The characteristics and strategies of Australian investment managers

We entrust investment managers with our money and we traditionally measure success by how the portfolio has performed. But is that really enough? In a ground breaking Australian survey of 808 managers from 28 active investment management organisations, DAVID GALLAGHER suggests that there should be greater emphasis on the characteristics and strategies of the manager in order to better understand investment performance.

The extent to which the investment performance of managed funds is related to investment manager attributes or characteristics are a largely unknown empirical question.

This is despite the significant attention given to investment management organisations and their specific investment products by market regulators, the media, institutional and retail investors, institutional asset consultants and fund ratings agencies.

So why are investment manager characteristics important?

The answer is relatively straightforward – investment managers operate in the market place for the provision of products and services like other corporations in the economy. Therefore, the commercial success enjoyed by investment managers is very much dependent on their ability to differentiate their products (or investment strategy), their ability to “sell” their organisational strengths to clients, and at the end of the day to deliver their services in ways that meet the needs and expectations of consumers.

A fund manager’s investment philosophy is critical to the process of “delivery”. The investment philosophy encapsulates a manager’s understanding of how capital markets operate and the strategies, which they believe will enhance returns above the levels, which would otherwise be expected, from a traditional passive investment strategy.

While academic research to date has largely concentrated on the measurement of portfolio performance and the performance persistence phenomenon (repeat winners and losers in two time periods), research is sparse with respect to the determination of investment performance and the specific characteristics or attributes that differentiate the returns achieved by managers.
The first part of this study provides background information concerning the attributes of 28 active Australian investment management organisations with respect to their unique characteristics and strategy. The sample of managers accounts for more than 70% of all Australian funds under management or combined assets of $A495 billion.

PRIOR US RESEARCH
In 1999, Chevalier and Ellison’s paper published in the Journal of Finance, provides both the first and only empirical evidence surrounding investment performance and US mutual fund manager attributes.

Their paper addresses the question of whether manager characteristics are related to ability, knowledge and effort. After controlling for differences in risk characteristics, expenses, survivorship biases and factor loadings (with respect to market risk, market capitalisation, value/growth anomalies and momentum strategies), their two key findings were that:

- Performance could be differentiated with respect to the academic institution attended by graduates. Specifically, mutual fund managers attending more prestigious ‘Ivy League’ institutions were found to earn superior returns. This phenomenon may be related to differences in educational programs, social networks, or achieved due to the recruitment preferences exhibited by investment managers.

- Mutual fund manager age was also determined to be a significant discriminator in performance terms. Younger managers were found to outperform older managers. The potential difference may be attributable to incentive structures facing younger managers, and that, relatively speaking the younger manager has a longer employment horizon, performance is achieved with respect to this consideration. An alternative explanation may be that the more successful older managers have since ‘retired’, and hence they do not comprise the sample group.

Employing a unique data source, compiled from IFSA questionnaires and publicly available sources, this is the first Australian study to identify investment manager attributes and strategies adopted.

A later extension of the work, to be presented at the W.M. Mercer Global Investment Forum in Melbourne (November 2001) will ultimately examine the extent to which investment performance can be differentiated on the basis of investment manager attributes and strategies.

EDUCATIONAL QUALIFICATIONS OF INVESTMENT MANAGERS
The survey results of 808 investment manager personnel, employed by 28 funds management organisations, indicates that staff are highly educated and there exists a high degree of formal education beyond the attainment of an undergraduate degree.
that around 60 percent of investment managers hold an undergraduate business degree. One-quarter of investment managers have graduated with an Honours degree at either undergraduate or postgraduate levels.

In terms of postgraduate degrees (Figure 2), business oriented Masters degrees are predominant. The results indicate that a quarter of investment managers hold some form of Masters degree. Doctoral degrees are not commonplace in the industry, with only 3.3 percent of staff holding a PhD.

In terms of multiple degrees held across the industry, 30% hold at least 2 university degrees and 4.7% of staff have at least 3 university degrees.

Figure 3 presents the distribution of industry qualifications held by investment staff – the Chartered Financial Analyst's (CFA) program, the Securities Institute's Graduate Diploma of Applied Finance and Investment (GDAFI), accounting (CPA and CA) and actuarial (AIAA) qualifications.

The GDAFI diploma is the most widely held industry qualification by Australian investment management professionals, where more than 20% of all funds managers have been conferred with this qualification.

The survey data concerning qualifications in the investment management industry indicated the ratio of degrees awarded to investment staff people was 1.27. The ratio of industry qualifications to individuals was 0.38.

Overall, for all qualifications held, the statistics indicated each individual held 1.9 qualifications (tertiary and industry qualifications) on average.

INVESTMENT MANAGER STAFF EXPERIENCE, LOYALTY AND SENIOR STAFF TURNOVER
This section provides the results of the average manager's experience in the investment management industry. A perceived strength of an asset manager may well be the experience of the staff involved in the implementation of their investment process.

Experience, measured in years, is likely to demonstrate a track record of success, or that the manager has greater insights, ceteris paribus, to more easily identify the various stages in the economic and/or investment cycle.

Individuals employed by investment managers were classified into two groups - 'senior professional staff' and 'other professional staff'. Individuals were classified according to job title and their significance in the firm with respect to decision making.

The term "senior professional staff" incorporates chief investment officers (CIOs), asset class sector heads in equities, bonds, property, etc., chief executive officers (CEOs) where CEOs had direct involvement in money management, heads of tactical asset allocation (where appropriate), or other participants involved in the asset allocation team.

The term "other professional staff" includes investment analysts and portfolio managers not accounted for in the senior staff classification. The analysis indicated that the average senior professional has 16.2 years money management experience compared to other professional staff exhibiting 9.2 years experience.

The loyalty of staff may also be used as a qualitative filter when assessing investment managers. The perception may well be that the existence of strong loyalty in the organisation will be, ceteris paribus, more highly favoured by existing and future clients. This may be evidence of an investment process that has been successful in the past, a healthy team functioning under solid leadership, a positive culture and working environment that fosters communication and professional development of staff, and the availability of appropriate incentives to retain and reward individuals for performance.

Figure 4 shows the distribution of the years loyalty exhibited by senior managers and other money management staff across 26 investment managers.

The median manager, for both senior and other staff categories, has provided fund management organisations with 7.6 years and 4.6 years respectively.

In terms of the tenure of the heads of Australian equities and chief investment officers for the 28 managers comprising...
the sample in the period January 1994 to June 2001, the average tenure period for those both arriving and departing in the period is equal to 2.5 years and 2.0 years respectively.

Where the analysis accounts for the tenure periods of the entire sample (remaining and departing CIOs and heads of equities in the 7.5 year period), the average tenure periods become 4.04 years for heads of equities and 4.47 years for CIOs.

Investors are also likely to be concerned about the stability of the senior managers implementing the organisation's investment process. In particular, where there exists turnover in the positions of chief investment officer, head of equities, head of bonds, or head of asset allocation (where this role is independent of the CIO), investors may require an explanation from the manager as to reasons behind the change of personnel.

In most cases, turnover may arise due to poor performance (either relative or absolute). However, turnover can also occur among the more successful managers, and this may in part be explained due to inadequate compensation arrangements or a change in the investment philosophy of the manager.

Preliminary analysis has been undertaken via an event study to determine the impact on investment performance before and after a change has occurred in the role of head of Australian equities in the period January 1994 to June 2001.

Using data provided by William M. Mercer Pty Ltd and public information sources, 44 changes in the role of head of Australian equities arose for the 28 managers comprising the sample.

Employing both a six and 12 month event window (pre and post analysis) and excluding the actual month of the departure (and months where the manager is awaiting a replacement), the performance during the six months after the departure of an Australian equities sector head leads to lower performance than previously.

One of the most fundamental ways that investment managers differentiate themselves in the market is their investment strategy.

This may be translated as incoming equity managers restructuring the existing equity portfolio and as a result the portfolio sustaining continued underperformance.

However, using a longer event window of 12 months prior to and after the departure (excluding the departure month), there is a reversal in performance in the subsequent period – performance is higher in the year after the departure.

Further research is being undertaken in this area with respect to predicting the timing of a departure in period of poor performance.

In terms of active Australian equity strategies, investment managers typically construct portfolios in one of two ways. This includes the investment manager adopting a bottom-up approach (where portfolios are constructed in light of the expected performance of individual securities) or a top-down, thematic approach, where economic data is instrumental in the investment manager’s stock selection decision based on perceived market ‘themes’.

Active equity managers also identify specific characteristics that describe the way their portfolio strategies are implemented. These include whether the manager’s strategy is ‘growth’ oriented, ‘growth at a reasonable price’ oriented, whether a value bias is predominant in the process, a blend between value and growth styles or whether a preference exists for style-neutral portfolios.

Figures 5 and 6 present survey results with respect to investment strategy for Australian equities and Australian bonds and the expected contribution to performance.

The percentage weights attached to each category are reported in the IFSA questionnaires and have been weighted across managers on the basis of funds under management.

This process helps to identify the most important strategies existing in the market.
on the basis of fund size. In terms of 
Australian equities, investment managers 
predominantly favour security valuation 
and projected growth rates of stocks 
when constructing and managing their 
portfolios. Equity managers are also 
concerned about a listed company’s 
management quality.

Australian bonds on the other hand 
are managed with respect to duration. 
Yield curve positioning, sector and issue 
selection are important however duration 
remains the most significant factor in 
bond portfolio management.

SUMMARY
This paper provides both a 
comprehensive and original analysis 
of investment manager attributes and 
strategies undertaken by Australian 
investment managers. The findings 
provide insight into the qualitative 
features of individual investment 
managers investing superannuation 
and retail assets.

Further research is currently 
underway which will link investment 
manager characteristics and strategies 
with fund performance in an attempt 
to identify which characteristics and 
strategies have been most successful 
for investors. A comprehensive 
presentation of these findings is 
scheduled for the November 2001 
W. M. Mercer Global Investment 
Forum to be held in Melbourne.

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NOTES
1 The sample of managers is as follows: 
Aberdeen (ex-EquitiLink), AMP Henderson, ANZ, 
AXA (ex-NMFM), Barclays Global Investors, 
BNP Paribas, BT Funds Management, Colonial 
First State, Commonwealth, County, Credit 
Suisse, Deutsche, HSBC, ING (ex-Mercantile 
Mutual), JB Were, Macquarie, Maple-Brown 
Abbott, Perpetual, Portfolio Partners, 
Rothschild, Salomon Smith Barney, Schroder, 
SSGA, Suncorp, Tower, Tyndall, UBS, Westpac.

2 Source: Rainmaker Roundup, December 
Quarter, 2000. 

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