BUYERS' MARKET

IN SEARCH OF FRESH BLOOD

Industry standards dictate that fund managers need to clock up three-year track records before being considered by investors, but how closely do you stick to this in your search for new talent? Which new kids on the block are you backing and how did you discover them?

BUYERS' VERDICTS

Wim Antoons

Portolani, Belgium

In our search for new managers and funds, we like to see a three-year track record and a minimum size of €50 million. We are, however, flexible in accepting new talent. When conducting due diligence, most of our focus is on the investment process and the factors used to select equities, and the portfolio construction. Through academic research, we know which factors work in the long run, such as valuation, size and quality. If we understand the process and factors used by a manager, we may allocate to a newly-created fund. For example, we recently invested in the **Montanaro Better World** fund that was launched last year. Our due diligence revealed that the manager relies on an academic-oriented process and uses the right factors to screen equities. Furthermore, the manager has experience in the management of European and UK smaller companies and showed the ability to create alpha in the long run. Investing in new funds remains challenging, but we are convinced that fund screening is too often based on past track records and not on the quality of the process.

Daniele Sironi

Compass AM, Switzerland

I have always believed that fund managers with a 'thinking-outside- the-box' approach are a good source of new ideas compared with those that have a more conventional approach. **Edoardo Matarrese**, who runs the **CompAM Active Equity Selection** fund, is a good example of an 'innovative thinker' in the European equities context. He combines distinctive ideas with a rigorous methodological approach in a crowded space within fund management.

Martin Stolker

ABN Amro Investment Solutions, Netherlands

An investment strategy can only be properly assessed if the team has experienced a complete investment cycle. In other words, if they have been through and thrived in both good and bad times. Investment cycles typically last far longer than three years.

We do not select any investment strategy to manage our clients' assets without 'proof of concept'. There simply is no substitute for a proven track record or for experience. Therefore, the three-year track record, often referred to as the 'industry standard', is unsuitable.

When investment strategies are relatively new we require a 'proxy' proven track record and investment experience within a similar approach or in another asset class, at a minimum.

Our business model allows us not only to select external managers with a proven open-ended fund range, but also to onboard new managers in a sub-advisory mode. We engage with our managers on specific topics such as alpha extraction and ESG.

Our sub-advisory platform is including more and more boutique managers relying upon the proven expertise of investment professionals who started their own firms or joined smaller structures. Some examples of those boutiques are **Aristotle Capital**, founded in 2011 – and in sub-advisory with us since 2013 – or more recently **Liontrust Asset Management** on the sustainable side.

Paolo Terzi
Emil Banca, Italy

Generally, we look for a strong and consistent track record over a long period of time, normally a minimum of three years. This amount of time allows us to conduct a full and complete analysis of fund manager behaviour on several fronts, such as how they react to unexpected changes in market environment and how much they actively manage their portfolio. However, at the same time, we do try to identify opportunities that may come up with new funds. Firstly, we look at the quality of the asset management company they work for. We strongly believe that a firm with global research, trading platforms, a solid investment process, and broad and experienced analysts will help improve any manager’s skills, but particularly younger ones.

Another point we take into consideration is the type of investment strategy they run, so we try to deepen our understanding of their investment philosophy through bespoke articles, conference calls and workshops. We are presently conducting due diligence on the **T Rowe Price Emerging Market Corporate Bond** fund, managed by **Samy Muaddi**. He recently passed the three-year threshold and we like his risk-aware investment approach resulting in a fund with strong information and Sharpe ratio data. Since its launch on 30 September 2015, the strategy has outperformed its benchmark and this is reflected in solid peer group rankings. We have also recently started to back **Maria Municchi** who manages the **M&G Sustainable Allocation** fund in order to follow her approach to sustainable investment in the multi-asset category.

Thierry Crovetto
TC Stratégie Financière, Monaco

Most selectors are constrained by a minimum three-year track record and AUM of at least €100 million for a fund to be included in their investment universe. We tend to be more flexible in these rules and apply them either to a fund or to a fund manager who has implemented the same strategy for another company or fund, sometimes non-Ucits.

Sticking too strictly to selection rules can be counterproductive. The first potential danger is the risk of missing out on exceptional funds and managers or taking them into consideration when it is too late, and the fund has closed. This can happen when too large a size may prevent the fund from implementing its strategy freely without the risk of running into liquidity or market-pricing issues.

We use quantitative screening as the first step of our fund-selection process to avoid emotional biases. Our model considers risk-adjusted return ratios and the convexity of returns, placing more weight on the recent past, while favouring funds with a long track record. Thus, a strategy with less than a three-year track record has to be excellent to be considered. Furthermore, we may choose to apply the above screening process to other funds and/or fund managers when we deem their strategy to be close enough to the current one.

Once a fund has met our quantitative screening requirements it is then submitted to a more specific analysis including a conference-call with managers.

By applying the above fund-screening techniques, we have identified the following funds/fund managers early enough so they are still open for underwriting: **Ethan Johnson**, manager of the **Ramius Merger Arbitrage Ucits** fund; **Laurent Kenigswald**, who runs the **Butler Credit Opportunities** fund, which closed to new investors before its third year; **Damien Buchet**, manager of the **Finisterre Unconstrained Emerging Fixed Income** fund; and **Mike Pingerra**, who runs the **Sanlam Real Estate** fund, a carve-out of one of the strategies used in another fund.

Edward Heath-Thompson
Coutts, UK

Coutts has a fluid approach to manager track records. For example if an experienced manager joins another firm to run the same strategy we would be happy to invest on day one if we believe other investors will follow. We take advantage of the fact that some other firms stick rigidly to the three-year rule by negotiating keen terms for our investment at the initial stage.

We often use our industry contacts to highlight rising stars in the fund management industry. We find it particularly interesting when managers are promoted from within. When you get a large asset manager with the resources to hire experienced professionals, which instead backs internal young talent, this is usually a strong signal.

We recently met with **Mike Totton** from Majedie whom has just become co-manager on the **Majedie UK Focus** fund. He came across as someone with a bright future. **Matt Tonge** and **Victoria Stevens** who run the **Liontrust Micro Cap** fund have also impressed me.

Erik Aalbers
Forza Asset Management, Netherlands

Track record is one of the variables we look at when selecting fund managers. Although a long, preferably consistent record is important, we are able to select managers with a short or even no track record. In those situations the reputation of the manager, his or her previous track record – if there is one – and whether the strategy fulfils a specific need in our portfolios that cannot be achieved via another fund, is more important. This mostly happens when selecting thematic funds such as the **BNY Mellon Mobility**

Innovation fund, which will be part of our allocation. In our due diligence we try to find out where the catalysts for the strategy are to ensure we are not just dealing with hype. In these situations the process, risk management and portfolio construction are key considerations.

Jurijs Gnusins
Allianz Global Investors Europe, Germany

On the advisory side it is key to select a manager with a proven, long-term track record of success. More importantly, you need to assess how this record may have been affected by macro trends, style or a particular strategy bias and to distinguish between the effects the manager has no control over and idiosyncratic manager skill.

It is also essential to build an opinion on the relevance of the past track record to the current market environment. This implies that, usually, we apply a three-year track record as a minimum criteria. However, while analysing a manager, we consider both the track record of the manager at the current company/in the current fund vehicle and also their performance at previous firms. A typical exemption from the three-year minimum criteria could be a new fund managed by the same portfolio manager/team with the same process, but with a different risk budget, or applying some additional restrictions such as ESG or regulatory constraints.

Discovering up-and-coming managers is an essential part of our manager research process. Rather than relying on luck, we base our analysis on an established, well-structured process. This involves sourcing new talent via different markets. For example, a successful US or offshore strategy might be successful in a Ucits format as well. We also extend our search via conferences, industry networking, prime broker contacts and database screening. Our experience has shown that a manager research model with intensive collaboration and idea-sharing across research teams is the most successful way to identify new, undiscovered talent.

We’ve been very active in the alternative risk premia space and supported a manager with a track record of less than three years within his new fund vehicle. Our due diligence has shown that the new fund taps into the same successful investment process and infrastructure of a general strategy and we were convinced the manager would continue to be successful in a slightly different set-up. Another example is an event-driven manager, who moved to another company while keeping the same investment philosophy and process.

Guilherme Cardoso
Millennium bcp, Portugal

Vehicle, strategy and manager track records play an essential role in our selection process. Our decision on how long the track record has to be is a function not only of the asset class of the fund but also the amount we plan to invest and the nature of the period during which that track record occurred. In other words, it’s really important for us to be able to understand how a strategy performs in different regimes and sometimes, a three-year period is not enough to form an opinion.

Therefore, we tend to be on the more conservative side of the required track record period but we don’t consider three years as a definitive rule.

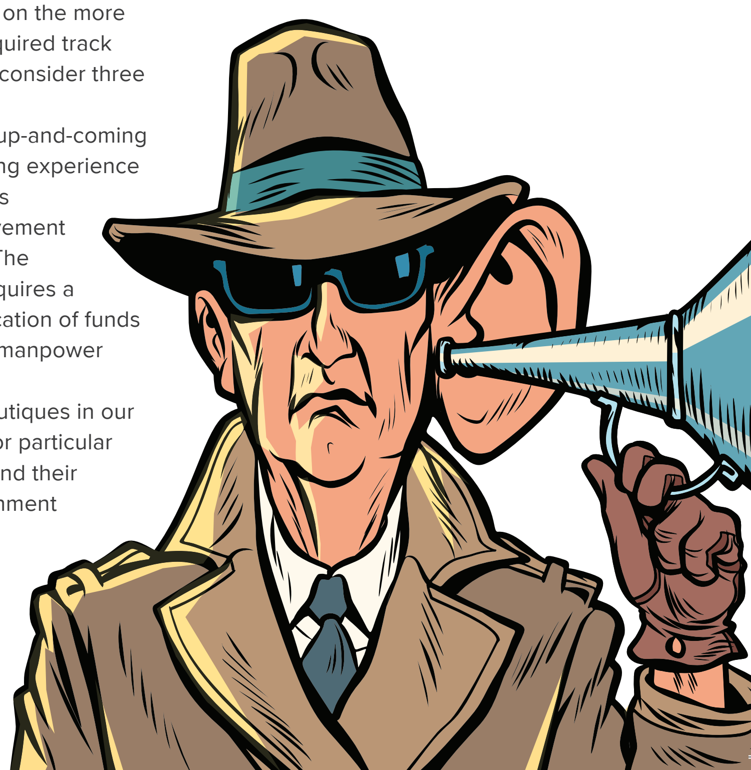
Investing successfully in up-and-coming managers is a very rewarding experience for fund selectors as there is definitively a level of achievement when it goes successfully. The problem is that doing so requires a significantly larger diversification of funds and that consumes a lot of manpower which is a rare commodity.

We often favour small boutiques in our search for new managers for particular assets classes as we’ve found their specialised nature and alignment of interests works well. The level of service is often better too.

Benoît Ruelle
Degroof Petercam, Belgium

We do not have a hard rule requiring a three-year track record but some sort of valid track record is necessary to assess the quality of a manager. One of the key steps of our manager selection process is the peer-group comparison, we therefore ideally aim to also compare their track records. However, we are very open to the origin of these track records which could stem from the same long-standing fund, segregated accounts, mandates or different vehicles at different asset management companies. As we typically invest in mainstream asset classes, we have a choice between many managers who can already show a three-year track record.

Never say never, of course, but it would be very difficult for us to entrust money to a manager who cannot show any track record. The only situation I can see where we would invest with a newcomer would be if a new thematic pops up where we would like exposure. In practice however, we have never invested with a new-to-the-scene manager before.



SPOTLIGHT ON SELECTORS' PICKS

In their search for new talent, T. Rowe Price's Samy Muaddi (pictured) was one of the rising stars mentioned by our selector panel.

Muaddi runs several emerging market corporate bond funds and received a Citywire A rating soon after reaching his three-year track record. Paolo Terzi from Emil Banca highlighted the manager for his strong investment approach.

Elsewhere in the EMD realm, Damien Buchet was named as running one of the newest strategies to watch. The former head of EMD at Axa IM stepped down in summer 2015 to launch a total return fund at UK boutique Finisterre Capital.

Thematic funds are a hothouse for undiscovered talent, according to this month's selectors, and BNY Mellon Mobility Innovation is one of the stand-out strategies in this space, says Erik Aalbers from Forza AM.

Citywire Verdict

Jessica Beard, Deputy Editor

The fear of the unknown often favours the familiar and proven above the new and uncharted. Investors are no exception when it comes to this behavioural bias.

The industry has long placed a hard rule on managers clocking up three-year track records before they can be considered for investment but this can steer fund selectors away from the hottest up-and-coming talent the market has to offer.

So, how firmly should a professional fund buyer stick to this widely-held rule of fund picking? Martin Stolker, head of fund selection at ABN Amro, says the rule itself needs to be much tougher. In his view, three years isn't long enough as you can't properly assess an investment strategy if the team hasn't experienced a complete investment cycle, which typically covers a longer timeframe. Nevertheless, he is prepared to relax these guidelines in the case of buying into new or boutique managers on a sub-advisory basis.

Thierry Crovetto from TC Stratégie Financière runs with this point and says it's important to be flexible as too strict an approach can be counterproductive. The way to ensure you don't miss out on exceptional fund managers and spot talent early is to first screen the manager and fund from a quant perspective before subjecting them to a round of conference calls, he says.

One of the most common areas where selectors cut themselves a little more slack was thematics, as these strategies tend to operate off the beaten track by their very nature.

Selectors' favoured funds

FUND	MANAGER	CITYWIRE RATING
BNY Mellon Mobility Innovation	Sean P. Fitzgibbon	n/a
Butler Credit Opportunities	Walter Butler, Laurent Kenigswald, Olivier de Parcevaux, Cyril Furtak	n/a
CompAM Fund - Active Equity Selection	Edoardo Matarrese, Roberto Condulmari	CITYWIRE A
Finisterre Unconstrained Emerging Fixed Income	Damien Buchet	n/a
Liontrust Micro Cap	Matt Tonge, Victoria Stevens	CITYWIRE AAA
M&G Sustainable Allocation	Maria Municchi	n/a
Majedie UK Focus	Mike Totton	n/a
Montanaro Better World	Charles Montanaro	CITYWIRE AA
Ramius Merger Arbitrage Ucits	Ethan Johnson	n/a
Sanlam Real Estate	Mike Pingerra	n/a
T Rowe Price Emerging Market Corporate Bond	Samy Muaddi	CITYWIRE A