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Ten (or so) questions to ask a fund manager

Discovering why poor performers remain in portfolios and uncovering managers' real - as opposed to stated - investment objectives can give advisers an edge on fund due diligence, writes Graham O'Neill...

Fund managers' meetings are key to the fund review process. Not only do they increase understanding of the fund and how it operates, but they also provide the opportunity to ask the questions you want answers to - not just the ones the fund managers want to answer.
In our view, preparing for these meetings is as important as the meeting itself - ensuring that we ask relevant and timely questions focussing on the areas that we see as important. In this article, we highlight some key areas to cover.

So, you took a 'gap year'?

Getting an understanding of the manager's career background is very important. Ask why they were attracted to the fund management industry and what roles they have had previously.

Great up front, dodgy at the back

As well as looking at the performance record of the lead manager of the fund, find out what records other team members have established. All this helps with an understanding of the fund manager's style and motivations, and will also show whether the manager has a real passion for the job.
It is also important to find out what other responsibilities the manager has, as if they are overloaded with other funds, their time devoted to this one will be limited.

Under the skin

Asking what the manager thinks they can achieve with the portfolio they manage will uncover the real investment objective of the fund which could actually be quite different from a lot of its peers.

Stuck in the mud

Liquidity issues can impact on a fund's performance, especially if it invests in smaller companies or less liquid markets. You need to ascertain not only the size of the fund, but also the total amount run in the strategy - if the UCIT is small, but the total amount of AUM in the strategy is large the advantage of nimbleness may not be there.

Spotting weaknesses

When considering performance, it's necessary to see the longer term strategy on a discrete year basis. This will help to identify if the manager has a strong style bias, or if particular market or economic conditions suit the way money is managed.

It will also demonstrate whether outperformance has been generated on a consistent basis, or just through one or two particularly strong years, which in turn will help you to understand when the fund might struggle.

The use of currency hedging is also important as this could make performance seem much better or worse than would otherwise be the case.

Who's doing what?

Looking at the investment process, it is important to understand how responsibilities in the team are divided, and how this fits with research and portfolio construction.

Find out if macro analysis is included in the process, or if it is purely bottom up. Ask how long the process has been in place as this will demonstrate if it is tried and tested through an economic cycle.

What can you see that others can't?

Finding out what a manager is trying to achieve is important to know - targeted alpha can vary between country/sector, or bottom up stock selection.

When looking at individual companies, find out what the manager looks for and what they consider important - it is also useful to know what a manager's sell discipline is, as many fund managers find selling harder than buying.

Some portfolio managers are prepared to hold cash and use it as an asset allocation tool, whereas other managers are prepared to be fully invested. Ask what they think their competitive edge is.

Maximum risk

Risk management should be discussed - both formal and informal systems. There can be controls at country, sector, stock or market capitalisation levels, or it could be an unconstrained mandate.
Whether managers use or rely on tracking error or Var (Value at risk) is also important to find out. Investors can do a common sense check by looking at minimum/maximum stock positions or seeing if leverage is used in portfolio construction.

What is it about Tesco?

We like to focus on a manager's current strategy and the types of positions held in the portfolio and we then check that these fit within the process described. It is also interesting to look at whether the fund's worst performers over the last 12 months are still held, and if so, why.

Why so busy?

The final thing to consider is fund turnover. Turnover costs money, but some managers are able to implement trading strategies successfully.

If turnover shoots up at a time when a manager is underperforming, it can be a warning sign that there is a lack of conviction in decisions made and can be a pre-cursor to further underperformance.

www.professionaladviser.com 10 September 2015