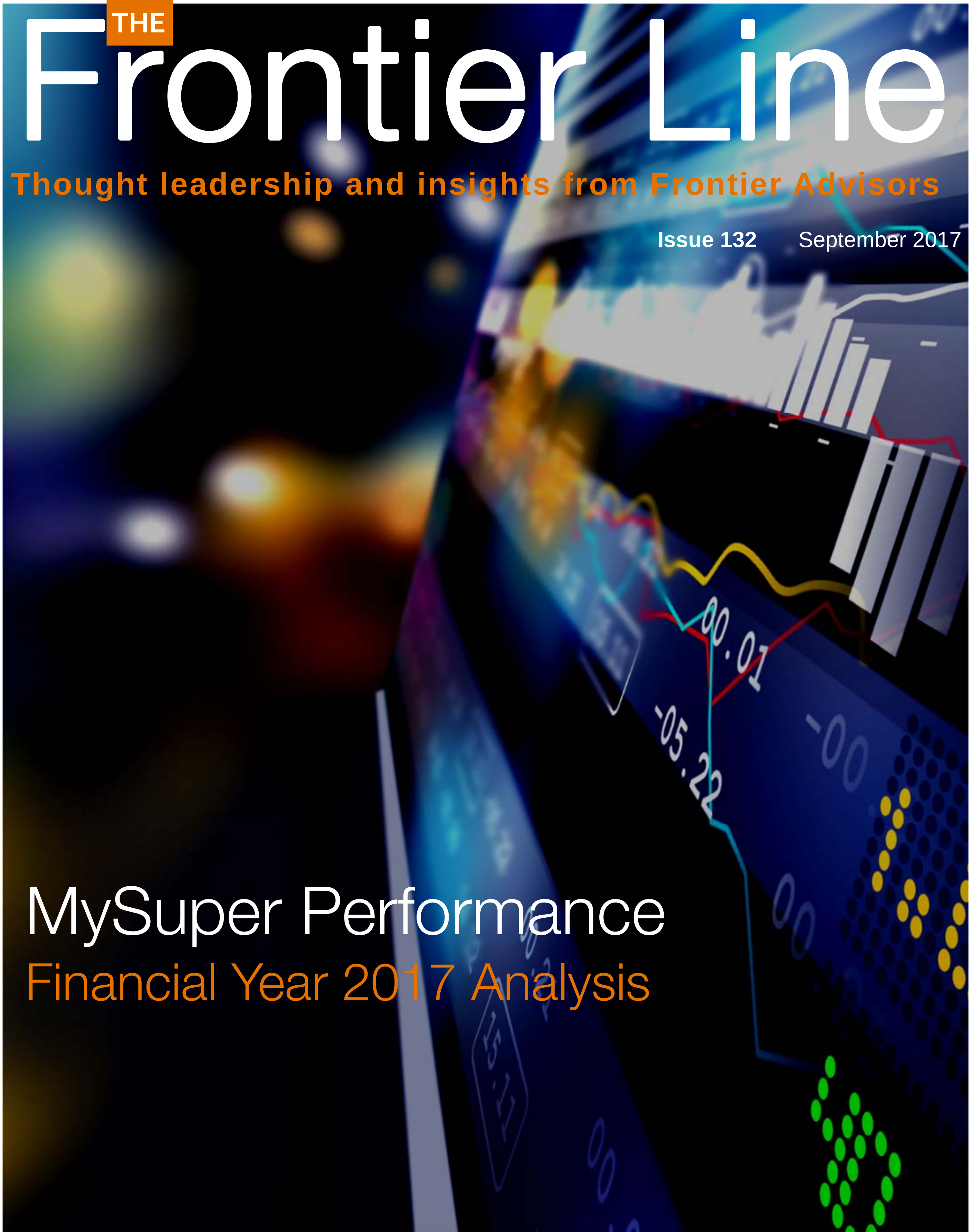

THE Frontier Line

Thought leadership and insights from Frontier Advisors

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MySuper Performance

Financial Year 2017 Analysis

FRONTIER ADVISORS

Frontier Advisors

Frontier Advisors has been at the forefront of institutional investment advice in Australia for over two decades and provides advice over more than $265B in assets across the superannuation, charity, public sector and higher education sectors.

Frontier's purpose is to enable our clients to generate superior investment and business outcomes through knowledge sharing, customisation, client empowering technology and an alignment and focus unconstrained by product or manager conflict.

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David joined Frontier in 2015 as a Senior Consultant and leads the Retirement Solutions Group. He conducts research and provides advice in the area of retirement strategy and product development for superannuation funds.

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Introduction

Despite warnings that returns will be "lower for longer", superannuation returns for the financial year just ended were healthy. The average fund returned 10.5% for the 2017 financial year, as measured by the SuperRatings SR50 Balanced[1] index.

Choosing the right fund was important, with the best performing fund for the year providing double the return of the worst fund. The best returning balanced fund, the HOSTPLUS Balanced fund, returned 13.2% while the worst performing balanced fund only returned 6.7%.

With increased regulatory scrutiny, particularly from the Productivity Commission and APRA's proposed outcomes test, understanding the performance of funds is especially important. Have the top performing funds just taken more risk? Was the performance due to asset allocation positions? What part did fees play? And have the top funds performed consistently well?

In this article we compare funds' 2017 financial year performance and identify the main drivers of performance. We examine the 10 best performers and measure how much they earned, the degree of risk they took to achieve it and what influenced their relative returns.

In summary, we made the following observations from the analysis using the Glide module of Frontier Partners Platform.

- There was no clear relationship between the return and the level of risk in FY17
- The noticeable asset allocation difference of the top performing funds was their underweight to fixed income and cash, and that they were not necessarily overweight to equities
- The dispersion of returns in individual sectors among the top 10 funds was as large as 13%
- There has been a positive correlation between size and performance for funds – only if the fund is bigger than $10bn
- Low fee funds did not have any better (or worse) performance than high fee funds
- The best performing fund over the last 10 years did not appear in the top 10 in any of the last three years

1. Balanced funds include funds with 60-70% of exposure to growth assets.

Financial year recap

Over the course of FY17, balanced funds' performance varied across funds, with returns (after fees and taxes) ranging from 7% to 13%. The top 10 performers (according to the SuperRating's SR50) earned over 12%, as highlighted in Table 1.

Table 1: Top SR50 balanced funds – 30 June 2017

FY Rank	Fund - Option	Return (%)	St Dev (%)	Growth Ratio [2](%)	Target Return [3] (%)	Investment Risk [4] (years/20)	Fees [5] ($)	Option Size ($m)
1	HOSTPLUS - Balanced	13.2	2.6	76	3.5	4.5	678	18,347
2	AustralianSuper - Balanced	12.4	3.4	69	3.9	4.0	398	72,203
3	Sunsuper for Life - Balanced	12.3	3.2	69	5.3	3.8	368	3,156
4	First State Super - Growth	12.3	3.9	75	3.0	4.5	397	38,750
5	Club Plus Super - MySuper	12.2	3.1	76	3.0	4.8	404	2,008
6	Intrust Core Super - MySuper	12.2	3.3	75	5.0	4.0	523	1,631
7	Equip - Balanced Growth	11.9	3.7	70	3.7	2.3	463	854
8	Kinetic Super - Growth	11.9	3.8	65	3.5	5.0	431	2,868
9	Cbus - Growth	11.9	3.1	67	4.8	3.0	498	29,555
10	Catholic Super - Balanced	11.8	3.2	70	4.1	3.9	563	4,446
	Median	**10.6**	**3.5**	**71**	**3.5**	**3.7**	**520**	**2,048**

Source: SuperRatings, APRA

On the following pages, we analyse the degree to which funds performance can be explained by:

- the level of risk taken
- asset allocation effects
- sector performance
- asset size; and
- fees.

2. Self-reported to SuperRatings
3. APRA defines Target Return as the net mean annualised return above CPI over 10 years
4. APRA defines Investment Risk as the estimated number of negative annual returns in 20 years
5. APRA Statement of fees and other costs

Effect of risk on performance

The level of risk the funds took to achieve their returns can be measured in various ways:

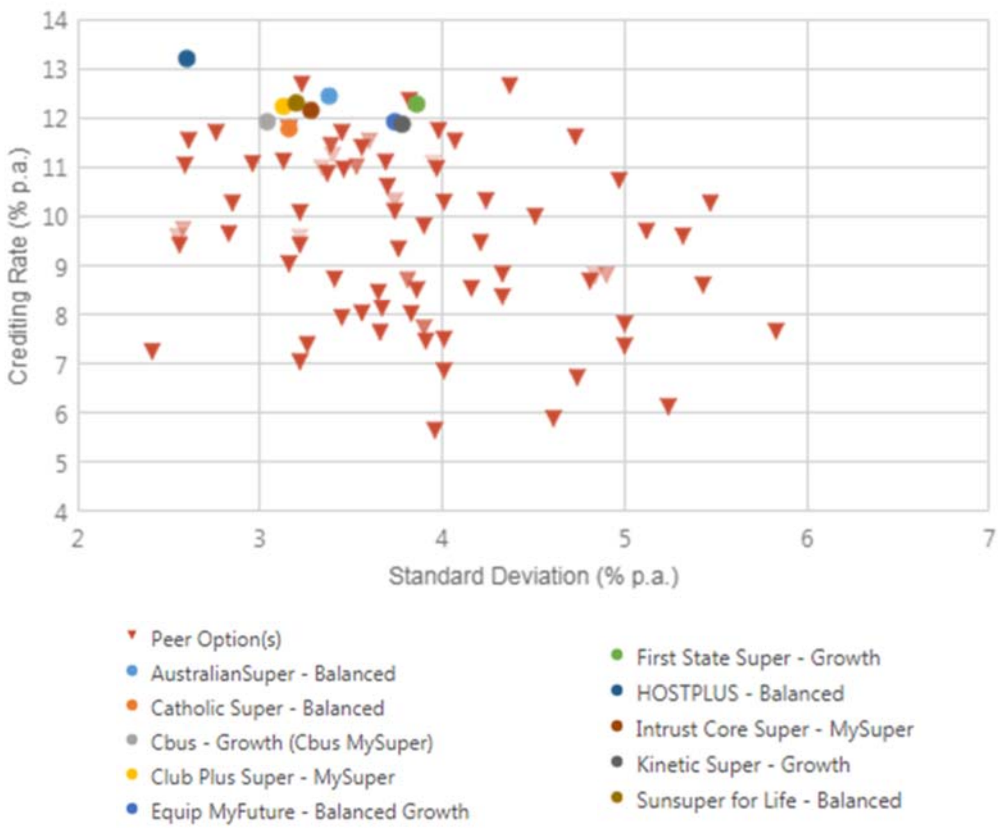
Standard deviation – calculating the volatility of returns over the year provides one measure of risk, although measuring over longer periods will provide a better measure. Nonetheless, on this measure most of the 10 funds were less risky than the average fund over the year, with 7 out of 10 near or less than the median risk.

Growth ratio – as growth assets are typically more risky than defensive assets, a fund with a higher growth ratio can be more risky, although this may not show up in any particular year. On this measure, four of the funds have equal or more exposure to risk assets than the average fund.

Investment risk – the expected number of negative returns in 20 years is another measure of investment risk. Eight of the top 10 funds listed above are targeting a risk level equal to or greater than the average fund based on this measure.

Based on these results, there is no clear evidence that the top performing funds over the year achieved this performance by taking higher risk than their competitors. Indeed, if we look at all the -balanced funds in the universe over this period, as highlighted in Chart 1, there is no relationship between the return and the level of risk.

Chart 1: Return v risk—1 year to 30 June 2017 (after fees, after tax)



Source: Frontier Glide, SuperRatings

Allocation effects

Asset allocation is a key driver of performance. Chart 2 shows the average asset allocation of each of the top 10 funds over the last year.

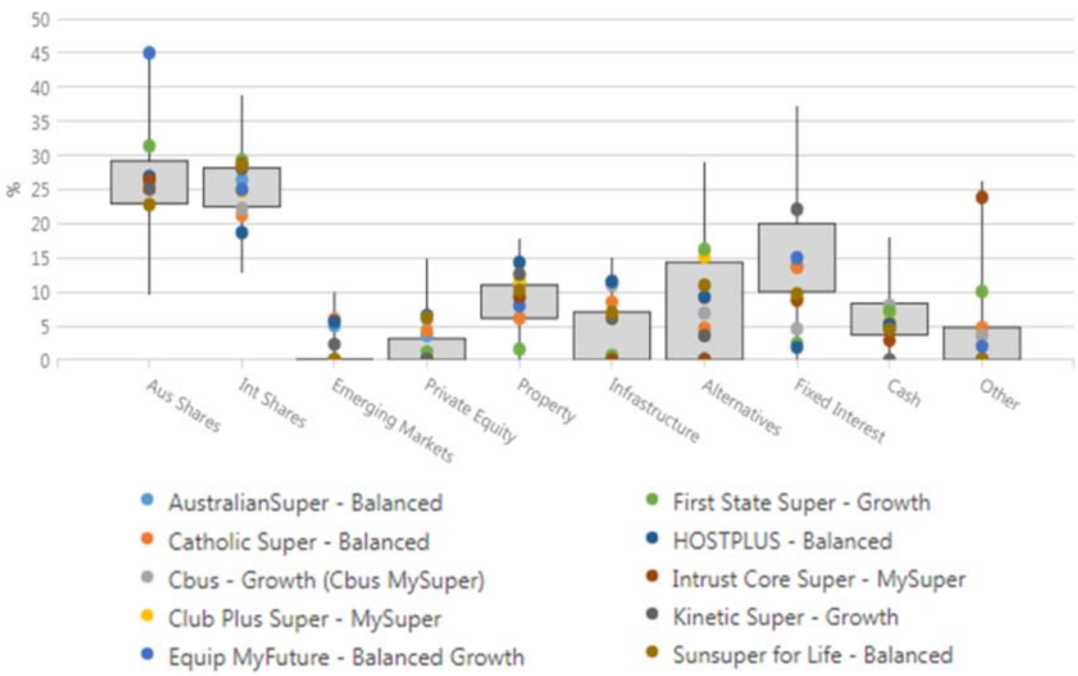
Based on their average asset allocation, six of the funds had an overweight position in Australian equities compared to the median fund. Surprisingly, only five of the top 10 funds had a greater exposure to international equities (including emerging markets) than the average fund.

The best performed funds were fond of real assets – seven funds were overweight property, compared to the median 9% allocation, and seven were also overweight the median infrastructure allocation.

The most noticeable asset allocation difference was that the top performing funds were underweight both fixed income and cash relative to the average. Only two funds reported overweight positions in fixed income and three funds were overweight cash – all the rest were underweight.

Chart 3 highlights these differences in detail. The left hand side of the chart shows the relationship between the allocation to infrastructure and the fund return for the year – across all funds, a higher allocation is correlated with a higher return (note however that a number of funds do not report any allocation to infrastructure). The right hand side of the chart shows comparable figures for fixed income – in this case a higher allocation correlates with a lower return.

Chart 2: Average asset allocation—1 year to 30 June 2017

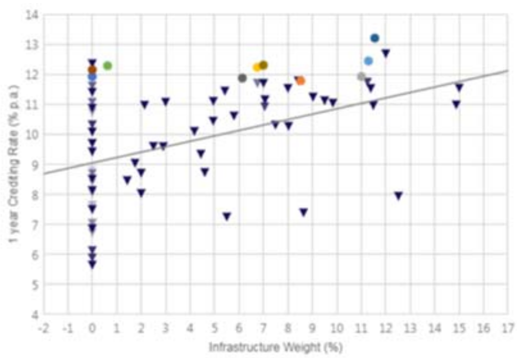


Note: The top and bottom ends of a candle stick represent the maximum and the minimum value of the range, respectively. The body (rectangular) of each candle stick represents the 25-75 percentile range.

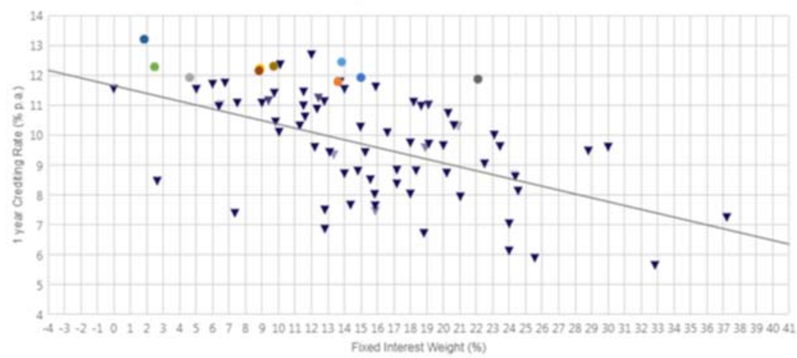
Source: Frontier Glide, SuperRatings

Chart 3: Sector allocation v returns

Infrastructure v 1 year returns
1 year to 30 June 2017



Fixed Interest v 1 year returns
1 year to 30 June 2017



Source: Frontier Glide, SuperRatings

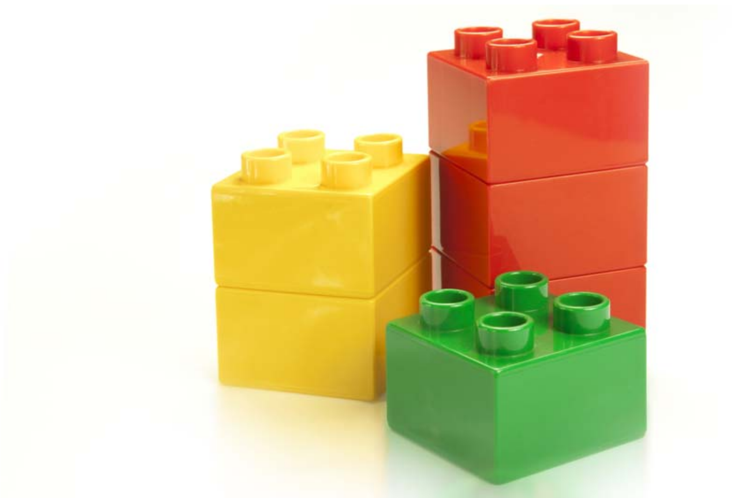
Sector performance

While a fund's asset allocation decisions will have played a major role in determining the fund's return for the year, it will not have been the only factor. Having good investment managers played a key role for the year, particularly in equities and property.

While the underlying sector performance of the funds is not available, the performance of funds' individual asset class option performance can be used as a proxy. For example, just for the top 10 funds over the year, the returns for Australian Shares sector options varied between 12.7% and 16.9%, implying manager selection had materially impacted on funds' performance over the year.

The dispersion of returns in the property sector among the best performance funds was a significant 13%, with one fund returning almost 19% and another earning less than 6% in their property options. Fortunately, the fund with the poor property performance was also the fund with the lowest allocation to property.

By using this information, it becomes easier to understand where positive and negative manager selection effects offset a good asset allocation call.



Size and fees

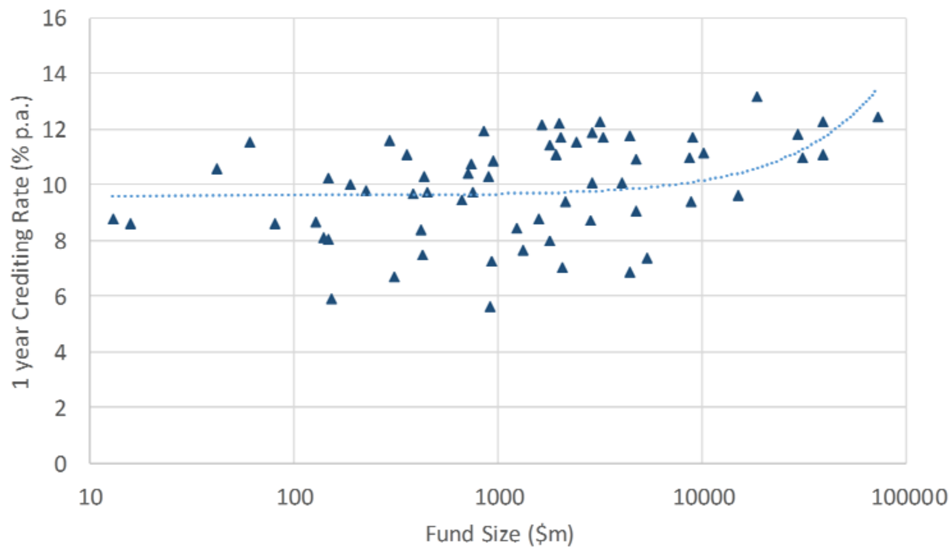
APRA's scale test and the musings of the Productivity Commission would lead one to believe that larger funds will automatically have better returns. They will be able to use their size to negotiate better deals with investment managers and pass these on to members in lower fees. Indeed, analysis of the top performing funds over the year seems to back this up. Four of the largest ten funds appeared in the top 10 performers for the year, and seven of these best performing funds were larger than average.

Size

Chart 4 plots each fund option's size versus its return for the year – note a log scale has been used to make the smaller funds more easily discerned.

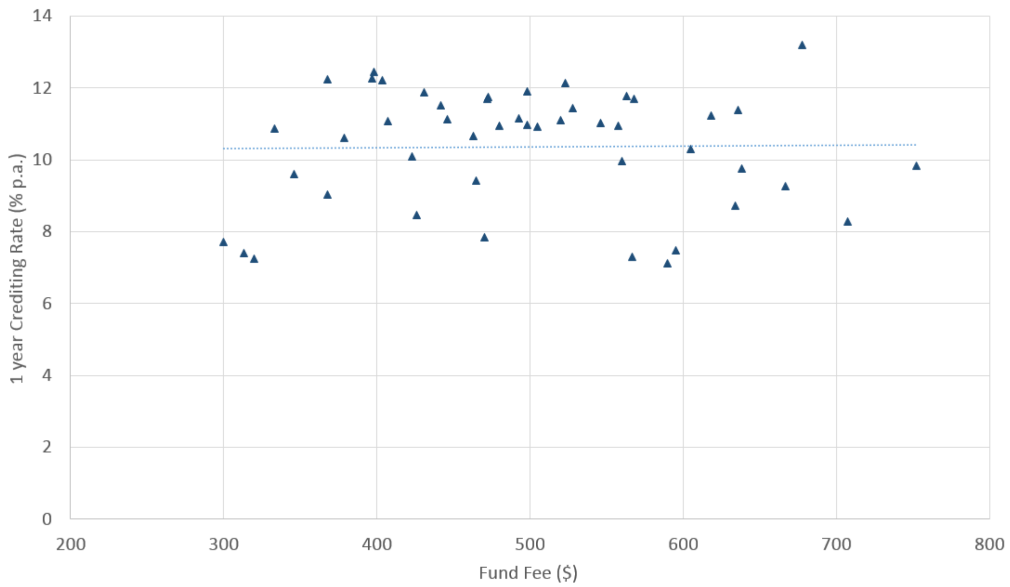
From these results, there is no identifiable relationship between size and return for funds with less than $10bn in assets. There appears to be a positive correlation between size and performance for funds of more than $10bn, however given there are only a few funds of this size, the relationship is not statistically significant.

Chart 4: Size v 1 year returns—1 year to 30 June 2017



Source: Frontier, SuperRatings

Chart 5: Fee v 1 year returns—1 year to 30 June 2017



Source: Frontier, SuperRatings

Fees

Chart 5 highlights the relationship between the fee each fund option charges (as measured by the member cost per year for an account balance of $50,000) and the after fee return for the year.

Contrary to expectation, the funds which charge a lower fee did not have any better (or worse) performance than those which charge a higher fee.

One explanation for this is the additional charges incurred by a high fee option (such as active manager fees and investing higher fee asset classes) increased the relative return for these funds, justifying the additional expenses incurred.

Longer term analysis

Our analysis to date has analysed the performance of superannuation funds over the most recent year. However, superannuation is a long term investment, 40 years plus for most members. Consistent performance over the longer term should be more highly valued over great performance in a single year.

Corroborating this, APRA states that caution should be exercised when comparing funds' performance:

"APRA also notes that performance over the long term is a key determinant of members' retirement outcomes and that there is likely to be considerable variability in some data over the short term. In that context, APRA strongly recommends that users of statistics exercise caution in making assessments or drawing conclusions based on short-term information." [6]

Consistency of performance

In Table 2, we highlight the performance of this year's top 10 performers over the past three years.

As can be seen, the performance of both HOSTPLUS and AutralianSuper has been remarkably consistent over the past three years – with top 10 performance in each year. However, the performance consistency for funds more generally is less clear. Three of this year's top performers underperformed the median in 2016, two underperformed in 2015, and one underperformed in both periods – was this year's good performance a sign of things to come, or just a flash in the pan?

Furthermore, the top two best performing funds in 2016 and the best performing fund in 2015 all produced returns below the average fund in 2017.

Table 2: Top SR50 balanced funds—for last three financial years

Fund - option	FY 2017		FY 2016		FY 2015	
	Return (%)	Rank	Return (%)	Rank	Return (%)	Rank
HOSTPLUS - Balanced	13.2	1	5.0	7	11.0	6
AustralianSuper - Balanced	12.4	2	4.5	8	10.9	7
Sunsuper for Life - Balanced	12.3	3	3.1	19	10.2	14
First State Super - Growth	12.3	4	1.6	39	9.9	19
Club Plus Super - MySuper	12.2	5	3.3	18	8.7	35
Intrust Core Super - MySuper	12.2	6	3.5	14	11.1	3
Equip - Balanced Growth	11.9	7	2.8	26	10.5	12
Kinetic Super - Growth	11.9	8	2.7	28	8.3	38
Cbus - Growth	11.9	9	5.5	5	10.1	15
Catholic Super - Balanced	11.8	10	5.7	3	9.8	21
Median	**10.6**	**25**	**2.8**	**25**	**9.7**	**25**

Source: SuperRatings

6. APRA letter to RSE licensees, 9 February 2016

Longer term performance

Table 3 highlights the top 10 performing balanced funds over ten years to June 2017.

The above results show that choice of superannuation fund can be important – the best performing fund over the ten year period outperformed the worst fund by 4% p.a., which equates to an extra $46,000 in the end balance for an average member.

Five of the top ten performing funds over the financial year 2017 also appear in the best funds over ten years. Interestingly, REST, the top performing fund over the last ten years, did not appear in the top 10 performing funds in any of the last three financial years.

Simply choosing a fund based on one year of good performance is no guarantee for success.

Table 3: Top SR50 balanced funds—10 years to 30 June 2017

Rank	Option Name	Return (%p.a.)	St Dev (%)	Current Growth Ratio (%)	Current Fees ($)	Current Size ($m)
1	REST - Core Strategy	6.1	5.9	76	407	39,052
2	CareSuper - Balanced	6.0	5.8	72	568	8,963
3	UniSuper Accum (1) - Balanced	5.8	6.6	70	346	15,006
4	HOSTPLUS - Balanced	5.8	5.6	76	678	18,347
5	Equip - Balanced Growth	5.7	6.4	70	463	854
6	Cbus - Growth	5.6	5.6	67	498	29,555
7	Commonwealth Bank Group Super - Balanced	5.6	6.0	68	368	4,735
8	AustralianSuper - Balanced	5.6	6.3	69	398	72,203
9	BUSSQ Premium Choice - Balanced Growth	5.5	5.9	71	638	454
10	Catholic Super - Balanced	5.5	6.0	70	563	4,446
	Median	4.8	6.6	71	493	2048

Source: Frontier Glide, SuperRatings

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