Evaluating Investment Managers

Will Harrell

Robert Harrell Inc.

Two types of criteria for investment managers

Qualitative:

- Location
- Size of Firm (depth)
- Litigation
- AUM (strategy-dependent)
- Years in business/age of strategy
- Individual/Team approach
- Top Down/Bottom Up
- Quant/Algorithmic

Quantitative:

- Net Performance vs. Benchmark
- Peer Group Ranking
- Risk (standard deviation)
- Market/benchmark?
- Turnover
- Fees
- Attribution analysis
- Alpha (risk-adjusted)

Watchlist Triggers

- Change in primary manager personnel or fundamental approach
- Being sold or merging firms
- Significant Style Drift
- Underperformance within peer group on a three-year trailing basis < 70-75th percentile ranking
- Manager appears to take eye off ball (politics or personal)

Easy to hire. Tough to fire. So, when?

- When the trailing 3-year risk-adjusted peer group ranking falls below 80th percentile for active managers with a good fit to their market, it is time to seriously consider change.

  - Best indicator of the magnitude of recent underperformance (1-year is volatile for good reason)
  - A 3-year 80th percentile risk-adjusted rank is a statistical hole he/she is not likely to get out of without an extraordinary string of outperformance
  - Manager is aware of underperformance and may deviate from mandate
  - Opportunity cost of keeping an underperforming

Simple steps to achieve a target rate of return

1. Develop a predominately traditional asset allocation strategy with limited alternative investments exposure 10%~15%
2. Include plenty of mid and small cap investments in your equity composite by weighting accordingly
3. Create a slight value tilt in your equity composite
4. Employ 2 total return bond managers to fully diversify your fixed income.
5. Maintain managers high in their respective peer groups net of fees
6. Rebalance regularly