The future of European fund selec

Panel debate

Keeping active

In the first of two panel debates, the focus was on the outlook for Europe's fund selectors. The issues, it turns out, are varied: everything from interest rates to technology to the one of the oldest problems of all – how to find alpha generators

For Jarl Åkerlund, the biggest issue is the low-yield environment, which has affected all of his clients.

"We have to explain to customers and their advisers that they have to expect a lower return on investments, but at the same time we have a lot of mandates that require a higher return than they will probably have in the future," he explained. "We have no concrete solution for the moment but we have to do something."

Geert Roggeman suggested his approach might be part of a solution: the increased use of alternative strategies.

"We have a quantitative-based approach so we go from one absolute return strategy to another based on quantitative inputs. It's a strategy that we've been following for 10 years now and we've not had to change it."

"I agree with that," Åkerlund replied. "We will continue to increase our weighting to alternatives, quite possibly at the expense of fixed income products, where you have almost no return at all. We are also looking at multi-strategy solutions."

IT improvements

Niclas Hiller had quite a different point to make – he has recently gone through the process of outsourcing all his company's IT systems – something he thinks many of his competitors should do as well. Of the 75 fund selectors in the room, the majority agreed with his point of view (see chart 1 below).

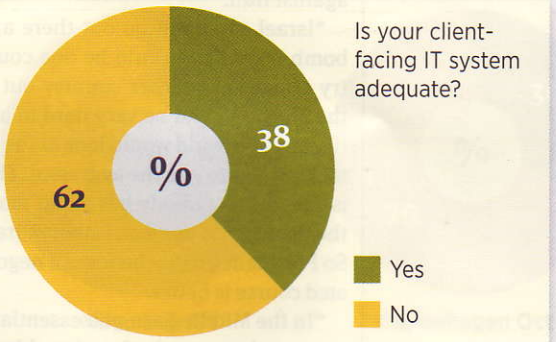
"We needed our reporting system to be much more client friendly and much more transparent, allowing us to focus more on the objectives and needs of the clients.

"We've also spent a lot of resources to comply with the new regulatory requirements – Mifid, the new AIFMD and so on.

"I think many people have been through this. You start out and you have your own computer infrastructure, then you do software development because you think you need something that is unique for your clients, and you end up in a situation where you are a more a computer firm than a wealth management firm. So we outsourced everything.

We need to focus on what we are good at – we are not computer programmers or software developers."

Chart 1: IT facing systems



Source: EIE Pan-European Congress 2015 delegates

Active share

For Mussie Kidane, the biggest problem facing him is very clear – the recent lack of alpha from fund managers, especially in the mainstream markets.

"Industry figures for 2014 indicate that 90% of US equity managers underperformed the S&P 500," he said. "As a whole, active management is facing a challenge from the very active side – some hedge funds and so on – and also the cheap beta strategies like ETFs and trackers.

"Increasingly, people are asking themselves 'Why are we paying all these fees if we are going to end up earning less than the index?'"

Kidane said the same is just as true of long/short equity hedge fund managers as long-only managers and the reason is the structure of the market. Even if a manager systematically excludes index constituents, it is almost impossible to consistently outperform.

"If you look at fund manager performance over the past three years, it has been disappointing on average and the consistency has been reduced. You may find a manager outperforming in one year but it doesn't mean that they will do well the next year."

Kidane points out the problem – research indicates that even the best managers will underperform up to three years of every 10. But almost all investors refuse to accept that level of underperformance.

"This industry has a disease," he

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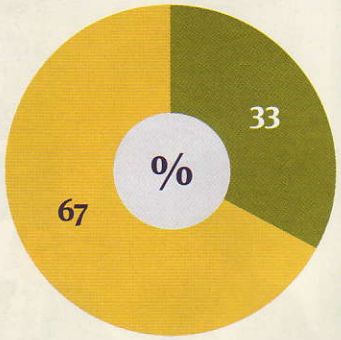
Chart 2: Size-limited funds



Would you be prepared to pay more for a fund that has a size limit?

Source: EIE Pan-European Congress 2015 delegates

said, "and it is short-termism. We all face it."

"I totally agree with Mussie," said Vincent Vandorpe from Puilaetco Dewaay in Belgium. "I can add that maybe the solution is that asset managers need to hard-close their funds more quickly."

He suggests that it is not possible to manage a €50m fund in the same style that you manage a €2bn fund.

"Often, there might be a good fund manager, who, when they got to €3bn we asked them 'When are you going to close?' and they said 'At €5bn-€6bn'. But when it came to it, they didn't do it."

We asked the room whether they would be prepared to pay more in fees to funds that hard-close early and perhaps we have part of the explanation: only a small proportion of fund selectors are happy to pay more for smaller funds (see chart 2).

Swedish investigation

Åsa Norrie from Standard Life then came in with a particular question for Åkerlund – what did he make of the Swedish investigation into fund groups allegedly charging high active fees for funds that are closet index trackers?

"It's a big discussion in Sweden," Åkerlund replied. "We already did work on this several years ago when we decided to make sure all our funds were really actively managed. If you are very close to the index year after year, then the clients should buy an index fund instead."

When asked what measure fund selectors should use to avoid buying closet trackers, he was unequivocal: active share. It seems most of the room agreed with him (see chart 3), but not everyone.

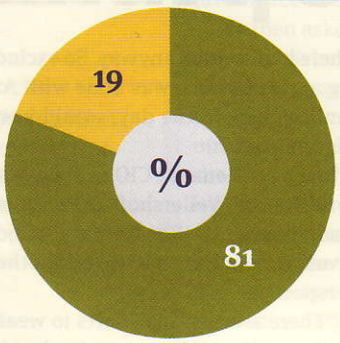
Sebastian Vargas from Eaton Vance said: "We keep trying to find the holy grail when it comes to ratios and active share might be good indicator for a bottom up manager to show if he is taking risk or not; but for top-down managers, they might well own an index for a while. So for those sorts of managers, active share is flawed. Beatriz Gimeno Gimenwz of MoraBanc agreed.

"I think we have to differentiate between tracking error and active share and also take into account the philosophy of the manager," she said.

Arild Orgland of Industrifinans had a different point of view: "If you have a core/satellite strategy and you have an index fund at the core – then you should be concerned about the active share of your active funds.

"But if you have more of an overall strategy then you would be more concerned about having the best companies in the fund. You shouldn't avoid a good company just because it's part of the index."

Chart 3: Active share



Is active share important in your fund selection process?

Source: EIE Pan-European Congress 2015 delegates

Crucial factor

Jeroen Vetter of Guia Advisory pointed out that the results you get from measuring active share heavily depend on the market you invest in.

"If you take the S&P 500 Index, even managers with the highest active share were not able to outperform the S&P 500 because it's a very broadly diversified index. If you take an index like the FTSE 100, where a few sectors are very dominant, like oil and banking, then managers with a high active share are able to outperform."

Also, as was reported recently in an article in the FT, it seems that there is no predictive power in active share.

The use of the metric lets you analyse funds but just because someone has high active share doesn't mean that they have a higher chance of outperforming the index in the future – it could just as easily mean that they underperform. All it does is what you would expect – it shows variability from the benchmark.

"There are issues about how to measure active management," agrees Kidane. "But what is very good about the whole debate is that it has put the pseudo-active managers that populate the universe and overcharge under pressure.

"It's unfortunate that it's the regulators who are tackling this issue – it should have been the industry who did it. But what is coming out of it all is eventually going to be good for our clients and good for the industry." ●

The panel

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