THE

Frontier Line

Thought leadership and insights from Frontier Advisors

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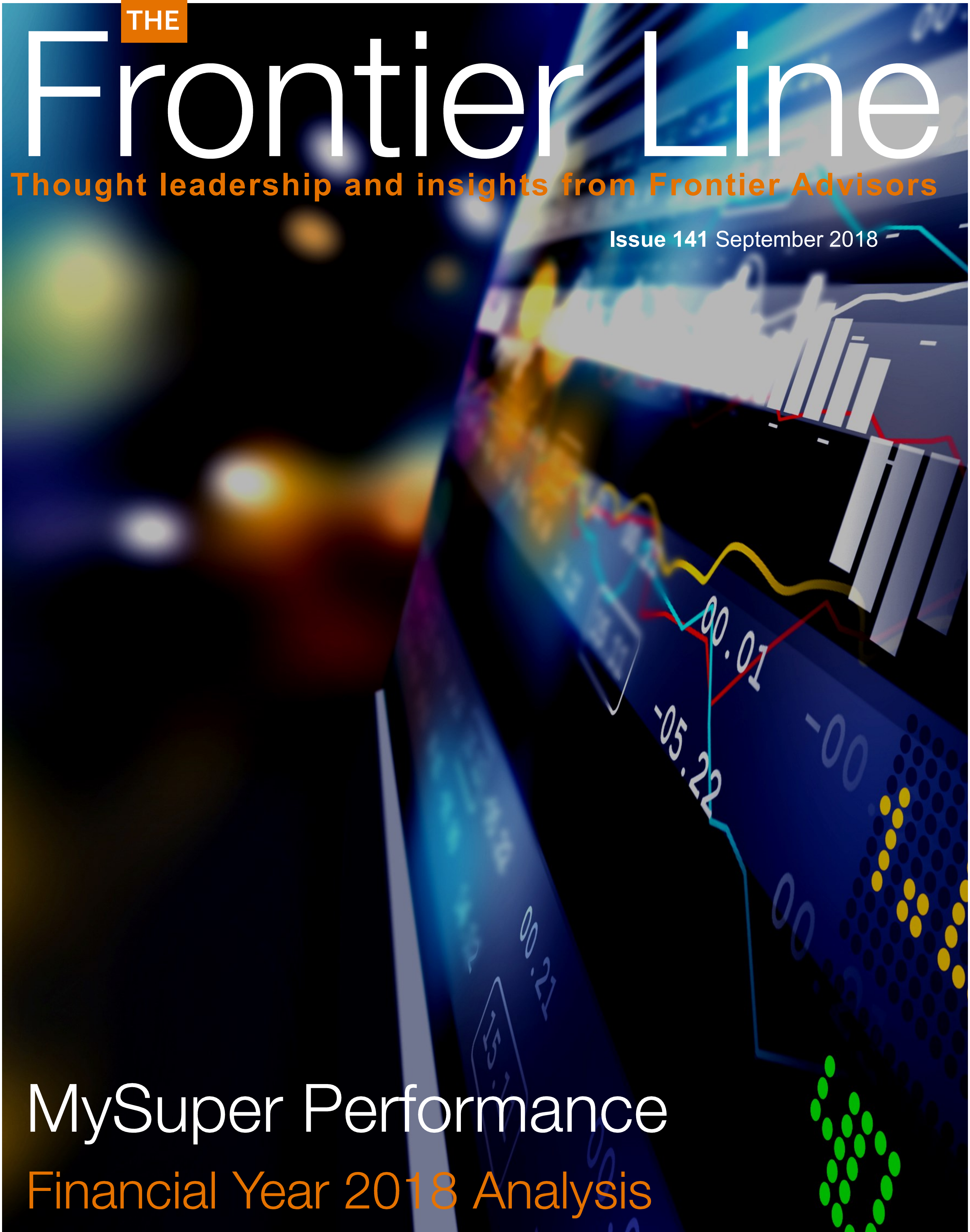

MySuper Performance

Financial Year 2018 Analysis

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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 $320B 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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Introduction

In this issue of FrontierLine we compare funds' 2018 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.

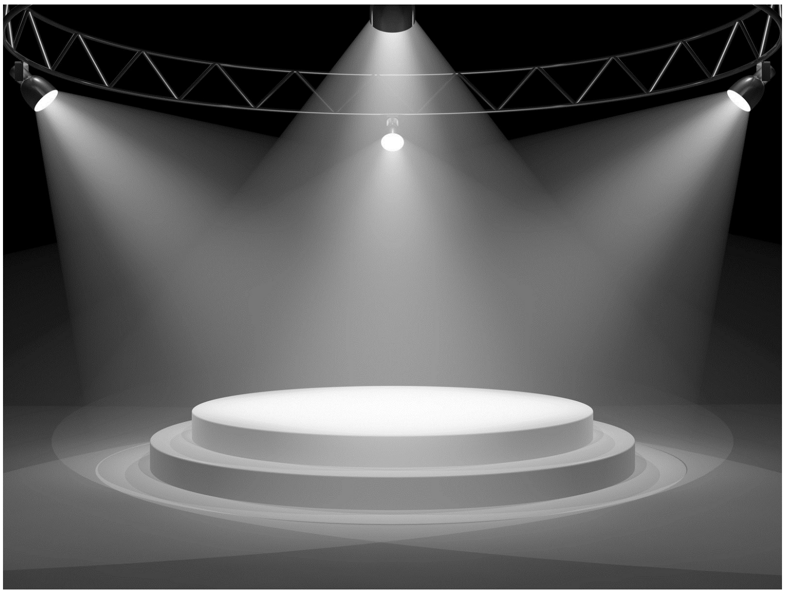
Superannuation is a long-term investment, literally intended to last a lifetime for fund members. Despite this, each year we pore over the latest financial year returns, identifying the short-term winners and losers. Past performance is no guide to the future. Short term performance is just noise.

However, the choice of super fund is important. The Productivity Commission[1] highlighted that underperformance compounds to substantially lower retirement balances – a member with a bottom quartile fund would have 53% less to spend in retirement than a top quartile fund member due to lower returns.

Can a "best in show" fund be identified in advance? Merely choosing funds based on the recent performance may not help, but understanding their performance will be 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 summary, we make the following observations from the analysis using the Glide module of Frontier Partners Platform:

- There was some relationship between the return and the level of risk in FY18. In particular, funds which had a lower allocation to fixed interest and cash performed better. Larger allocations to real assets such as property and infrastructure was beneficial;
- Perhaps supporting the industry consolidation theme, there has been some evidence of a positive correlation between size and performance for funds – but only if the fund is bigger than $10bn;
- Contrary to industry speculation, low fee funds actually had worse performance on average than high fee funds;
- The best performing funds over the last year were also high performers over the last three years, indicating that similar themes persisted. There was less consistency with the best funds over ten years.



[1] Australian Government Productivity Commission (April 2018), Superannuation: Assessing Efficiency and Competitiveness, Draft Report. Final report is TBA as at August 2018.

Financial year recap

Over the course of FY18, balanced funds' performance varied across funds, with returns ranging from 5% to 13%. The top 10 performers (according to the SuperRating's SR50) earned over 10%.

Effect of risk on performance

Inevitably, when the performance surveys are released, some commentators remark that "funds manipulate their inclusion into categories set by the ratings agencies"[2]. The question being raised is whether the top performing funds are "better" than other funds, or merely higher risk.

There is no single definitive definition of risk - the level of risk the funds took to achieve their returns can be measured in various ways:

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. Given funds self-report their growth allocation, this measure is open to some interpretation. On this measure, six of the top 10 funds have equal or more exposure to risk assets than the average fund.

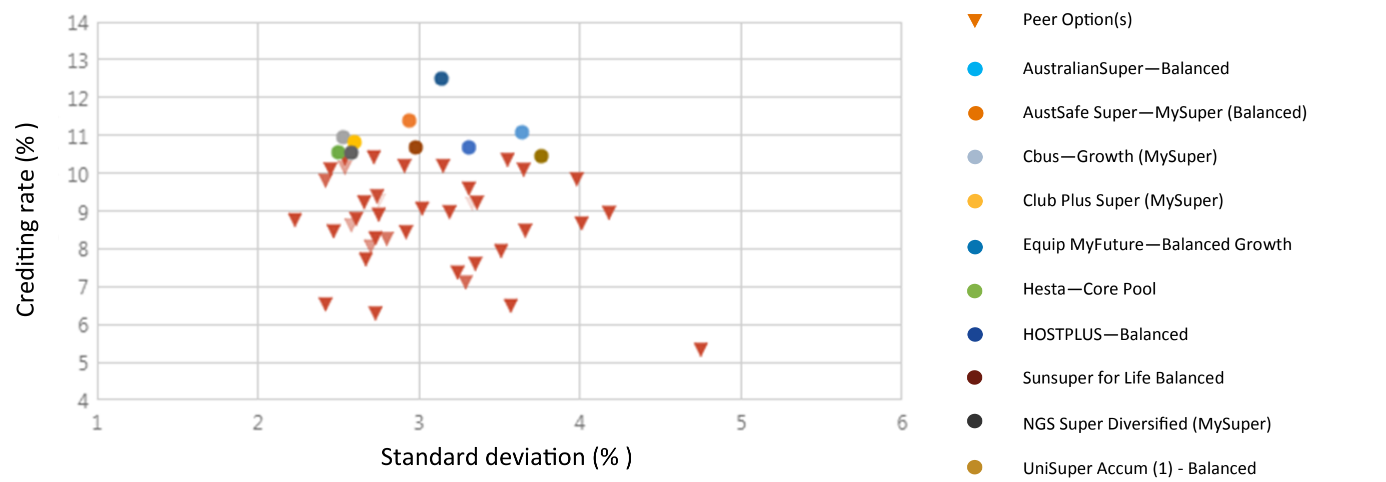
Standard Deviation – calculating the volatility of returns over the year provides one measure of risk, although measuring over longer periods will provide a better measure. Nonetheless, on this measure most funds were riskier than the average fund over the year, with 6 out of 10 having more than the median risk.

Investment Risk – the expected number of negative returns in 20 years is another measure of investment risk. Six of the top 10 funds listed in Table 1 are targeting a risk level equal to or greater than the average fund based on this measure.

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

Risk can be defined in other ways as well, with the ultimate risk for members being that their superannuation is not adequate for their retirement or that the fund is unable to pay benefits (for example due to liquidity issues).

Chart 1: Return vs risk
year to 30 June 2018 (after fees & tax)



Source: Frontier Glide, SuperRatings

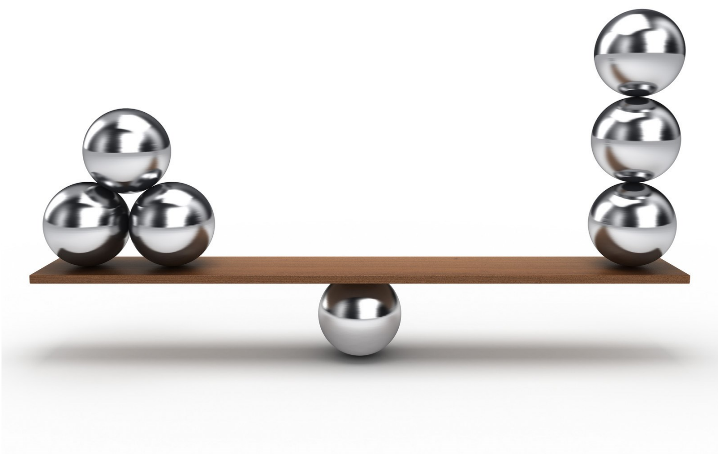
[2] "How super funds play the ratings game", nestegg.com.au, 1 August 2018

Table 1: Top SR50 balanced funds – 30 June 2018

Rank	Fund – Option	Return (%)	St Dev (%)	Growth Ratio[3] (%)	Target Return[4] (%)	Investment Risk[5] (years/20)	Fees[6] ($)	Size ($m)
1	HOSTPLUS – Balanced	12.5	3.1	76	3.5	4.1	803	21,287
2	AustSafe Super – MySuper (Balanced)	11.4	2.9	71	4.4	3.9	510	2,077
3	AustralianSuper – MySuper Balanced	11.1	3.6	72	3.9	4.0	453	72,203
4	Cbus – Growth (MySuper)	11.0	2.5	71	4.8	3.0	483	40,068
5	Club Plus Super – MySuper	10.8	2.6	76	3.0	5.3	710	2,255
6	Equip MyFuture – Balanced Growth	10.7	3.3	70	3.7	2.3	463	978
7	Sunsuper for Life - Balanced	10.7	3.0	69	5.5	3.6	368	3,156
8	HESTA - Core Pool	10.6	2.5	71	5.0	3.5	630	34,935
9	NGS Super - Diversified MySuper	10.5	2.6	68	3.0	3.3	665	4,763
10	UniSuper Accum (1) - MySuper Balanced	10.5	3.8	70	4.6	4.0	376	16,373
25	**Median**	**9.2**	**2.9**	**71**	**3.5**	**3.9**	**600**	**2,255**

Source: SuperRatings, APRA

The SuperRatings SR50 survey does not include every super fund as not all funds elect to be in the survey. Some funds outside the survey, such as the First Super Balanced which returned 10.7% for the financial year, have also performed well.



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

Allocation effects

Asset allocation is a key driver of both risk and 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 did have an overweight position in Australian equities compared to the average fund. Surprisingly, only four 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 (property and infrastructure) – all but two of the funds had an overweight allocation relative to the median (4%) infrastructure allocation.

The most noticeable asset allocation difference was that the top performing funds were underweight fixed income relative to the average. Only three funds reported overweight positions in fixed income – all the rest were underweight. Chart 3 highlights this in detail and the relationship between the allocation to fixed interest and the fund return for the year – across all funds, a lower allocation is correlated with a higher return (R-squared of 0.23).

Chart 2: Average asset allocation
1 year to 30 June 2018

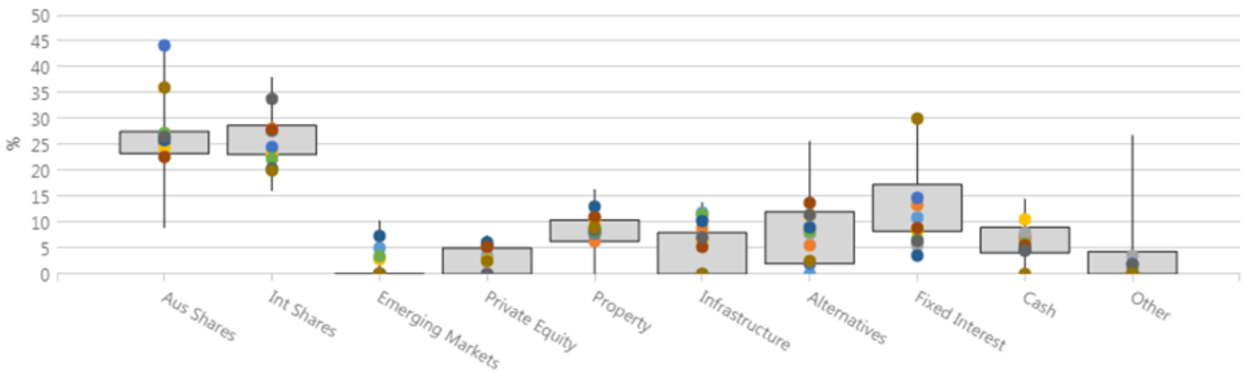
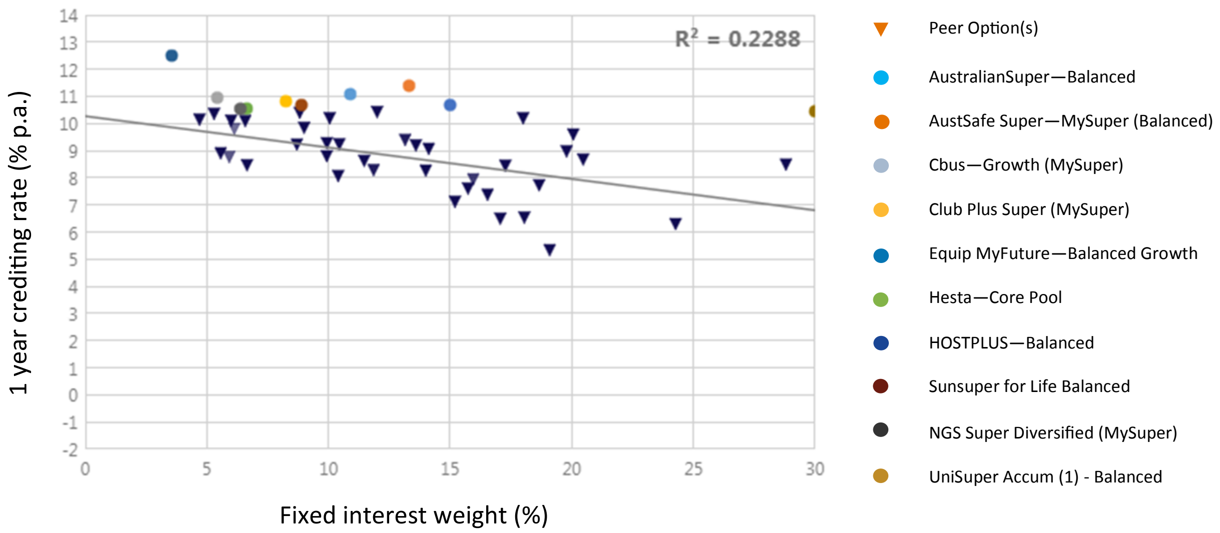


Chart 3: Fixed interest vs 1 year returns
1 year to 30 June 2018



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 12.6% and 18.3%, implying manager selection had materially impacted on funds' performance over the year. For comparison, the median return of SR50 Australian Shares sector options was 13.4%.

The dispersion of returns in the International Shares sector among the best performing funds was almost 6%, with one fund returning 18.1% and another earning 12.2% in their options. Fortunately, the fund with the poor International Shares performance was also the fund with the lowest allocation to International Shares. The median return of SR50 International Shares sector options was 12.3%.

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 and Royal Commissions 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. Analysis of the top performing funds over the year seem to back this up. Five of the largest 10 funds appeared in the top 10 performers for the year, and nine of these best performing funds were larger than average.

Size (over page)

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.

Fees (over page)

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 didn't have any better performance than those which charge a higher fee – indeed funds charging a higher fee typically outperformed. 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.

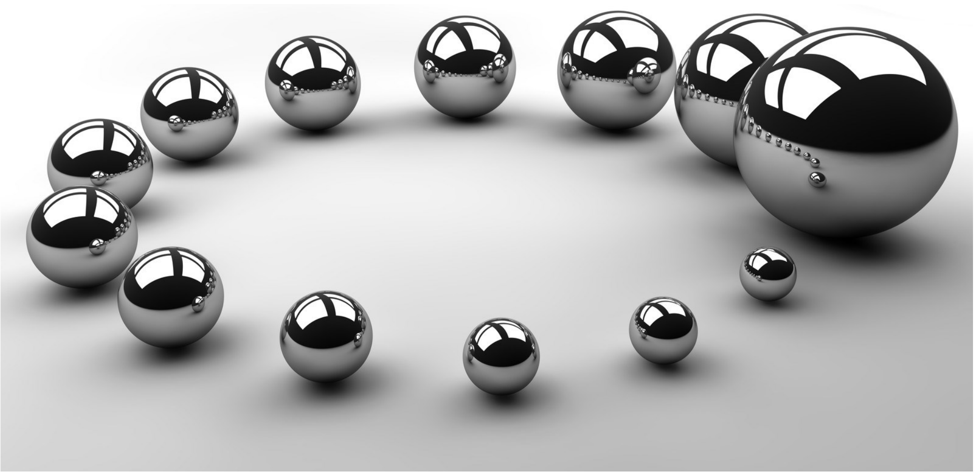


Chart 4: Size vs 1 year returns
1 year to 30 June 2018

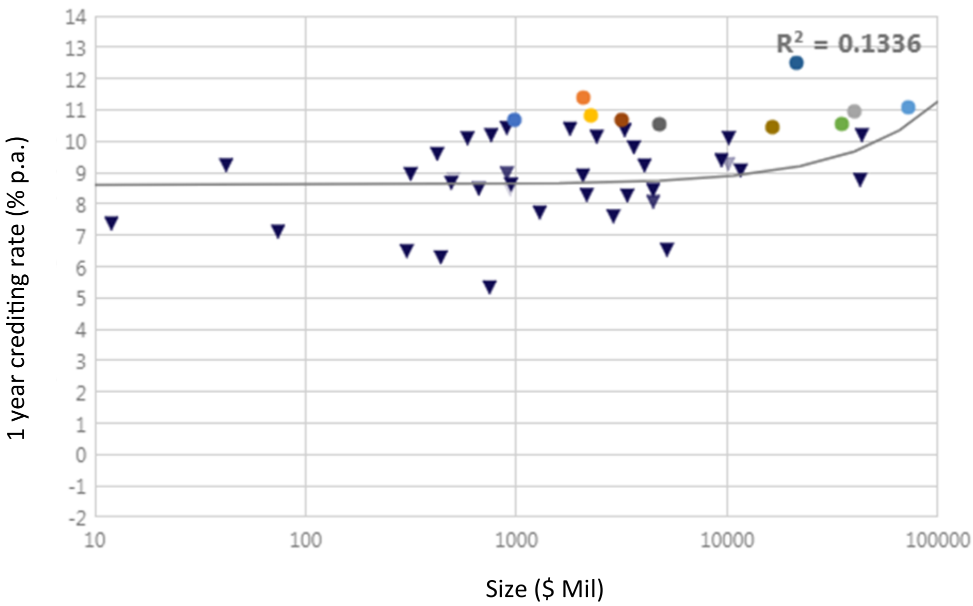
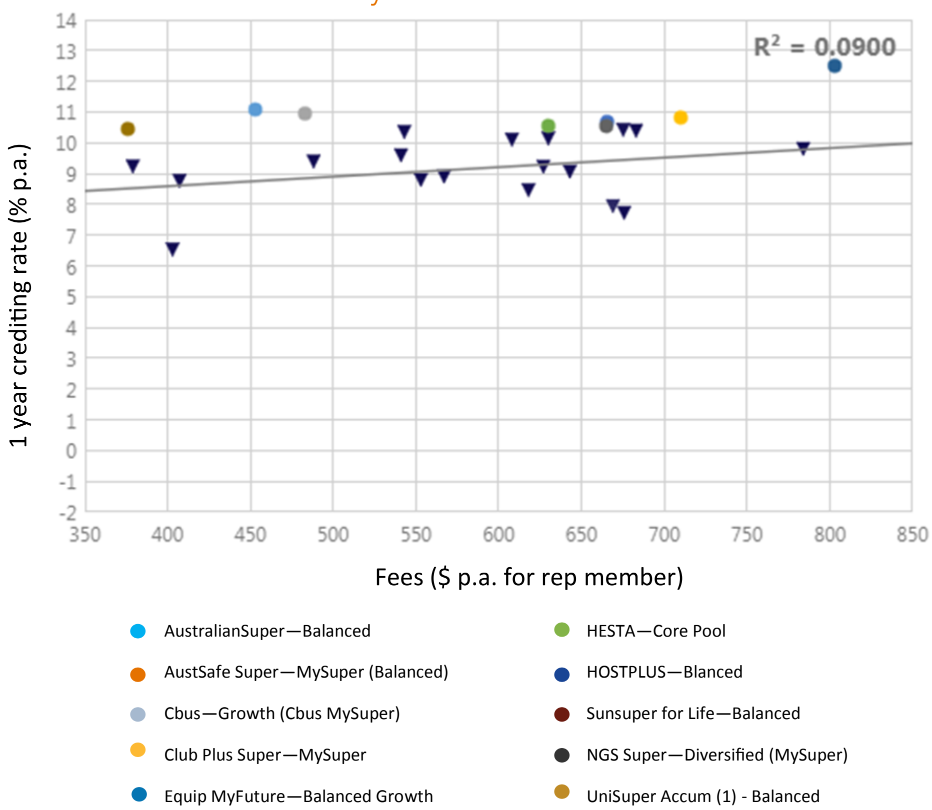


Chart 5: Fees vs 1 year returns
1 year to 30 June 2018



Source: Frontier Glide, SuperRatings

Longer-term analysis

Our analysis has assessed 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."[7]

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 HostPlus, Cbus and AustralianSuper has been remarkably consistent over the past three years – with top 10 performance in each year.

Indeed, the performance consistency for these top funds has generally been good. Only one of this year's top performers underperformed the median in 2017, and a different fund underperformed in 2016.

Chart 6 (over page) compares the performance over the most recent year with their performance of three years.

A strong relationship between good performance in this year and performance over three years is clear. This can either be seen as:

- a sign that past performance is a guide to the future; and/or;
- that the markets over the last three years have been consistent, and favoured funds with certain characteristics.

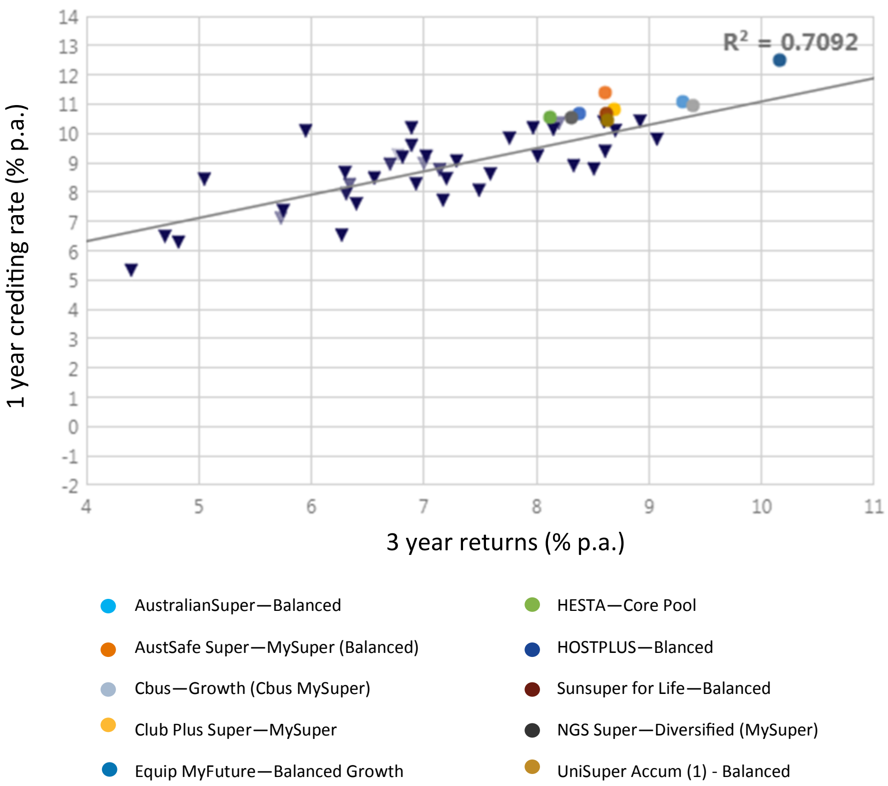
Table 2: Top SR50 Balanced Funds – Last 3 Financial Years

Fund - option	FY 2018		FY 2017		FY 2016	
	Return (%)	Rank	Return (%)	Rank	Return (%)	Rank
HOSTPLUS - Balanced	12.5	1	13.2	1	5.0	7
AustSafe Super - MySuper (Balanced)	11.4	2	11.1	18	3.4	16
AustralianSuper - MySuper Balanced	11.1	3	12.4	2	4.5	8
Cbus - Growth (MySuper)	11.0	4	11.9	9	5.5	5
Club Plus Super - MySuper	10.8	5	12.2	6	3.3	18
Equip MyFuture - Balanced Growth	10.7	6	11.9	8	2.8	25
Sunsuper for Life - Balanced	10.7	7	12.3	5	3.1	19
HESTA - Core Pool	10.6	8	11.0	21	3.0	20
NGS Super - Diversified MySuper	10.5	9	10.9	22	3.6	13
UniSuper Accum - MySuper Balanced	10.5	10	9.6	33	5.9	2
Median	9.2	25	10.8	25	2.8	25

Source: Frontier Glide, SuperRatings

[7] APRA letter to RSE licensees, 9 February 2016

Chart 6: Three year returns vs one year returns
1 year to 30 June 2018



Longer-term performance

The table below highlights the top ten performing balanced funds over ten years to June 2018.

Table 3: Top 10 SR50 balanced funds – 10 years to 30 June 2018

Rank	Option NameRank	Type	Return (%p.a.)	St Dev (%)	Current Fees ($)
1	UniSuper Accum - MySuper Balanced	Industry	7.6	6.2	376
2	CareSuper - Balanced	Industry	7.5	5.0	608
3	Equip MyFuture - Balanced Growth	Industry	7.5	6.0	463
4	REST - Core Strategy	Industry	7.4	5.5	407
5	HOSTPLUS - Balanced	Industry	7.4	5.1	803
6	AustralianSuper - MySuper Balanced	Industry	7.3	5.7	453
7	Cbus - Growth (MySuper)	Industry	7.2	5.1	483
8	Catholic Super - Balanced (MySuper)	Industry	7.2	5.3	784
9	Telstra Super - MySuper Balanced	Corporate	7.2	6.6	628
10	AustSafe Super - MySuper (Balanced)	Industry	7.0	6.3	510
	Median		**6.4**	**6.0**	**600**

Source: Frontier Glide, SuperRatings

The final word...

Whilst the top 10 performing funds all had similar returns over the period, the choice of superannuation fund can be important – the best performing fund over the ten year period outperformed the worst fund by 3.9% p.a.

Six of the top ten performing funds over the financial year 2018 also appear in the best funds over ten years. REST and Telstra Super, two of the top performing funds over the last ten years, did not appear in the top 10 performing funds in any of the last three financial years.

Interestingly, all the top performing funds over ten years were profit-to-member funds. The highest retail fund was in 23rd place, with all the remaining retail funds producing a below median return.

Choosing a fund based on one year of good performance is fraught with danger. Adjusting for risk is important, but risk is multi-faceted and requires detailed analysis. Alternatively, choosing a fund because it has low fees will have resulted in lower performance over recent periods. Basing your choice on longer term performance has more appeal. However, care is needed to differentiate between those funds which have done well in the past and those which do well in the future. Regardless, detailed analysis is required.

One factor that has been consistent for many years is the out-performance achieved by profit for member funds.

GLIDE

Throughout this paper we have referenced the Frontier Glide tool.

Glide is a module within the award-winning Frontier Partners Platform and provides users with a comprehensive superannuation fund comparison and attribution tool. Determining fund performance and positioning versus peers and the broader industry is usually a complicated and time-consuming process, however Glide provides these metrics in just a few clicks.

Users can monitor their performance over various periods and also compare themselves against peers in areas such as asset allocation, target return and risk, funds under management and fees. Glide is updated every month with the latest data sourced from SuperRatings and APRA. Users can have either pre-defined or customised peer groups that can be useful for reporting.

Glide can identify the key drivers of funds' outperformance/underperformance against peers in terms of sector asset allocation and manager selection. Results are summarised in a neat colour-coded tabular format.

Users can take guidance on longer-term strategies by comparing key member demographics to answer questions such as – how old/young my fund is compared with peers, what is the average balance per age group, and how many members will retire within next ten years.

To find out more about Glide, or to organise a demonstration, please contact Frontier.

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