UNITED KINGDOM

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When analysing an investment strategy, every team has its own approach. Traditionally, the process will be **multi-focus and multi-step**, looking iteratively at the different components of the investment value chain. These components are often known as 'Pillars', and, if you believe all the marketing material, typically start with the letter P: Philosophy, Process, People, Portfolio, Parent, Performance, Price and Platform, to name only a few. While companies will invariably argue that their approach is different and, of course, superior to their competitors', **in practice there is a striking degree of commonality.**

Throughout my career in manager selection, I have found that research teams tend to put most emphasis on people, process, portfolio, and performance analysis. Although I am a great advocate of checking managers' credentials, evaluating investment processes, auditing portfolios, reviewing trades, and analysing performance, **I do not believe that they are necessarily the most important aspects of a selection process**, especially in the early stages of a due diligence. I would even say that they are not a good indication of a strategy's potential for outperformance. Focusing on these pillars is of course extremely useful when you want to analyse if a manager is following a process with rigour and success, **but it does little to assess the legitimacy of the approach itself.**

In my mind, the first and most important step when researching an investment strategy is to understand the investment philosophy underpinning the approach and its potential for success. Even the best people and processes are unlikely to sustain performance without a strong philosophy behind them. To give an extreme example, a disciplined process leading to only holding mega-caps beginning with 'A' would have reaped impressive returns in recent years (Alphabet, Apple, Amazon, Alibaba), but such an approach clearly lacks a sound investment rationale.

To deliver sustainable outperformance over time, an active asset manager needs to **identify and capture one or many alpha-generating market inefficiencies.** Therefore, before trying to analyse how a manager hunts for them, we need to ensure not only that the opportunities exist, but also that they are likely to generate outperformance. A simple yet extremely effective way to decide if we want to proceed with a due diligence is to ask managers to describe what inefficiencies they are targeting and to explain why capturing them will generate performance.

I do not claim that an investment strategy can be fully assessed simply by asking "What are you trying to achieve and why will it work?". It is nevertheless, in my opinion, the first question that should be asked to a manager when starting our analysis. **If we were not to get a clear and concise satisfactory answer, it ought to be the last one too.**

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Although it is an industry adage that sometimes fund selection is more art than science, it is quite important for an investment professional to establish an appropriate framework and approach towards the end goal. Generally, in my view the CFA Institute's tangible 4 "P"s (people, process, portfolio and performance) combined with a fifth "P" – price, are excellent guidance to shape the selection process. Nonetheless, it is **equally essential to define a relatively small peer group of strategies** with as similar as possible objectives, investment style and horizon – that would allow the creation of custom benchmarks and could provide more accurate comparison within a specific segment.

From a quantitative perspective, what I look for is **consistency over the medium-to-long term.** That includes consistency of both performance and the levels of risk, while at the same time keeping an eye on how the shape of the portfolio evolves over time. To be more specific, I believe that **performance and risk-adjusted metrics**, such as **Alpha and Sharpe** (depending of course on portfolio concentration), could be very useful when selecting equity funds, especially when focusing on the three and five-year cumulative numbers. Considering risk and exposure to different factors is also worth mentioning here as that would assist to identify strategies which benefited from the prevailing market environment, but may potentially struggle as a result of market rotation – a good example is the cyclical rally we saw in Q4 2020. After all, t**wo of the main challenges are to understand what is the source of the manager's Alpha and how sustainable the profits and cash flow generation abilities of the underlying companies are.** In addition, my preference goes with funds that demonstrate high active share and ability to take bets that are not necessarily in-line with their target index – good way for managers to add value for the end client.

In terms of qualitative skills and methods to assess a fund, nothing can replace a face-to-face meeting with the manager(s) of a fund, but this could be also very tricky as the majority of fund managers are great salespeople too. It is my view that a team approach eliminates key man risk to a greater extent and without compromising the quality of decision-making. **Clearly defined and easy to understand processes** may sound rather subjective but indeed offers the basics for understanding a strategy and its unique selling point. Various other factors – manager(s) experience in running mandates in the asset class, the depth and quality of the research resources and transparency to name a few, could all make a difference in selectors' final say. Last but not least, the **growing pressure on costs triggered extensive value for money assessment across the industry**, which further helps investment professionals to establish whether a product offers an attractive fee structure relative to its peers.

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