

Value & Growth – Are There Problems? (Part 2)

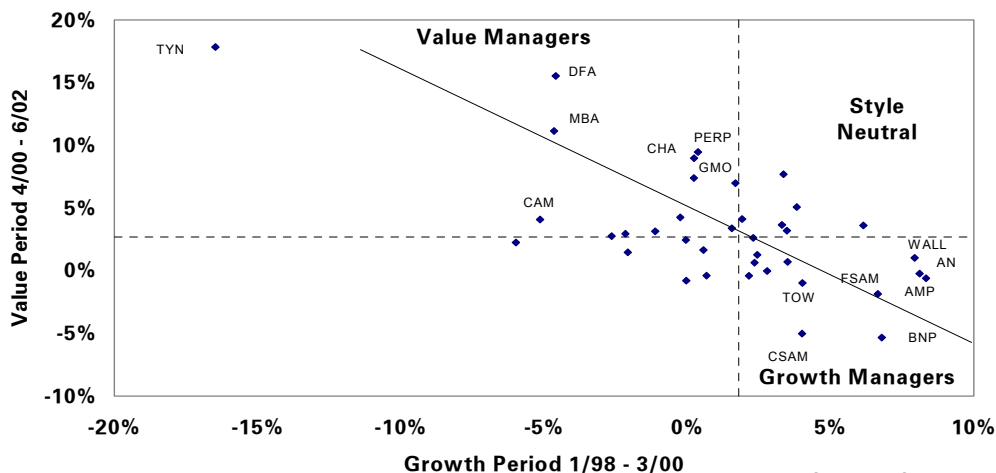
In our last newsletter we drew attention to some of the problems that the style segmentation of Australian equities can create for Australian investors. In this newsletter, we look at manager classification and the difficulties of holding managers to account.

(i) Classification of Managers by Style

The most robust way to classify managers by style is to examine the characteristics of their portfolios over time. However, this is computationally and data intensive. An alternative is to focus on particular time periods like the extreme growth and value environments of recent years.

The chart below plots the performance of managers relative to the ASX/S&P 200 index in the 27-month period since the growth bubble burst in March 2000, against performance in the preceding 27-month period. This creates a growth period, followed by an equal length value period. The axes represent median manager performance in each period. Managers in the top right quadrant beat the median manager in both periods, managers in the bottom right quadrant beat the median manager in the growth period but underperformed in the value period, managers in the bottom left period underperformed in both periods while managers in the top left quadrant outperformed in the value period but underperformed in the growth period.

Active Return in Value Period V Growth Period



Source: Salomon Smith Barney, WestAM

Only a handful of managers clearly differentiate themselves as value or growth.

- The characteristic performance of a value manager was to underperform the median manager in the period leading up to March 2000, then outperform. This pattern applies to 7 managers who are identified in the chart.
- The characteristic pattern for growth managers was to outperform leading up to March 2000 but underperform subsequently. This also applies to 7 managers.
- The sloped line from top left to bottom right is the hurdle for better than median performance over the entire 54 months.

There is a group of managers in the top right hand quadrant who beat the median manager in both periods: these are style neutral managers.

(ii) Performance Assessment for Value & Growth Managers

It can be hard to manage and assess the performance of style-based managers.

- Managers may underperform because their process has deteriorated.
- On the other hand, managers may underperform because their style is out of favour.
- More complicated, are situations where a manager may be underperforming but appear to be doing better than other managers of the same style. Such a manager may well be retreating from their style, a development that could prove costly when the time comes for the manager to outperform

For style-neutral investment, the S&P/ASX 200 or S&P/ASX 300 work well as benchmarks. However, for style-biased managers the situation is more complex, especially as a full style cycle can be longer than the 3 year rolling period that is often used to monitor managers.

The classification of managers, outlined above, yields two style cohorts. The median performance of these two cohorts is compared below to the Salomon Smith Barney style indices and the S&P/ASX 200.

Style Manager and Style Index Performance

	Performance 1/98 – 3/00	Performance 4/00 – 6/02	Performance 1/98 – 6/02
Value Manager Median	7.8%pa	14.0%pa	12.3%pa
Growth Manager Median	19.2%pa	3.6%pa	10.6%pa
Overall Manager Median	13.6%pa	7.0%pa	10.5%pa
Salomon Value Index	11.3%pa	11.5%pa	11.4%pa
Salomon Growth Index	10.8%pa	6.9%pa	8.9%pa
S&P/ASX 200	12.4%pa	4.6%pa	8.4%pa

Source: Manager return data from William M. Mercer, Indices from ASX, Salomon Smith Barney, All Calculations by WestAM

The data suggest that over the last 4-5 years, style influences have had a dramatic impact.

- The difference in performance between a value and a growth manager has been much wider than the difference in the value and growth indices.
- The deterioration in the performance of growth managers between the two sub-periods is remarkable at around 16% compared to only around 4% for the growth index.*
- Style indices do not cast much light on the behaviour of Australian style managers.
- Australian style managers are quite aggressive. They are likely to be at the very top or the very bottom of performance surveys.

*One explanation for the dramatic swing in the performance of growth managers is the impact of initial public offerings (IPO's) over the period. We calculate that for the growth period, up to March 2000, stag profits measured one month after the float amounted to \$2.4b for the market overall at an average float premium of 16%. In the subsequent period the IPO result for the market was negative at -\$0.3b for an average float discount of -3.3%.

Disclaimer

Information in this newsletter is believed to be reliable but its completeness and accuracy is not guaranteed. Opinions expressed may change without notice. It should not be used as a substitute for professional investment advice nor as a basis for investment decisions. This newsletter is not, and is not to be construed as, a solicitation to buy or sell any security. Past performance should not be taken as an indication or guarantee of future performance. This material is for Australian institutional investors only and is not intended for distribution to private investors.