

## Multi-Manager Solutions – what’s the big deal?

The financial press is currently full of articles and advertisements regarding a ‘new’ concept in investment, the Multi-Manager approach. Advisers up and down the country are espousing the concept to their clients and many consultative companies are marketing this strategy as one of the cornerstones for a successful advisory practice.

### So, what is a Multi-Manager approach?

The basic concept is that the adviser, once he has determined a suitable asset allocation for his client, no longer attempts to pick and choose a range of investment funds. Instead the adviser hands the money over to a multi-manager, a specialist who will invest the money in a portfolio of funds appropriate to the asset allocation or risk profile already decided upon.



The term ‘multi-manager’ is frequently used loosely and encompasses three types of service.

1) Funds of funds: this is the option that private investors will encounter most often. As the name suggests, these are funds that build a portfolio of other funds and do not make any direct investments into stocks and shares. Although they can be more expensive they are expected to be more nimble at reacting to market conditions and fund manager changes.

2) True multi-manager funds use different fund managers to invest in their area of expertise. A simple example would be a pan-European product using separate managers for the UK, Europe and Emerging Europe sub-sectors. Each is allocated a proportion of the assets to invest directly into the stock market and the intention is that their local expertise should enable them to outperform more generic funds.

Multi-manager products are usually aimed at institutional investors and can be tailored to a specific requirement, for example, a guaranteed income of 7% per annum. However, this is changing, with multi-manager products becoming more available to private investors.

3) Private portfolio service. Here a stockbroker takes your money and invests it directly, rather than through a fund, into a portfolio of funds. It usually requires a bigger minimum investment than a fund of funds but leaves the investor with a bespoke portfolio tailored to their individual needs.

With all three options you can usually choose the general nature of your investment. For example, the investor might opt for capital growth, income or a mixture of both. Or perhaps a risk rated fund – cautious or balanced for example.

## What are the advantages?

Providers of fund of funds and multi-manager products contend that they offer several benefits.



The first is that you diversify your portfolio even though you are buying a single product, since it is invested in a spread of funds or by a spread of fund managers. Such diversification, in turn, should help to lower risk and avoid some of the ups and downs in the volatile stockmarket.

The second benefit is that the provider of the multi-manager or funds of funds has 'specialist tools' and 'expertise' to monitor fund and fund manager performance. So, in theory, they should only back the best. A fund of funds manager investing in the UK, for example, will regularly seek the opinions of the best fund managers in that area. This should give him or her a much more detailed impression of which funds are likely to perform well given certain economic conditions.

True multi-manager products are also said to have a third benefit lacking in the fund of funds approach. A multi-manager provider ultimately has more control over how investors' money is handled. When allocating a portion of their portfolio to a favoured fund manager the provider is effectively giving the fund manager a mandate to run the money in a particular way. It can spell out how much risk the fund manager should take and indicate what type of stock to invest in and so on. In contrast, if a fund of funds wants to back the same manager, it will have to buy one of his existing funds, whose investment mandate is already fixed.

## What are the disadvantages?

The most obvious and tangible is the cost. Essentially an additional layer of 'expertise' has been added into the equation, which must be paid for. The vast majority of these arrangements use actively managed funds that, as our clients that have been reading these articles are aware, are expensive in themselves. Typically the annual cost on a multi-manager arrangement is in the region of 3.0% to 3.5% after all expenses have been taken into consideration. Given expected long-term investment returns of 6% to 8% per annum on equities, this is a very significant proportion of the growth that investors can expect to receive.

The only way in which multi-manager arrangements can justify these arrangements is through out performance. They expect to achieve this through judicious selection of fund managers, something that the existing academic research believes is not possible to achieve consistently.

The multi-manager has the facility to replace fund managers, typically within the constraints of a pre-selected pool. The intention being that if a fund manager performs 'poorly', they will be replaced by one who, it is hoped, will do better. Most multi-managers expect to have to do this with between 10% and 15% of their fund managers each year. In effect the portfolio could be completely overhauled over every 7 to 8 year period. This in itself incurs additional costs, which further reduce the return.

## Conclusion

The success of the whole multi-management concept hinges upon the ability of the multi-manager to successfully pick the funds that are going to beat their benchmark indices.

Research suggests that 85% to 90% of fund managers fail to beat their comparable index over longer investment timescales. There is no reason to believe that a multi-manager will be able to consistently select the winners, anymore than the fund managers he selects are able to outperform their benchmark.

Investing through a multi-manager, therefore, is a simply an extension of the gamble that investors are taking by choosing to invest through actively managed funds. Despite all of the evidence to the contrary, they are willing to pay additional costs on the expectation that a fund manager will, through his expertise, out perform the benchmark index and that a multi-manager will, through his expertise, be able to select those funds that do so.



## Summary

The fundamental proposition is that advisers (in the broadest sense) should not pick which actively managed funds to invest their clients' money in. Subject to some caveats we agree with this basic premise. However, the solution is not to pay someone else to pick these funds. There is no compelling evidence that over the medium or long term this strategy will perform well – it still ultimately relies on a professional fund picker in tandem with a professional fund manager spotting inefficiencies in the stockmarket. There is unfortunately compelling evidence that net of charges this strategy will in the majority of real life medium term cases underperform a portfolio of pure asset class funds.

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