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Persistence of the Performance of Active Managers to June 2018

S&P Dow Jones Indices recently released their analysis of the Persistence of Australian Active Funds[1] performance for periods to June 2018.

The analysis, found that, ‘A minority of Australian high-performing funds persisted in outperforming their respective benchmarks or consistently stayed in their respective top quartiles for three consecutive years, and even fewer maintained these traits consistently for the five-year period’.

The conclusion by S&P Dow Jones Indices was that these results, ‘suggest weak performance persistence in top-performing funds in Australia across the three- and five-year periods’.

As explained in a previous Research Note (Consistency of Manager Performance: www.prigia.com), the analysis conducted by **S&P incorrectly assumes that repetition of quartile performance** (1st to 1st; 2nd to 2nd; 3rd to 3rd; and 4th to 4th) **is indicative of consistent active manager performance.**

In reality this pattern of performance will only occur where markets are in static equilibrium.

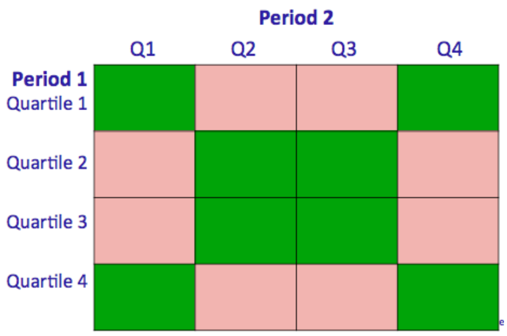
The only thing that S&P’s analysis is testing for is whether markets are static. Hopefully it does not come as a surprise to those involved in actual markets that the results of S&P’s analysis are consistent with markets not being static.

Importantly, this is the only conclusion that can be drawn from the analysis conducted by S&P – **the results say nothing about the consistency of manager performance**.

In real investment markets, some managers will perform well or poorly due to luck, while other will perform consistently by adding value. Managers whose results are significantly determined by luck will tends to be in the 1st and 4th quartiles of their peers, while consistent managers will tend to be in the 2nd and 3rd quartiles.

Thus, when active managers are consistently adding value the pattern of performance in the contingency table (transition matrix) will appear as in Figure 1, where a green cell represents more manager outcomes than random, and a pink cell fewer outcomes.

Figure 1: Persistent Pattern of Performance

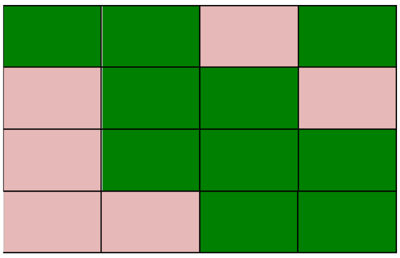


[1] https://us.spindices.com/documents/research/research-persistence-of-australian-active-funds-september-2018.pdf

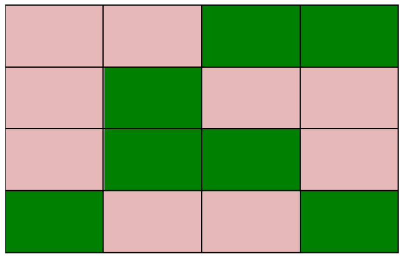
Whether the actual pattern of performance produced by managers is consistent with the Persistent Pattern of Performance can be assessed statistically.

The actual Patterns of Performance of the actively managed Large-Cap Australian Equity Funds (General Funds) in the S&P Dow Jones Indices Persistency analysis, over the two consecutive 3-year and 5-year periods to June 2018 are given below.

3-Year Pattern of Performance



5-Year Pattern of Performance



Over the consecutive 3-year periods to June 2015 and 2018, there was a **98.5% probability that active manager performance was persistent**; and

Over the consecutive 5-year periods to June 2013 and 2018, there was a **99.7% probability that active manager performance was persistent**.

Summary

As in previous periods, the S&P Dow Jones Indices analysis of the consistency of performance of Australian Equity Funds to June 2018 actually provides evidence that:

1. **Markets are not in static equilibrium; and**
2. **Australian equity managers exhibited strong consistency of performance.**

The strong consistency of performance implies that institutional investors, such as Australian Superannuation Funds, are able to identify and select managers who will add value in the future.

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