



## Getting the edge with managed funds

# A yardstick for dollars and cents

Often we hear the word *benchmark* and *index* used in relation to investment performance, but what are they and how are they useful?

Benchmarks and indices are standards by which something can be measured or judged against. Acting as a gauge, they provide a useful way to monitor the performance of an investment. Comparing the actual performance of an investment against an index or benchmark provides an objective assessment of how a particular investment has performed.

A benchmark is something that a fund manager sets as an objective for the investment performance of a particular fund they are offering. In many cases the benchmark will be an index. Indices are not only useful for fund managers in setting their investment performance objectives, but they can be also be used by every day investors to help assess the returns of their investments.

### What is an index?

An index is a measure of the movement in value of the market, or various asset categories in the market, providing a snapshot of how the market is performing.

Charles Dow first introduced basic indices in the early days of the New York Stock Exchange (NYSE) when there were no performance measures. The Dow Jones Industrial Index was created, which still exists today and is made up of 30 of the largest and most widely held of the 2,800 public companies on the NYSE.

Today, indices cover almost every industry sector and asset class, including Australian and international shares, property, bonds or other securities. Standard & Poor's (S&P) are responsible for calculating most of the indices used within the Australian share market, which measure the performance of the most liquid stocks.

### How is an index formed?

The inclusion of a stock (shares or other securities able to be traded on a stock exchange) within a particular index is the result of extensive analysis, so that an index will only contain companies that are representative of the market. S&P use a strict criteria to measure a stock's eligibility for inclusion in an index, including it's liquidity, free float or the percentage of each company's shares that are available for trading in the market, as well as market capitalisation. A stock will only be considered after these critical factors have been rigorously analysed.

The S&P Australian Index Committee is responsible for maintaining indices. The committee is made up of five members from both S&P and the Australian Stock Exchange and is responsible for setting policy, determining index composition and administering the indices in accordance with the S&P/ASX index methodology. The committee may also add, remove or by-pass any company or security during the selection process.

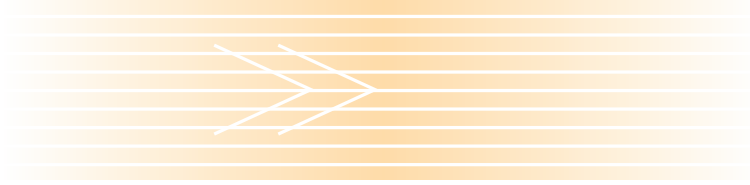
### What are the main indices?

Companies such as JP Morgan, Smith Barney, Frank Russell, Standard & Poor's, Morgan Stanley Capital International (MSCI), and UBS Warburg manage and publish literally thousands of indices that the world's investment management industry relies on.

While there are no formal guidelines for how fund managers should choose a benchmark for a particular investment vehicle, benchmark selection is informally regulated by research houses through their regular review processes.

#### Changes to an index

As well as being added to an index, stocks can also be removed. In December 2004, S&P removed News Corp from the S&P/ASX300, following the company's decision to shift it's main share market listing to Wall Street.



The research houses aim to ensure the benchmark is appropriate to the assets being managed; not one that can be easily beaten due to a mismatch of what the fund is actually investing in.

## Measuring up

Useful indices for you to compare your investments with:

### Global Shares

The **MSCI World Index** is a measure of performance for the entire world's listed stocks, covering shares in over 1,400 companies listed on the exchanges of 22 of the world's major share markets. This is the relevant index for you to assess your global share investments against.

### Australian Shares

**S&P/ASX 300 Accumulation Index** - This benchmark is the broadest index for Australia, covering 91% of Australia's market capitalisation. Your Australian Share investments can be compared against this index.

### Australian Bonds

**UBSWA Composite Bond Index** - Index for the Australian bond market and covers primarily government and semi-government bonds, which provide regular income. If you are invested in an Australian Bond fund this is the relevant index for you to compare performance.