

EYE ON THE MARKET

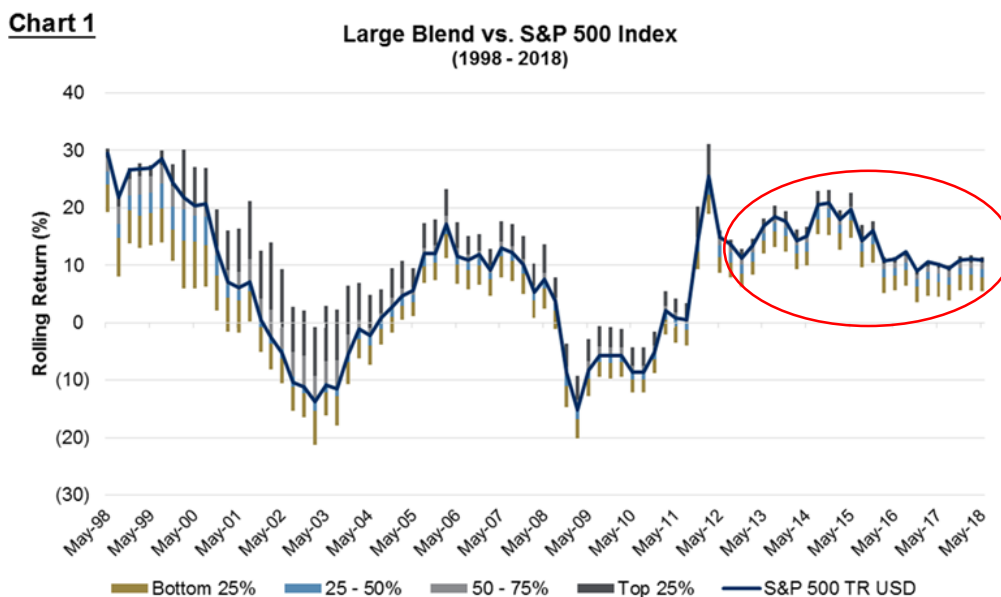
Manager Selection: People, Process, and more

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After nearly twenty years of following a wide range of investment strategies, Eye on the Market (“EotM”) has identified several key considerations to make when gauging the success of investment managers. Considerations affecting the net performance of a strategy are both qualitative and quantitative in nature, including a detailed review of the portfolio managers, the investment philosophy and process behind the strategy, and all expenses incurred by the investor.

JUST CAN’T GET ENOUGH

Over the last few years, significant inflows have been made to passive strategies with the belief that active managers cannot outperform the broad market after fees. To date, passive strategies have enjoyed outperformance relative to their active counterparts across many major asset classes. Chart 1 shows that the S&P 500 Index (horizontal line) has outperformed most of the managers in Morningstar’s Large Blend Category (vertical bars). Other categories mirror this trend¹.



Source: Morningstar Direct and Raymond James. All data is as of May 31, 2018.

¹An index cannot be invested in directly, and investing in passive strategies is not without risk.

While investing in passive strategies has been advantageous for investors, the trend is likely to shift at some point, as is has in previous cycles. Despite positive sales trends in passive strategies, there can be too much of a good thing.

PEOPLE ARE PEOPLE

Benjamin Graham, Peter Lynch, and Sir John Templeton earned their stripes as prominent investors over the years by demonstrating similar investment disciplines. Each developed their own unique investment process and stuck to that process, almost unwaveringly over time. In turn, this led to significant return generation for investors over the long run. Using this as a backdrop, EotM will share several key tenets applied in the manager selection process for the Mutual Fund Research (“MFR”) group at Raymond James.

A) People: Consideration of who is managing the strategy. Important questions to ask include:

- How long have the members of the team worked together?
- What are each individual’s responsibilities in the management process?
- Who has ultimate authority over making final investment decisions?

B) Philosophy: Analysts and investors needs to understand what the management team’s investment approach is:

- Does the investment manager believe in taking a contrarian approach or does it follow the prevailing trends?
- Will the manager deviate from the philosophy if deemed appropriate, or remain steadfast?
- What is the manager’s view on risk mitigation?

By developing an appreciation for a manager’s vision, the investor can determine whether it is in line with her own.

C) Process: EotM spends most of its time ensuring that the investment manager’s process follows its philosophy. For example, if a manager follows a growth-oriented approach, an investor should ask questions around how the manager views growth. Is growth tied to reported and estimated earnings, free cash flow, and/or momentum? It is important to know how securities are selected for purchase, and equally as important to understand when the manager will sell. There is no single correct answer to these.

D) Price: Investors should be vigilant in making sure that they are paying for competitive net returns. Some performance data will report the total return generated by a strategy prior to expenses being deducted (referred to as the gross return). While this return may appear to be competitive, investors must account for the fees associated with the strategy. A returns that is net of fees (also referred to as net return) is a more accurate measure of performance and can help determine whether an investor can meet his goals and objectives.

E) Performance: EotM views performance as the aggregate result of the people, philosophy, process, and price. It is when these variables are implemented in a patient and methodical manner that an investor is more likely to experience a favorable outcome.

ENJOY THE SILENCE

Despite the struggles that many active managers have faced relative to passive approaches, there are managers that have successfully demonstrated an ability to generate attractive results. MFR uses the five tenets outlined above in selecting and monitoring the funds on the Highly Recommended List. Over time, this approach has been successful but it requires time and patience.

EotM believes that investors should seek out portfolio managers and strategies that have the ability to let their best ideas become a meaningful portion of the portfolio. Managers who can invest across different sectors and industries are able to focus on those companies that have the most favorable attributes. Many times, this flexibility results in a portfolio of securities that does not mirror the broad market, but that is okay. The purpose is to outperform the index, not replicate it.

The following table highlights strategies that MFR currently assigns a Highly Recommended Rating to or views favorably. Each manager takes a differentiated approach and has demonstrated an ability to execute its philosophy during different market cycles.

Chart 2

Return and Risk Statistics for Funds Referenced in the Report											
Highly Recommended Funds	Ticker	Inception Date	Total Return			Sharpe Ratio			Maximum Drawdown		
			1 Year	3 Year	5 Year	1 Year	3 Year	5 Year	1 Year	3 Year	5 Year
Baron Emerging Markets Institutional	BEXIX	12/31/2010	14.02	6.48	6.92	1.12	0.48	0.56	(8.87)	(20.89)	(21.74)
ClearBridge Aggressive Growth I	SAGYX	1/30/1996	10.21	4.32	10.30	0.80	0.33	0.82	(7.20)	(17.07)	(17.07)
JPMorgan Value Advantage L	JVAIX	2/28/2005	9.19	6.96	10.12	0.85	0.64	0.98	(6.67)	(11.61)	(11.61)
Other Funds to Consider											
Alger Small Cap Focus I	AOFIX	3/3/2008	36.39	17.91	16.02	2.73	1.13	1.09	(1.90)	(20.33)	(20.33)
Morgan Stanley Inst International Opp I	MIOIX	3/31/2010	32.07	18.70	18.95	2.49	1.29	1.42	(3.07)	(10.95)	(10.95)
S&P 500 TR USD		9/11/1989	14.38	10.97	12.98	1.44	1.00	1.25	(6.13)	(8.36)	(8.36)
MSCI EAFE PR USD		12/31/1969	5.09	1.51	3.13	0.43	0.13	0.28	(7.75)	(17.95)	(20.99)

Source: Morningstar Direct. All data is as of May 31, 2018, and the information above reflects either the institutional or wrap-based share class. The Sharpe ratio is a measure of a Fund's reward per unit of risk. The higher the Sharpe ratio, the better the portfolio's risk-adjusted performance. Maximum drawdown measures the peak-to-trough decline during a specific period of time.

SIDE NOTE

Depeche Mode released its first studio album, *Speak & Spell*, in 1981. Since that time it has released 14 studio albums with the most recent being in 2017. The band's success stems from their ability to write music that people like. Fortunately for the group, fans have favored listening to their music over enjoying the silence.