

Fund Performance – how averages don't tell the full story

October 2018 | Chris Gosselin, Australian Fund Monitors

The old saying about averages that “when your head is in the freezer and your feet are in the oven, overall your temperature is average” is particularly relevant when looking at the investment returns of managed funds, when “average” can disguise the real opportunities – and risks – of selecting the correct fund.

In this Fundmonitors.com Insights article, we look behind average performance numbers to examine the range of returns within the actively managed funds, including between the performance of both established and early stage or emerging managers and their funds.

Financial markets, and equity markets in particular, are a haven for statistics. Managed funds are no exception, and although investors are frequently warned not to use past performance as an expectation of future returns, it is only historical measurements of performance and risk that enables an analyst to judge how a fund might perform in the future. The term “might” is important, as other factors, including age of the fund and the market itself, can throw the most careful analysis out of the window.

Overall, the tendency to measure the performance of a managed fund against a benchmark – either a relevant market index, a target return, or an index of similar funds – can on the surface make it easier to gauge fund performance. By grouping funds of similar types into various groups or buckets, each one becoming an index of its own, one can compare and argue to relative merits of the group versus the underlying market, and in turn the individual fund against their peers.

Given the constant arguments for and against “active” vs. “passive” or index investing, it is worth considering the longer-term performance of actively managed funds, including hedge and absolute return funds, against the ASX200 total return (as a proxy for passive funds) as shown in Chart 1 below:

Chart 1: Cumulative return of AFM's index of Equity funds (after fees) vs ASX200 Total Return



Chart 1 clearly shows that over the past 15 years on a cumulative basis funds in AFM's Equity Index have, on average, significantly outperformed the ASX200 Accumulation (total return) Index after fees. This is not simply a case of funds outperforming the market. It is as much, if not more, a case of the funds being less volatile and therefore performing better when the market falls.

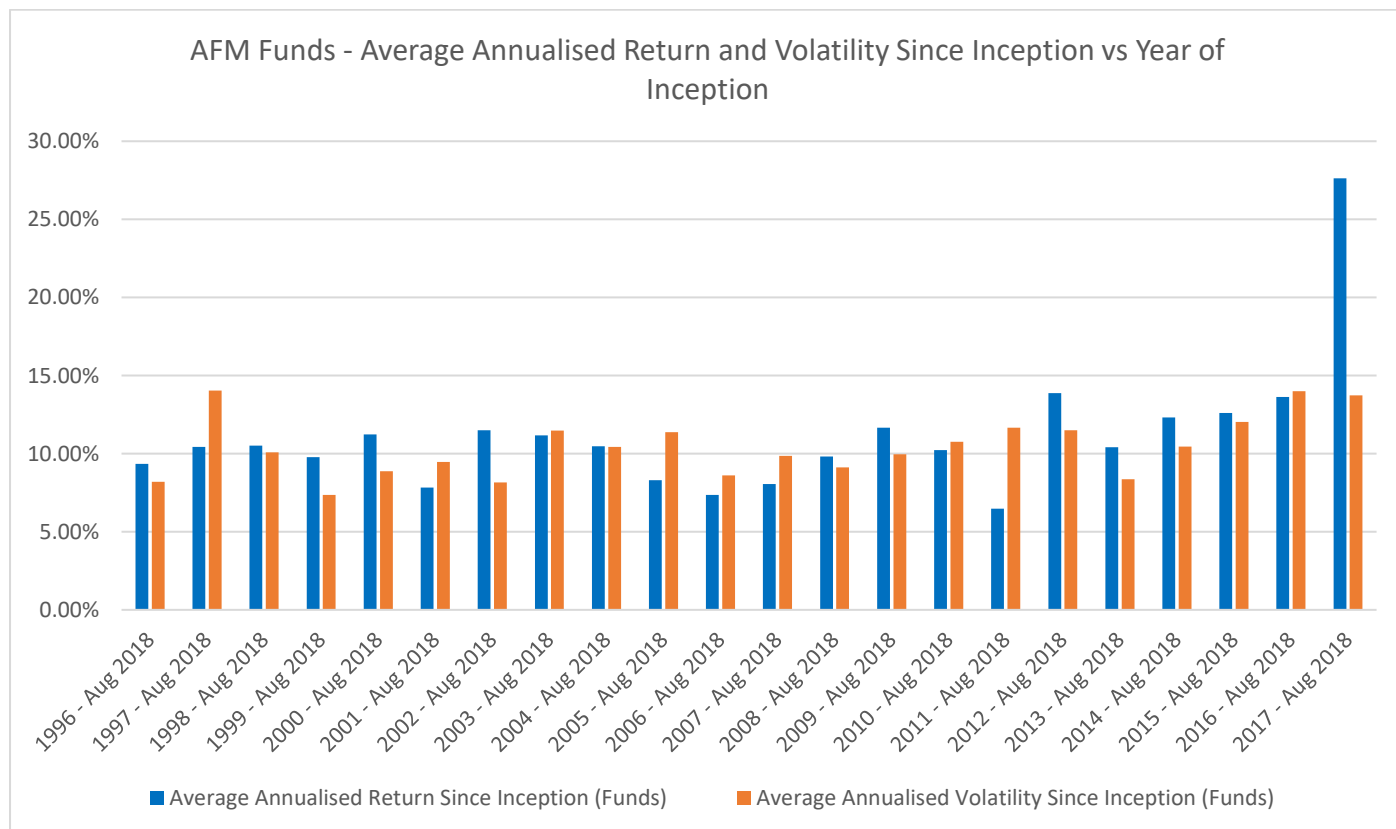
However, depending on how you look at them, averages can either prove everything or nothing at all. If one took the cumulative return in Chart 1 and changed the starting date to the market peak in mid-2007, whilst equalising the relative return lines, the out-performance of funds would have been even greater, as the active funds suffered (on average) only half the losses of the market.

Re-calibrate again to March 2009 when the GFC rout bottomed and the rally began, and the difference becomes less marked. Do so again to a more recent date and the ASX200 would have held its own against active managers, leading to the more recent argument for passive funds providing the same or better returns than active managers, at a fraction of the cost.

Performance over various time frames

Performance of funds based on the year of their launch also varies – and shows a trend. Chart 2 shows the performance and volatility of funds based on their year of inception; in other words, each bar represents the average annualised performance and volatility of funds launched in each calendar year. However, the average performance of funds launched more recently can be misleading as there can be several mitigating factors involved. In the past 12 months for instance we have seen a number of funds launched in the small and mid-cap sector which has been particularly strong.

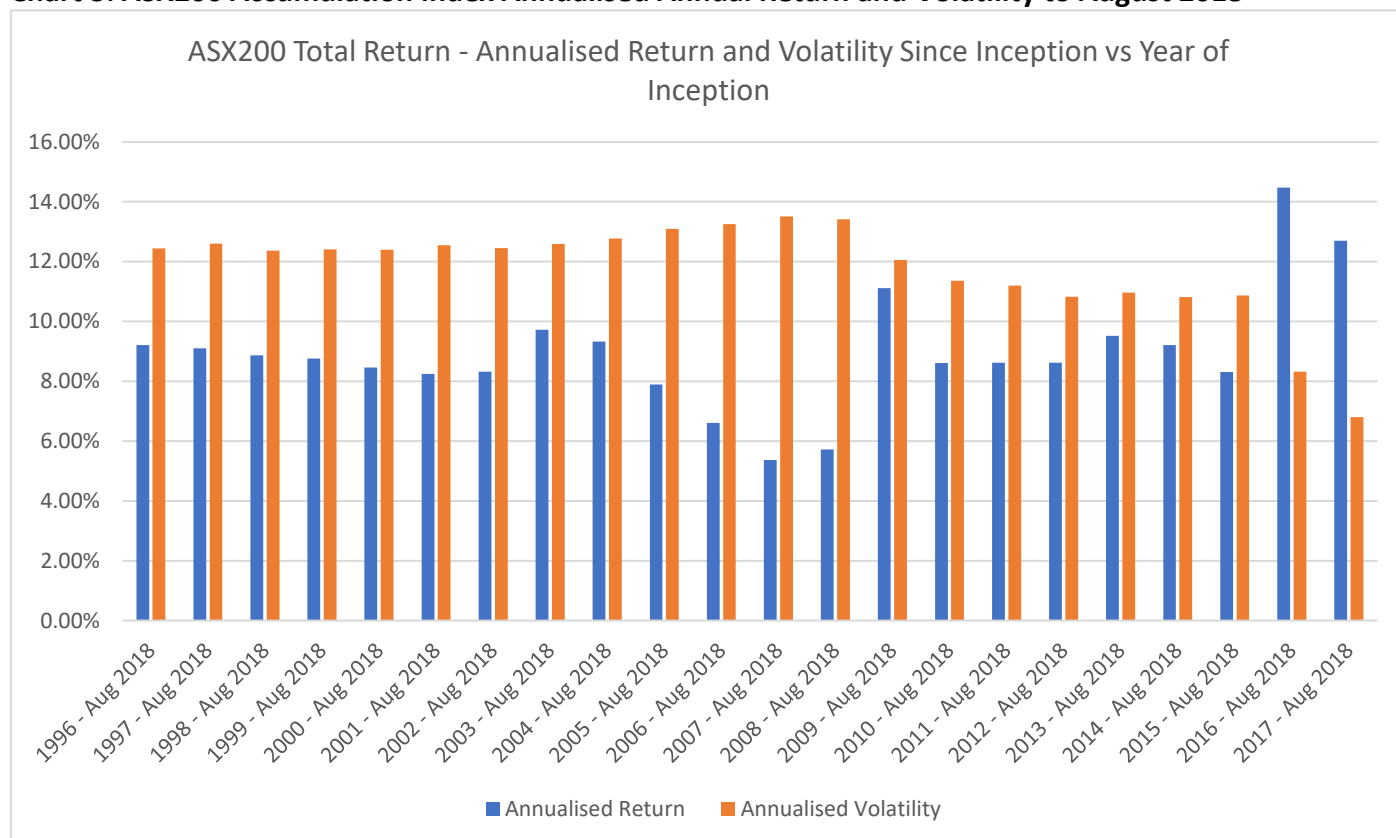
Chart 2: Active Equity Funds annualised return and volatility based on year of inception.



Overall, many investors fail to recognise the level of risk in equity markets as shown by Chart 3 below which shows the annualised performance and volatility of the ASX200 on an annualised basis from each year to August 2018; in other words, the equivalent of the launch date in Chart 2 above.

For example, the annualised return of the ASX200 from 2008 to August 2018 was +5.72% with annualised volatility of 13.41% - not a great return considering the risk involved. Only in the past two years – in other words, from 2016 to August 2018 and from 2017 to August 2018 – has the return been greater than the volatility.

Chart 3: ASX200 Accumulation Index Annualised Annual Return and Volatility to August 2018

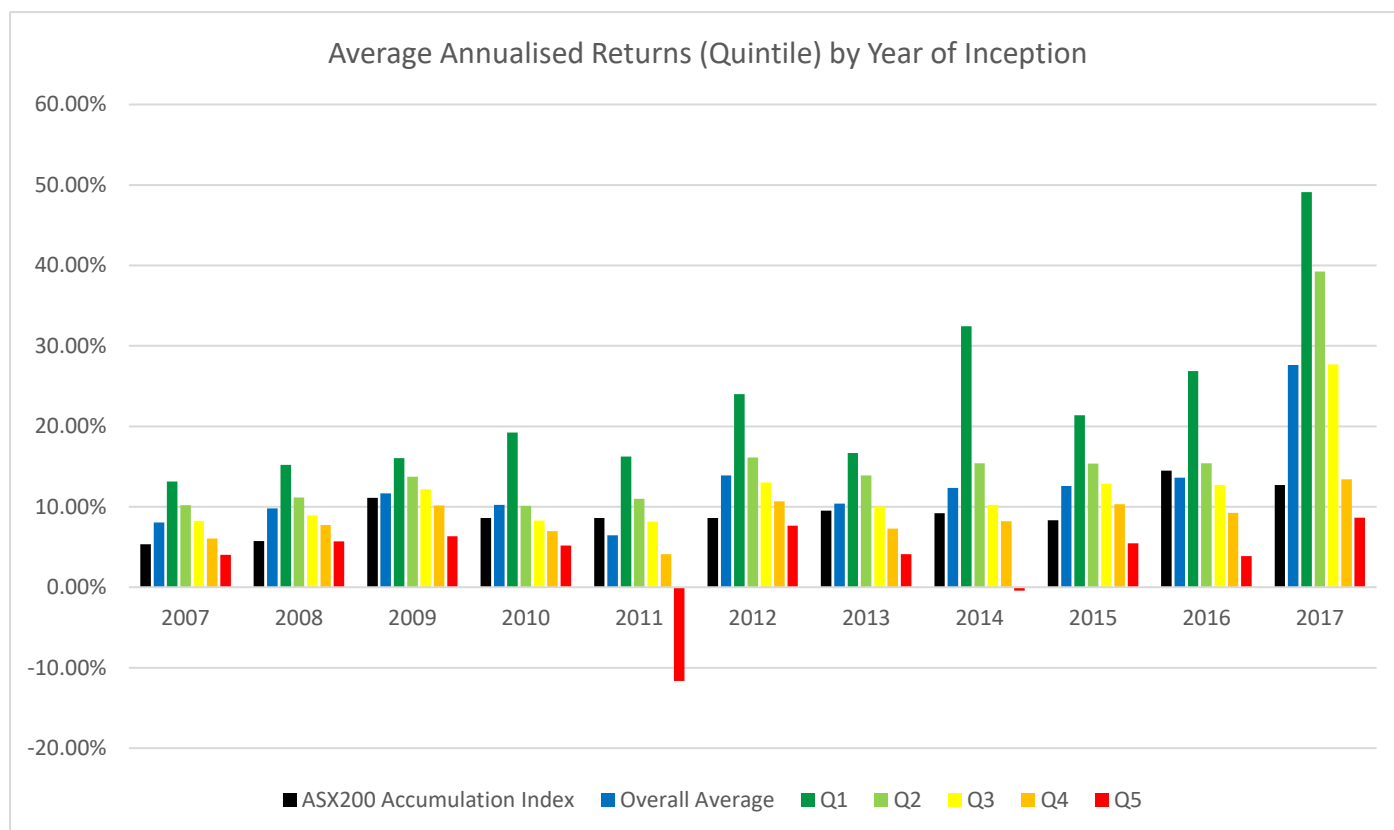


From each year since 1996 to August 2018, with the exception of 2016 and 2017, ASX200 volatility – a well-accepted, albeit blunt measure of risk – has been higher than the market’s annual return. Whilst this Insights article is not about predicting the future direction of markets, the sharply higher returns over the periods of 2016 to August 2018 and 2017 to August 2018, along with falling volatility over the same period, is perhaps worth noting... with caution.

Average – a dangerous and often misleading measure.

Of course, measuring a series of averages can disguise the extreme variances that can, and do, occur. The distribution of returns from the funds within AFM’s actively managed index, when divided into quintiles as shown in Chart 4, shows a remarkable diversity of results.

Chart 4: Average Annualised Return based on year of inception (i.e. Track Record) by quintile.



What is clear is not so much that there's no such thing as average, but that the range of performances are so different that, unless investors are able to make informed decisions, the potential for average (or worse) is significant!

Disclaimer: Australian Fund Monitors Pty Ltd, holds AFS Licence number 324476. The information contained herein is general in its nature only and does not and cannot take into account an investor's financial position or requirements. Investors should therefore seek appropriate advice prior to making any decisions to invest in any product contained herein. Australian Fund Monitors Pty Ltd is not, and will not be held responsible for investment decisions made by investors, and is not responsible for the performance of any investment made by any investor, notwithstanding that it may be providing information and or monitoring services to that investor. This information is collated from a variety of sources and we cannot be held responsible for any errors or omissions. Australian Fund Monitors Pty Ltd, A.C.N. 122 226 724