

Index Versus Active Funds Scorecard For Canadian Funds

Standard & Poor's Indices Versus Active Funds Bear Market Report (Aug 2000 – Dec 2002)

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SPIVA Canada Scorecard

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SPIVA Methodology

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□ The Standard & Poor's Indices Versus Active Funds (SPIVA) Scorecard compares performance of actively managed Canadian mutual funds (corrected for survivorship bias) with performance of relevant benchmark indices.

□ This special edition of SPIVA follows the Canadian market from a peak in August 2000 through to the trough in December 2002 to analyze the effects of a bear market on active versus passive performance.

Domestic Equities:

□ Many people believe that actively managed funds perform better than indices during bear markets. However:

- From the August 2000-December 2002 period, only 38.9% active Canadian Equity funds outperformed the S&P/TSX Capped Composite Index.
- Canadian Equity funds exceeded the S&P/TSX Capped Composite return on an equal and asset weighted basis; this reflects the strong performance of only a few funds.
- The majority of Canadian equity funds still underperformed the index reflecting the high degree of active risk.
- Only 34.4% of active Large Cap Equity funds were able to beat the large cap S&P/TSX 60 Capped Index.
- The S&P/TSX SmallCap Index outperformed 70% of active Small Cap Canadian Equity funds.

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Foreign Equities:

□ During the same period, only 29% of active U.S. Equity funds were able to outpace the S&P 500.

□ International Equity active funds present a similar picture with only 32% beating the S&P/Citigroup EPAC PMI Index.

□ The S&P/Citigroup World PMI Index outperformed 54.1% of active funds in the Global Equity fund space.

Introduction

The SPIVA Scorecard goes beyond simple performance numbers of each fund category to report detailed apples-to-apples comparisons corrected for survivorship bias.

Equal weighted returns are a measure of average manager performance. Asset weighted returns are a measure of the performance of the average invested dollar.

The Standard & Poor's Indices Versus Active Funds Canada (SPIVA Canada) Scorecard keeps tabs on the active-versus-index debate in Canada.

SPIVA Canada shows performances of actively managed Canadian mutual funds compared with Standard & Poor's indices in their respective categories. Although many such reports are available, the SPIVA Canada scorecard is unique in many respects:

- **Survivorship bias correction:** Many funds might be liquidated or merged during a period of study. However, for someone making an investment decision at the beginning of the period, these funds are part of the opportunity set. Unlike commonly available comparison reports, SPIVA removes this survivorship bias.
- **Apples-to-apples comparison:** Fund returns are often compared with a popular benchmark regardless of its investment category. An appropriate comparison would be to measure a fund's returns against the returns of a benchmark for that particular investment category. The SPIVA scorecard does this.
- **Asset-weighted returns:** Average returns for a fund group are often calculated using only equal weighting, which results in the returns of a \$10 billion fund affecting the average in the same manner as the returns of a \$10 million fund. Equal weighted returns are a measure of average fund performance. Asset weighted returns are a measure of the performance of the average invested dollar. The SPIVA scorecard shows both equal- and asset-weighted averages.

This special edition of SPIVA examines the last Canadian bear market from the peak in August 2000 through the December 2002 trough to analyze the effects of a bear market on active versus passive performance.

SPIVA reports can be found online at www.spiva.standardandpoors.com.

SPIVA Canada does not make investment recommendations or offer comments on the suitability of either index or active investing. The scorecard simply reports results according to the SPIVA methodology briefly analyzes the numbers. Furthermore, we advise reading the methodology at the end of the report to understand how we derive the numbers.

The Bear Market at the turn of the Century

The S&P/TSX SmallCap Index did not exhibit as large a decline in the Aug 2000 – Dec 2002 period.

The August 2000-December 2002 period represented one of the longest and most severe bear market for the Canadian equity market since 1929. As evidenced in Reports 3 and 4, the S&P/TSX Composite Index lost more than a third of its value during the period. The S&P/TSX 60, which represents the large cap segment of the Canadian equity market, similarly experienced large declines during the period. The one component of the Canadian equity markets that did not reflect such a severe downturn was the S&P/TSX SmallCap Index. Although its performance was slightly negative overall during the period, the index displayed prolonged upswings, and was characterized by volatility and a number of reversals.

Global markets experienced similar market upheavals. U.S., Asia and Europe all suffered steep declines during this period. The 2000-2002 period represented the first three-year losing streak for the S&P 500 Index since 1941. In addition, 2002 was the worst year for the broad U.S. market since 1974, and all sectors finished in the red for the first time in at least two decades.

It is timely to reexamine this period in light of the current turbulence in equity markets globally. Although peaks and troughs might not have been identical, the period chosen for the report reflected steep declines in the markets examined.

Canadian Equity fund managers should be benchmarked to the S&P/TSX Capped Composite, which properly reflect the concentration limits in place in their portfolios.

In the Reports we compare Canadian Equity funds to both the S&P/TSX Capped Composite and the S&P/TSX Composite Index and the Canadian Large Cap funds to both the S&P/TSX 60 and the S&P/TSX 60 Capped and there is a stark contrast in results between the indices. A much higher percentage of active funds were able to beat their benchmark when compared with the 'uncapped' index. This disparity in results can be explained by the "Nortel effect". At its peak (July 2000) Nortel represented 36.5% of the relative weight of the S&P/TSX Composite Index (and an even larger percentage of the S&P/TSX 60). Nortel's steady decline followed, and while the S&P/TSX Composite was fully exposed to this decline, funds had concentration limits (which generally prohibited asset managers from investing more than 10% in any one stock) which effectively limited their exposure to this decline. As a result, the correct benchmark to measure active fund performance within these categories was the S&P/TSX Capped Composite or S&P/TSX 60 Capped Indices respectively, which place an upper limit of 10% on the relative weight of any single index constituent.

The categories examined during the August 2000 – December 2002 period are historical Canadian Investment Funds Standard Committee (CIFSC) categories¹ which were in place at the time. The benchmark selected to compare against each category is defined in the glossary in accordance with its form during the historical period.

Rethinking Bear Market Beliefs

Report 1 shows 38.9% of actively managed funds in the Canadian Equity category have outperformed the S&P/TSX Capped Composite Index.

A bright spot for active funds was equal weighted and asset weighted returns over the period. Active Canadian Equity funds exceeded the S&P/TSX Capped Composite returns. This would imply that a few funds were able to beat the index by a large margin thereby pulling the

¹ Additional information regarding this organization and their categories can be found at www.cifsc.com.

average equal and asset weighted returns higher.² However, given that investors are limited to investing in a small number of funds, the outperformance figures better represent replicable performance by the average retail investor.

The Canadian Large Cap category performance results are similar to those for Canadian Equity. When comparing active Canadian Large Cap Equity funds versus the S&P/TSX 60 Capped Index, Report 1 indicates that only 34.4% outperformed the index. On an equal and asset weighted basis, Canadian Large Cap funds underperformed the S&P/TSX 60 Capped Index.

Most Canadian Small Cap Equity funds active funds were unable to beat the S&P/TSX SmallCap Index during the period. The index outperformed 70% of active funds in this space. On an equal and asset weighed basis, Canadian Small Cap Equity funds underperformed the S&P/TSX SmallCap Index.

In Report 1, just 29% of U.S. equity funds³ in this category outperformed the S&P 500 Index (in Canadian dollar terms) in the bear market period. On an equal weighed basis U.S. Equity funds slightly underperformed the S&P 500, while on an asset weighted basis they marginally outperformed the S&P 500.

International equity⁴ funds didn't fare any better. Report 1 shows that only 32% of funds in this category outperformed the S&P/Citigroup EPAC Index (in Canadian dollars). On an equal and asset weighed basis, International Equity funds underperformed the S&P/Citigroup EPAC Index.

In contrast, active Global equity⁵ funds outperformance was more favorable. Report 1 showing that 45.9% were able to outperform the S&P/Citigroup World PMI Index. In addition, on both an asset weighed and equal weighted basis, Global Equity fund funds outperformed the S&P/Citigroup World PMI Index.

Survivorship

A key advantage of the SPIVA report is its correction for survivorship bias, which can skew results as funds merge or liquidate. For example, if there are 100 funds in the beginning of a five-year period and 20 dropped out or merged by the end of the period, this would imply 80% survivorship.

Report 2 indicates that survivorship in the period was 72.2%, 96.9%, and 74% for Canadian Equity, Canadian Large Cap Equity, and Canadian Small Cap Equity categories, respectively. The non-domestic categories of U.S. Equity, International Equity and Global Equity yielded survivorship figures of 67.7%, 96%, and 90.2%, respectively.

The significant liquidation and merger activity in some categories makes it imperative that survivorship bias correction be made in any fund performance calculation.

² In addition, asset-weighted returns were higher than equal weighted, implying that funds with larger asset sizes did better than those with smaller funds.

³ This category encompasses funds that can invest in U.S. equity markets with Canadian dollar returns. In addition to equity risk, these funds carry currency risk.

⁴ This category encompasses funds that invest most of their assets in developed countries other than Canada and the U.S. In addition to equity risk, these funds carry currency risk.

⁵ This category encompasses funds that can invest in securities domiciled anywhere across the globe. In addition to equity risk, these funds carry currency risk.

Appendix 1: SPIVA Methodology

Data

Standard & Poor's obtains a custom feed of monthly return data from Fundata Canada for all equity mutual funds that have information in their database. The feed includes data on funds that have merged or liquidated. Fundata applies the following filters to the file we receive:

- All non-equity funds are excluded
- All pooled funds, segregated funds or other specialized categories that do not qualify as retail mutual funds are excluded
- Multiple occurrences of the same funds' portfolio reporting in two or more currencies are also excluded – we simply take the Canadian dollar version
- Only a single share class is included

The file has the following data fields on a monthly basis:

1. Fund name
2. Fund identifier
3. Month and year
4. Fund returns for the month, after management and other costs, and including distributions
5. Fund assets under management in that month
6. Fund categorization in that month
7. Management type, i.e., whether the fund is indexed or actively managed

We then limit our subset using the following filters:

- We choose funds that are actively managed, excluding index funds.
- We remove from the sample funds that do not have information on assets under management for any month within the time period examined. These funds are relatively few, and we compare their equal weighted returns to those of the funds with assets reported in Report A1 to illustrate the impact of their exclusion. We remove these funds because our report on asset-weighted returns cannot be computed without fund asset information, and we wish to use a consistent data set across the four main reports on active-versus-index performance included in SPIVA Canada.

Fund Categories

We chose funds that have, at any point in the August 2000-December 2002 period, been classified in at least one of the following CIFSC⁶ categories:

1. Canadian Equity
2. Canadian Large Cap Equity
3. Canadian Small Cap Equity
4. U.S. Equity
5. International Equity
6. Global Equity

⁶ Refer to www.cifsc.com for additional information regarding this organization and their categories.

Benchmarks

The benchmarks we choose are shown in the table. All the index returns are total returns (i.e., include dividend reinvestment) in Canadian dollars. **There has been no deduction of index returns to account for fund investment expenses.** Active fund returns are after expenses, but do not include front- or back-end loads or other commissions that investors might pay.

Fund Category	Comparison Benchmark
Canadian Equity	S&P/TSX Composite Index S&P/TSX Capped Composite Index ⁷
Canadian Large Cap Equity	S&P/TSX 60 Index S&P/TSX 60 Capped Index
Canadian Small Cap Equity	S&P/TSX SmallCap Index
U.S. Equity	S&P 500 Index
International Equity	S&P/Citigroup EPAC PMI Index
Global Equity	S&P/Citigroup World PMI Index

For additional information on any of the benchmark indices, please see the one-page glossary at the end of this report, or visit our website at www.standardandpoors.com.

Reports

Report 1: Percent of Active Funds Outperforming Index

This report shows the percent of funds that have outperformed the comparison benchmark in the August 2000-December 2002 period. We start with the funds in a category at the beginning of the period. At the end of the period, we report what percent of funds have survived and outperformed the index. We don't consider the fund's category at the end of the period, since the category at the beginning of the period is of interest.

This report essentially shows what percentage of funds in the opportunity set at the beginning of the period survived and beat the benchmark.

Most reports that purport to show the percent of active funds outperforming index work with the funds in a category at the end of the period, and then compare their historical returns to the benchmark. SPIVA corrects for this survivorship bias by starting with the funds at the beginning of the period.

⁷ The main reports show a comparison with the S&P/TSX Capped Composite, since mutual funds are restricted from holding more than 10% of their portfolio in a single stock. A capped index better represents an active manager's opportunity set in periods where the history includes a concentration problem. In practical terms, both benchmarks would be equivalent where the history under consideration does not have a greater than 10% single-stock concentration in the S&P/TSX Composite Index.

Report 2: Survivorship

This report shows the count of funds that existed in a particular category at the beginning of the August 2000-December 2002 period, and how many survived at the end of this period. The fund's category at period-end is not considered, since the category at the beginning of the holding period is of interest.

This report essentially shows what percentage of funds in the opportunity set at the beginning of the period survived.

Report 3: Equal Weighted Fund Returns

This report shows the equal weighted average returns of funds in a particular category for the August 2000-December 2002 period. For every month in the period, we take all existing funds in a category and calculate the simple average return. We then compound the returns from all months in the period. These returns are compared with those of the benchmark returns. The funds used in the averaging process in one month might not be the same as the next, since some funds would have merged or liquidated, new funds would have been formed, and some might have had their categories changed.

This report essentially shows equal weighted performance of actively managed funds in a category over the time period, with the level of granularity for determining the eligible population in that category being monthly.

Most reports that purport to show average active fund performance work with the funds in a category at the end of the period, and then take the average of their historical returns. SPIVA presents a more accurate picture of active fund performance in a category by calculating the average performance of the active funds within a category each month.

Report 4: Asset Weighted Fund Returns

This report shows the asset weighted average returns of funds in a particular category for the August 2000-December 2002 period. For every month, we take all funds in a category and calculate the average return by weighing each fund's return by its month-end assets. We then compound the returns from all the months in the period. These returns are compared with those of the benchmark returns. The funds used in the averaging process in one month might not be the same as used the next, since some funds would have merged or liquidated, new funds would have been formed, and some might have had their categories changed.

This report essentially shows asset weighted performance of actively managed funds in a category over the time period, with the level of granularity for determining the eligible population in that category being monthly.

Most fund reports do not show asset weighted returns. SPIVA presents an accurate picture of asset weighted active fund performance in a category by calculating the asset weighted average performance of the active funds within a category each month.

Report 1: Percent of Active Funds Outperforming Index: Aug 2000 – Dec 2002

Category	Comparison Index	
Canadian Equity	S&P/TSX Composite Index Total Return	66.67
Canadian Equity	S&P/TSX Capped Composite Index Total Return	38.89
Canadian Large Cap Equity	S&P/TSX 60 Index Total Return	87.50
Canadian Large Cap Equity	S&P/TSX 60 Capped Index Total Return	34.38
Canadian Small Cap Equity	S&P/TSX SmallCap Index Total Return	30.00
U.S. Equity	S&P 500 Total Return Index C\$	29.03
International Equity	S&P/Citigroup EPAC PMI Index Total Return C\$	32.00
Global Equity	S&P/Citigroup World PMI Index Total Return C\$	45.90

Source: Standard & Poor's, Fundata. All data ending Dec 31, 2002. CIFSC categorizations.

Note: There has been no deduction of fund expenses from index returns.

Report 2: Survivorship: Aug 2000 – Dec 2002

Category	Count at Beginning of Period	Survivorship %
Canadian Equity	90	72.22
Canadian Large Cap Equity	32	96.88
Canadian Small Cap Equity	50	74.00
U.S. Equity	62	67.74
International Equity	25	96.00
Global Equity	61	90.16
Source: Standard & Poor's, Fundata. All data ending Dec 31, 2002. CIFSC categories.		

Report 3: Equal Weighted Fund Returns: Aug 2000 – Dec 2002

Fund Category or Index	
Canadian Equity	-14.13
S&P/TSX Composite Index Total Return	-33.93
S&P/TSX Capped Composite Index Total Return	-18.59
Cdn Large Cap Equity	-19.64
S&P/TSX 60 Index Total Return	-38.97
S&P/TSX 60 Capped Index Total Return	-13.23
Cdn Small Cap Equity	-10.48
S&P/TSX SmallCap Index Total Return	-1.94
U.S. Equity	-33.65
S&P 500 Total Return Index C\$	-32.47
International Equity	-35.36
S&P/Citigroup EPAC PMI Index Total Return C\$	-33.19
Global Equity	-31.64
S&P/Citigroup World PMI Index Total Return C\$	-33.92
Source: Standard & Poor's, Fundata. All data ending December 31, 2002. CIFSC categories.	
Note: There has been no deduction of fund expenses from index returns.	

Report 4: Asset Weighted Fund Returns: Aug 2000 – Dec 2002

Fund Category or Index	
Canadian Equity	-11.95
S&P/TSX Composite Index Total Return	-33.93
S&P/TSX Capped Composite Index Total Return	-18.59
Canadian Large Cap Equity	-14.64
S&P/TSX 60 Index Total Return	-38.97
S&P/TSX 60 Capped Index Total Return	-13.23
Canadian Small Cap Equity	-14.33
S&P/TSX SmallCap Index Total Return	-1.94
U.S. Equity	-32.20
S&P 500 Total Return Index C\$	-32.47
International Equity	-35.31
S&P/Citigroup EPAC PMI Index Total Return C\$	-33.19
Global Equity	-23.75
S&P/Citigroup World PMI Index Total Return C\$	-33.92

Source: Standard & Poor's, Fundata. All data ending December 31, 2002. CIFSC categorizations.

Note: There has been no deduction of fund expenses from index returns.

Report A1: Funds Excluded from Sample Due to Missing Asset Data: Aug 2000 – Dec 2002

<i>Equal Weighted Returns</i>		
Category	In Sample?	
Canadian Equity	Included	-14.13
	Excluded	-14.90
Canadian Large Cap Equity	Included	-19.64
	Excluded	-37.75
Canadian Small Cap Equity	Included	-10.48
	Excluded	-8.98
U.S. Equity	Included	-33.65
	Excluded	-26.99
International Equity	Included	-35.36
	Excluded	-40.04
Global Equity	Included	-31.64
	Excluded	-32.32
Source: Standard & Poor's, Funddata. All data ending December 31, 2002. CIFSC categorizations.		
Note: There has been no deduction of fund expenses from index returns.		

Report A1 (continued): Count of Funds at Beginning of Period

Category	In Sample?	Last Quarter
Canadian Equity	Included	90
	Excluded	27
Canadian Large Cap Equity	Included	32
	Excluded	3
Canadian Small Cap Equity	Included	50
	Excluded	8
U.S. Equity	Included	62
	Excluded	9
International Equity	Included	25
	Excluded	2
Global Equity	Included	61
	Excluded	20
Source: Standard & Poor's, Funddata. All data ending December 31, 2002. CIFSC categorizations.		
Note: There has been no deduction of fund expenses from index returns.		

Glossary

S&P 500 Index

Widely regarded as the best single gauge of the U.S. equities market, this index includes a representative sample of 500 leading companies in leading industries of the U.S. economy and provides over 80% market coverage of the U.S. equities market.

S&P/TSX 60 Index

This index is designed to measure the performance of large cap Canadian securities with a view to matching the sector weights of the S&P/TSX Composite.

S&P/TSX Capped Composite Index

This includes all the constituents of the S&P/TSX Composite Index with relative weighting of each constituent capped at 10%.

S&P/TSX 60 Capped Index

This includes all the constituents of the S&P/TSX 60 Index with relative weighting of each constituent capped at 10%.

S&P/Citigroup EPAC PMI Index

This index is a float-weighted, rules based benchmark that captures universe of securities in the developed markets less North America. The Primary Market Index (PMI), covering world equity markets, constitutes the top 80% of the available market cap of the global S&P/Citigroup EPAC BMI Index.

S&P/Citigroup World PMI Index

This index is a float-weighted, rules based benchmark that captures securities in the developed markets. The Primary Market Index (PMI), covering world equity markets, constitutes the top 80% of the available market cap of the global S&P/Citigroup World BMI Index.

S&P/TSX Composite Index

This is the headline index and the principal broad market measure for Canadian Equity markets. Previously this index was referred to as the TSE 300.

S&P/TSX SmallCap Index⁸

This index includes those securities in the S&P/TSX Composite which are not members of the S&P/TSX 60 or S&P/TSX MidCap Indices.

⁸ This is an historical definition applicable to the 2000 to 2002 period under examination. This index was redeveloped on March 2007. The current S&P/TSX SmallCap Index is calculated as a separate index from the S&P/TSX Composite Index.

For more information, please go to www.spiva.standardandpoors.com

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