The multi-manager approach to investing

Relying on more than one investment manager gives investors access to a mix of styles, which reduces portfolio biases. But to make this work, investors need to pick the right type of manager and know how to avoid the risks.

What is the idea behind using a multi-manager approach?

No single active manager is the best at managing every asset class. There are benefits to investing with specialist managers who are best in class with what they do. In practice, a multi-manager approach uses rigorous investment research to analyze the universe of active managers. They determine the best active managers and create a portfolio using a combination of those managers, with the objective of developing a better risk-adjusted return for clients. Creating the right balance of managers is key, you want to be careful not to have too many managers or you’ll risk over diversifying and getting index or market-like performance.

Why is manager diversification important?

Even though some managers are good at what they do relative to their peers, they can also have certain biases. Money managers invest in different areas or sectors of the market and have varying styles or approaches to how they invest. For example, there are manager styles with equity investing, such as growth and value. Manager diversification offers optimal exposure to those different investment styles, which provides a more consistent return experience throughout a market cycle. Simply put, your portfolio is exposed to specific areas of the market so that you don’t miss out when one style happens to be performing better than another. This approach, by philosophy and process, blends managers together in an efficient way to benefit client portfolios.

What kinds of risks are involved when you use third-party investment managers?

A key risk associated with investing with third-party managers is that some firms might not have the proper controls, procedures, or standards of care in place. Some of the events that made financial headlines over the last couple of years were caused by inadequate focus and adherence on these points. These risks materialized as a disruption to investor portfolios in some cases. In worst-case scenarios, some investors incurred significant losses.

How do you manage those risks?

Proper due diligence must be conducted on an organization in order to be comfortable with the controls and procedures in place before investing client assets. This is typically done by having subject matter experts thoroughly review all aspects of an organization, including compliance, risk management and trading desk procedures. Although serious procedural risks can be identified before investing client assets, unforeseen events can sometimes occur with any organization. Therefore, an additional method to protect client assets is to properly diversify manager exposure in client portfolios. This is done by ensuring that no single manager holds too great a position within a client portfolio, so that, if something does go wrong, the impact can be minimized and dealt with quickly and efficiently.

What should investors look for in a good multi-manager program?

All investment firms applying a multi-manager approach aim to accomplish the same goal—to find the best investment managers in the market and use those managers in portfolio solutions aligned with client expectations. In practice, however, some multi-manager investors are more active at managing portfolios than others. Some might be less active and tend to act more like “arms length” advisors to clients with respect to

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which managers they should be using, while other firms might take a more active role in managing the day to day manager selection and implementation decisions. From my perspective, a good multi-manager investor should have the same compelling characteristics as the underlying managers they’re investing with. They should have a competitive advantage in identifying the best managers, and when to buy and sell those managers, as well as how to use them effectively to deliver better future returns. They also need a well articulated philosophy and process aligned with those competitive advantages and must be committed to delivering superior returns for clients. As the investment opportunities expand globally, having a robust research process with local market insight and perspective is also an increasingly important factor.

**Why would you sell a particular investment manager?**

There are three main reasons. If the manager isn’t delivering the performance in the way that was expected based on the original investment thesis, you may need to make a change. Secondly, if there is a significant change with the manager, such as a key portfolio manager departure, the reasons for investing with them may no longer apply.

Thirdly, you may consider selling a particular manager if another manager with a stronger investment thesis has been identified. This is always considered in the context of the costs of the change versus the benefits. While these are the three main reasons, it is important for a multi-manager investor to always be proactive and engaged in making sure the best solution is in place for clients, and to have enough good implementable manager ideas to deliver on that.

*How can investors take advantage of a multi-manager approach in their portfolio?*

For investors who are interested in making their own asset allocations and manager selections, they could build their own multi-manager portfolios using mutual funds from a variety of different firms. Alternatively, if an investor prefers to delegate the decisions of manager selection and portfolio structuring to a professional multi-manager investment firm, but likes to maintain control of their asset allocation, they could buy a multi-manager managed fund for individual asset classes in their portfolio strategy. Finally, for investors who have an investment advisor managing their asset allocation and manager selection, they should contact their advisor to explore multi-manager capabilities.

For more information, visit your local HSBC branch.