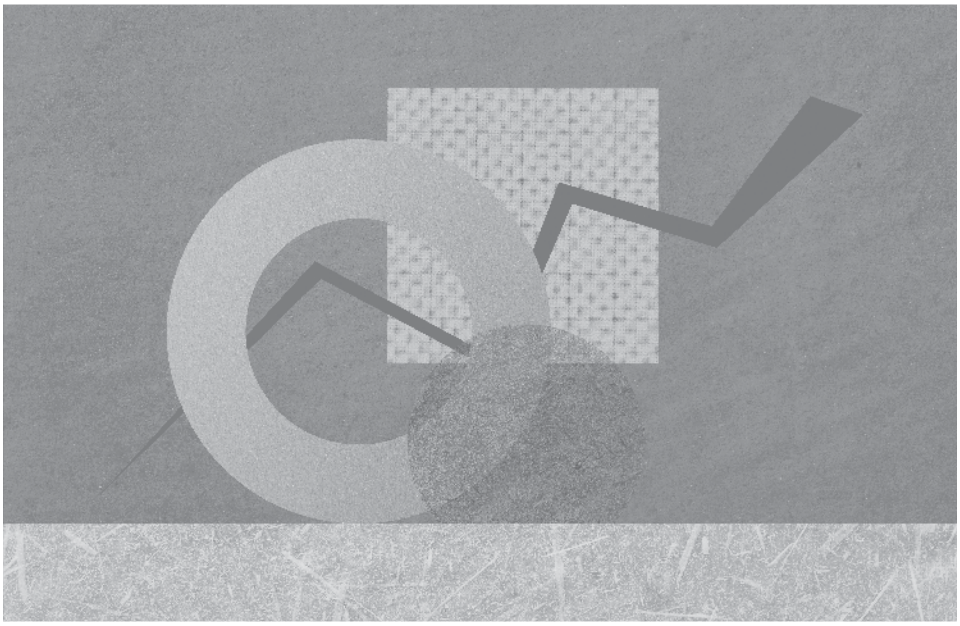


21 years of data and passive usually beat active

Betashares

The results are in—21 years of data, and passive usually beat active. The SPIVA scorecard comes of age this year. For 21 years it has been the go-to report for investors and others interested in the 'active versus passive' debate. With more than two decades of data to refer to, what can we learn from these reports?

What is SPIVA?

SPIVA stands for 'S&P Indices versus Active'. The SPIVA reports are published by S&P Dow Jones Indices, a division of S&P Global.

Their primary purpose is to inform the active versus passive debate, by providing data on how actively managed funds around the world have performed, over both the long and the short term, against appropriate benchmarks.

The two main reports that are produced are:

The SPIVA Scorecards

These provide data on the performance of active funds against relevant benchmarks. Reports are provided for markets around the world, both equity markets and fixed income markets. They are broken down into categories according to the type of fund, to ensure the appropriate benchmark is used—for example, large, mid or small-cap funds.

The SPIVA Persistence Scorecards

These measure the consistency of a fund's performance relative to its peers. In other words—are funds that outperform in a given period able to maintain that outperformance in subsequent periods? This scorecard is designed to address the question of whether outperformance is the result of skill—in which case outperformance would be expected to persist over time—or luck—in which case outperformance would be expected to be more random.

What do the results tell us?

The SPIVA data tells a remarkably consistent story. Craig Lazzara, managing director of Core Product Management S&P Dow Jones Indices said:

Our very first SPIVA Scorecard reported that most active managers had underperformed a benchmark appropriate to their investment style over a full market cycle. Our most recent SPIVA update reports more or less the same thing.

The first SPIVA Report covered the US equity market only. Figure 1 shows the percentage of large-cap US equity funds underperforming the S&P 500 each year since then.

Since the first report, SPIVA has expanded to nine different geographies, and now reports on the performance of over 100 different active fund categories around the world.

A consistent theme of SPIVA Scorecards over the years has been that underperformance rates generally rose with the length of the period in which performance was measured. Table 1 shows the percentage of active Australian and US equity funds that have underperformed their relevant benchmark.

Table 1. Percentage of active Australian and US equity funds that underperformed their benchmark

Time period				
	1 year	3 years	5 years	15 years
US Large Cap Funds underperferforming	60.9%	79.8%	86.6%	92.2%
Australian General Equity Funds underperforming	76.5%	69.3%	77.6%	85.4%

Source: https://www.spglobal.com/spdji/en/research-insights/spiva/. US Large Cap Funds are compared to the S&P 500 Index; Australian General Equity Funds are compared to the S&P/ASX 200 Index. Past performance is not indicative of future performance.

Good luck or good management?

The disclaimer 'Past performance is no guarantee of future performance' is included in material on all funds offered to investors—including our own. What this is telling potential investors is that just because a fund, or fund manager, has produced good results in the past, this does not necessarily mean they will do so in the future.

However, past performance tends to be one of the first things that potential investors look at when deciding whether to put their precious savings into an investment. Human nature is such that— while the lawyers are telling us not to count on it—we tend to be biased towards funds that have done well in the past.

With index tracking funds, there is no decision to be made around the 'skill' of the fund manager, as the manager is simply aiming to replicate the performance of the index (before fees and expenses). If the index does well, so too does the fund—if the index performs poorly so too does the fund.

This is not the case with the active fund manager, who typically aims to do better than the index—and in doing so, justify their active management fee.

For this exchange—that is, fees charged for the fund manager's skill—to be justified, any outperformance has to be the result of that 'skill', rather than luck. And if it is the result of skill, then that outperformance should persist over time. If it does not, that indicates that chance is playing a part in the proceedings.

What does the data tell us?

The SPIVA Persistence Scorecards show the percentage of funds that remain in the top-quartile or top-half rankings over consecutive three- and five-year periods.

The US Persistence Scorecard Year-End 2022 found that of 2020's top quartile large-cap funds, none continued in the top quartile for the next two years and only 5% of the above-median large-cap active equity funds in calendar year 2020 remained above median in each of the two succeeding years.

The report also looked at the top 50% of domestic equity funds in the 12 months ending 30 December 2018, and their performance over the subsequent three years. It found that among all domestic equity funds, there was a 0% chance of a top half performer, as of 31 December 2018, still being a top half performer as of 31 December 2022.

The quote

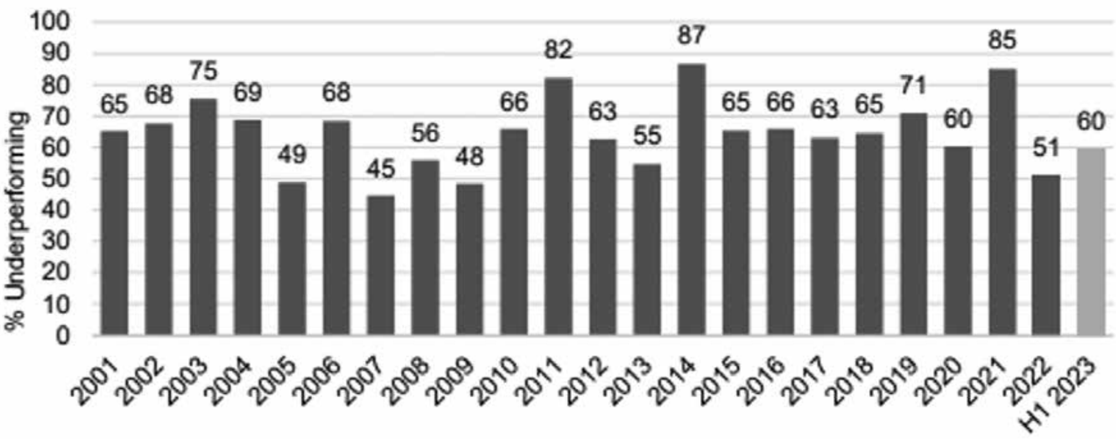
A consistent theme of SPIVA Scorecards over the years has been that underperformance rates generally rose with the length of the period in which performance was measured.

Table 2. Performance persistence of US domestic equity funds over three consecutive 12-month periods

Fund Category	Fund Count at Start (December 2020)	Percentage Remaining in Top Quartile	
		December 2021	December 2021
Top Quartile			
All Domestin Funds	488	4.10	0.00
All Large-Cap Funds	156	7.05	0.00
All Mild-Cap Funds	63	0.00	0.00
All Small-Cap Funds	123	2.44	0.81
All Mulit-Cap Funds	121	9.09	0.00

Source: S&P Dow Jones Indices LLC, CRSP. Data as of December 31, 2022. Chart is provided for illustrative purposes. Past performance is not indicative of future performance.

Figure 1. Percentage of large-cap domestic equity funds underperforming the S&P 500 each year



Source: S&P Dow Jones Indices LLC. Data as of 30 June 2023. Chart is provided for illustrative purposes. Past performance is not indicative of future performance.

Turning to the Australian market, the most recent data show that 77% of 'Australian Equity General Funds' underperformed the S&P/ASX 200 in 2023. This was the second-worst result for active managers since the beginning of the data in 2009, refer to Figure 2.

Looking at longer timeframes, the story is similar. In every category with a 10-year history, 75% or more of the funds underperformed their as shown in Figure 3.

The Australia Persistence Scorecard (December 2022) showed that 6.25% of Australian equity funds in the top quartile as of 30 December 2021 remained there at 30 December 2022, while none of the funds in the International Equity, or A-REIT categories remained there.

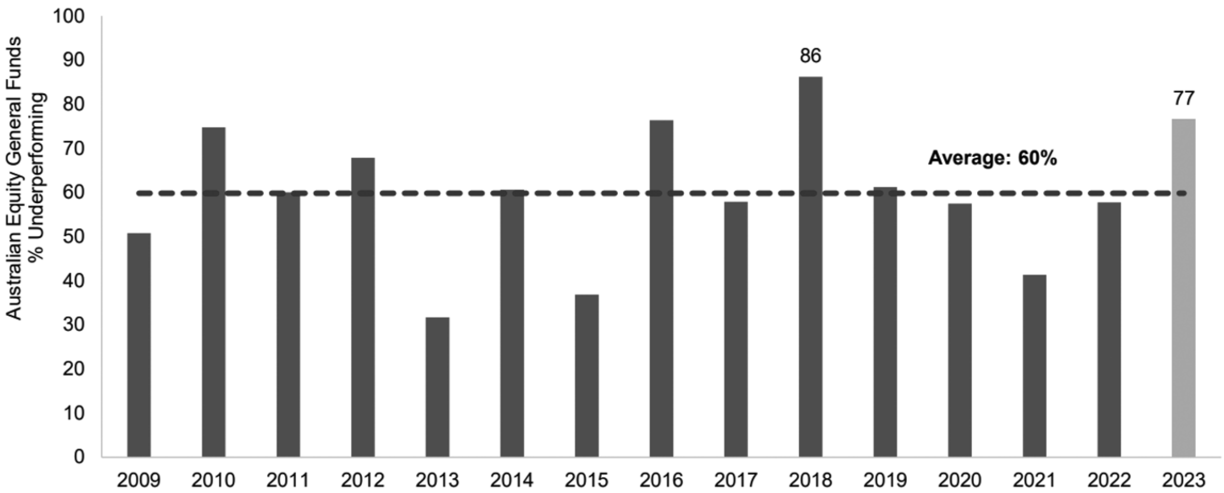
The conclusions, which SPIVA states are 'robust across geographies', include:

Table 3. The Australia Persistence Scorecard (December 2022)

Fund Category	Fund Count at Start (December 2020)	Percentage Remaining in Top Quartile	
		December 2021	December 2021
Top Quartile			
All Equity General	80	37.50	6.25
All Equity Mild- and Smal-Cap Funds	35	22.86	2.86
International Equity General	66	10.61	0.00
Australian Bonds	16	18.75	6.25
Australian Equity A-REIT	15	46.67	0.00

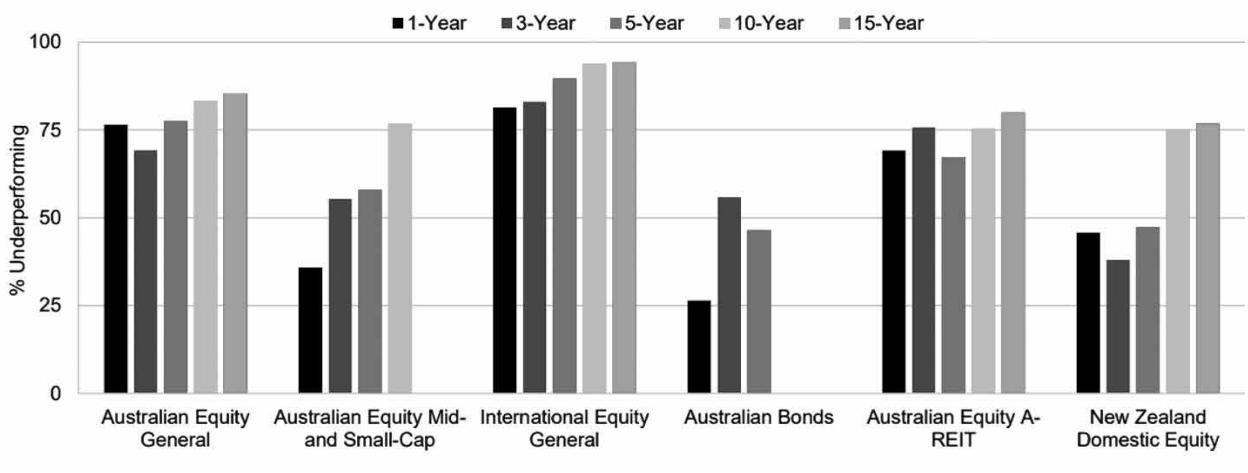
Source: S&P Dow Jones Indices LLC, CRSP. Data as of December 31, 2022. Chart is provided for illustrative purposes. Past performance is not indicative of future performance.

Figure 2. Percentage of Australian equity general funds underperforming the S&P/ASX 200 each year



Source: S&P Dow Jones Indices LLC, Morningstar. Data as of Dec. 31, 2023. Chart is provided for illustrative purposes. Past performance is not indicative of future performance.

Figure 3. Percentage of underperforming active Australia and New Zealand funds



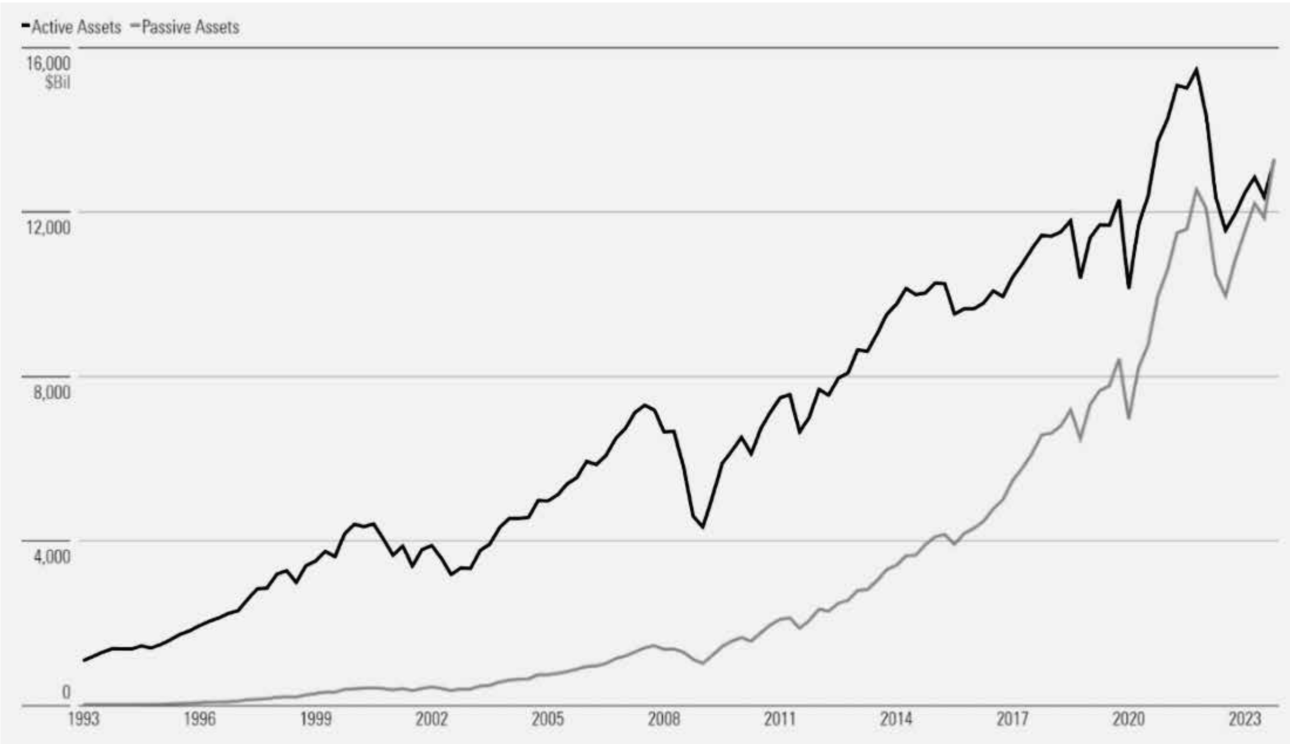
Source: S&P Dow Jones Indices LLC, Morningstar. Data as of Dec. 31, 2023. Past performance is not indicative of future performance. Chart is provided for illustrative purposes. Underperformance rates for the Australian Equity Mid- and Small-Cap and Australian Bonds categories are reported for time horizons over which the respective benchmark indices were live.

- Most institutional managers underperform most of the time.
- The tendency for underperformance typically rises as the observation period lengthens.
- When good performance does occur, it tends not to persist. Above-average past performance does not predict above-average future performance.

How do investors see the active/passive question?

Figure 4 shows historical fund assets from 1993 in US active and passive funds. While it is impossible to know how many investors are influenced by the data presented by SPIVA over the last two decades, it is unarguable that investors are increasingly favouring passive exposures over active ones. FS

Figure 4. Historical fund assets: Active versus passive



Source: Morningstar Direct Asset Flows. Data as of Dec. 31, 2023.