The Frontier Line

Active management outcomes in the 2024 financial year

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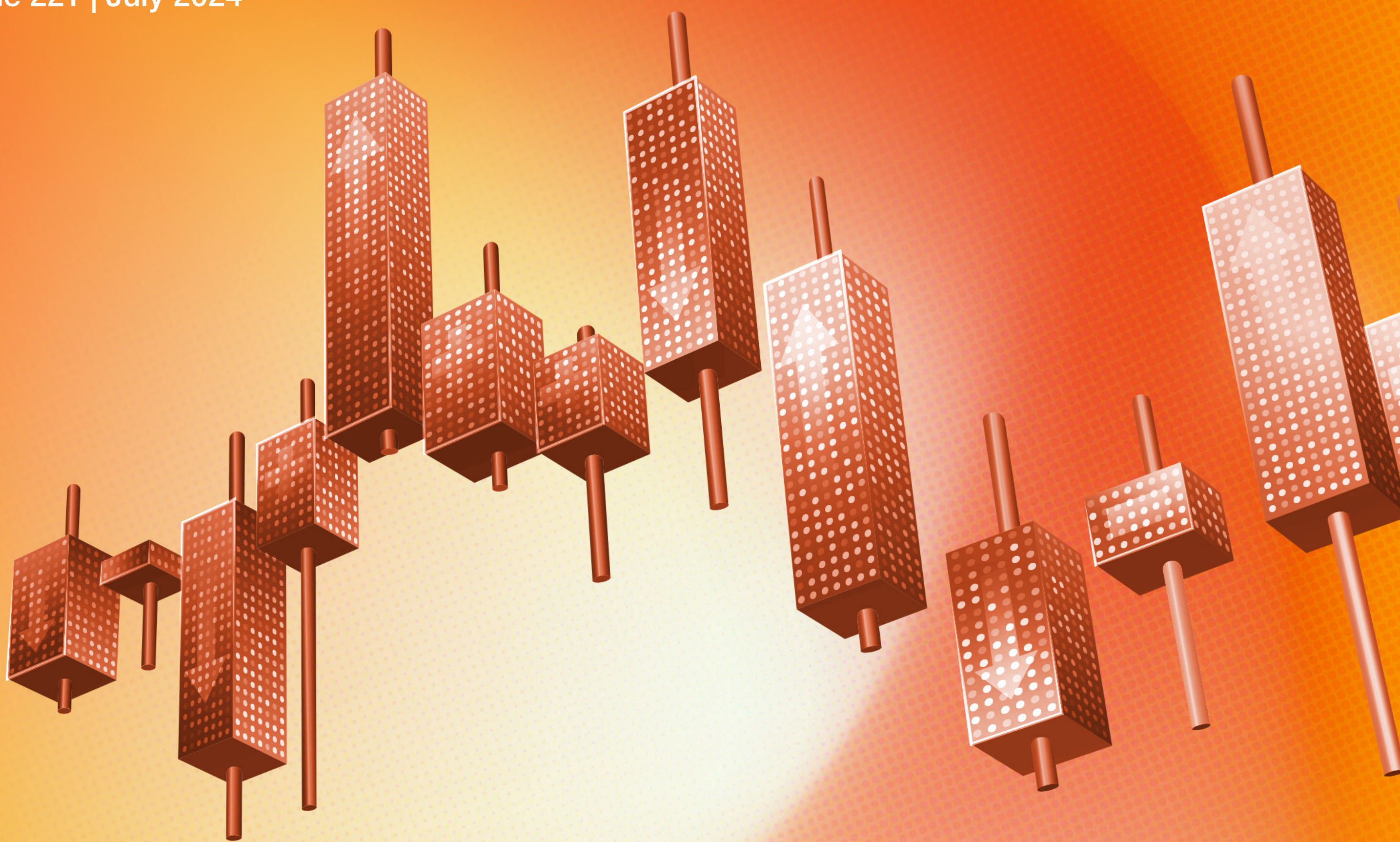

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About us

Frontier Advisors has been at the forefront of institutional investment advice in Australia for almost thirty years and provides advice on around $700 billion of assets across the superannuation, charity, public sector, insurance and university sectors.

Our purpose is to empower our clients to advance prosperity for their beneficiaries through knowledge sharing, customisation, technology solutions and an alignment and focus unconstrained by product or manager conflict.

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Brad is a Senior Consultant, having joined Frontier as an Associate in 2021. His role spans across equities research and client consulting. Brad is involved in providing specialist advice to clients with respect to their equity portfolios including various contemporary research projects while his client consulting efforts span across both the superannuation and emerging institutional space.

Prior to joining Frontier, Brad worked for five years at Intrinsic Investment Management firstly as a research analyst before moving into the role of assistant equity analyst covering the industrials sector of the ASX200. Brad graduated from Monash University with a Master of Applied Finance following on from a Bachelor of Commerce from Deakin University majoring in economics, finance and quantitative business analysis.

Global equities

The 2024 financial year saw a return of challenging market conditions that many global investment managers experienced in 2020 and 2021.

With some slight compositional changes in market leadership, the 'FAANG' cohort of stocks morphed into the 'magnificent seven'. However, this increasingly narrow market leadership painted an all too familiar story for active management. Despite continued market leadership from a narrow cohort of mainly US stocks, the first nine months of the year saw global managers posting solid gains against the MSCI ACWI. The gains built by managers in the first nine months were completely wiped out by what can only be described as a terrible June quarter for active managers in global equity markets. Table 1 summarises active management results in global equities.

A word on Frontier's Equity Peer Sets

Frontier curates granular style-based peer sets in both Australian and global equity markets to better understand active management outcomes for clients, while also taking into account the prevailing market environment. Through the elimination of duplicates and rigorous analysis of the underlying manager constituents to ensure correct style classification, we believe these curated lists and the underlying peer set performance provide investors with greater insight into the performance of their active managers. These cohorts exist at a more granular level than what is presented in this paper.

Table 1: Frontier Global Equity Peer Set returns against the MSCI ACWI

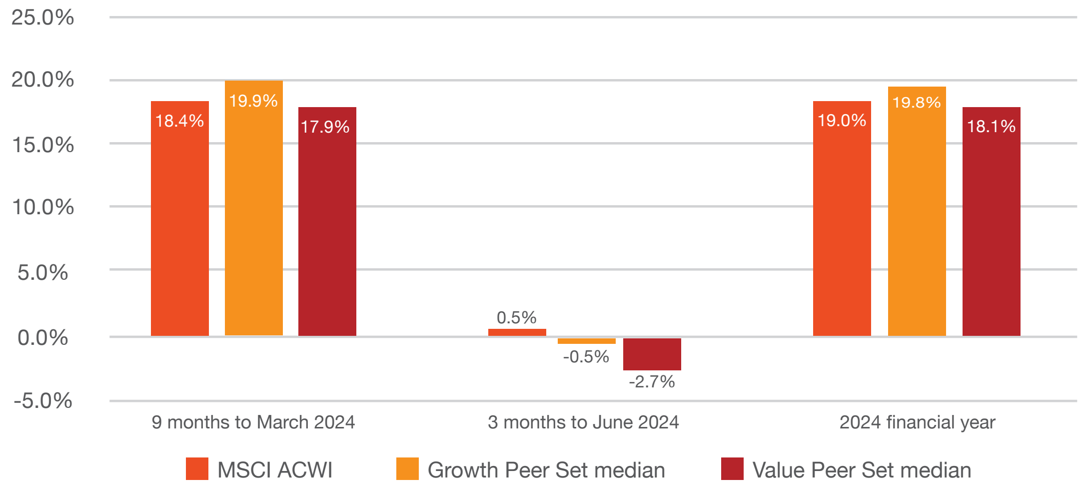
Index	Nine months to March 2024 (%)	Three months to June 2024 (%)	One year return to June 2024 (%)
MSCI ACWI	18.4	0.5	19.0
Frontier Global Equity Peer Set (median manager)	19.5	-1.2	18.1
Relative performance	+1.1	-1.7	-0.9
Managers ahead of MSCI ACWI	54	28	44

Breaking down these results across style, we saw an outperformance of growth managers across both the nine months to March 2024 and over the financial year. The excess returns delivered by the median manager in Frontier's combined growth peer set over the year in many ways hides the challenges faced by individual managers. Despite the outperformance of the growth factor, moderate growth managers who tend to display higher levels of valuation sensitivity (relative to high growth managers) lagged the benchmark over both the first nine months and the financial year.

Value managers did a respectable job in the first nine months of the 2024 financial year, only modestly underperforming the MSCI ACWI and outperforming the MSCI ACWI Value. The June quarter however proved to be exceedingly challenging with steep underperformance leading to another below benchmark outcome over the financial year.

Of Frontier's five equity peer sets only high growth managers were able to outperform the benchmark in the final quarter, demonstrating how challenging the narrow markets were for most global managers, and especially those displaying valuation sensitivity in their process.

Chart 1: Growth and value cohort returns in global equities



Beyond the traditional growth and value debate, Frontier has witnessed an interesting dynamic within our Global Core Peer Set. We often find it challenging to pinpoint specific drivers in performance of this peer set due to the range of managers that reside within the group (discretionary core, multi-factor quant, quality/franchise and top down), however this year has seen a large and consistent divergence in outcomes within the peer set. Core managers with a quantitative investment process have enjoyed an exceptionally strong 12 months of performance (indeed this has been the case over the past three years) with the median quant (core) manager outperforming the MSCI ACWI by 5.9% over the financial year. This compares to the remainder of the Core Peer Set which has faced similar struggles to that of Frontier's Value Peer Set. The inherent risk controls in quant strategies such as sector and country neutrality has assisted in navigating the challenging and at times macro driven market compared to discretionary managers.

Table 2: Core Equity Peer Set manager median excess returns to 30 June 2024 (versus MSCI ACWI)

Manager peer set	One year (%)	Three years (% p.a.)
Core Peer Set	+3.8	+2.3
Core (excluding quant)	-1.1	+0.6
Core (quant)	+5.4	+3.5

While discretionary managers have, for the most part, struggled with the high levels of market concentration, the past three years in markets have seen above average stock dispersion in global markets and low levels of pairwise correlations. This is typically a very conducive environment for quantitative managers who are able to take advantage of such factors through intra-sector value signals.

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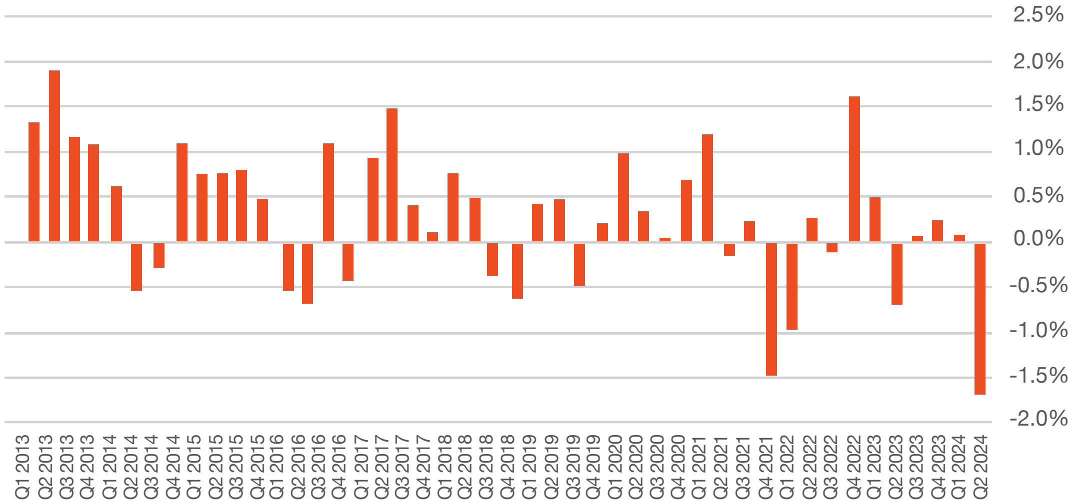
Just how bad was the June quarter

Chart 2: Frontier's Global Equity Peer Set median quarterly excess return (versus MSCI ACWI)



When examining excess returns, the June quarter represents by far the worst quarter (at a median manager level) experienced by global equity managers over the past ten years. As we discussed earlier, this performance was demonstrated across the style spectrum with only 29% of managers outperforming the benchmark. For value managers, the June quarter proved particularly challenging with only two of 45 managers in the combined value peer set outperforming the MSCI ACWI. Not even the median manager in Frontier's combined Growth Peer Set outperformed over the final quarter, underscoring the challenges felt across the style spectrum.

Emerging markets

Table 3: Frontier's Emerging Markets Equity Peer Set returns against the MSCI EM index

Index	Six months to June 2024 (%)	Six months to December 2023 (%)	One year return to June 2024 (%)
MSCI EM	9.8	2.2	12.2
Frontier EM Equity Peer Set (median manager)	8.8	1.4	11.8
Relative performance	-1.0	-0.8	-0.4
Managers ahead of MSCI EM	41	42	46

Emerging markets managers also struggled over the 2024 financial year, with the median manager in Frontier's Emerging Markets Equity Peer Set underperforming in each half, trailing the MSCI EM benchmark by 0.4% over the year. While the Chinese equity market's continued underperformance will have assisted managers (who are on average underweight), this underweight by managers has been steadily closing over time and thus providing less of a tailwind for excess returns. Conversely, the continued outperformance of Indian equities (and growing share of the EM index) will have been a strong headwind for managers with underweight positions.

The next section dissects active management outcomes over the financial year and seeks to explain some of the rationale behind these outcomes in global equities. The analysis breaks the year down across various country, style and capitalisation factors and splits them into the first nine months and the final quarter of the financial year where we saw a significant inflection in markets.

Factors contributing to outcomes in global equities

Country/region allocation

- Regionally we saw consistent leadership from US equities over the 2024 financial year. Given the US market's large (~63%) share of the ACWI benchmark, all other markets underperformed the broad benchmark over the year in Australian dollar terms. While mentioning currency, it would be remiss not to touch on the performance of Japanese stocks. Spare a thought for global managers invested in Japanese equities which at 25.9% delivered the highest local currency return of any developed market. Despite this, the substantial depreciation of the Japanese Yen over the year led to a halving in performance in AUD terms.
- The more meaningful outperformance of US equities in the final quarter of the year (if annualised) is likely to have been a determining factor behind the level of outperformance we saw from growth managers (relative to value managers and the benchmark) during this period. We observe the overall active management cohort is underweight the US market and as such, the outperformance of US equities over the year has proven a headwind for managers.
- The divergence of performance across countries (and currencies) also demonstrates how quantitative managers have been able to better navigate the current market environment. With specific parameters around country and currency risk that are either highly constrained or eliminated altogether, the outperformance of the US market (and currency) didn't prove to be the same headwind for quantitative managers as it did for discretionary managers.

Table 4: Country and regional index returns (in AUD)

Index	Nine months to March 2024 (%)	Three months to June 2024 (%)	One year return to June 2024 (%)
MSCI ACWI	18.4	0.5	19.0
S&P 500	21.9	1.9	24.2
MSCI Europe ex-UK	14.1	-2.7	11.1
MSCI UK	11.1	1.0	12.3
MSCI Japan	20.6	-6.5	12.8
MSCI ACWI ex-US	12.8	-1.4	11.3
MSCI EM	9.4	2.6	12.2

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Style

- Similar to the country/regional returns, the first nine months of the 2024 financial year saw limited divergence in the overall leadership of styles in the market. Given the significant inflection in markets in the final quarter, it is perhaps unsurprising to see the divergence in performance between growth and value in the final quarter of the year.
- While growth managers outperformed value managers over the financial year, the median underperformed the MSCI ACWI growth index. Conversely, value managers outperformed the corresponding value index. Anecdotally, some value managers have reported the outperformance of mega-caps is now beginning to skew value indices further into less cheap names to capture the 'cheapest half' of the stock market. We believe this further highlights the limitations in using these indices alone in the assessment of manager performance.

Table 5: Style index returns (in AUD)

Index	Nine months to March 2024 (%)	Three months to June 2024 (%)	One year return to June 2024 (%)
MSCI ACWI	18.4	0.5	19.0
MSCI ACWI Growth	19.8	3.8	24.3
MSCI ACWI Value	16.9	-2.9	13.6

Market capitalisation

- By this point, it should be unsurprising that there was an acceleration in market leadership between the first nine months and the final quarter of the year, which occurred on a market capitalisation basis as well. Overall, it was still a year dominated by large cap stocks as demonstrated in Table 6.
- Over the years, Frontier has observed a tendency for global active managers to seek alpha/outperformance opportunities further down the market cap spectrum due to more inefficiency and the diversification of increasingly concentrated benchmarks. This has typically led to active managers underweighting mega and large-cap companies and overweighting mid and small-cap companies. The recent increase in market concentration levels has only served to accentuate the problem with all but a small minority of global managers underweight the high and growing benchmark allocation to the 'magnificent seven'. This contributed to the modest results we saw for active managers over the year, particularly in the final quarter.

Table 6: Capitalisation index returns (in AUD)

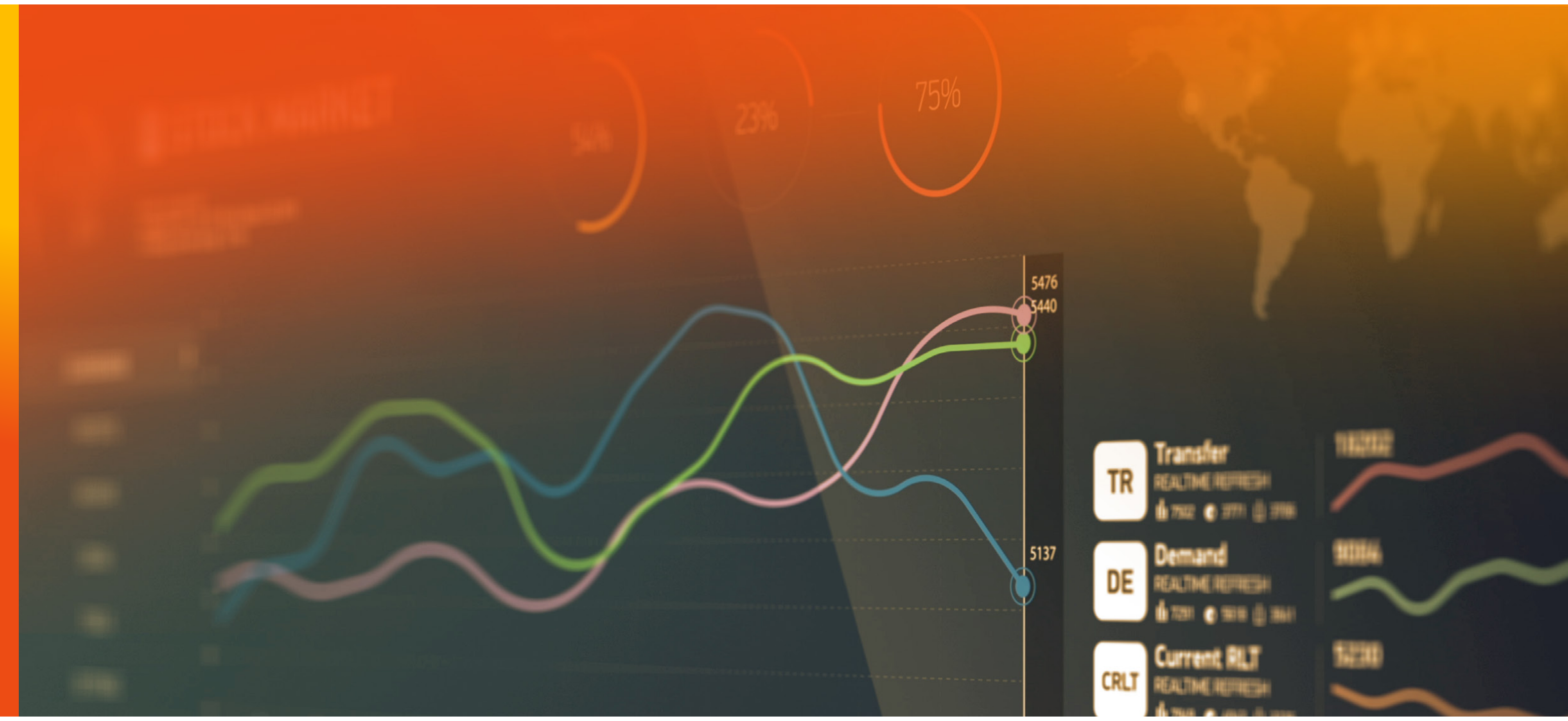
Index	Nine months to March 2024 (%)	Three months to June 2024 (%)	One year return to June 2024 (%)
MSCI ACWI	18.4	0.5	19.0
MSCI ACWI Large Cap	18.9	1.4	20.6
MSCI ACWI Mid Cap	15.9	-4.7	10.4
MSCI ACWI Small Cap	14.7	-3.8	10.3

Market concentration effect

- For active managers and institutional investors more broadly, market leadership of US large cap growth companies (which are increasingly representing a larger weight within MSCI ACWI) made it far more challenging to match benchmark returns. While US large cap growth stocks outperformed over the entire year, this outperformance was far more pronounced in the final quarter. During the final quarter, the extreme level of outperformance from this cohort led to negative outcomes for most global active managers, with less than a third of global managers outperforming in the final quarter. Even in Frontier's combined peer set of value managers (both deep and moderate), not a single manager outperformed the benchmark over the June quarter.
- To illustrate how concentrated markets were, the final quarter saw Nvidia, Apple, Alphabet, and Eli Lilly return 34%, 20%, 18%, and 14% respectively relative to the largely flat (+0.5%) outcome for the MSCI ACWI. Indeed, over the full year, Nvidia alone accounted for ~25% of the MSCI ACWI gains. Investment managers with little or no exposure to this group were highly unlikely to come close to matching the benchmark.

Table 7: Market concentration effect

Index	Nine months to March 2024 (%)	Three months to June 2024 (%)	One year return to June 2024 (%)
MSCI ACWI	18.4	0.5	19.0
MSCI US Large Cap Growth	26.0	8.4	36.7
MSCI ACWI ex-US Large Cap Growth	11.5	-1.0	10.1



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Australian equities

The 2024 financial year ended as a somewhat disappointing year for Australian equity managers, with the median manager in Frontier's Australian Equity Peer Set underperforming the S&P/ASX 300 over the financial year.

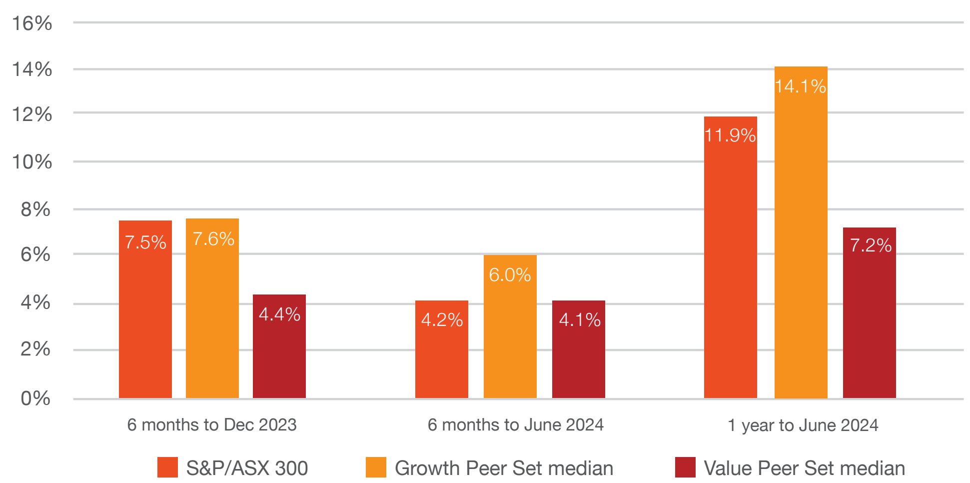
While the concentration in global equity markets seemed to grab all the attention over the year, Australian managers faced the same headwinds in local markets leading to their first financial year of underperformance since 2019 (see Table 8). The modest absolute returns for the benchmark in the second half of the financial year hid underlying variability between the performance of key index constituents and sectors in the Australian market. This marked an improved second half for active managers, however it was not enough to overcome the poor first half.

Table 8: Frontier Australian Equity Peer Set performance against S&P/ASX 300

Index	Six months to December 2023	Six months to June 2024 (%)	One year return to June 2024
S&P/ASX 300	7.5	4.2	11.9
Frontier Equity Peer Set list median	6.8	5.0	11.8
Relative performance	-0.7	0.8	-0.1
Managers ahead of S&P/ASX 300	43	55	45

Chart 3 shows growth managers in Australian markets enjoyed a more productive financial year than their value counterparts, outperforming the S&P/ASX 300 benchmark by 1.8% relative to a 4.7% underperformance for value managers. The underperformance of value managers predominately occurred during the first half of the year with a moderation in the second half. Similarly, growth managers improved on their modest excess return from the first half to deliver a strong second half and overall year. Again, these directionally consistent excess return profiles of growth and value peer sets (weaker first half into an improving second half) highlight the large role other factors such as size and sector play in determining outcomes for Australian active managers.

Chart 3: Growth and Value Peer Set returns in Australian equities



Sector effects

- While there are less factors affecting active management outcomes in the Australian equity market relative to global equities (one equity market, less currency), the unique structure of our market leads to active management trends that can be observed over time. We have observed Australian managers are generally underweight resources (or more specifically BHP) as well as the big four banks given their respective weights in the benchmark.
- With the 'magnificent seven' grabbing most of the equity market headlines, the performance of Australian banks seemed to fly under the radar over the financial year. Following outperformance in the first half, the unexpected economic resilience (and house price strength) saw the financial sector enjoy a particularly impressive second half. NAB, Westpac, CBA and ANZ, which make up ~20% of the S&P/ASX 300, returned 48%, 40%, 35% and 34% respectively over the year accounting for slightly more than 50% of the market's total return of 11.9%. It is little surprise active managers who hold collective underweight positions in this cohort of stocks struggled to beat the benchmark over the year. What is perhaps surprising is the lack of success of value managers over the year given their higher propensity (backed up by Frontier's Australian manager portfolio holdings monitoring efforts) to invest in the financial sector. Looking deeper into this trend, we see many value managers over the year have preferred to gain exposure to the sector via insurance and diversified financial companies such as AMP, all of which underperformed the big four banks in the 2024 financial year.
- It is also worth mentioning the REIT sector's performance over the calendar year. As a cohort, Australian equity managers have been paying more attention to the sector in recent years (as demonstrated by a reduction in the underweight allocations we've witnessed). Despite this, Australian equities managers remain underweight this sector relative to the index. While accounting for only ~6% of the S&P/ASX 300 benchmark currently, the relative performance of the sector can have a meaningful impact on the relative returns of managers. In the 2024 financial year, the A-REIT sector outperformed over both halves proving another headwind for active managers.
- Two other sectors worth calling out over the financial year are the healthcare and communication services sectors. Frontier's quantitative monitoring of the Australian active manager cohort has shown that managers across the style spectrum have increasingly looked to these two sectors for alpha opportunities. The emergence of the GLP-1 thematic has given managers an opportunity to invest in companies such as ResMed at a discount (relative to its history). Media platform stocks such as REA Group, Carsales, Seek and Domain, alongside market stalwart Telstra, have proven to be widely held across the manager universe. While there are some success stories amongst those names, the underperformance of each sector has proven to be a headwind for the Australian active management cohort.

Table 9: Sector returns of the S&P/ASX 300

Index	Six months to December 2023 (%)	Six months to June 2024 (%)	One year return to June 2024 (%)
S&P/ASX 300	7.5	4.2	11.9
S&P/ASX 300 Materials	10.1	-11.8	-2.9
S&P/ASX 300 Financials	10.7	16.5	29.0
S&P/ASX 300 A-REIT	13.0	9.6	23.8
S&P/ASX 300 Comm Services	5.5	-3.9	1.3
S&P/ASX 300 Health Care	3.1	5.4	8.7

Size effects

- Similar to global equities, in Australian equities, we find active investors are often underweight large-cap companies in favour of alpha opportunities further down the cap spectrum. There has been a common belief (backed up by historical evidence) that the market becomes less efficient further down the cap spectrum, which has often led active managers to be underweight large-cap companies and overweight mid and small-cap companies.
- Across both halves of the year, we saw large caps (as denoted by the ASX 20 and ASX 50 indices) outperform both mid and small caps. In particular the Mid Cap 50, which continues to be a favoured area for active managers, has proven another challenge for relative returns in the 2024 financial year.

Table 10: Market caps returns of Australian equities

Index	Six months to December 2023 (%)	Six months to June 2024 (%)	One year return to June 2024 (%)
S&P/ASX 300	7.5	4.2	11.9
S&P/ASX 20	10.0	4.5	14.9
S&P/ASX 50	8.3	4.5	13.2
S&P/ASX Mid Cap 50	3.0	3.4	6.6
S&P/ASX Small Ordinaries	6.4	2.8	9.3

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The final word

The 2024 financial year represented a challenging year for active managers in both Australian and global equity markets.

The underperformance of the median manager in Frontier's Global Equity Peer Set can be solely attributed to the June quarter where exceedingly narrow markets resulted in the worst quarterly excess return outcome for global managers in over a decade. One bright spot in the global active management community was the performance of quantitative managers, whose explicit risk controls around factors such as currency, country and sector biases enabled them to successfully navigate the challenging markets. Australian managers suffered a similar fate, with the market leadership centred around the big four banks leading to the 'median manager' in Frontier's Australian Equity Peer Set to record the worst level of excess returns in a financial year since 2019.

This paper serves as a reminder to investors that active management is cyclical (though it may not feel that way for investors in global equity markets currently!). We also highlight that factors beyond traditional style biases affect performance relative to equity benchmarks. Frontier believes it is important to assess individual active management performance not only against style peers, but equally against a whole other range of factors (market breadth, country/sector leadership and size impacts) which ultimately can impact benchmark relative outcomes.

Learn more

Our Equities Team is available to discuss our curated peer set service in more detail with interested clients. If you want to discuss this paper in more detail, please reach out to your consultant or a member of Frontier's Equities Team.

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