

## Index Versus Active Funds Scorecard for Canadian Funds

### Standard & Poor's Indices Versus Active Funds Scorecard, Second Quarter 2006

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❑ **The S&P Indices Versus Active Funds (SPIVA) Scorecard reports performance of actively managed Canadian mutual funds corrected for survivorship bias and shows equal- and asset-weighted peer averages.**

❑ **Actively managed Canadian Equity funds, US Equity funds and Small-Cap Equity funds have lagged indices in the first half of 2006. The S&P/TSX Composite Index outperformed 81.2% of Canadian Equity funds, while the S&P 500 Index outperformed 61.4% of US Equity funds. In a reversal from the last few quarters, only 48.4% of SmallCap Equity funds have outperformed the S&P/TSX SmallCap Index.**

❑ **Over longer time periods, we continue to observe indices outperforming a majority of active funds. Over the past five years, 13.9% of actively managed Canadian Equity funds have outperformed the S&P/TSX Composite Index, 43.8% of actively managed Canadian SmallCap funds have outperformed the S&P/TSX SmallCap Index and 25% of U.S. Equity funds have outperformed the S&P 500 Index.**

❑ **Over the last three years, 12.5% of actively managed Canadian Equity funds have outperformed the S&P/TSX Composite Index, 61.9% of actively managed Canadian SmallCap funds have outperformed the S&P/TSX SmallCap Index and 17% of U.S. Equity funds have outperformed the S&P 500 Index.**

❑ **Five-year average fund returns show active funds underperforming the S&P/TSX Composite Index and the S&P/TSX Capped Composite, both on an equal and asset weighted basis. Canadian SmallCap Equity funds fared better over this time frame outperforming the S&P/TSX SmallCap Index.**

❑ **Five-year survivorship ranges from 60% to 66% for the Canadian Equity, Canadian SmallCap and U.S. Equity fund categories. This suggests that approximately one in three funds in these three categories has merged or liquidated in the past five years. Three-year survivorship is between 53% and 78%.**

## Introduction

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*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.*

*SPIVA reports are the only comprehensive, periodic and publicly available sources of such data.*

The Standard & Poor's Indices Versus Active Funds Canada (SPIVA Canada) Scorecard keeps quarterly tabs on the active-versus-index debate in Canada. SPIVA Canada shows performances of actively managed Canadian mutual funds as compared to Standard & Poor's indices in their respective categories. Although many such reports are available, the SPIVA Canada scorecard is unique in a few 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.

SPIVA reports are the only comprehensive, periodic and publicly available sources of such data. Quarterly SPIVA reports can be found online at [www.spiva.standardandpoors.com](http://www.spiva.standardandpoors.com).

SPIVA Canada builds upon the success of SPIVA scorecard in the U.S., where it has been widely accepted among financial advisors, institutional investors and the media. Like its U.S. counterpart, SPIVA Canada does not make investment recommendations or offer comments on the suitability of either index or active investing. The scorecard simply reports quarterly numbers according to the SPIVA methodology and provides a brief analysis of the numbers. Further, we advise reading the methodology at the end of the report in order to understand how the numbers are derived.

## Canadian Equity Funds

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*Less than one in seven of actively managed Canadian Equity funds have outperformed the S&P/TSX Composite Index over the last five years. However, they fare much better if one uses a blend index of 70% S&P/TSX Composite-30% S&P 500.*

Over the last five years, Report 1 shows that only 13.9% of actively managed funds in the Canadian Equity category have outperformed the S&P/TSX Composite Index. Less than one in seven active funds in this category have outperformed the Composite over the three and one-year periods. In addition, Reports 3 and 4 show that the average returns of active funds in this category for all periods, on both an equal- and asset-weighted basis, have been inferior to those of both the Composite and the S&P/TSX Capped Composite.

Funds in this category may have as much as 30% of their equity assets in non-Canadian equities (lifting of the foreign content rule will see this percentage rise in the future). In practice, the non-Canadian allocation is mainly U.S. equities. If one uses a blend index of 70% S&P/TSX Composite-30% S&P 500, active funds in this category fare better. This is shown in Report A2.

## Canadian SmallCap Funds

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*It is commonly believed that in the small cap space, active managers have a better chance of beating benchmarks because of the relative inefficiency of that market.*

It is commonly believed that in the small cap space, active managers have a better chance of beating benchmarks because of the relative inefficiency of that market. Over the last five years, Report 1 shows that 43.8% of actively managed Canadian SmallCap funds have outperformed the S&P/TSX SmallCap index. 61.9% of active funds in this category have outperformed the Index over the three-year period. In contrast to most previous periods, the second quarter of 2006, shows that only 25% of active funds outperformed the index. In the equal and asset weighted average returns from Reports 3 and 4 show active funds in this category have exceeded index returns over most periods. Exceptions are the asset-weighted year to date active small cap equity manager returns and returns for both asset-weighted and equal-weighted for the most recent quarter.

## U.S. Equity Funds

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*Less than one-third of U.S. equity funds have outperformed the S&P 500 Index (in Canadian dollar terms) over the last five-, three- and one-year periods.*

U.S. equity funds offer Canadian investors exposure to the U.S. equity market with Canadian dollar returns. In addition to equity risk, these funds carry currency risk. Report 1 shows that 25%, 17% and 31.3% of funds in this category outperforming the S&P 500 Index (in Canadian dollar terms) over the last five-, three- and one-year periods respectively. Equal and asset-weighted average returns for this category were generally worse than the benchmark for the last five-, three- and one-year periods. The one exception was the asset-weighted return for the one-year period, which outperformed the S&P 500 Index by 0.37%.

## Survivorship

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Survivorship over the five-year horizon is 63.3%, 60.2% and 65.8% for Canadian Equity, U.S. Equity and Canadian Small Cap funds, respectively. The corresponding survivorship figures over the three-year horizon are 74%, 53.2% and 77.8%. In other words, roughly one in three funds in these three categories has been merged or liquidated over the past five years. This suggests that not accounting for fund survivorship would present a very inaccurate picture of fund category performance.

## Appendix 1: SPIVA Methodology

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### **Data**

We obtain a custom feed of monthly return data from Fundata Canada for all equity mutual funds whose data are available 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 previous 60 months. These funds are relatively few, and we compare their equal weighted returns to those of the funds with assets in Report A1 so that readers can understand the impact of their exclusion. The reason we remove these funds is because we have a report on asset-weighted returns that 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 that SPIVA Canada shows.

### **Fund Categories**

We choose funds that have, at any point in the previous 60 months, been classified in at least one of the following four categories:

1. Canadian Equity
2. Canadian Equity Pure
3. Canadian SmallCap Equity
4. U.S. Equity

These categories, we believe, represent the major categories of interest for Canadian investors in equity funds. We did consider including other categories, particularly Canadian Income Trust Funds and Canadian Dividend Funds. However, these categories did not have a sufficient number of funds going back five years, particularly after application of filters mentioned before. We will gradually include specialized equity fund categories if we see a number of meaningful observations over three and five years.

The Canadian Investment Funds Standards Committee (CIFSC) governs categorization of Canadian mutual funds.<sup>1</sup> A major change in the CIFSC's fund categorization structure in recent years poses challenges for three and five year reports. For example, the Canadian Equity category now refers to funds that invest at least 70% of their non-cash assets in Canadian equities. Canadian Equity Pure is a recent category (effective 2003) that refers to funds that invest almost exclusively in Canadian equities. The Canadian Large Cap category does not exist any more, with funds in that category being folded into either the Canadian Equity or Canadian Equity Pure category. Similarly, some Canadian Equity funds have been reclassified into Canadian Equity Pure based on the new classification structure.

The file Funddata supplies us helps achieve comparability across history by back-filling the classifications prior to the restructuring of the classification system. For the funds that were assigned to Canadian Equity Pure category in 2003, the monthly style categorization in prior months is changed to Canadian Equity Pure. The historical style categorization of Canadian Large Cap funds is changed to either Canadian Equity or Canadian Equity Pure, depending upon how the funds were classified after the restructuring. We realize that this induces a backward looking bias, but we are fortunate in the fact that the benchmark for both Canadian Equity and Canadian Equity Pure categories is the S&P/TSX Composite Index. Further, this affects only our three-year and five-year numbers in these two categories. The Canadian SmallCap Equity and U.S. Equity category are largely unaffected by the restructuring.

### **Benchmarks**

The benchmarks we choose are shown in the table below. 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.

<b>Fund Category</b>	<b>Comparison Benchmark 1</b>	<b>Comparison Benchmark 2</b>
Canadian Equity	S&P/TSX Composite Index	S&P/TSX Capped Composite Index
Canadian Equity Pure	S&P/TSX Composite	S&P/TSX Capped Composite Index
U.S. Equity	S&P 500 Index	
Canadian SmallCap Equity	S&P/TSX SmallCap Index	

- For Canadian Equity and Canadian Equity Pure, the main reports show a comparison with:
- The S&P/TSX Composite, since it is their most appropriate benchmark in terms of representing the Canadian equity market. We use the S&P/TSX 300 history prior to the official switchover to the S&P/TSX Composite.
  - 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, there would be no differences in periods where the history under consideration does not have a greater than 10% single-stock concentration in the S&P/TSX Composite.

Funds in the Canadian Equity category have non-Canadian, primarily U.S., equity exposure. In order to measure the performance of these funds to accord for this fact, we present in Report

<sup>1</sup> See [www.cifsc.com](http://www.cifsc.com)

A2 a comparison of funds in this category to a monthly returning series consisting of 70% S&P/TSX Composite returns and 30% S&P 500 returns measured in Canadian dollars. This comparison is for theoretical purposes only – for all practical purposes the retail investor's options are between an active fund in this category and an index fund investing in Canadian equities.

## **Reports**

### **Report 1: Percent of Active Funds Outperforming Index**

This report shows the percent of funds that have outperformed the comparison benchmark over three-month, year-to-date, one-year, three-year and five-year time periods. We start off 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. The category of the fund at the end of the period is not considered, since the category of interest is the category at the beginning of the holding period.

This report essentially shows what percent of funds in the opportunity set at the beginning of the period (a) survived and, (b), having survived, 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.

### **Report 2: Survivorship**

This report shows the count of funds that existed in a particular category at the beginning of three-month, year-to-date, one-year, three-year and five-year time periods, and how many survived at the end of the period. Once again, the category of the fund at the end of the period is not considered, since the category of interest is the category at the beginning of the holding period.

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

### **Report 3: Equal Weighted Fund Returns**

This report shows the equal weighted average returns of funds in a particular category for three-month, year-to-date, one-year, three-year and five-year time periods. For every month in the time period, we take all funds that are in existence in a category and calculate the simple average return. We then compound the returns from all the months in the time period. These returns are compared to the benchmark returns. Note that the funds used in the averaging process in one month might not be the same as used in the next month, 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 in existence in 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 three-month, year-to-date, one-year, three-year and five-year time periods. For every month in the time period, we take all funds that are in existence 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 time period. These returns are compared to the benchmark returns. Note that the funds used in the averaging process in one month might not be the same as used in the next month, 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 in existence in a category each month.

**Report 1: Percent of Active Funds Outperforming Index**

<b>Category</b>	<b>Comparison Index</b>	<b>Last Quarter</b>	<b>Year To Date</b>	<b>One Year</b>	<b>Three Years</b>	<b>Five Years</b>
Canadian Equity	S&P/TSX Composite Index Total Return	21.33	18.79	12.50	12.50	13.89
Canadian Equity	S&P/TSX Capped Composite Index Total Return	21.33	18.79	12.50	12.50	13.89
Canadian Equity (Pure)	S&P/TSX Composite Index Total Return	26.79	29.31	36.51	8.33	3.23
Canadian Equity (Pure)	S&P/TSX Capped Composite Index Total Return	26.79	29.31	36.51	8.33	3.23
Canadian Small-Cap Equity	S&P/TSX Canadian Small Cap Total Return	25.00	48.39	55.88	61.90	43.84
U.S. Equity	S&P 500 Total Return Index C\$	35.58	38.61	31.25	16.96	25.00

Source: Standard & Poor's, Funddata. All data ending June 30, 2006. CIFSC categorizations.

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

**Report 2: Survivorship**

<b>Category</b>	<b>Period</b>	<b>Count at Beginning of Period</b>	<b>Survivorship %</b>
Canadian Equity	Last Quarter	150	100.00
	Year To Date	149	99.33
	One Year	160	88.75
	Three Years	208	74.04
	Five Years	180	63.33
U.S. Equity	Last Quarter	104	97.12
	Year To Date	101	97.03
	One Year	144	67.36
	Three Years	171	53.22
	Five Years	108	60.19
Canadian Equity (Pure)	Last Quarter	56	100.00
	Year To Date	58	100.00
	One Year	63	95.24
	Three Years	12	66.67
	Five Years	31	87.10
Canadian Small-Cap Equity	Last Quarter	32	100.00
	Year To Date	31	100.00
	One Year	34	88.24
	Three Years	63	77.78
	Five Years	73	65.75

Source: Standard & Poor's, Funddata. All data ending June 30, 2006. CIFSC categorizations.

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

**Report 3: Equal Weighted Fund Returns**

<b>Fund Category or Index</b>	<b>Last Quarter</b>	<b>Year To Date</b>	<b>One Year</b>	<b>Three Year (Annualized)</b>	<b>Five Year (Annualized)</b>
Canadian Equity	-4.69	2.39	13.37	16.12	7.35
S&P/TSX Composite Index Total Return	-3.50	4.19	19.65	20.69	10.48
S&P/TSX Capped Composite Index Total Return	-3.50	4.19	19.65	20.69	10.48
U.S. Equity	-6.63	-2.30	-1.77	1.75	-5.81
S&P 500 Total Return Index C\$	-5.81	-1.43	-1.05	4.45	-3.57
Canadian Equity (Pure)	-4.37	3.53	17.86	19.35	9.29
S&P/TSX Composite Index Total Return	-3.50	4.19	19.65	20.69	10.48
S&P/TSX Capped Composite Index Total Return	-3.50	4.19	19.65	20.69	10.48
Canadian Small-Cap Equity	-4.51	6.89	21.24	21.25	11.15
S&P/TSX Canadian Small Cap Total Return	-2.11	6.29	17.50	17.37	9.68

Source: Standard & Poor's, Funddata. All data ending June 30, 2006. CIFSC categorizations.

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

<b>Report 4: Asset Weighted Fund Returns</b>					
<b>Fund Category or Index</b>	<b>Last Quarter</b>	<b>Year To Date</b>	<b>One Year</b>	<b>Three Year (Annualized)</b>	<b>Five Year (Annualized)</b>
Canadian Equity	-4.40	2.73	13.81	16.03	7.24
S&P/TSX Composite Index Total Return	-3.50	4.19	19.65	20.69	10.48
S&P/TSX Capped Composite Index Total Return	-3.50	4.19	19.65	20.69	10.48
U.S. Equity	-6.07	-2.04	-0.68	3.19	-4.21
S&P 500 Total Return Index C\$	-5.81	-1.43	-1.05	4.45	-3.57
Canadian Equity (Pure)	-4.65	2.70	16.71	19.04	9.10
S&P/TSX Composite Index Total Return	-3.50	4.19	19.65	20.69	10.48
S&P/TSX Capped Composite Index Total Return	-3.50	4.19	19.65	20.69	10.48
Canadian Small-Cap Equity	-4.06	4.69	19.54	19.80	9.79
S&P/TSX Canadian Small Cap Total Return	-2.11	6.29	17.50	17.37	9.68

Source: Standard & Poor's, Funddata. All data ending June 30, 2006. 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**

<i>Equal Weighted Returns</i>						
<b>Category</b>	<b>In Sample?</b>	<b>Last Quarter</b>	<b>Year To Date</b>	<b>One Year</b>	<b>Three Year (Annualized)</b>	<b>Five Year (Annualized)</b>
Canadian Equity	Included	-4.69	2.39	13.37	16.12	7.35
	Excluded	-4.33	3.06	13.52	15.77	NA
U.S. Equity	Included	-6.63	-2.30	-1.77	1.75	-5.81
	Excluded	-6.18	-1.34	2.53	8.35	NA
Canadian Equity (Pure)	Included	-4.37	3.53	17.86	19.35	9.29
	Excluded	-4.69	1.30	12.23	16.04	NA
Canadian Small-Cap Equity	Included	-4.51	6.89	21.24	21.25	11.15
	Excluded	-4.45	9.71	29.98	26.50	NA

<i>Count of Funds at Beginning of Period</i>						
<b>Category</b>	<b>In Sample?</b>	<b>Last Quarter</b>	<b>Year To Date</b>	<b>One Year</b>	<b>Three Years</b>	<b>Five Years</b>
Canadian Equity	Included	150	149	160	208	180
	Excluded	27	27	29	28	0
U.S. Equity	Included	104	101	144	171	108
	Excluded	9	9	18	13	0
Canadian Equity (Pure)	Included	56	58	63	12	31
	Excluded	4	4	4	4	0
Canadian Small-Cap Equity	Included	32	31	34	63	73
	Excluded	5	6	6	5	0

Source: Standard & Poor's, Funddata. All data ending June 30, 2006. CIFSC categorizations.

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

**Report A2: Measuring Canadian Equity Fund Category Performance Versus a Blend Index*****Average Returns***

<b>Fund Category or Index</b>	<b>Last Quarter</b>	<b>Year To Date</b>	<b>One Year</b>	<b>Three Year (Annualized)</b>	<b>Five Year (Annualized)</b>
Canadian Equity Funds - Equal Weighted	-4.69	2.39	13.37	16.12	7.35
Canadian Equity Funds - Asset Weighted	-4.40	2.73	13.81	16.03	7.24
70% S&P/TSX Composite Index Total Return + 30% S&P 500 Total Return Index C\$	-4.20	2.51	13.44	15.82	6.27

***Percent of Active Funds Outperforming Index***

<b>Comparison Index</b>	<b>Last Quarter</b>	<b>Year To Date</b>	<b>One Year</b>	<b>Three Year (Annualized)</b>	<b>Five Year (Annualized)</b>
70% S&P/TSX Composite Index Total Return + 30% S&P 500 Total Return Index C\$	40.00	37.58	45.00	41.35	38.89

Source: Standard & Poor's, Funddata. All data ending June 30, 2006. CIFSC categorizations.

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

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For more information, please go to [www.spiva.standardandpoors.com](http://www.spiva.standardandpoors.com)

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