

Evolution of Manager Research – our response to a changing environment

The search for skilled investment managers is edging ever higher up the agenda as investors look for new ways to boost investment returns and reduce risk. This search has led funds to diversify beyond traditional asset classes into a broad range of new and complex strategies that are frequently run by a new breed of investment management firms. As a result, picking the right manager for the task has never been more difficult than it is now.

Consultants have had to make huge strides to keep pace with these changes. Although manager research has always been a core service that we have offered to our clients, it has now grown into a large, globally integrated operation, increasingly staffed by specialists, and it is playing a larger role within investment consulting. As the emphasis on high quality manager research increases within investment strategy, we believe that few firms will have the necessary depth of resources, the global approach and the technology.

The pressure to provide better analysis of investment managers is coming from many different sides. In the past, the industry was dominated by investors who had relatively simple requirements based around multi-asset management, and on passive and active 'core' mandates. They typically made their selection from a small group of large, well-known institutional managers.

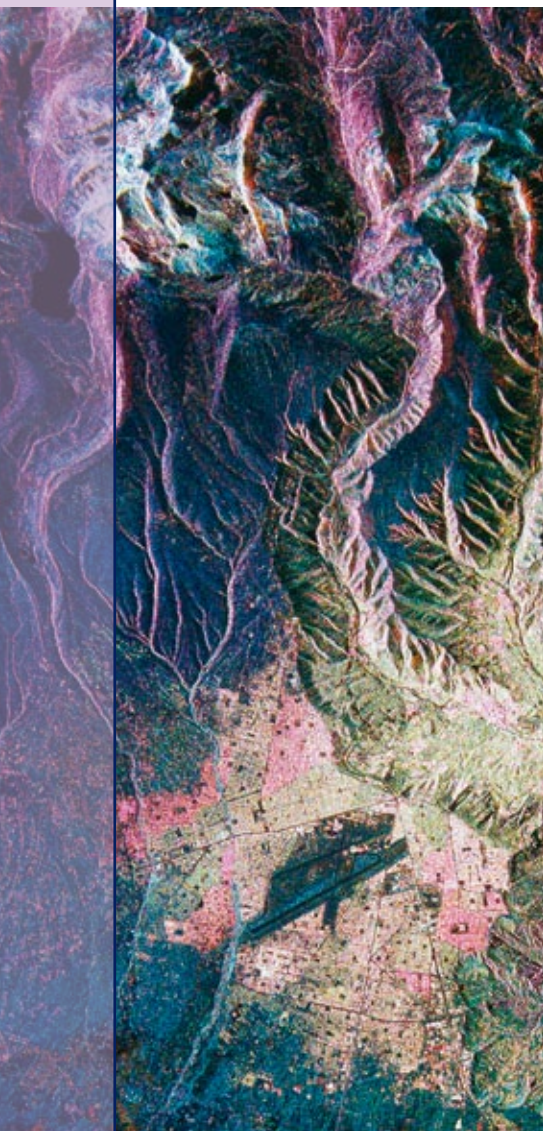
But these funds have grown more sophisticated in managing their risk/return profiles and are building more complex multi-manager structures. Demand for specialist managers has increased, as investors explore new and

complicated asset classes and niche strategies in pursuit of alpha. Many of these strategies are run by new managers, many of which are smaller organisations. In this more complex environment, fund fiduciaries are increasingly recognising that selecting managers is not an integral part of their job. So they are delegating more of the decisions to a trusted adviser.

The distinction between asset classes is increasingly blurred, with hedge funds becoming more institutionalised, with longer-term views and lock-ups that are more characteristic of private equity and with private equity investments becoming more opportunistic like hedge funds. Even the distinction between equity and debt is fading – are corporate bonds distressed equity or debt?

At the same time, upheavals in the investment management industry have put new pressures on manager research. Many of these changes are connected with the abrupt ending of the great bull market. The good times meant profitable businesses that attracted corporate acquirers. This, in turn, led to the dominance of large investment firms, and a focus on investment process and team management. But flatter markets have squeezed margins, destabilised businesses and led to staff contraction, resulting in many investors turning to niche firms – in the previous pages of this publication, many of the issues have been discussed in some detail.

Where do investment consultants fit into this changing landscape? The complexity of the task at hand has increased enormously, leading to the need for more dedicated resource than previously.



The old model is clearly no longer viable as the business has grown more complex and investors have become more ambitious. Whereas in the past we only covered the main asset classes, now the list grows longer every year. It now includes regional equity and bonds, emerging market and high-yield debt, long-short equity, private equity, real estate, commodities, swaps and options and more recently infrastructure and timber. We used to cover only the larger houses, now we cover thousands of organisations including funds of funds and retail as well as institutional managers. We cover all levels of risk, and continually try to find new manager names in the early stages of development.

The need to do in-depth research on managers and their strategies as they multiply has led us to take on professionals from many different financial disciplines, including fund managers and investment bankers, as well as actuaries and CFA Charterholders. We have become far more specialised as analysts. We have also enlisted quantitative experts capable of performing style and risk analysis on portfolios to enable us to ask more penetrating questions of managers.

An important part of the process has been to make our business more global. This is essential as investment managers operate out of multiple locations around the world. But a global business does not mean having people dotted around the world in different locations, all focusing on their own back yard. The business must be globally integrated so that researchers share their ideas and have access to the same information, and

follow one global process. This does not mean that everyone has to hold the same opinion. Lively debate is very much part of our process.

Given these new parameters, it is clear that developing and maintaining a top quality manager research operation has become a costly undertaking, which has required investment consultants to re-examine their business model. Some have chosen to develop their own funds of funds, an option we have decided not to adopt as we believe that our clients value our impartiality and independence. Where appropriate, we prefer to be paid a performance fee when we give the right advice.

Whichever way consultants are responding, the point is that the business of manager research has changed enormously over the past few years and will most likely have to change even more in the decade ahead. As we look to the future we see manager skill becoming a focal point of attention for the whole industry. We are increasingly committed to identifying that skill for our clients and harnessing it in the search for alpha.

