Investment Insights

Multi-Councillor through the lens of a Multi-Manager

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When looking at a risk and return scatter graph of funds, it seems as if those funds are standalone entities, far removed from the faces of the portfolio managers behind them. In evaluating managers for more than 20 years, STANLIB Multi-Manager has found that these portfolio managers and how they are set up to make investment decisions can be a critical factor in evaluating the investment house overall. Reason being is that these managers are only human and subject to same human bias as all of us.

Portfolio management approaches

In South Africa, the majority of funds are run by a lead portfolio manager, who is fully accountable for the performance of their funds. Often, we see in larger houses a team set up where the lead portfolio manager is supported by co-portfolio managers. We believe the benefit of this is that it reduces key-man risk and when incorporated with a good culture, leads to robust discussion and debate, which in turn leads to richer investment decision making.

More than one portfolio manager behind a fund

There is another approach where multiple portfolio managers make investment decisions alongside, but independently from each other, for the same fund or portfolio. We believe that Capital Group was the first large international manager that started this approach, which they call the "Capital System", in 1958. "The Capital System combines independent high-conviction decision-making with the diversity that comes from multiple perspectives. It has delivered long-term results that help clients pursue their goals."

We understand this to mean that investors could benefit from having multiple portfolio managers who come from different backgrounds and have different styles. While the team shares insights and collaborates, each manager implements their highest conviction views. Therefore, the clients receive a blended portfolio with all the individual portfolio manager views having been incorporated. The clients then have exposure to diverse investment ideas that could provide a more consistent return through various market conditions.

We have also learnt that to become one of the multiple portfolio managers at Capital takes a long time, with the build-up of experience at Capital. An individual would first have to spend eight to 10 years as an analyst and only then, do successful analysts move on to manage an 'analyst portfolio'. These individual analyst portfolios are then evaluated over at least five years before the analyst can be considered for inclusion to run investors' money alongside other portfolio managers.

Multi-Councillor is the more general term used in South Africa

In South Africa, the approach of blending individual portfolio manager views from the same asset manager, to run a fund or portfolio is more generically known as multi-councillor. Locally this is a unique approach with just a handful of asset managers adopting it. Allan Gray has been using this approach since the late 1990's and Foord has used this approach since 2009. More recently, in 2015 Coronation gradually implemented a multi-councillor approach for some of its capabilities, namely Fixed Income, Aggressive and House View Equity. Coronation prefer that multi-asset portfolios be managed with a common view on asset allocation and have therefore, only implemented the multi-councillor approach for some of its specialist offerings.

The differentiators and benefits of multi-councillor

While there are specific benefits to each asset manager, we found a few golden threads. Generally, asset managers believe that a multi-councillor approach facilitates robust discussion and debate. Each councillor's portfolio is frequently reviewed by the other councillors or the wider investment teams. During these discussions councillors' views are thoroughly assessed and the discussions are also a source of idea generation.

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A second benefit is that the multi-councillor approach creates a platform for transitioning analysts to portfolio managers in a deliberate way. Providing analysts with this career path is great for incentivising and retaining talented investment professionals. We highlight that while the co-portfolio manager approach supports the development of analysts into portfolio managers, the degree of accountability will also be much higher when a portfolio manager has the responsibility of managing 'live' client funds.

A third golden thread is that there seems to be no set time frame for strong analysts who show signs of being good money managers, to progress. There is a preference to apply an individualistic approach based on the strengths of the upcoming analyst. The chief investment officers at these houses therefore prefer not to hold back strong talent, with each buddying portfolio manager having their own growth trajectory. Risk is managed by giving new councillors small allocations – even as low as five percent – to start , which is then increased over time. This is differs to Capital where analysts need many years in the saddle but in contrast, new portfolio managers at Capital are given a more equal weight of the fund to start off with.

In South Africa the number of multi-councillors on a fund usually ranges from 3-5 since the asset managers generally believe that if the number of councillors is too large then their conviction gets diluted.

Why would a multi-manager allocate to a manager using the multi-councillor approach?

The primary role of a multi-manager is to assist investors to diversify single manager risk. Every manager, even the good ones, experiences periods of underperformance. A multi-managed approach is likely to deliver a more consistent outcome over time by blending managers with different investment approaches and strengths. To some extent this is also the objective of the multi-councillor approach.

The degree of diversification from a multi-councillor approach is limited to the portfolio construction component of the investment process and therefore, the degree to which councillors differ in terms of the final stock selection and level of conviction. There are many other house and investment considerations that contribute to single manager risk that are not diversified by the multi-councillor approach. Furthermore, since the research and perspectives of analysts are groomed by senior team members that have been with the asset manager for a while, the team may start to view investment opportunities through a similar lens. Having this similar lens also limits the diversification achieved by multi-councillors.

From STANLIB Multi-Manager's perspective we see multi-councillor as the antithesis of 'star portfolio managers' who often come with their own biases and may be less open to having their views criticised or discussed. We also like that there is less reliance on only one strong portfolio manager and that the multi-councillor approach reduces key-man risk. Therefore, the client impact of portfolio managers leaving or retiring is limited. We highlight that while we like the benefits of multi-councillors, we are not signifying that multi-councillor is the best approach as it depends on many other factors.

Portfolio managers at Capital are picked by a portfolio coordinating group that is looking for more diversity in style and investment approaches; and perhaps specific asset class strengths. We feel that South African managers want their councillors to work within the house philosophy, process and risk management tools. For example, councillors may have a common buy-list or ranking table as a basis for the construction of their individual portfolios. Therefore, we need to first like the investment approach of the house to stock and security selection, as opposed to simply buying in to the benefits of multi-councillors.

Those South African managers adopting the multi-councillor approach are firm on the opinion that the incentivisation of the majority of councillors is linked to the performance of the overall fund, as well as the success of the asset manager's wider investment team. Therefore, the performance of the individual portfolios of the councillors contributes less towards their incentivisation. Even though the multi-councillors brings in their own high-conviction views, they are still more incentivised on their idea generation and contribution to the investment process via discussions and debate. We like how this approach fosters a strong investment culture.

As an important and concluding remark, we highlight that we do not start with investment ideologies and therefore, do not prefer the multi-councillor approach over any other portfolio management approach. We will always assess numerous house factors including the strength and quality of the individuals who contribute to analysis, portfolio management and the overall investment process. We also evaluate how the house is set up to generate investment ideas and the robustness of the discussion and will assess how the house reviews prior investment decisions. Most importantly, we try to understand whether the numerous factors, characteristics, interactions and attributes of an asset manager result in investment skill and the ability to generate alpha on a forward looking basis.

STANLIB Multi-Manager: Manager Research Team