STANLIB Multi-Manager
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Focused Investing
STANLIB

The role of the multi-manager in South Africa

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Many debates in the investment industry focus on esoteric criticisms of opposing views that get lost in translation for the lay person, leaving them no better informed when the dust has settled. One of these debates revolves around the advantages versus costs of using a multi-manager.

I believe that having an honest and sober debate around the many different ways of investing will help to inform the investing public and increase the level of trust needed when making long term commitments with their hard earned money.

Cost vs benefit
Investment professionals are often critical of intermediaries, believing that there is no value to be added along the value chain from investor to investment. This is very short sighted. Intermediaries exist because there is a dire need for their added value. When the need for them dries up, the intermediaries tend to disappear. Investing is a very complicated business. Information asymmetry is very high and the products and services offered are anything but simple commodities. This is why the investment industry is amongst the most intermediated, and this is generally a very good thing.

The investment landscape is full of complex instruments in which investors can invest. Investors can choose to make their own investment decisions. However, many have little to no knowledge of where to begin, and an intermediary can be critical to the success of meeting their investment aspirations.

It is always interesting to see an investor who is a master of his own occupation, argue as to why his services should be used, and then not share this consistent thinking when it comes to investing. In other words, he feels that he can make these decisions himself. In behavioural psychology, we call this cognitive dissonance i.e. holding two conflicting ideas at the same time and believing them both to be true.

When I want work done on my house, I call in an electrician, or a plumber, or a tiler. I'm none of the above and respect the work done by these professionals. It is easy to make this decision because the quality of the function performed is fairly simple to evaluate. In statistics we would talk about this function having a very strong signal to noise ratio.

In investments however, the signal to noise ratio is really small, meaning that any signal of skill is completely lost in the noise of the markets, especially over short time frames. In the absence of a clear signal, investors turn to any signal, even if it is completely irrelevant.

Minimising the noise
We would never claim a football captain was unskilled after calling "heads" before the match, if the coin ended up producing "tails". In the face of uncertain capital markets, skilled investment professionals craft investment strategies so as to maximise the chance of achieving the required outcome, not guaranteeing it. They focus on what they can control and influence and "ignore" the "noise" of the market. They look through the noise and don't focus on acting or reacting to every move the market makes.

Multi-manager as an intermediary
This is where multi-managers and other intermediaries can play a critical role in the investment value chain. Investors need guidance on how to craft an investment strategy, given their specific preferences and needs. Financial advisors can assist in understanding these and translating them into investment products and services.

I think an adviser function is correctly focused on the investor, as this is their core skill. They will then look to other industry players to assist with the non-client-facing function of surveying the landscape, performing due diligences, and crafting products and services to meet specific requirements.

This is where multi-managers can add tremendous value. For example, we spend in excess of 600 man hours per year engaging with asset managers. We then spend three times that amount of time analysing and debating these managers and the products and services they offer. Clearly this would be difficult to achieve for a financial advisor who needs to spend time with his customers, understanding their needs and crafting their strategies.

Financial advisors and individual investors may of course choose to do this themselves. I could choose to fix my electrical problems myself, but it would be wrong to assume that this will cost me less in the long run.

Our investment process
We have a saying that you pay one layer of fees (to us as multi-managers) for five layers of service.

We begin by understanding the investment objectives of the product or service that we are commissioned to create. We work with consultants and financial advisors who know exactly what their customers need.
We then consider the strategic asset allocation needed to achieve these objectives. Most people are aware of the importance of the asset allocation decision, which generally dwarfs most other decisions over long time frames.

We also survey the asset management landscape and research as much of it as we can. This includes due diligence questionnaires, qualitative and quantitative evaluation of manager performance and of their philosophy and process, and investment and operational due diligence meetings, including site visits.

These three inputs - investment objectives, asset allocation, and manager research - can then be combined by a multi-manager into a portfolio through our portfolio construction process, which focuses on maximising the chance of meeting the investment objectives.

The portfolio is then managed by our portfolio managers and reviewed by a broader investment team, ensuring that all the individual components behave as they were designed to, and changed as necessary. An example of this is tactical asset allocation, where we can make minor adjustments to the strategic asset allocation based on various views that we glean from the markets in general and our multiple managers specifically.

Additional diversification
Multi-managers have the advantage of using diversification at the manager level. Single-managers will diversify a portfolio by including many different shares with varying exposures to a multitude of economically sensitive variables. However, their valuations are all exposed to the same assumptions, models and thinking (collectively referred to as philosophy and process). By combining multiple asset managers, you get somewhat independent philosophy and process, diversifying a single manager's view.

We believe that as multi-managers, we are an important component in the value chain of investment professionals that dedicate our working lives to helping our customers build and protect their wealth.

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