A Second Look at Performance Persistence Among Core Open End European Real Estate Funds

Snapshot Research

Top half performing funds are worthy of closer attention

- Top half funds maintain their superior position for longer than their underperforming peers
- Top half performing funds also show greater performance stability
- Pure top half performers delivered 7.5% on average, 220 basis points above the overall group average

This research builds on the previous INREV investigation into Persistence Performance Among Core Open End European Non-Listed Real Estate Funds. With an extended time series, the findings from the study further support the notion that past performance can be a good guide to future performance.

The research findings indicate that persistent performance does exist, although it is not consistent across all funds and does not last forever. There are several reasons for this, competition dictates that over time competing managers will adopt similar strategies to outperformers, and the gap between leading performers and others will close. Consequently, the excess return will also disappear.

Bottom quartile funds show greater performance stickiness than funds in any of the other three quartiles. However, the reverse is true when funds are grouped into halves. Here, top half performing funds maintain their position for longer than bottom half performers.

Outperformance in the top half can last up to 11 years, while bottom half performance continues for up to nine years. Meanwhile bottom quartile performance lasts only up to four years, suggesting that top quartile funds tend to lose their ranking more quickly. This indicates that sustaining stellar performance over a long period of time is difficult.

Focusing on quartiles analysis alone may be misleading and counterproductive in the longer term. A safer bet would be to focus on funds with consistent performance in the top half, and where greater performance stability is observed.

Figure 1: Persistence in quartiles among European core open end funds

- Top half funds maintain their ranking for a longer period of time
- Top half performing funds also show greater performance stability
- Pure top half performers delivered 7.5% on average, 220 basis points above the overall group average

"Top half performing funds maintain their ranking for a longer period of time"
The paths to performance

The pathways analysis indicates that fund performance is not evenly distributed. Certain paths are taken more frequently than others while some paths are not travelled at all. The most popular path that funds travelled was Q4 to Q4 to Q4. This path, where funds hovered at the bottom of distribution, appeared 9.1% of the time. In other words, there is a one in nine chance that a fund will consistently underperform compared to its peers if it starts in the bottom quartile. The second most travelled pathway was Q1 to Q1 to Q1, where funds continued with their superior outperformance for three consecutive years. This path occurred 4.3% of the time.

Does persistent performance translate to excess returns?

Having established that persistent performance does exist, the natural next question was to ask “by how much?” Pure top half performing funds delivered an average return of 7.5% per annum, 220 basis points above the unweighted average of 5.3%. Extreme performers, funds that experienced both pure top half and pure bottom half performance over the entire analysis period, delivered 5.3% on average, on par with the universe average. Flip-flop performers, funds that fluctuated between top and bottom half rankings, were less successful and generated an average of 4.1%. Finally, pure bottom half performers delivered 2.8% on average, almost half the universe average.

Table 1: Persistent patterns and associated impact on returns among funds

<table>
<thead>
<tr>
<th></th>
<th>Number of funds</th>
<th>% of total</th>
<th>Average annual return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pure top half performers</td>
<td>55</td>
<td>34.4%</td>
<td>7.5%</td>
</tr>
<tr>
<td>Pure bottom half performers</td>
<td>56</td>
<td>35.0%</td>
<td>2.8%</td>
</tr>
<tr>
<td>Extreme performers</td>
<td>28</td>
<td>17.5%</td>
<td>5.3%</td>
</tr>
<tr>
<td>Flip-flop performers</td>
<td>21</td>
<td>13.1%</td>
<td>4.1%</td>
</tr>
<tr>
<td>All funds</td>
<td>160</td>
<td>100.0%</td>
<td>5.3%</td>
</tr>
</tbody>
</table>

For further details, contact research@inrev.org

The full report is available to members at inrev.org/library

---

1 Funds that retained a top half ranking over three consecutive years
2 Funds that retained a bottom half ranking over three consecutive years