The Frontier Line

Active management outcomes in the 2024 calendar year

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Frontier Advisors | Forefront Thinking

About us

Frontier Advisors has been at the forefront of institutional investment advice in Australia for almost thirty years and provides advice on more than $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.

Brad Purkis
Senior Consultant

Brad is a Senior Consultant, having joined Frontier as an Associate in 2021. His role spans across 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 stretch 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

With the turn of the year, asset owners and investment managers will be hopeful 2025 marks a turning point in the fortunes of global active management.

The continued narrow markets across most of 2024, led to a continuation of headwinds for all but a select group of active managers. In previous versions of our active management commentary, there were select periods over a 12-month span that provided some relief for active managers. However, the 2024 calendar year offered no such conditions. With the Mag-7 grabbing most of the headlines over the year, managers who did not hold Nvidia faced a 3.1% headwind alone. While the MSCI ACWI benchmark returned 17.5% (in USD) in 2024, the median stock return was less than 1%, highlighting the level of market concentration. This led to the worst outcome for global active managers relative to the MSCI ACWI benchmark (at the median level) in well over 20 years. 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 is presented in this paper.

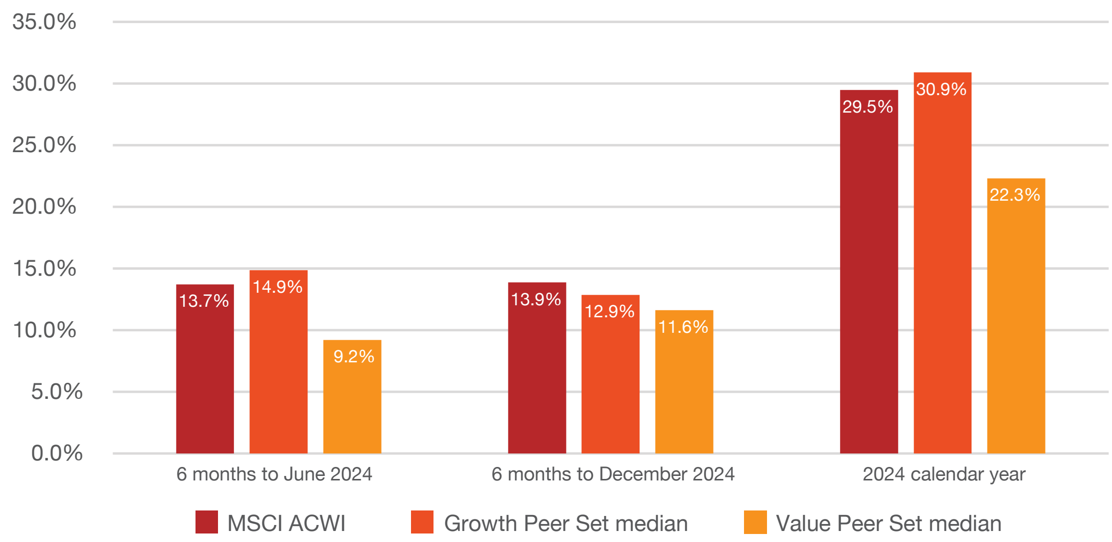
Table 1: Frontier Global Equity Peer Set returns against the MSCI ACWI

Index	Six months to June 2024 (%)	Six months to December 2024 (%)	One year return to December 2024
MSCI ACWI	13.7	13.9	29.5
Frontier Global Equity Peer Set (median manager)	11.7	12.4	24.8
Relative performance	-2.0	-1.4	-4.6
Managers ahead of MSCI ACWI (%)	39	26	36

Breaking down these results across style, we saw an outperformance of growth managers across the first six months to June, though the second half proved more challenging with the median growth manager lagging the benchmark. The excess returns delivered over the year by the median manager in Frontier's combined growth peer set 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 and second half of the year, leading to a 3.7% underperformance (at the median level) over the calendar year.

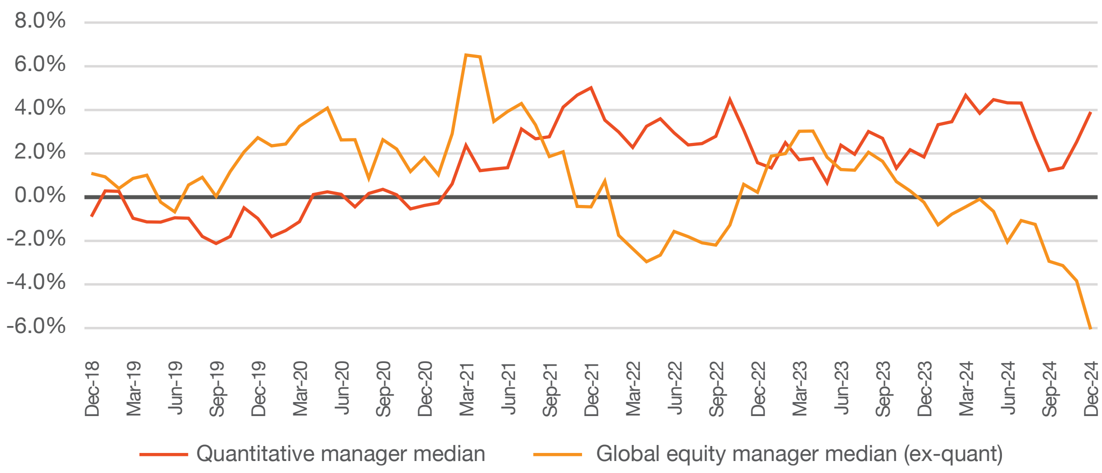
As expected, value managers had an extremely tough year relative to global benchmarks. The brief market rotation in the September quarter, following a partial unwind of the Yen carry trade, gave some joy to both moderate and deep value managers in an otherwise challenging year. Overall, value managers underperformed in both the first and second half leading to the median value manager in Frontier's combined value peer set underperforming by over 7% in the calendar year. None of Frontier's five style peer sets (High Growth, Moderate Growth, Core, Moderate Value and Deep Value) managed to outperform the benchmark in the second half (at the median level), underscoring just how difficult an environment it was for active management in global equity markets.

Chart 1: Growth and value cohort returns in global equities



The continued outperformance of quantitative managers in recent years highlights the value of portfolio diversification beyond traditional style biases. Quantitative managers typically hold more diversified portfolios and have explicit risk controls around sector/country and even stock tilts. This explicit risk control, coupled with high levels of stock dispersion has benefited the breadth of quantitative managers processes. In our discussions with quantitative managers, we have observed that signals relating to momentum, and in particular ETF flows, have performed exceptionally well over the past year. We plan on exploring this idea further in an upcoming research paper into the rise of passive management and its effect on equity markets.

Chart 2: Rolling 12-month excess returns of quantitative managers and global managers (ex-quant) relative to the MSCI ACWI



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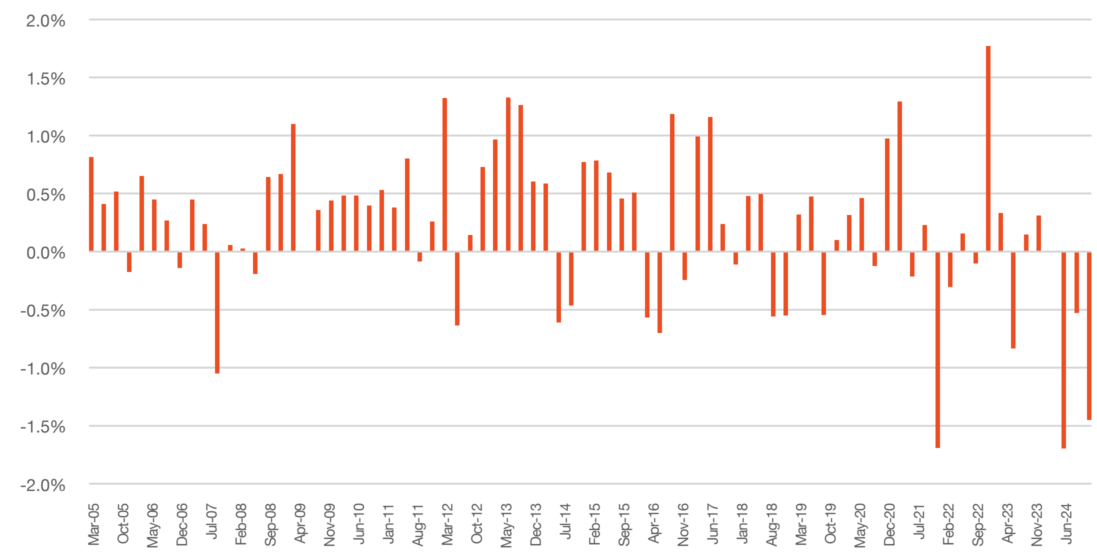
Quarterly excess returns illustrate how challenging recent markets have been

Chart 3: Frontier's Global Equity Peer Set median quarterly excess return (versus MSCI ACWI)



In our last paper, we discussed how challenging the June quarter was for active managers. Unfortunately, the December 2024 quarter was just as tough for active managers, with the median manager in Frontier's Global Equity Peer Set underperforming the benchmark by 1.4%. Less than 40% of managers outperformed the benchmark in the quarter, owing to the concentrated nature of the market.

While the MSCI ACWI returned a healthy 10.9% over the quarter (in AUD), this was dominated by US markets, with the S&P 500 returning 14.8%. By comparison, the MSCI ACWI ex-US returned just 3.5% over the period, while the MSCI ACWI Equal Weight Index fared slightly better with a 4.6% return. Both sharply underperforming the headline cap weighted index. US equities were so dominant that we saw MSCI Europe underperform the S&P 500 Index in Q4 by the widest margin since 1976. Europe is typically a region where we see investment managers overweight (relative to the MSCI ACWI benchmark) to make up for their US equity underweight - this is particularly the case for value managers. As such, the regional tilt (away from the US and toward Europe) has been a strong headwind for the relative performance of global active managers.

Emerging markets

Table 2: Frontier's Emerging Markets Equity Peer Set returns against the MSCI EM Index

Index	Six months to June 2024 (%)	Six months to December 2024 (%)	One year return to December 2024 (%)
MSCI EM	9.8	7.9	18.5
Frontier EM Equity Peer Set (median manager)	8.8	7.4	17.8
Relative performance	-1.0	-0.5	-0.7
Managers ahead of MSCI EM (%)	41	45	43

Emerging markets managers also struggled over the 2024 calendar year, with the median manager in Frontier's Emerging Markets Equity Peer Set underperforming in each half, trailing the MSCI EM benchmark by 0.7% over the year. While concentration within the emerging markets benchmark is less spoken about, TSMC returned over 90% in the calendar year. With a benchmark weight of more than 10%, investment managers who held any meaningful underweight would have faced substantial excess return headwinds. For example, even a 5% absolute weight (-5% active) in TSMC would have cost a strategy ~5% in excess returns over the year.

The next section dissects active management outcomes over the calendar 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. While historically we have split the analysis into different periods to dissect shifts in market leadership, the 2024 calendar year did not warrant such analysis. With the exception of a brief period in July/August, we saw similar trends of US exceptionalism and mega-cap dominance across global markets throughout the calendar year.

Factors contributing to outcomes in global equities

Country/region allocation

- Regionally we saw consistent leadership from US equities over the 2024 calendar year. Given the US market's large (~66%) share of the ACWI benchmark, all other markets significantly underperformed the broad benchmark over the year in Australian dollar terms.
- We observe the overall active management cohort is underweight the US market by ~5% (as at 31 December 2024) and as such, the outperformance of US equities over the year has been a headwind for managers. Also worth mentioning is the outperformance of the US dollar compared to other currencies, with the US dollar Index (DXY), appreciating by 6.4% over the year. Given most active managers hold an underweight to US markets, and therefore the US dollar, this has acted as a further headwind to excess returns over the year.
- 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) did not prove to be the same headwind for quantitative managers as it did for discretionary managers.

Table 3: Country and regional index returns (in AUD)

Index	One year return to December 2024 (%)
MSCI ACWI	29.5
S&P 500	37.8
MSCI Europe ex-UK	10.4
MSCI UK	18.1
MSCI Japan	19.4
MSCI ACWI ex-US	16.3
MSCI EM	18.5

Style

- Similar to the country/regional returns, the 2024 calendar year saw the consistent outperformance of the growth factor relative to value. The magnitude of outperformance (14.8%) underscores the headwinds faced by value managers over the year.
- While growth managers outperformed value managers over the calendar year, the median growth manager 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.

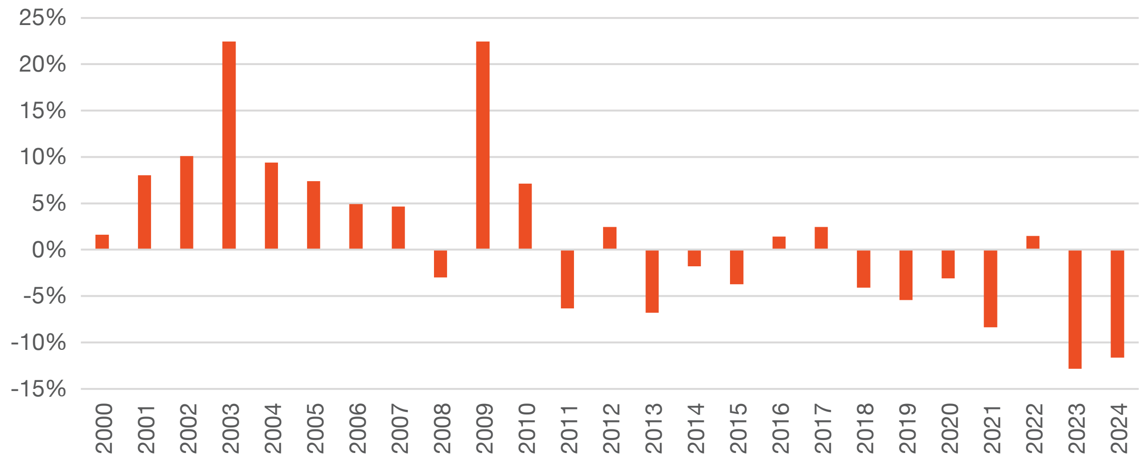
Table 4: Style index returns (in AUD)

Index	One year return to December 2024 (%)
MSCI ACWI	29.5
MSCI ACWI Growth	36.9
MSCI ACWI Value	22.1

Market capitalisation

- 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 2024 calendar year marked the second year running that the MSCI ACWI Equal Weight Index underperformed the capitalisation weighted (MSCI ACWI) benchmark by more than 10%. The relative performance of the equal weighted index is a good proxy for market breadth, and as we will show, active managers struggle to outperform in periods of weak breadth.

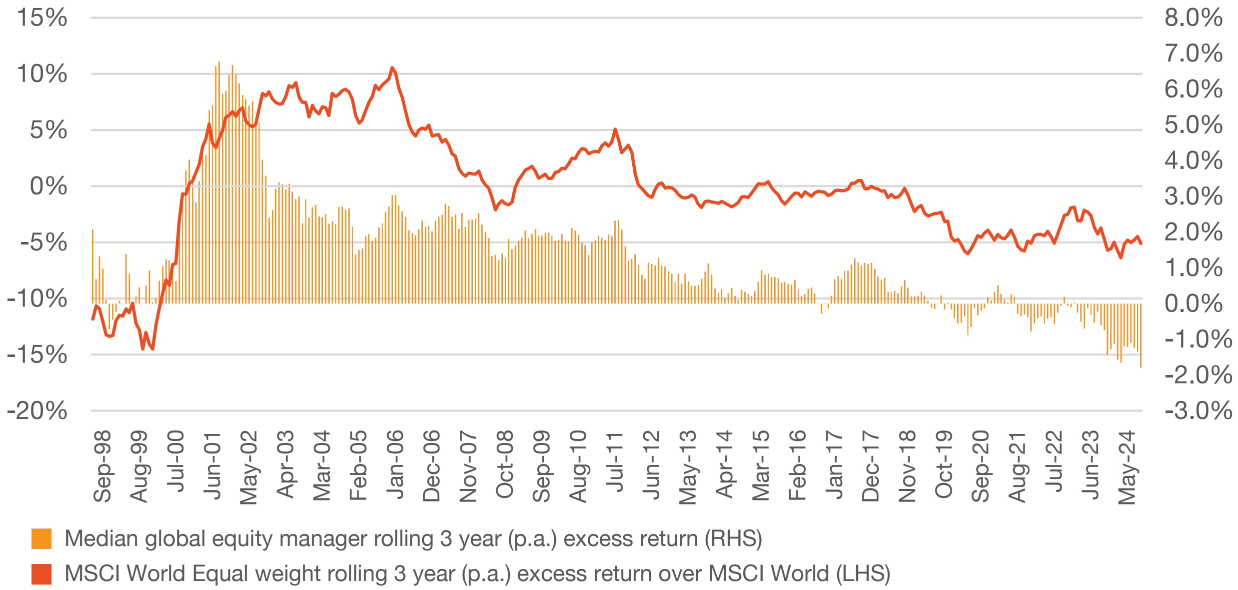
Chart 4: Calendar year excess returns of MSCI ACWI equal weight (versus MSCI ACWI)



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. Chart 5 shows the effect market breadth has on active management outcomes, with a high correlation between the excess returns of the MSCI World Equal Weight Index (versus the Capitalisation Weighted benchmark) and overall active management returns.
- To illustrate just how concentrated markets were, the Bloomberg Magnificent 7 Index (an equally weighted portfolio of Apple, Amazon, Alphabet, Meta, Microsoft, Nvidia and Telsa) delivered 67% in returns over the year. This represented 46% of the total return of the MSCI World Index, almost matching the return contribution of the remaining 1388 index constituents.

Chart 5: Median global equity manager excess return versus MSCI World during different periods of market breadth



Australian equities

The 2024 calendar year was a modest year for Australian equity managers as well, with the median manager in Frontier's Australian Equity Peer Set slightly underperforming the S&P/ASX 300.

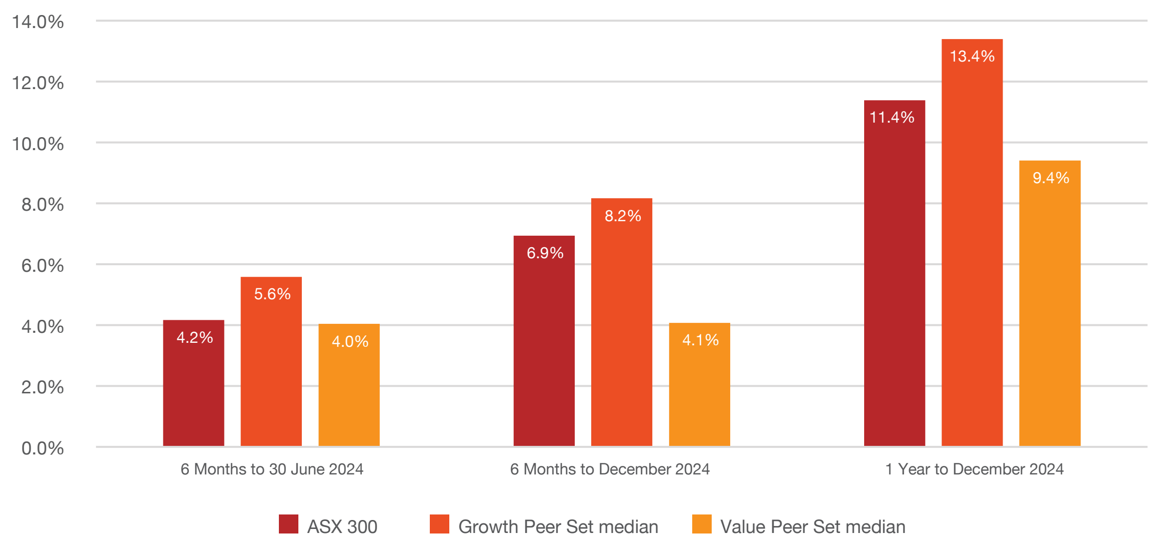
While the concentration in global equity markets seemed to grab all the attention over the year, Australian managers faced the same headwinds in local markets. The modest absolute returns for the benchmark over the calendar year hid underlying variability between the performance of key index constituents and sectors in the Australian market. A positive start to the calendar year from managers was not sufficient to overcome a challenging end to the year.

Table 5: Frontier Australian Equity Peer Set performance against S&P/ASX 300

Index	Six months to June 2024 (%)	Six months to December 2024 (%)	One year return to December 2024 (%)
S&P/ASX 300	4.2	6.9	11.4
Frontier Equity Peer Set list median	5.0	6.1	11.3
Relative performance	+0.8	-0.8	-0.1
Managers ahead of S&P/ASX 300 (%)	55	39	41

Chart 6 shows growth managers in Australian markets enjoyed a more productive calendar year than their value counterparts, outperforming the S&P/ASX 300 benchmark by 2.0% relative to a 2.0% underperformance for value managers. The underperformance of value managers predominantly occurred during the second half of the year with only a small level of underperformance in the first half. Growth managers delivered solid gains in the first half of the year, with a slight moderation in the gains against the benchmark in the second half.

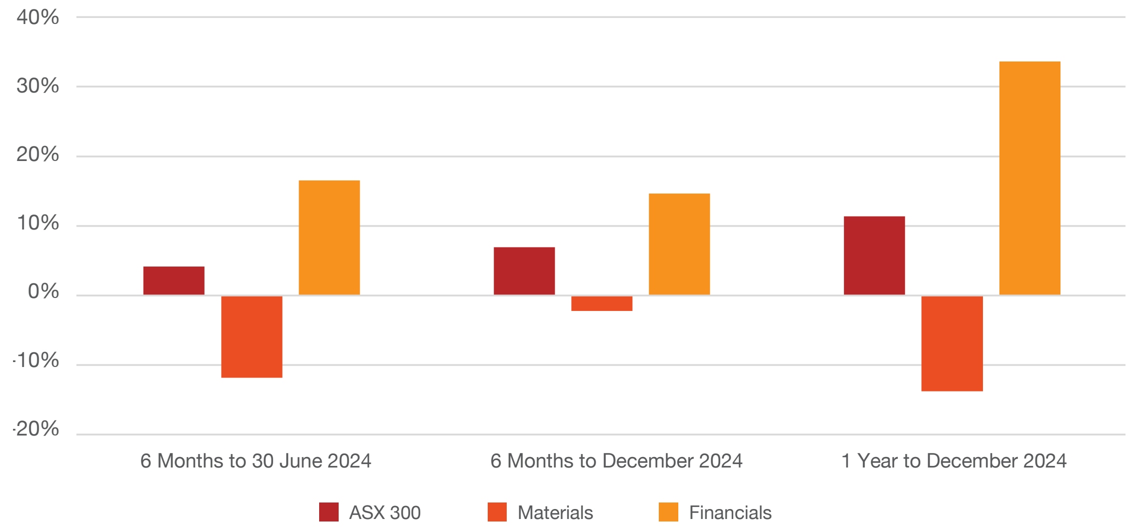
Chart 6: Growth and Value Peer Set returns in Australian equities



Sector effects

- While the Australian equity market has fewer factors impacting active management outcomes compared to global equities (one equity market, less currency), its unique structure leads to active management trends 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. Over the calendar year, we found these effects to largely offset each other at a median level with the tailwinds of the sharp underperformance of BHP (and resources more generally) somewhat offsetting the outperformance of the 'big four' banks. While the median manager ended the year relatively equal (-0.1%) with the benchmark, the large dispersion in outcomes with respect to the financials and resources sectors, and investment managers' respective allocations here, is likely to have been a large determinant of overall benchmark relative outcomes in 2024.

Chart 7: Performance of the S&P/ASX 300 materials and financials sectors over 2024



- With the Mag-7 grabbing most of the equity market headlines, the performance of Australian banks seemed to fly under the radar over the calendar year. The unexpected economic resilience over the year (and house price strength) saw the financials sector enjoy a particularly impressive 12 months of returns. NAB, Westpac, CBA and ANZ, which make up over 20% of the S&P/ASX 300, returned 26%, 47%, 40% and 16% respectively over the 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 have witnessed). Despite this, Australian equities managers remain underweight this sector relative to the index. While accounting for only ~7% 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 calendar year, the A-REIT sector outperformed over both halves proving another headwind for active managers.
- We also highlight the underperformance of the energy sector, which was particularly pronounced in the second half alongside the consumer staples sector. Both sectors, in particular energy, have been popular areas with value managers recently. The large underperformance in the second half, has likely contributed to value managers weaker result (Table 6) in the second half of the year.

Table 6: Sector returns of the S&P/ASX 300

Index	Six months to June 2024 (%)	Six months to December 2024 (%)	One year return to December 2024 (%)
S&P/ASX 300	4.2	6.9	11.4
S&P/ASX 300 A-REIT	9.6	7.3	17.6
S&P/ASX 300 Comm Services	-3.9	10.5	6.2
S&P/ASX 300 Cons Disc	9.4	12.7	23.3
S&P/ASX 300 Cons Staples	2.1	-2.9	-0.9
S&P/ASX 300 Energy	-2.5	-11.4	-13.6
S&P/ASX 300 Health Care	5.4	2.5	8.0
S&P/ASX 300 Information Technology	26.6	17.3	48.5

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.
- There was less of a story to tell over the year in terms of differentiated performance down the capitalisation spectrum. Despite the remarkable strength of the 'big four' banks, the underperformance of BHP and RIO actually led to large caps (ASX 20) marginally underperforming the broad index over the year. The slight outperformance of mid-caps over the year is likely to have provided a tailwind for managers, although small cap underperformance may have offset this.

Table 7: Market caps returns of Australian equities

Index	Six months to June 2024 (%)	Six months to December 2024 (%)	One year return to December 2024 (%)
S&P/ASX 300	4.2	6.9	11.4
S&P/ASX 20	4.5	6.4	11.2
S&P/ASX 50	4.5	6.9	11.7
S&P/ASX Mid Cap 50	3.4	8.7	12.4
S&P/ASX Small Ordinaries	2.8	5.5	8.4

The final word

The 2024 calendar 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 over the past 12 months was the most significant calendar year in over 20 years.

Barring a brief change in market leadership in the September quarter, there was no reprieve from the highly concentrated global equity markets that managers struggled to contend with. 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 as well as exposure to factors such as quality and momentum enabled them to successfully navigate the challenging markets. Australian managers suffered a similar fate, though not to the same magnitude. Market leadership which centred around the big four banks led to the median manager in Frontier's Australian Equity Peer Set to record a slight underperformance relative to the S&P/ASX 300 Index.

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 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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