passive versus enhanced management, allowance needs to be made for higher management fees and realisation of capital gains normally associated with active management. The performance thresholds have been designed to compensate for typical costs incurred by a *wholesale superannuation* investor. The lower threshold selected for Listed Property Trusts reflect the generally lower turnover by active managers, the more limited opportunities for active management, and lower active fees in this asset class.

The table below summarises the data and assumptions for each asset class.

Asset Class	Dataset	Assumed benchmark	Performance Threshold
Australian Equities	Australian Shares Specialist, "Active" universe	S&P / ASX 200 Accumulation Index	Index + 0.9% pa
International Equities	Overseas Shares Specialist, "Value Biased", "Growth Biased" and "Core" universes	MSCI World ex Aust^{SM} in AUD, net divs	Index + 0.9% pa
Listed Property Trusts	Listed Property Specialist, "Active" universe	S&P / ASX 200 Property Accumulation Index	Index + 0.6% pa

For ease of comparison, the methodology and presentation of results is the same for each asset class as follows.

Year on Year Survey Results

The first table shown for each asset class provides year-on-year results for the last 15 years. Dark blue bars above the horizontal axis indicate the number of managers who exceeded the index (plus the threshold) for that year to 30 June. Light blue bars indicate the number of managers who fell below index (plus the threshold). The clear triangles indicate the median performance (against the right hand axis) of the managers then appearing in the survey.

Performance Persistence

While the year-on-year charts indicate how managers as a whole have moved above and below index plus a threshold, they do not trace persistence – in other words have the same managers been above index plus a threshold each year? In the second chart shown for each asset class we have grouped results from different time periods in order to try and gauge the overall persistence of managers in adding value. The clear triangles indicate the number of observations included in the assessment[1]. The 3 year measures, for example, first identify the number of times a manager has exceeded the performance threshold over a 3 year period. Each chart then sets out what happened in the subsequent 3 year period for that particular set of "successful" managers. Included are managers who no longer appeared in the survey. Possible reasons include discontinued products, withdrawal from the Australian market, and mergers or takeovers.

Average Value Added across all Managers

There is more than one way that average value added can be gauged. Traditional surveys do not provide a good guide to average value added as they include survivorship bias plus they only provide results over set periods (1 year, 3 years, 5 years etc). Any manager who did not have a track record for the entire period selected is excluded.

For the final table in each asset class, we have calculated for each manager

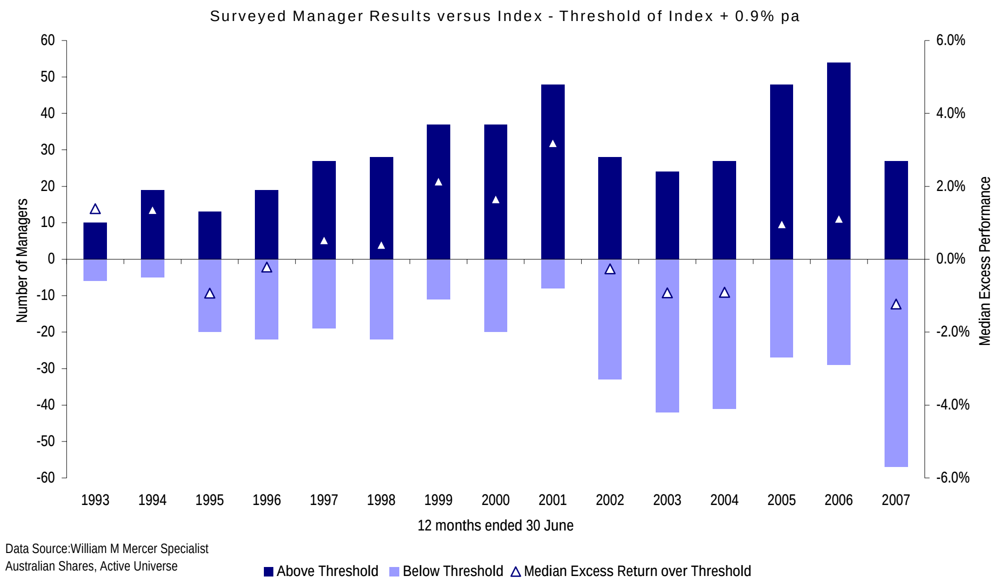
(i) total performance from inception to the end of the track record; and
(ii) total performance of the performance threshold over the same period.

We have then calculated the geometric average across all managers of (i) and of (ii). Note that this approach includes the full track record of every manager and, by using total performance, it also gives greater weight to managers with a longer track record. Results have been shown for the most recent 3 and 5 years, the preceding 5 years, and across the full history contained in the database.

[1] One year persistence results are based on the last 17 years, while results over 2 years or more cover the full data period.

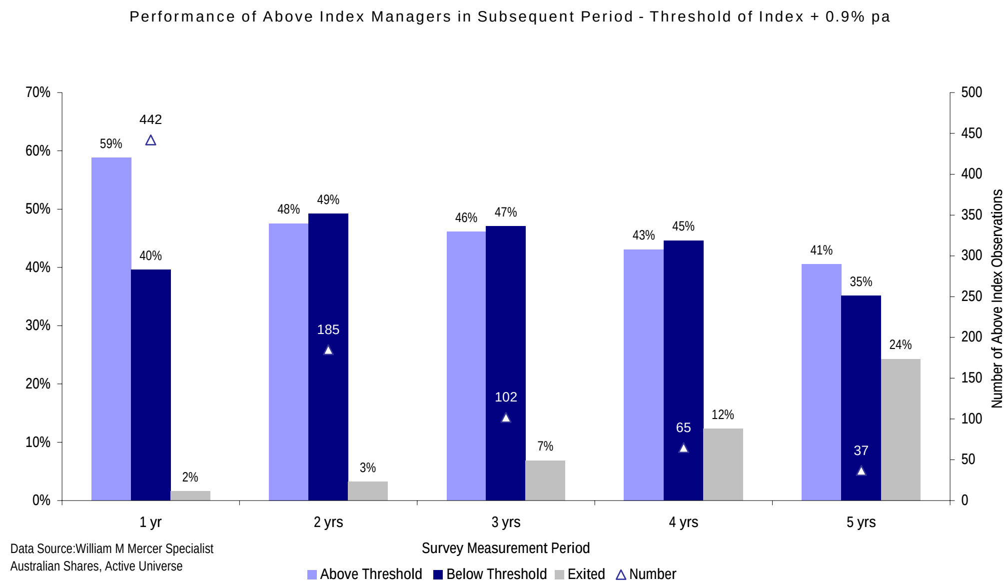
1. Australian Equities

Year on Year Survey Results



The year-on-year chart indicates that there have been periods where more managers have outperformed than under performed (eg 1999 to 2001) the index plus 0.9% pa, and periods where more managers have under performed (eg 2002 to 2004). Following two years of generally good performance in 2005 and 2006, the last 12 months has seen more managers underperform the performance threshold.

Performance Persistence



The three year figure is of particular interest, given that this is oft-cited as a minimum period for assessing past performance. Of the 102 instances where a manager was successful in achieving index plus 0.9% over a 3 year period, in the subsequent 3 year period only half duplicated their success while the remainder either failed to achieve index plus 0.9% or no longer appeared in the survey.

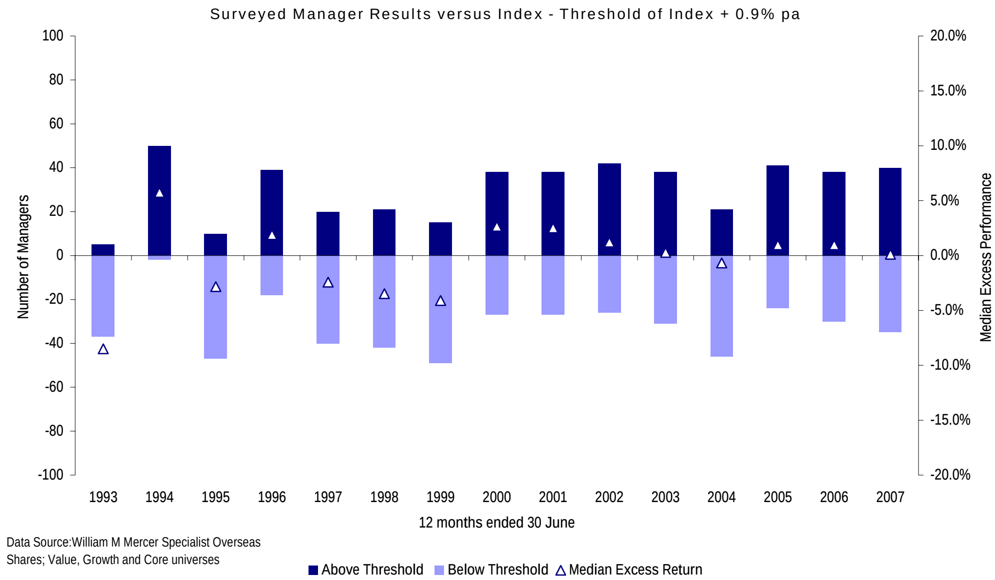
Average Value Added across all Managers

Period	Average Value Added
Jun 2004 to Jun 2007	-0.4% pa above threshold
Jun 2002 to Jun 2007	-0.4% pa above threshold
Jun 1997 to Jun 2002	+1.3% pa above threshold
Inception of survey data	+0.6% pa above threshold

The poorer results over the year to 30 June 2007 have seen the five year average value added drop below the performance threshold.

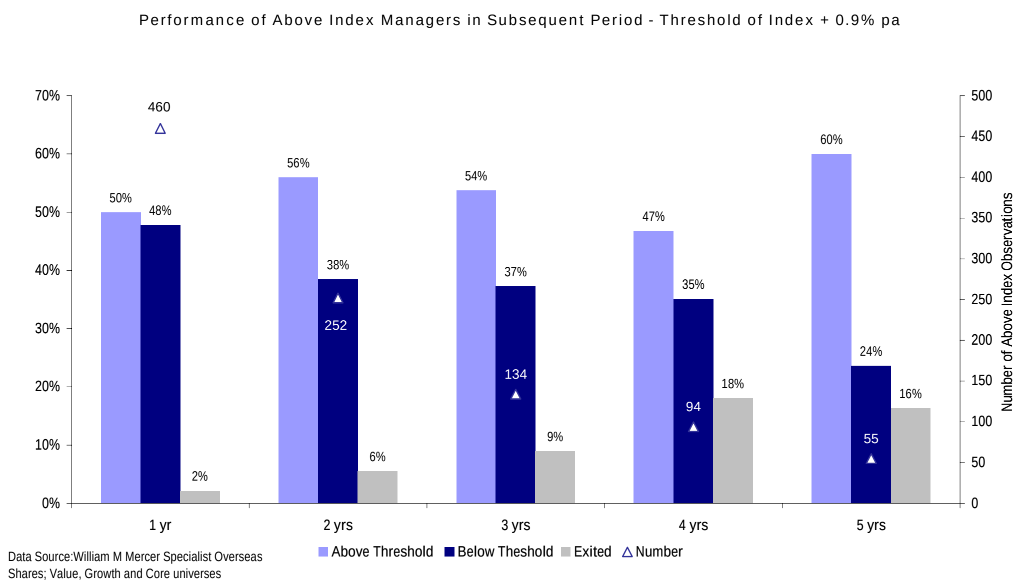
2. International Equities

Year on Year Survey Results



There have been periods where more managers have outperformed than under performed (eg 2000 to 2002) the index plus 0.9% pa, and periods where more managers have under performed (eg 1997 to 1999). Over the last couple of years, managers have been fairly evenly divided between over- and under-performance of the performance threshold.

Performance Persistence



Of the 134 instances where a manager was successful in achieving index plus 0.9% pa over a 3 year period, in the subsequent 3 year period 54% duplicated their success while the remainder either failed to achieve index plus 0.9% or no longer appeared in the survey.

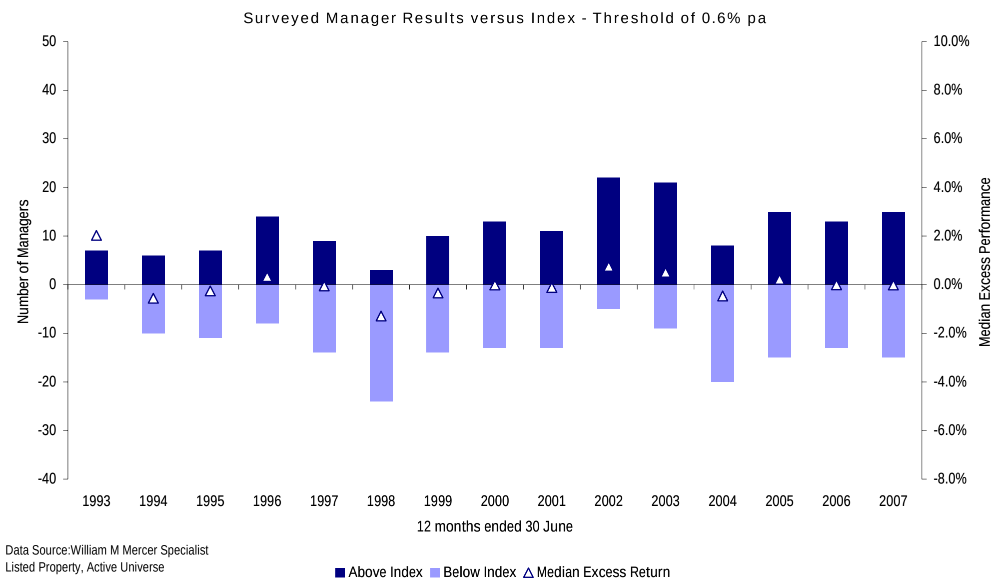
Average Value Added across all Managers

Period	Average Value Added
Jun 2004 to Jun 2007	+0.9% pa above threshold
Jun 2002 to Jun 2007	+0.4% pa above threshold
Jun 1997 to Jun 2002	+1.1% pa above threshold
Inception of survey data	+0.5% pa above threshold

Results over the last 5 to 10 years have generally been favourable with more managers outperforming than underperforming the threshold since the collapse of the bubble in 2000. Nonetheless, results since inception in the database are only 0.5% pa above the performance threshold.

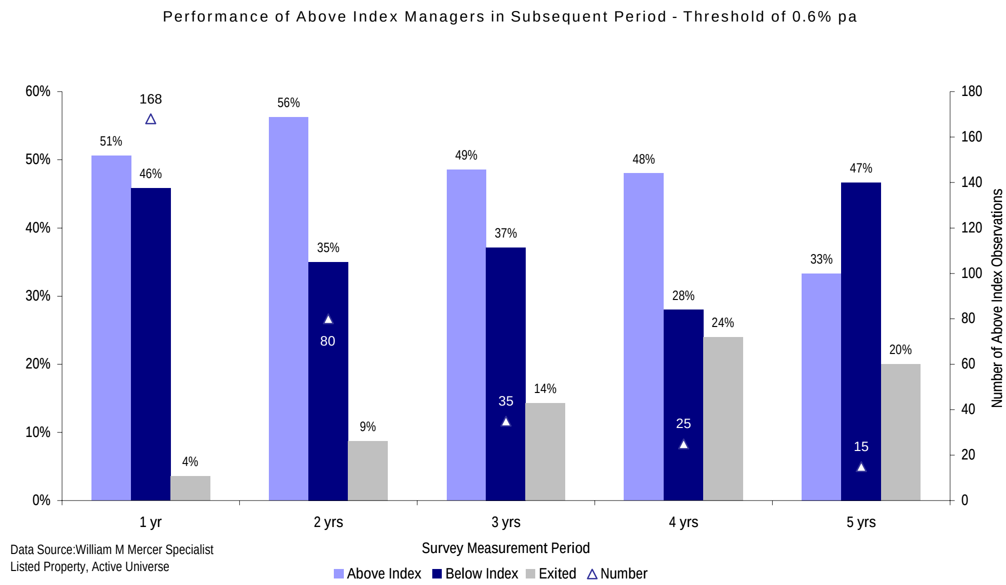
3. Listed Property Trusts

Year on Year Survey Results



There have been periods where more managers have outperformed than under performed (2002 in particular) the index plus 0.6% pa, and periods where more managers have under performed (1998 in particular). Results over the last 2 years have been fairly evenly divided between managers who have outperformed and managers who have underperformed the threshold.

Performance Persistence



Of the 35 instances where a manager was successful in achieving index plus 0.6% pa over a 3 year period, in the subsequent 3 year period 17 (49%) duplicated their success while the remainder either failed to achieve index plus 0.6% or no longer appeared in the survey. The persistency results for this sector have proved to be volatile due to the relatively small number of managers and the impact of manager turnover.

Average Value Added across all Managers

Period	Average Value Added
Jun 2004 to Jun 2007	+0.4% pa above threshold
Jun 2002 to Jun 2007	+0.1% pa above threshold
Jun 1997 to Jun 2002	-0.2% pa above threshold
Inception of survey data	+0.1% pa above threshold

Results since inception in the database are very close to the performance threshold.

Appendix – Comment on Data

The data used in the charts was sourced from the William M Mercer Performance Analytics software. This data set includes a wide range of managers and/or products with some performance histories dating back to 1981. The following comments about the data can be made:

(i) Given that the data includes managers and/or products that no longer appear in the survey "survivorship bias" is minimal.

(ii) We have not attempted to remove apparent duplication where more than one performance series appears in respect of a single manager. This can occur for a number of reasons; for example some managers offer products with different risk profiles, in some cases a manager has "inherited" a second track record via a merger or takeover and so on. In any event the data reflects the published William M Mercer Survey and the level of genuine duplication is probably minimal.

(iii) Effective April 1999 William M Mercer do not allow new managers entering the survey to include extensive past histories of performance. This is to ensure that the snapshot of managers included at any particular date is reasonably representative of managers who were actively promoting their services at that time. It is possible that there might be biases in some of the early data periods relating to inclusion of back histories for new managers.

(iv) The analysis has been conducted assuming a common benchmark for each asset class. While a number of survey participants are benchmarked against other indices (the S&P / ASX 300 Accumulation Index in Australian shares for example), the differences are not expected to materially alter the results.

(v) The number of managers and/or data series for the analysis was 128 for Australian equities, 146 for overseas equities, and 54 for listed property securities.

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