2018 SPIVA Canada Report

The SPIVA (Standard and Poor's Index Versus Active) Canada 2018 report is out and again it is damning for active investment management.

SPIVA reports compare the results of after-cost mutual fund performance against their relevant benchmarks. With the advent of low-cost, passively managed, broad-market Exchange Traded Funds, investors can invest in the benchmark for under 1/10 of a percentage point or 10 basis points. (1 basis point = 1/100 of a percentage point).

The data clearly shows that mutual fund money managers can not consistently outperform the return of the market index. Much wealth is sacrificed by investors as a result.

You can access the report here, but I've summarized the most important data below.

SPIVA Canada Scorecard Year-End 2018	**Average Annualized Percentage**			
	Equal Weighted			**Asset Weighted**
Category	**10 Year**			**10 Year**
Canadian Equity	6.77			6.73
S&P / TSX Composite Index	7.92			7.92
Average Annualized Fund Underperformance	-1.15			-1.19
US Equity	11.21			11.25
S&P 500 Index (CAD)	14.27			14.27
Average Annualized Fund Underperformance	-3.06			-3.02
International Equity	6.55			5.59
S&P EPAC LargeMidCap Index (CAD)	8.16			8.16
Average Annualized Fund Underperformance	-1.61			-2.57
Global Equity	8.51			8.36
S&P Developed LargeMidCap Index (CAD)	11.45			11.45
Average Annualized Fund Underperformance	-2.94			-3.09

A fundamental premise of BYOFA (Be Your Own Financial Advisor) is that investing is a positive sum. All can have more than their original investment. However, outperformance is a zero-sum game. All can't outperform the benchmark. For any invested dollar that outperforms the benchmark, there must be dollar that underperforms in an offsetting manner. This is pre-cost. Cost makes the performance worse.

We would expect post-cost performance of mutual funds to average underperformance by the magnitude of the average cost factor.

The above data compare the post-cost returns of mutual funds offered to Canadian investors to the relevant benchmark. The data is damning for active fund managers. Remember, the view of active managers is that their skill and resources will allow them to overcome the cost factor and generate results that outperform the benchmark. This must be their opinion, or they would advocate passive (indexed) investments.

Equal weighted fund returns show the average performance of fund managers. Asset weighted fund returns give larger funds more weight and smaller funds less. Asset weighted fund returns show the average performance of a dollar invested. Both paint a bad picture.

There is significant underperformance in all categories. This is what we expect. The return received by the average investor must equal the benchmark less cost.

Canadian equity fund managers seem to fair the best, but this is misleading. Virtually all Canadian equity funds have a small portion of their portfolio invested outside of Canada. This is reasonable. There are sectors that are significantly underrepresented in the Canadian economy. The Tech and Consumer Staples sectors are examples. To gain exposure to underrepresented sectors fund managers must invest in non-Canadian companies. Why is this an issue? An example helps explain. If a fund manager consistently invests 5% of the portfolio outside of Canada, the proper benchmark for the fund would be 95% S&P/TSX and 5% in a non-Canadian index. Benchmarking this example fund to a 100% S&P/TSX index is less accurate than the benchmark could be. Over the past 10 years, investing a portion of a Canadian equity fund in US investments would've boosted performance.

It is important to remember what you are buying when you invest in a mutual fund through a financial advisor. You are buying the expertise of the fund manager and you are buying financial planning advice. A significant percentage of the M.E.R. is sent to the financial advisors' firm to be shared with the financial advisor. When you BYOFA, you forfeit the expertise of the fund manager and the financial advisor. The value of the expertise of the fund manager is questionable at best and a fundamental premise of BYOFA is that for most Canadians financial planning is basic, and the value of the financial advisor is not commensurate with the cost.

The significant underperformance could be avoided by investing in low-cost, broad market, passive investments. To do this you must Be Your Own Financial Advisor.