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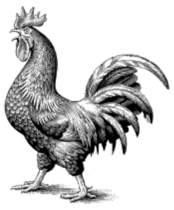
The inconspicuous investor in bed with Australia's biggest super funds

Global asset managers swarm to Australia's super system like bees to a honeypot. Few pick up mandates as big Dimensional. So, who is it?



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We're going to hear a lot this week about how Australia's big superannuation funds manage their customers' money.

The truth is that despite all the talk of hiring stock pickers and traders, new offshore offices and building internal real estate and infrastructure teams, the vast majority of Australia's $3.9 trillion retirement savings pile is managed by third-party asset managers.

Gerard O'Reilly, who has a PhD in aeronautics, runs investment giant Dimensional Fund Advisors. **Louise Kennerley**

These asset managers flock to Australia for a slice of the savings pie. Australians pay more than $30 billion in fees every year to their super trustees, who pass a lot of it on to mandated asset managers.

One of the most successful at tapping that superannuation savings pile is Dimensional Fund Advisors, a systematic equities and bonds investor (think quantitative, data-driven, computer modelling) based in Texas.

It manages $1.1 trillion in such retirement savings for investors all over the world, including $55 billion for Australian and New Zealand clients.

That $55 billion is a lot more than most global asset managers get out of Australian super funds. It helps that Australia's two biggest superannuation funds [https://www.afr.com/link/follow-20180101-p5kd0m] – the only $300 billion-plus club members AustrailanSuper and Australian Retirement Trust which are growing like weeds – both list Dimensional's local office DFA Australia as an investment manager, which is a rare feat.

But Dimensional is a bit of an enigma in Australian equity capital markets. It is one of those funds that those in the bubble know is a big player because of its huge pool of capital and the 30-plus funds it sells to Australian clients, but its systematic process keeps it below the radar. Its portfolio managers are not usually the type to be banging their fists on the table about an ASX-listed company's strategy or speak out in a proxy fight, even if we see the firm pop up as a substantial shareholder from time to time.

But it is still a big player. Dimensional trades every day, and has 120 staff across Sydney and Melbourne. The offices include an investment team that picks up Australian portfolios and about half of its Asia markets trading and currencies in the region. The firm operates 24/6. Co-CEO and co-chief investment officer Gerard O'Reilly says the Aussies pick up what happens in their market or timezone.

Dimensional's process is heavily steeped in academic research. A lot of its funds are decades old – O'Reilly says all the funds Dimensional had in Australia 20 years ago are "still alive and well" – and typically hold lots of positions, are rules-based, underpinned by computer modelling and low cost.

About 80 per cent of Dimensional's $1.1 trillion under management is in equities and it traded more than $250 billion of stocks globally in the past year – a staggering $1 billion or so every day. That sort of turnover is a core feature.

But where does it fit into the broader equities landscape?

O'Reilly calls it a "non-index approach" – albeit low-cost relative to other active investors, which can make it look more like an index fund. Its starting position – and the core of its style – is that it does not try to out-guess market prices, unlike most active equities shops on the street, which rely on being faster and smarter to make money.

AI: assisted implementation

"Market prices are the best prediction of the future that we have, with all the information about differences in expected return and differences in risk," he says, pointing out there are 45 million market prices to factor into its models every day.

"And so we're trying to use that [pricing] information to build well-diversified, systematic strategies that can emphasise the areas of higher expected return in markets."

He says its strategies are not based on an index, but its own definition of an eligible universe of stocks or bonds. That universe usually goes down to much smaller market capitalisation stocks than the big indices and filters out other non-equity-like exposures. One example is companies subject to an agreed M&A bid which should trade more like cash than an equity.

“We’re starting with what we think is a more complete definition of the market, and use that more complete definition to identify the segments of the market that we think have higher returns to offer for investors,” he says from the firm Sydney office, which overlooks Sydney Harbour.

It uses liquidity around index changes to implement its ideas, but sticks to a “participate, don’t initiate” philosophy.

While declining to talk about any specific clients, O’Reilly says big super funds or pension funds will often use Dimensional to get low-cost exposure to a specific segment of the market – like stocks trading with low prices relative to fundamentals, or companies that have high profitability and are of a certain size.

You can see how that may be helpful to big super fund CIOs who tend to invest on a three-year outlook. CIOs think and talk in buckets – “we want this, we have skewed the portfolio towards that”.

Dimensional also offers standard trusts and funds that are sold to Australians via financial advisers, some of which look more like souped-up index funds.

Its Australian Large Company Trust, for example, was founded in 2000, has $851.6 million in assets and charges 0.16 per cent in management fees and costs, according to its most recent disclosures. It owned 100 stocks at September 30, including BHP (9.75 per cent of the portfolio), Commonwealth Bank (9.61 per cent), CSL (5.69 per cent), National Australia Bank (4.67 per cent) and Westpac (4.35 per cent), and its performance is similar to the S&P/ASX 100’s total return in the past decade.

Given Dimensional’s focus on academic research and applying it to real-world portfolios, what about the hottest topic in financial market research this year: generative AI?

Surely if anyone could harness it, Dimensional and its 350-strong investment team would have the computing power and DNA to at least have a good shot. O’Reilly has a PhD in aeronautics and formerly ran the firm’s research division.

“I don’t think AI is going to be a massive game changer in helping people pick stocks or out-guess market prices,” he says.

“Old techniques on new data yield far more insights than new techniques on old data.

“So while there’s a big segment of academic research these days about using machine learning and AI on existing data sets, they provide far fewer insights because those data have been well tested already.”

O’Reilly says stock pickers will run into the same consistency, liquidity and scalability problems they’ve been battling for years, while index funds will continue to get tangled in their own rigidity.

Where AI should help is efficiency – coders will develop code faster, analysts will analyse data faster, traders will trade faster. That should lower the costs of running an asset manager and put more downward pressure on fees, O’Reilly says.

Dimensional already has plenty of proprietary data sets at its disposal, including daily pricing on millions of stocks and bonds linked to things like income statement and balance sheet data going back decades. He says AI is more “assisted implementation than artificial intelligence”.

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