THE Frontier Line

Thought leadership and insights from Frontier Advisors

Issue 151 August 2019

Superannuation Performance

Financial Year 2018-19

FRONTIER ADVISORS

25 years

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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

Superannuation is a long-term investment, literally intended to last a lifetime for fund members. Short term performance is often just noise. Past performance is no guide to the future. While we recognise these notions, it is interesting and informative to analyse 30 June performance data.

ASIC warns that "it may be misleading to imply that reliance on simple past performance figures would be a good way to select a financial product or service."[1] Given this, can a "best in show" fund be identified in advance?

Merely choosing funds based on 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 consistently performed well?

In this issue of The Frontier Line we compare funds' 2018-19 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 make the following observations from our analysis using the Glide module of Frontier Partners Platform:

- Despite a sell-off in equity markets in the December quarter, most funds produced healthy returns for the financial year, exceeding their CPI linked objectives.
- There were few consistent themes in the way in which the top funds achieved their outperformance over the year. Some benefited from strong returns from bonds, while others were rewarded for sticking in the equity markets as they rebounded.
- With many active equity managers underperforming over the year, choice between active and passive, along with manager choice itself was important, particularly in Australian equities.
- The best performing funds over the last year were also high performers over each of the last three years, showing a level of consistency.
- Over the longer term, the best performing funds typically had lower risk attributes, showing that simply investing more in high risk assets is not necessarily the best way to the top.

[1]ASIC RG53, The use of past performance in promotional material, July 2003

Financial year recap

Over the course of 2018-19, Balanced funds' performance varied considerably, with returns ranging from 4% to 10%. The top 10 performers (according to the SuperRating SR50) earned over 7.5%, as highlighted in Table 1 below.

With inflation for the year at 1.6%, the average superannuation fund produced a real return of 5.4%. The typical fund is aiming to produce a real return of 3-3.5% p.a., so the 2018-19 return exceeded long-term expectations. Even the worst funds in the survey returned inflation +3% for the year.

Table 1: Top Ten SR50 Balanced Funds – 12 months to30 June 2019

FY Rank	Fund—Option	Return (%)	Growth Ratio[2] (%)	Return Target[3] (%)	Investment Risk[4] (years/20)	Fees[5] ($)	Size ($m)
1	UniSuper Accum - MySuper Balanced	9.9	70	4.6	4	361	17,314
2	QSuper - QSuper Balanced	9.7	62	n/a	2-3	n/a	11,920
3	Media Super - Balanced	8.8	71	3.4	3.4	555	2,675
4	AustralianSuper - MySuper Balanced	8.7	70	3.8	4	447	99,287
5	Sunsuper for Life - Balanced	8.6	70	5.4	3.6	553	4,517
6	Mercy Super - MySuper Balanced	8.2	70	5.3	2.9	675	931
7	VicSuper - Growth (MySuper)	8.2	75	3.5	3	563	13,058
8	First State Super MySuper - Life Cycle Growth	7.7	75	3.6	4.5	527	45,113
9	CSC PSSap - MySuper Balanced	7.7	63	3.5	3.5	535	11,425
10	MTAA Super - My AutoSuper	7.7	67	3.2	3.8	503	10,218
	Median	**6.9**	**71**	**3.6**	**3.5**	**567**	**2,407**

Source: SuperRatings, APRA

[2]Self-reported to SuperRatings

[3]APRA defines Target Return as the net mean annualised return above CPI over 10 years. As at March 2019

[4]APRA defines Investment Risk as the estimated number negative annual returns in 20 years. As at March 2019

[5]APRA Statement of fees and other costs for member with $50,000 account balance. As at March 2019

Analysis of performance

Quarter-by-quarter performance

It is instructive to analyse how funds performed in each quarter of the financial year as market returns varied considerably in each quarter. This is evidenced by comparing the returns on the Australian share market in each quarter:

- Quarter 1 (July to September 2018): Australian equities (S&P/ASX300) returned +1.5%
- Quarter 2 (October to December 2018): -8.4%
- Quarter 3 (January to March 2019): +10.9%
- Quarter 4 (April to June 2019): +8.0%

Quarterly performance is too short a time period to determine whether a fund is 'good' or 'bad', but it is helpful to understand their decisions taken. Those funds which were more defensive should have seen this payoff, in relative terms, in the December quarter, while those funds remaining in the equity markets will have been rewarded in the March quarter.

Table 2 highlights the returns of the top 10 performing funds in each of the quarters and helps understand the variation in the way each of the top funds positioned their portfolios and therefore performed.

For example, Unisuper started the year relatively slowly, being one of the worst performing funds in the first quarter. Its performance picked-up in the second quarter, but much of Unisuper's gains were made in the strongly performing third and fourth quarters – benefiting from the rise in the equity markets after the sell-off in December.

In contrast, QSuper was +3.6% ahead of the average fund in the second quarter, rewarded for taking a more defensive stance to its peers. When markets bounced back at the start of 2019, its return was lower than peers, but a still healthy +5.2%.

Table 2: Top SR50 Balanced Funds – Quarterly Performance 2018-19

Fund – Option	**One Year Return**	**Quarter 4**		**Quarter 3**		**Quarter 2**		**Quarter 1**	
	(%)	**Return (%)**	***Rank***	**Return (%)**	***Rank***	**Return (%)**	***Rank***	**Return (%)**	Rank
UniSuper Accum - MySuper Balanced	9.9	5.0	*1*	7.9	*2*	-4.1	*11*	1.1	49
QSuper - QSuper Balanced	9.7	3.6	*18*	5.2	*45*	-1.1	*1*	1.8	38[6]
Media Super - Balanced	8.8	4.0	*7*	5.5	*40*	-4.0	*10*	3.3	1
AustralianSuper - MySuper Balanced	8.7	4.8	*2*	6.6	*10*	-5.1	*37*	2.5	9
Sunsuper for Life - Balanced	8.6	4.2	*4*	6.0	*26*	-4.0	*8*	2.3	15
Mercy Super - MySuper Balanced	8.2	3.4	*28*	6.3	*22*	-4.2	*12*	3.2	2
VicSuper - Growth (MySuper)	8.2	3.6	*16*	6.2	*23*	-4.0	*9*	2.4	13
First State Super MySuper - Life Cycle Growth	7.7	3.7	*13*	6.3	*17*	-4.7	*25*	2.5	12
CSC PSSap - MySuper Balanced	7.7	3.6	*15*	5.6	*39*	-3.6	*5*	2.1	23
MTAA Super - My AutoSuper	7.7	3.6	*20*	6.9	*6*	-4.5	*21*	1.8	37
Median	**6.9**	**3.5**	***25***	**6.1**	***25***	**-4.7**	***25***	**2.0**	**25**

Source: SuperRatings

[6] QSuper's ranking if it had been a constituent of the SR50 universe during the quarter

Asset allocation effects

As the quarterly performance indicates, asset allocation is a key driver of both risk and performance. Chart 1 shows the average asset allocation of each of the top 10 funds over the last year.

The first point to note from the allocations is the dispersion of positions taken by the top performing funds. For example, QSuper had lower allocations to equities and higher allocations to fixed interest and cash. In contrast, Media Super had high allocations to equities and low allocations to bonds and cash.

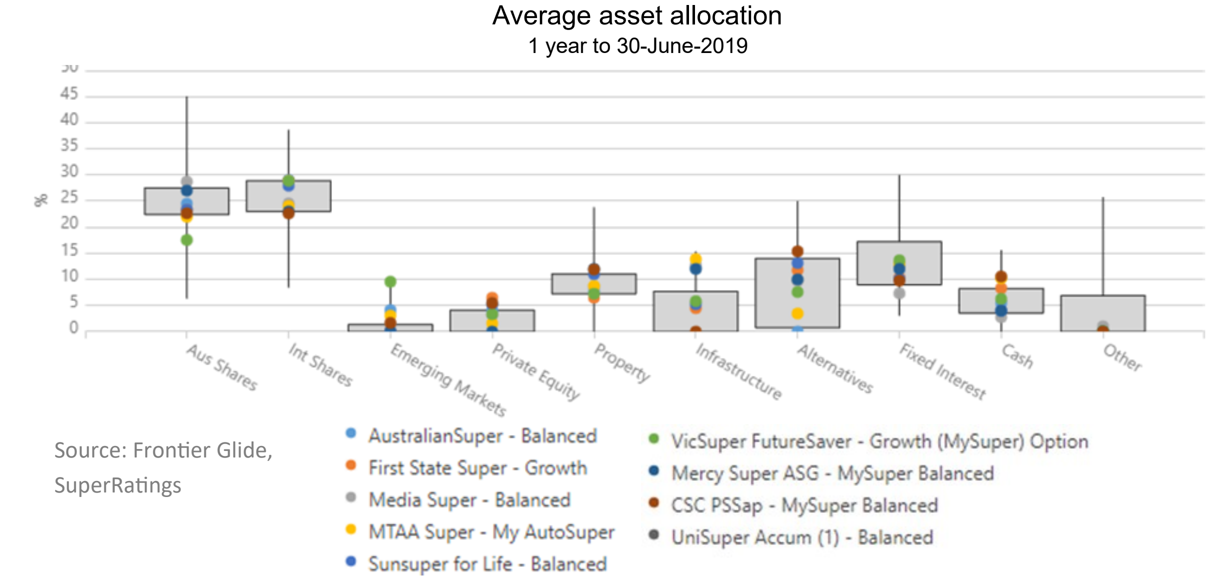
Based on their supplied asset allocations, half of the funds had an overweight position in Australian equities compared to the average fund.

In addition, six of the top 10 funds had a greater exposure to international equities (including emerging markets) than the average fund.

In contrast to last year, only four of the best performed funds were overexposed to real assets (property and infrastructure), and only three of the funds had an overweight allocation relative to the median (10%) property allocation.

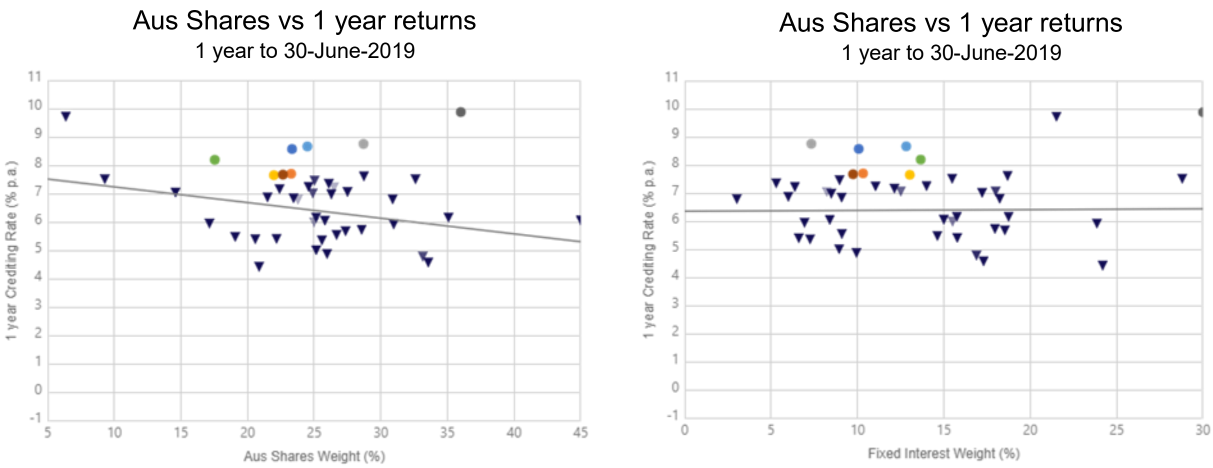
Chart 2 highlights the impact of some of these asset allocation decisions in more detail, showing the relationship between the allocation to Australian shares (left chart) and fixed interest (right chart) and the fund return for the year. In both cases, a fund's allocation to these asset classes was not a strong influence on their relative performance.

Chart 1: Top 10 SR50 Balanced Funds – Asset Allocation



Source: Frontier Glide, SuperRatings

Chart 2: Top 10 SR50 Balanced Funds – Effect of Asset Allocation Decisions



Source: Frontier Glide, SuperRatings

Asset class performance

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

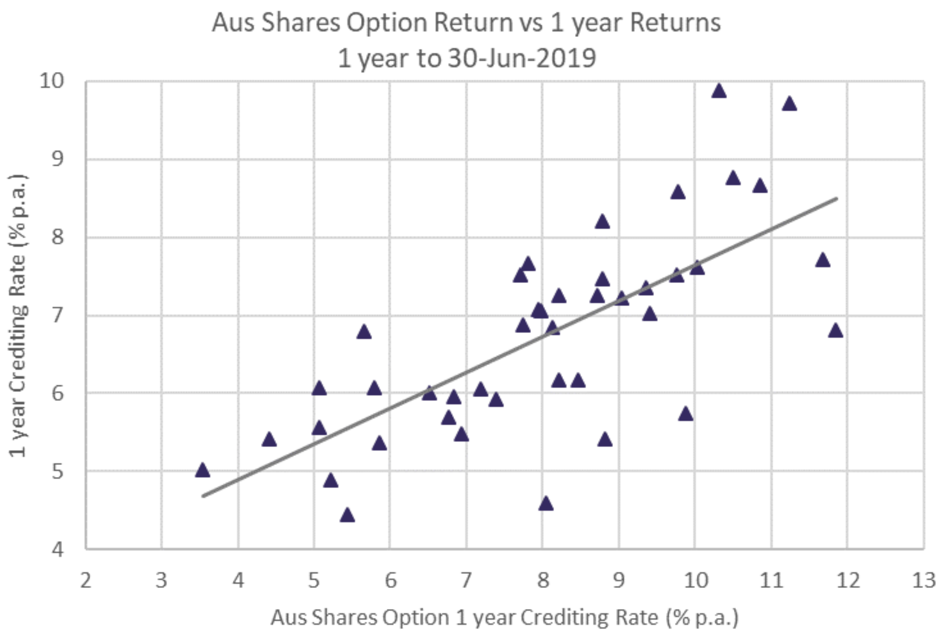
While the underlying sector performance of the funds is not available, the performance of funds' individual asset class option performance can be used as a proxy. The choice between active and passive and manager selection had materially impacted on funds' performance over the year.

As shown in Chart 3, the returns for Australian Shares sector options varied considerably. Passive options performed better than actively managed options, with the median return of SR50 Australian Shares sector options was 8.2% whilst a passively managed option returned over 11% (after tax and fees).

The dispersion of returns in the International Shares sector among the best performing funds was around 4.5%, with one fund returning 11.9% and another earning 7.5% in their options. The median return of SR50 International Shares sector options was 8.1%. Foreign currency will have also had an effect, as the Australian dollar fell from 74 cents to 70 cents over the year.

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

Chart 3: SR50 Balanced Funds – Australian Shares Option Return



Source: Frontier, SuperRatings

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, with seven of the largest 15 funds appearing in the top 10 performers for the year. However, this didn't hinder the performance of Media and Mercy Super, both medium sized funds, from beating many larger funds.

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.

Fees

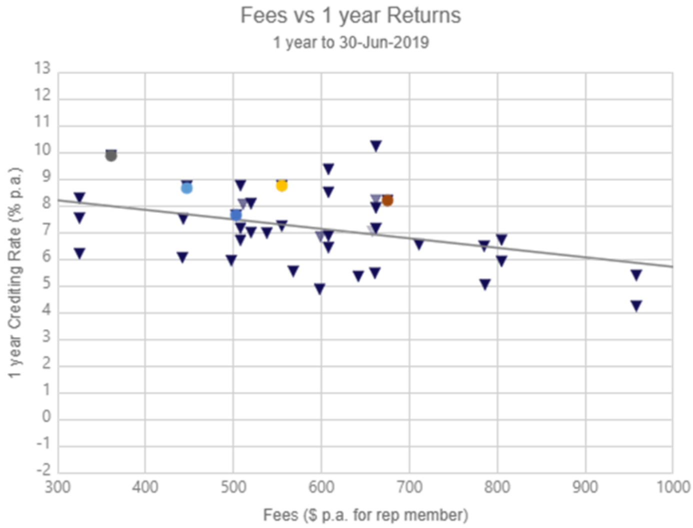
Chart 5 highlights the relationship between the fee each fund option charges (as measured by the member cost per year for an account balance of $50,000) and the after fee return for the year.

In contrast to last year, the funds which charge a lower fee had slightly better performance than those which charge a higher fee. The benefit of lower fees will have been two-fold over the year. Lower fees will have been beneficial in themselves. Also, using lower fee passive managers will have helped because active equity managers performed poorly over the year.

Chart 4: Top 10 SR50 Balanced Funds – Size Effect

Source: Frontier Glide, SuperRatings

Chart 5: Top 10 SR50 Balanced Funds – Fee Effect



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 than 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

Table 3 highlights the performance of this year's top 10 performers over the past three years.

As can be seen, the performance consistency for these top funds has generally been good. Only one of this year's top performers underperformed the median in 2018, and three different funds underperformed in 2017. In particular, two of the funds have been remarkably consistent over the past three years – with top 10 performance in each year.

Table 3: SR50 Balanced Funds – Last 3 Financial Years

Fund - option	FY 2019		FY 2018		FY 2017	
	Return (%)	Rank	Return (%)	Rank	Return (%)	Rank
UniSuper Accum - MySuper Balanced	9.9	1	10.5	10	9.6	35
QSuper - QSuper Balanced	9.7	2	6.9	-	9.5	-
Media Super - Balanced	8.8	3	10.1	16	11.5	16
AustralianSuper -	8.7	4	11.1	3	12.4	2
Sunsuper for Life - Balanced	8.6	5	10.7	7	12.3	5
Mercy Super - MySuper Balanced	8.2	6	10.4	11	12.7	-
VicSuper - Growth (MySuper)	8.2	7	9.1	28	11.2	18
First State Super MySuper - Life Cycle Growth	7.7	8	10.2	15	12.4	3
CSC PSSap - MySuper Balanced	7.7	9	9.3	24	9.4	37
MTAA Super - My AutoSuper	7.7	10	9.4	23	11.0	21
Median	**6.9**	**25**	**9.2**	**25**	**10.5**	**25**

Source: SuperRatings

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

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Longer term performance

Table 4 highlights the top 10 performing balanced funds over ten years to June 2019.

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 3.3% p.a., a significant amount when compounded over ten full years.

Six of the top ten performing funds over the financial year 2019 also appear in the best funds over ten years.

Interestingly, all the top performing funds over ten years were profit-to-member funds. The highest retail fund was in 18th place, with all the remaining retail funds producing a below median return.

Table 4: Top SR50 Balanced Funds – 10 Years to 30 June 2019

Rank	Option Name	Type	Return (%p.a.)	Current Growth Ratio (%)	St Dev (%)	Current Investment Risk (%)
1	AustralianSuper - MySuper Balanced	Industry	9.8	70	5.3	4.0
2	HOSTPLUS - Balanced	Industry	9.7	75	4.5	4.5
3	UniSuper Accum - MySuper Balanced	Industry	9.6	70	5.7	4.0
4	Cbus - Growth (MySuper)	Industry	9.4	70	4.5	3.0
5	CareSuper - Balanced	Industry	9.3	70	4.3	3.1
6	QSuper - QSuper Balanced	Public Sector	9.3	62	4.1	2-3
7	Mercy Super - MySuper Balanced	Corporate	9.2	70	4.8	2.9
8	VicSuper - Growth (MySuper)	Public Sector	9.2	75	5.9	3.0
9	Telstra Super - MySuper Balanced	Corporate	9.1	75	5.5	4.1
10	Sunsuper for Life - Balanced	Industry	9.1	70	4.8	3.6
	Median		**8.6**	**71**	**5.1**	**3.5**

Source: Frontier Glide, SuperRatings

Effect of risk on performance

Inevitably, when the performance surveys are released, the old growth/defensive debate is revisited. This year we've had a call for "a common classification system for assets and liabilities would allow members to determine whether they are getting an acceptable rate of return given their own personal risk stance".

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.
- **Standard Deviation** – Calculating the volatility of returns is a traditional measure of risk. However, it can be affected by the valuation policy used for illiquid assets.
- **Investment Risk Label** – The expected number of negative returns in 20 years is another measure of investment 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).

On these measures, in respect of the top 10 performing funds over ten years:

- Seven of the top 10 funds have equal or less exposure to growth assets than the average fund;
- Six out of 10 having produced a standard deviation of return lower than the median fund; and
- Five 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 little evidence the top performing funds over ten year achieved this performance by taking more risk than their competitors.

Chart 6: Growth ratio

Chart 7: Standard deviation

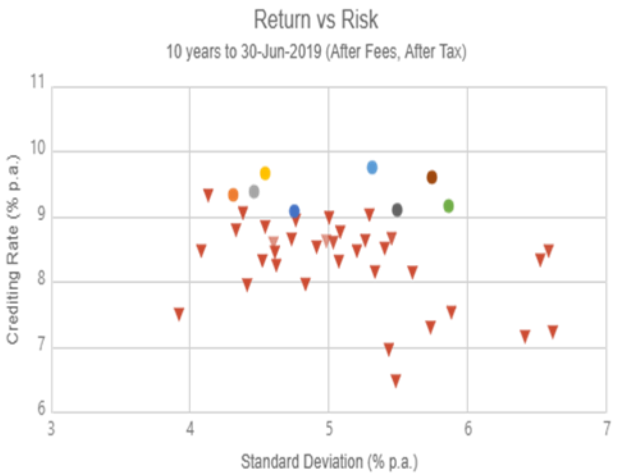
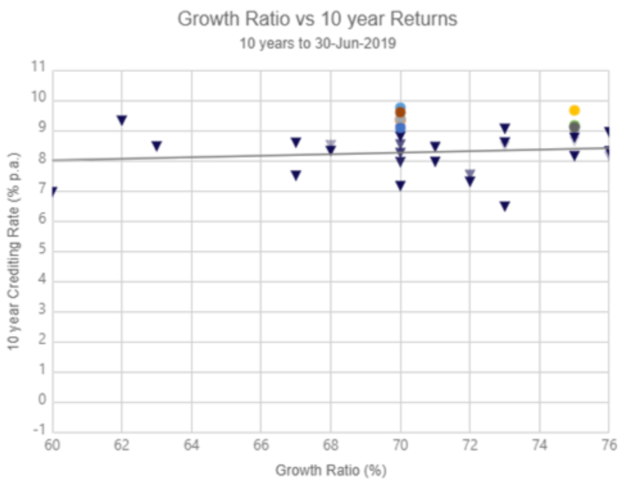


Chart 8: Investment risk label



The final word..

Superannuation is a long term investment, and it is long term returns which impact on member outcomes. Analysing short term performance can be helpful, especially in understanding how performance was achieved and whether there are any trends. Waiting ten years to determine that a fund is persistently underperforming will negatively affect members' benefits.

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 knowledge and understanding. Alternatively, choosing a fund because it has low fees is no panacea - after fee returns are important, rather than just the level of fees.

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 funds which will do well in the future.

As we've highlighted, a robust assessment across a wider range of factors is needed to be able to be satisfied that each fund is of appropriate quality and providing good value for its members. This includes:

- Investment performance measured across multiple time periods, and consideration of the level and nature of investment risk.
- Level of fees and costs, particularly where these are increasing.
- Size of assets and cashflow position, especially if the cashflow is negative.
- Fund governance, business management and trustee oversight.
- Other factors such as member services and other qualitative factors.

The focus should be on improved outcomes for members.

GLIDE

The analysis in this paper has been produced from 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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