

## Multi-Manager Investment & Selection

The subject of manager selection has become a widely discussed topic of late as the ultimate objective is to achieve added value against the benchmark chosen. However before considering this topic, it is essential that you identify the long term objectives for the capital which is to be invested. This is normally our starting point so that we can determine the most appropriate asset classes and then, once we have chosen the amount of money to be invested into, say, managed funds and have determined the specific risk profile, income and liquidity needs of the client, we can then structure the investments accordingly.

One of the problems with fund manager selection is that over the last couple of years, many fund managers have underperformed the relevant benchmark. For example if a manager invested in UK equities, then that manager should be judged against the FT-SE All Share Index unless the manager is selecting larger company stocks in which case the FT-SE100 index may be more appropriate. However the problems of the past year or two has been the under performance of "mid cap" and "small cap"

stocks and the poor stock selection of a number of fund managers. Also the markets have been driven by liquidity and a relatively small number of sectors.

For example last year in the UK, it would have been necessary for the portfolio to have a high weighting in telecommunication, tobacco and certain other sectors and many managers would not have such a high weighting in these sectors. Therefore many tracker funds out performed active managers who have attempted to provide a lower risk by spreading the assets across shares in different sectors. Some managers may now contend that a tracker fund is high risk and even though it has performed well in the past, good active fund managers

should out perform the index over the longer term. However only a handful of managers have consistently achieved this and the lower charges of a tracker fund make outperforming even more difficult.

Therefore, by way of background, the last year or two has been a difficult one for the active fund management industry. If you are seeking to invest money for a UK resident client in a balanced portfolio, this will often have 55 percent to 60 percent in UK equities, 25 percent to 30 percent in

overseas equities and the balance of around 15 percent in cash and bonds.

It is therefore extremely important to ensure that the UK fund managers who are to be selected are likely to add value because the larger weighting will be UK stocks and overseas stocks.

If the money to be invested is relatively small, then many clients may be happy with a pooled fund from one particular investment house, recognising that you are buying the strengths and weaknesses of that house. For example, if one particular house is chosen as it has a good track record in UK equities, it is unlikely that the same house will also have excellent per-

formance in all overseas equity markets, such as the US, Japan, Europe and the Far East. This is why a number of clients have sought the benefit of a multi-manager approach so that you can select specialist UK managers to handle that

part of the portfolio, US specialist to handle the money to be invested in American shares and specialist managers in the other regions of the world. However careful selection is required from the

outset and monitoring is important to ensure that the managers chosen are likely to provide added value over the longer term.

This approach is normally carried though by selecting pooled funds within the various investment houses although



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there is nothing to stop a manager seeking out fund management houses which will manage money on a segregated basis. However there normally needs to be a significant fund size to warrant the extra costs of investing money on a segregated basis and many investment house tend to opt for pooled funds unless the money under management is at least £2 to £5m.

An alternative method of multi-manager selection is that instead of choosing managers for specific geographical areas, you could choose, say three investment management houses, each of which have significant strengths in the main geographical region (for example the UK) and in most of the other regions. You will therefore recognise that you are buying strength in most of the regions but that in some of the geographical areas, some of the managers will be a little weaker. However if the money to be allocated to those regions is relatively small, this may not have a great impact upon performance. You may also be able to negotiate lower charges by investing all the money with two or three fund management houses rather than spreading the money across a large number of companies. By giving each of the managers the same performance benchmark, you will be spreading the risk.

For example if you were to merely choose one manager and that manager underperformed significantly, then your portfolio will clearly suffer to that extent. However if you choose three managers, then an underperformance by one manager does not have the same dramatic effect.

**M**any multi-manager funds are set up in this way by choosing managers with different approaches to fund management. For example one manager may be a growth manager while another may be a value investor and a third could be a specialist in larger company stocks. In some cases, one manager may perform well in a particular market cycle while in other economic conditions, another manager may shine. Over the long term you would hope that the managers chosen will outperform the benchmark but by spreading the money between three managers, you can reduce volatility by this approach.

Whether you choose multi-managers for specific reasons or different managers with the same overall benchmark, it is important that you assess the performance of each of the managers chosen. I suggest that from the outset, that you discuss with the managers the composite benchmark for their fund. We have devised sophisticated software which can

very easily track the performance of a manager once you have set the benchmark.

We have found this agreement of the benchmark from the outset, the continuing monitoring of the manager and the agreement of the fund performance with that manager had added value for the client. Firstly the manager is clearly aware that the performance will be monitored. There is also no variance on the actual results or discussion about whether the manager has under or overperformed. This also tends to make the meetings with the client more meaningful as you have identified the performance results before the meeting and can then discuss the under or overperformance and the reasons for any significant variance.

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**T**axation is another matter to be taken into account. Pooled funds are now more tax efficient for UK resident clients. UK capital gains tax is only levied when an asset is sold and if a fund is run through an authorised unit trust or an open ended investment company, then the client will only suffer capital gains tax when the units are sold. Any purchase and sale of shares within the fund will not attract tax if carefully structured.

The effect of tax deferral is significant both in terms of the money saved over a period of time and also the way in which a manager approaches investment. A number of managers have been somewhat restricted by large inbuilt capital gains tax liabilities which they would not wish to realise.

The other benefit of the new capital gains tax regime is that tapering relief is available and over a period of ten years, the capital gains tax rate falls from 40% for a higher rate taxpayer to the basic rate which is now 23%. Therefore by holding units in a fund and selling the units after ten years, the tax rate is significantly reduced. In addition, the new rules relating to offshore trusts also make the use of pooled vehicles more attractive. As you can appreciate, the structuring selection and tax efficiency of a multi-manager fund needs to be carefully considered. However planning before the investments are made and careful monitoring throughout the investment period should create added value over the long-term.

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