
Gale Blowing for Index Unaware

Setting Daniel's [closet index huggers](#) to one side, the past few years have been exceptional for Australia's genuinely active fund managers. Our Australian Shares Fund has returned 34% over the last 12 months. According to Morningstar, that ranked the Fund just 7th out of 24 in its category. There are plenty of fund managers that have returned better than 30% this last year. And that's one in which the main index, the All Ordinaries Index, returned just 14% including dividends.

Trailing Total Returns		as at 30 Sep 2016		
	Total Return	+/- Cat	+/- Index	Cat Rank
1 Month	4.50	2.89	2.98	2 / 24
3 Month	15.45	3.92	6.95	3 / 24
1 Year	34.05	7.09	4.88	7 / 24
3 Year	15.57	3.02	8.49	6 / 24
5 Year	24.40	9.54	19.13	2 / 21

Forager Australian

Shares Fund returns from morningstar.com.au

When it comes to international shares, the opposite has been true. Our International Shares Fund has outperformed the index by just 4.8% over the past year, yet that ranks it 10th out of 204 global funds Morningstar deems to be similar. Over three years, we are less than 1% ahead, yet Morningstar ranks the three-year performance 11th out of 176 funds.

Trailing Total Returns		as at 30 Sep 2016		
	Total Return	+/- Cat	+/- Index	Cat Rank
1 Month	1.96	3.22	3.28	1 / 216
3 Month	10.71	8.23	8.75	1 / 216
1 Year	7.83	7.09	5.88	10 / 204
3 Year	13.99	2.37	0.58	11 / 176
5 Year	--	--	--	--

Forager International

Shares Fund returns from morningstar.com.au

One conclusion could be that we have some of the best and brightest fund managers in the world. If that is the case, though, there should be plenty of Australian based international funds shooting the lights out too.

Another conclusion could be that we should all stick to our own back yards. Perhaps the returns are simply better in our own home market. If that were true, though, we should see New York and London based fund managers performing just as well in their home markets. If those exist at the moment, they are particularly difficult to find. The international press is awash with commentary about how [disastrous active management](#) has been over the past few years.

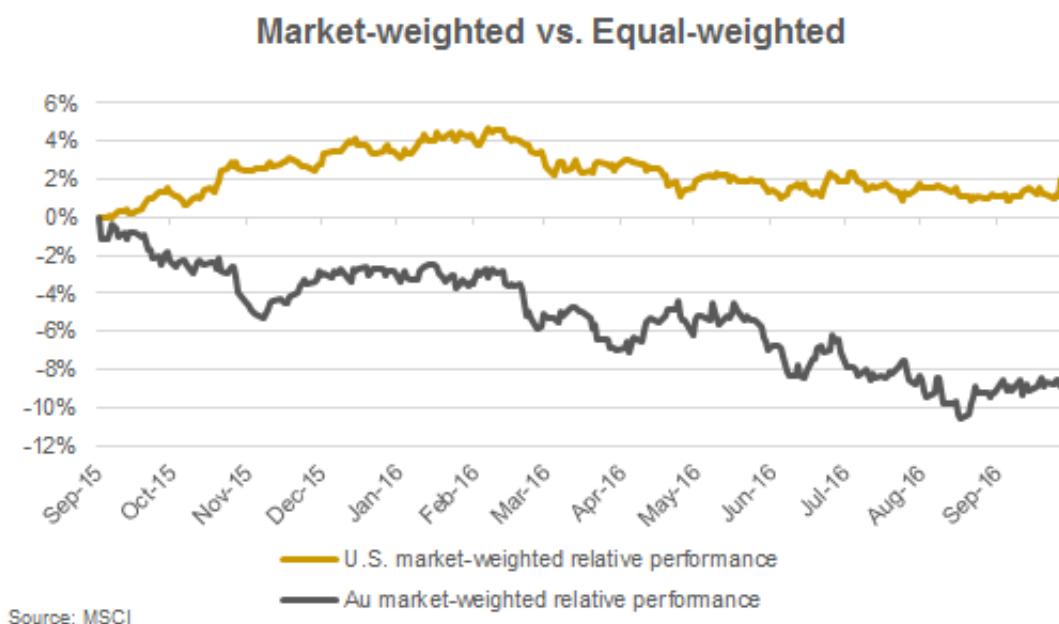
So how do we explain the vast gulf between Aussie fund managers and their global peers?

Index not the manager

Well, it might pay to look at the indexes rather than the fund managers. Most stock market indexes weight each of their constituents by market capitalisation. **Telstra** has a market capitalisation ten times that of **TPG Telecom**, so it gets 10 times TPG's weight in the index.

So the performance of large companies matters a lot more than the performance of small ones. In Australia, the share prices of our largest companies – the four big banks, Telstra, **BHP Billiton** and **Rio Tinto** make up 36% of the index – have performed poorly over the past year. In the U.S. the opposite has been true. **Facebook**, **Amazon**, **Netflix** and **Google** have lifted what would have otherwise been a muted index.

You can see the difference by comparing the indexes weighted by market capitalisation with ones where all stocks are given an equal weighting. The All Ords has underperformed an equal weighted index by a whopping 9%, while the American index has outperformed its equivalent by 2%.



Aside from requiring enough liquidity to be able to invest in the stock, most genuinely active fund managers couldn't give a hoot about market capitalisation. If TPG offers better returns than Telstra, we will buy TPG and not Telstra. So the fact that large caps have dramatically underperformed has been a huge tailwind in Australia. Internationally, their outperformance has been a headwind.

None of this should be particularly relevant over the long term. The variation in performance is hardly ever this wide and will likely mean-revert over time. But for the moment you should treat Aussie fund manager boasting – including ours – with a degree of scepticism. The tail wind has been gale-force.

Past performance is no guarantee of future performance. In fact, there is often a negative correlation between the two.