
# The active return journey continues

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## KEY TAKE-AWAYS

- *When analysing a fund's return performance, it's important to use rolling periods of return, rather than a simple "point-in- time" return period, such as five or 10 years, as the latter is an arbitrary period that says little about the consistency of a fund's behaviour through different market cycles.*
- *Although Prudential's more recent relative equity performance has been disappointing, a look at rolling periods over three years and longer shows the Prudential Core Equity Composite has continued to beat its benchmark consistently.*

**In a previous article, The active return** journey (***Consider this Q1 2019***), we proposed that investors should analyse a fund's returns relative to benchmark (active returns) on a rolling basis. We argued that this provides investors with a far more complete picture than the most popular method of looking at a fund's active returns, whether it be over 1 year or 10 years, at a single point-in-time. Analysing active returns in a monthly sequence provides more data points and allows investors to see how a fund has "behaved" over various investment cycles. When, and how, was outperformance delivered? To what degree of consistency, i.e. the frequency by which it has beaten its benchmark over various rolling return periods?

A key take-away from the previous article, where we analysed the performance of the Prudential Core Equity Composite up until 31 December 2018, was that over shorter time periods, such as rolling 12-month and even 36-month periods, underperformance can and does happen. However, Prudential has been able to consistently beat its benchmark over longer periods, for example five years and longer, by compounding more gains than losses against the benchmark over the shorter term.

The last 18-24 months has undoubtedly been a disappointing period of relative performance for investors in Prudential's equity portfolios. This on top of below-average equity market returns, or beta, which is outside of our control in a fully invested equity portfolio.

Graph 1 shows rolling 12-month active returns (vertical grey bars) for the Prudential Core Equity Composite since its inception in 2004. This is an aggregation of all the institutional portfolios we manage using our specialist Core (Houseview) equity process. After a particularly strong period of outperformance over 2017 and 2018, 12- month rolling active returns have largely been negative in the ensuing period.

Despite the recent downturn in active returns, the since-inception outperformance of 1.3% per annum remains very attractive. This means that over the 16-year tenor of the

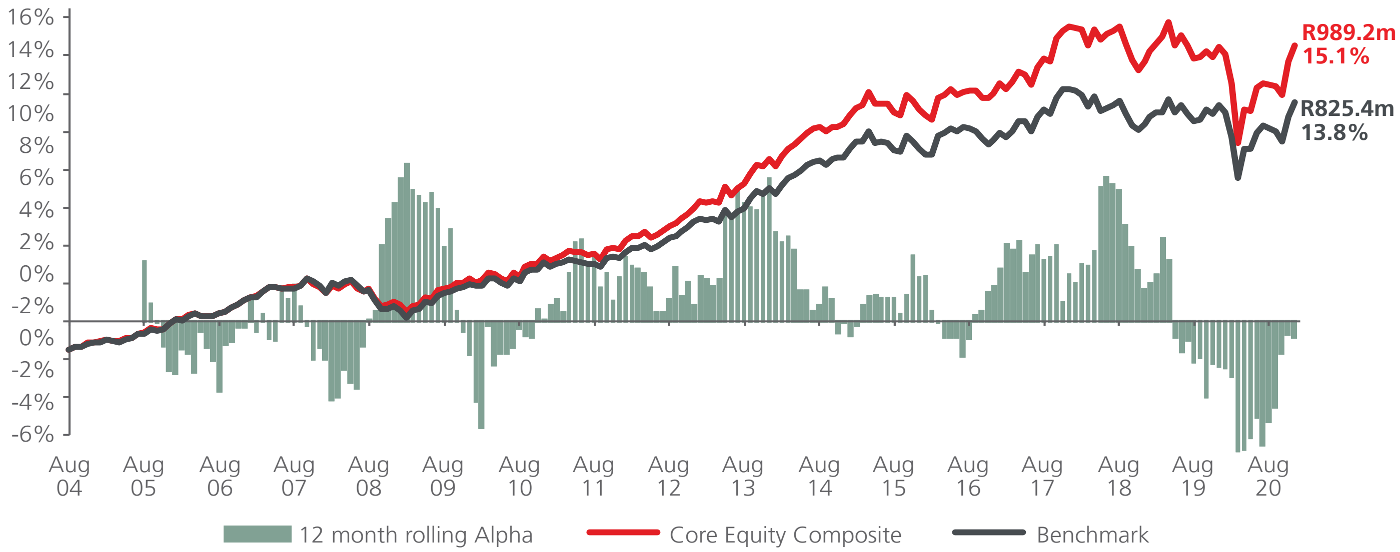
Prudential Core Equity Composite, a R100 million investment would have grown to R989 million (gross of fees), compared to R825 million for a similar investment in the benchmark.

While underperformance in the short term is not unusual, we do assess ourselves on a continuous basis. A superior long-term track record is ultimately achieved by the "wins" outweighing the inevitable "losses" against the benchmark over shorter time periods. An assessment along the following lines can prove particularly useful to our clients after a period of underperformance against the benchmark:

- What has caused the underperformance?
- Was the underperformance caused by any change to investment philosophy or process?
- Has the underperformance affected the long-term performance track record or consistency profile?

## Graph 1: Prudential Core Equity Composite

**Performance as at 31 December 2020**




Source: Statpro & Prudential Investment Managers
*Market value weighted blend based on the underlying fund benchmarks within the composite, it consists of the FTSE/JSE Shareholder Weighted Index and FTSE/JSE Capped Shareholder Weighted Index.



**SOURCES:** Statpro, Prudential Investment Managers

## Key detractors from recent relative performance

In Prudential's equity portfolios, key positions that detracted in the shorter term include overweight positions in Sasol, Sappi and banks, and underweight positions in the gold sector. A lot has been written previously about our original investment cases and current views on these stocks, so it won't be belaboured here. Suffice to say, we have been on the wrong side of some fairly significant price action in these stocks over the past 18 – 24 months. For example, Sasol halved in value over the course of 2020, while the gold sector gained 35% (and was in fact up more than 100% at one point during the year).

## Unchanged investment philosophy and process

We continue to follow the same team-based and prudent value approach to investing. Specifically, there has been no change to our internal risk limits, for example allowing a maximum 4% over- or underweight position in a stock against the benchmark. However, unusual about the recent period has been the high correlation between under-performing positions, and the extent of price moves in these. For example, even a relatively modest average overweight position of 1% during 2020 in Sasol (noting higher active positions at certain points during the year) detracted 1.4% from relative performance given the poor price performance of the stock.

## Consistent delivery of outperformance over the long-term remains intact

Graph 2 depicts the Composite's active returns over longer rolling periods to 31 December 2020, and confirms how it has still beaten its benchmark 86% of the time over rolling three-year periods, and a full 100% of the time over both rolling five- and 10-year periods.

The recent negative performance cycle has naturally pulled down the level of active returns over all rolling time periods; however, Prudential's track record of beating its benchmark with a high degree of consistency remains intact over longer, more meaningful investment periods.

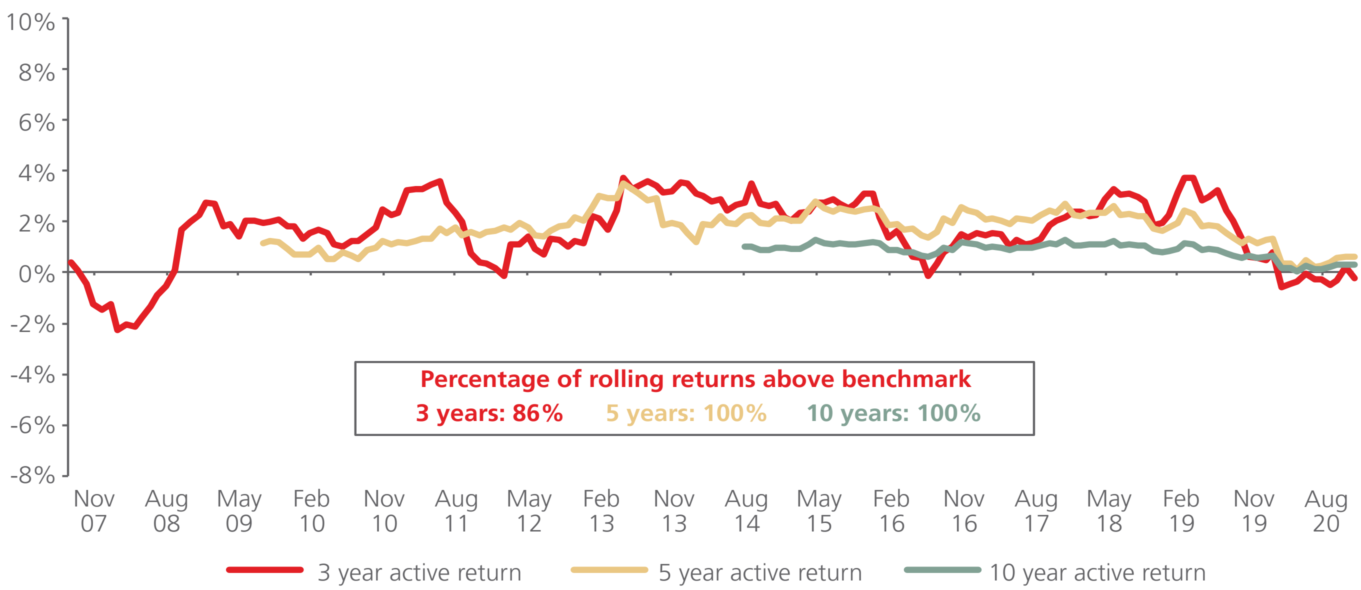
These "hit rate" statistics make a compelling argument for Prudential's ability to deliver consistent outperformance over the long term.

## The active return journey never stops

Performance cycles, negative and positive, are par for the course in active investing. We continually devote much time and effort to interrogating our performance outcomes – whether good or bad – and attempt to place them in a more holistic context by, for example, looking at rolling returns over longer time periods.

Investing is a continuous and forward-looking endeavour. We remain excited about the valuations of many companies which have the potential to deliver outperformance to our clients' portfolios – and see us adding more "good months" to our rolling returns. The last three months have provided early, albeit very short term, signs of this as some of our long-held positions, for example in banks, have started performing well.

**Graph 2: Prudential Core Equity Composite has outperformed consistently over 3 years and longer**




**SOURCES:** Statpro, Prudential Investment Managers

Our clients can take comfort that through all of this, we remain committed to our prudent, valuation-based approach to investing. This has yielded superior returns to investors over the long term, exemplified by the number-1 ranking over 10 years (the longest measurement period) of the Prudential Core Equity Composite in the Alexander Forbes S.A. Equity Manager Watch™ survey (benchmark-cognizant category) as at 31 December 2020. Of course this a point-in-time measure that we urge investors to be cautious about, but it is equally an industry standard. ■

*Valdon joined Prudential in 2009 and was appointed as Head of Institutional Business later in the same year. He is responsible for managing relationships with all of Prudential's institutional clients and is also a member of the Prudential Investment Managers (SA) (Pty) Ltd Board. Prior to joining Prudential, Valdon held a similar role at Investec Asset Management. He has a wealth of experience, having started his career in the insurance industry in 1996 where he worked in various areas, including: actuarial valuations, product management, marketing and strategy. In his spare time, Valdon enjoys spending time with his family and friends, working on his golf swing and playing fives football.*