



They do it with mirrors – part 1

Steve Delo, independent trustee of the year

Sixty years ago, Agatha Christie wrote a novel called *They Do it With Mirrors*. It featured Miss Marple solving a murder mystery in a reform school, where nothing was what it purported to be. Active investment management is rather similar!

A trustee recently asked me how to select a successful active investment manager. I told him that the start point should be a proper understanding of how an investment management business works. It comes down to an equation with three core parts:

A SUCCESSFUL INVESTMENT BUSINESS = TRACK RECORD + SKILL + STORY

Track record: all fund managers want an attractive track record to demonstrate added value over the time frames trustees are worried about.

Skill is an all-encompassing term describing whatever it is within an investment management organisation that gives it the ability to deliver attractive returns in the

future. Skill may come from strong leadership at the top, talented individuals at the coal-face, from the application of clever quant models, from some ethereal personal market intuition, or something else altogether.

Story is the investment management organisation's message. Through a combination of creative marketing skill and salesmanship an attractive image is created to make a fund management proposition a compelling "must have." It will be a tale of vision, passion, talent, perception, economic insight, market foresight, organisational and team dynamics, educational credentials, corporate culture, incentive plans, ownership structures etc that the manager claims makes it different and creates the platform for adding value.

With the combination of these three factors – good track record, high levels of skill and a compelling story – a fund management business is likely to be successful and win new clients.

This leads to the "doing it with mirrors" problem. One can just as easily create a

successful fund management business with only two of the factors, namely track record + story.

Gulp! That means you don't need...skill?! It is sad but true. With the combination of a good track record and a compelling story, you can pull in just as much business. Much of what happens in fund management, certainly over the shorter term, is down to random effects. As I have said before in this column, the shorter term is longer than you think – probably years for active equity management. You can therefore find yourself with a positive track record without applying any skill whatsoever.

This is the nucleus of the active manager selection problem. From the trustee's point of view, an asset manager that has built its business on three factors will look no different to one built on two factors. Yet repeatability will depend upon skill. The active manager selection process boils down to separating the three-factor asset managers from the two-factor managers. More next time! ■