20 CITYWIRE YEARS OF FUND SELECTION

As Citywire celebrates 20 years of business, we speak to the seasoned selectors who have two decades of fund buying under their belts. As a profession that truly took off in the 1990s, here are the stories from some of the industry's pioneers

'More assets mean more restrictions'

Thomas Romig

Head of multi-asset portfolio management, Assenagon

I started out in fund selection in 2000, so it's almost been 20 years. A key takeaway for me during that time is the fact that there are always new trends being promoted. The introduction of Ucits was one of the major achievements we have seen on the European side, and that has helped the industry to be flexible at a time when our English counterparts were still relying on the Oeics for part of their fund range.

The Ucits format meant regulation was more or less unified. However, despite this particular success, selectors should be wary of running after every new trend. When it comes to 'superfunds', 130/30 and quant, for example, it's a good idea to stand back for perhaps as long as four years to see if these products really have a better risk/return ratio.

Moving on to my experience of teams, the largest group I worked with was at Union Investment, where I had a team of 12. We had a lot of product lines and more to do around due diligence and marketing. But if you were to ask me for the ideal team size, I'd say between four and nine people.

The larger team at Union worked because the people were skilled and focused, and in this sense it's more about quality than quantity. A good team is one where people are free to act independently but still work together.

You can have a big problem if you have a team of five, for example, and everyone acts like they are king. It is important to have a wide perspective on investment rather than just focusing on the money you can make. The amount of money you oversee also has a big effect on how you invest. The bigger your responsibility in terms of assets, the more restrictions you have. If you oversee €200 million and want to allocate 1%, then you need to find something that can absorb €2 million. You are then looking at €2 billion strategies or those north of €1 billion.

The sweet spot for a normal all-cap equity strategy is €500-800 million, because you have maximum flexibility. If you go bigger you lose this ability to invest in the small or mid-cap area.

'AMs could tailor data more effectively'

Jörg Schmidt

Head of Manager Selection, Union Investment

The universe of funds has expanded significantly. Also, the breadth of strategies has increased: just think about the alternative Ucits space or the rise of ESG approaches. This has led to more complexity in screening techniques to identify any alpha beyond multiple layers of traditional and alternative betas. In addition, fund managers are now much better-prepared for due diligence activities than 15 years ago. The sophistication of our quantitative and qualitative research tools has massively improved over the last few years. For example, we recently created an internal ESG screening database which uses a large set of ESG data fields of more than 33,000 different fund share classes. This allows us to combine our proprietary alpha filters with ESG data. Access to large amounts of data in several categories and its systematic integration has become a key part of this assessment. Fund companies could improve on this process by becoming more flexible in the way they deliver specific data sets the selector has designed and asked for.

‘Fund selection is like riding a bike, you never forget it’

Sandrine Vincelot

Head of fund selection, Vega IM

At the end of 1996, the boss at Vega was full of new ideas and said there’s something emerging called a fund of funds. So we created the first fund of funds in October that year. In France there were two companies running one, Vega and Banque du Louvre. At the time I put in place a selection process which continues to develop to this day.

After three years of working in another part of the business, Marc Riez, the director general of Vega, asked me to re-join the selection team. Fund selection is like riding a bike, you never forget it and luckily I had followed all the evolution. It has developed throughout the years and there are 15 of us on the selection team at Vega. However, the heart of the process hasn’t changed. The profession was really created in the 1990s so it’s been interesting to be a pioneer, approaching asset managers and saying: ‘I would like to meet you because I am also a manager and I’m thinking of buying your fund.’ That never used to happen so it was nice to get the ball rolling. Our expertise has grown and asset management firms now recognise the profession.

When we talk about the progression over the last 20 years, our role has clearly been professionalised. On a more negative point however, investors have become more critical of funds of funds. Assets in these products grew strongly but from 2007/2008 onwards clients started to say that the fees were piling up and things weren’t as clear.

Multi-management via funds of funds has since suffered more outflows and assets have diminished across the board.

‘Standardisation led to herding behaviour in selectors’

Thierry Callault

Managing partner, Quaero Capital

The fund selector role has evolved towards more specialisation and standardisation. Originally, it was carried out by investment professionals who were also involved in security analysis, asset allocation, portfolio management and/or risk management. Naturally, they tended to be generalists. Today, it is very common to meet fund selectors whose entire career has been in fund selection and who might even have specialised in a specific asset class or strategy. Arguably, the fund management industry has also developed dramatically over the same period. Many fund managers institutionalised their investment process and professionalised their commercial effort, often to meet the expectations of fund selectors. So it is fair to say that the fund selection and fund management industry grew and evolved hand in hand, towards more transparency and higher standards. Today fund selectors and fund sales people form a community with a common language, a shared understanding of requirements and expectations, and with regular opportunities to meet and exchange ideas.

The biggest steps forward have been in systematising the different stages of the due diligence process. The scope of analysis has also been expanded to cover not only qualitative elements, but also quantitative analysis of past performance, which has benefited from progress in academic research. One of the drawbacks however of that standardisation and specialisation is a greater tendency for herding behaviour and a reluctance to select managers who are less conventional, but possibly add more value. In addition, the industry still suffers from a well-documented bias towards selecting managers that have outperformed over the recent past, and deselecting those that have underperformed, which is generally detrimental to long-term performance. The fact is that, even for a professional, it is very difficult to fully internalise that ‘past performance is not indicative of future results’.

I started my career in 1991 as a fund selector and multi-manager at Banque du Louvre. Since then, we have concluded that fund selection should form an integral part of the asset allocation process.

As early as 1994, we chose to set up a ‘partnership’ policy with management houses with a strong and distinctive investment style, favouring boutiques.

‘2018 was selection’s hardest period’

Philippe Sarica

Fund selector, multi-management consultant and founder, French Society of Fund Selectors/PHS Finance

I have been a fund selector for nearly 40 years. The last 20 have been the hardest as a result of the multiplication of crises including the tech bubble of 2000 and the subprime market collapse in 2008.

The hardest period for me was 2018. Markets were very unfavourable for managers that I prefer, which is to say those that have prudence and modesty and stay away from the most expensive stocks. That said, these stocks continued to be bought during the second trimester of the year, therefore increasing the underperformance of these managers.

The various challenges selectors have faced over the last 20 years has forced them to place more importance on qualitative rather than quantitative research to try to predict fund managers’ future behaviour. This approach will have helped them navigate particularly difficult periods such as the success of the value style from 2002 to 2009, and the outperformance of the growth style which followed.

Another key development has been increasing competition from passive management which has put more pressure on asset management firms to reduce fees on active funds.