



## **MONEY MARKETING MULTI-MANAGEMENT SURVEY**

**23 July 2009**

### **COST EFFECTIVE ACCESS TO PROFESSIONAL PORTFOLIO MANAGEMENT SERVICES**

*To maximise the benefit of diversification, a value-add of multi-managers, accurate asset class return assumptions and manager selection are key, writes Melville du Plessis, Senior Investment Analyst at Novare Investments*

In line with international trends, South African multi-managers have seen strong growth over recent years, enjoying widespread acceptance among investors to become an established part of the fund management industry.

Multi-managers experienced double-digit growth in assets under management between 2003 and 2007 and managed to hold their own in 2008 when international peers saw outflows coupled with severe market losses.

However investors remain hesitant to allocate money to higher risk mandates with the majority of discretionary flows going towards conservative, fixed income and cash portfolios so far this year. This is worrying given the high reinvestment risk in fixed income and cash as well as the fact that buying opportunities in equity markets don't present themselves often. By not allocating capital to more risky asset classes investors have sacrificed potential long-term performance.

#### **Diversification**

One of the advantages of multi-manager portfolios is diversification which is sought amongst asset classes, investment styles and managers. However truly maximising diversification benefits within a portfolio context requires careful thought.

Consider the “dotcom bubble” in the early 2000s when large losses were suffered in the technology and Internet sector. Investors vowed to never again put all of their eggs in one basket. It seemed that diversification was the route to superior results and investors proceeded to include a variety of alternative and diversified assets, assuming these asset were uncorrelated and that their portfolios were becoming incrementally less risky. Rising asset values reinforced this impression.

One of the problems was that the quantum of total risky assets in portfolios increased. Investors were structurally overweight and more exposed to risky asset classes. This overexposure was not identified as a significant risk because of the belief that if some asset classes performed poorly, other uncorrelated allocations would protect the portfolio.

As housing market problems started to surface in the US in 2007, problems spread very quickly to other areas of financial markets around the globe. The bursting of the bubble this time around was quite different to the IT-related incident in the early 2000's as the contagion was felt in most asset classes with few pockets left unscathed. The global marketplace has grown increasingly integrated due to technological and information advancements and portfolio values were driven sharply lower as “diversification insurance” failed to deliver.

It remains true that successful diversification among asset classes, investment styles and managers is a key value-add of multi managers and the aforementioned events highlight the need for a considered approach when constructing portfolios. Investment managers may want to revisit their asset class return (and correlation!) assumptions which are a key determinant of portfolio positioning.

### **Manager selection**

Like its cosmic counterpart, the investment universe is expanding at a rapid pace. At the end of March 2009 there were 891 unit trusts available to South African investors, more than double the number of stocks listed on the JSE. This leads to difficulty when making decisions among available options, with a second level of complexity introduced when considering how to optimally blend a number of selected managers.

Debate still rages around the true skill of investment managers as evidence frequently surfacing which suggests that the majority of managers fail to outperform passive benchmarks over the longer term. It is almost impossible to discern between luck and skill when evaluating only short-term performance and difficulties increase by way of the fact that

there are structural anomalies in datasets that must be taken into consideration when assessing manager skill.

Another layer of complication is that a manager's particular skill-set may only deliver superior results in certain market conditions. A manager specialising in a specific style may suffer significant underperformance for an extended period due to his niche being out of favour. In extreme cases certain styles of management can remain out of favour indefinitely.

These complexities support the view that investment manager selection should be delegated to specialists looking to identify the best managers of the future. Demand for multi-management solutions has been strong from smaller pension funds and individuals without the resources needed to undertake portfolio management on a daily basis.

Multi-managers are a cost-effective way of accessing professional portfolio management services including manager due diligence, asset allocation, risk management and administration. In addition, investors benefit from the lower fees multi-managers are able to negotiate with underlying managers.

Ends