

Demystifying Multi-Managers

What differentiates Multi-Managers?

There has been a lot of interest in ‘multi-manager’ investing recently, as advisers, researchers, platforms and, importantly, investors recognise the important risk-reduction that can result from diversifying a portfolio across a range of investment managers.

Whilst the benefits of diversification across different investment managers (and asset classes) are appreciated by most advisers, what is less clear are the important differences between the various forms of multi-manager investing, and the impacts on both clients and advisers.

This article provides a high level overview of the different forms of multi-manager investing, and acts as an introduction to a series of articles which will explore the differences between the alternate multi-manager structures in more detail.



What is multi-manager investing?

The term multi-manager has been adopted by many as a generic description for an investment solution that utilises the skills of more than one investment manager. Whilst the benefits of such diversification have long been understood by institutional investors, multi-manager investing is growing exponentially within the retail market (source: IFA, April 12-18 2004).

Multi-manager investing is based on the premise that no single manager is likely to perform well in all market conditions and in all circumstances. In addition, no-one can consistently and accurately predict which managers, or even which style of manager, will outperform over any given period. As a result, advisers have realised the best solution for their clients is to diversify across a range of investment managers with complementary styles and across different asset classes. The objective of multi-manager investing is illustrated in Diagram 1 below, which shows that, if done properly, you can reduce the risk (or volatility) of investors' portfolios, without impacting on their overall long-term returns by correctly and efficiently combining managers.

**Diagram 1 – The objective of multi-management
– reduced risk without impacting returns**



A recent study by InvestorWeb Research (Multi-manager Australian Share Survey, September 2003), found that the median multi-manager in Australian shares produced returns equivalent to the median single manager, but did so with lower risk, demonstrating the benefit of the multi-manager approach. However, whilst the aggregate risk adjusted performance of ‘multi-managers’ has been strong, each approach is likely to lead to different outcomes, and have different impacts for advisers and investors.

So if multi-manager investing makes good financial sense, how should advisers and investors use it within their portfolios? The rest of this article introduces the main differences in the various types of multi-manager investing. Over the coming months, we will explore in greater detail some of the key features that makes MLC’s approach stand out from other ‘multi-managers’, and highlight the benefits for you and your clients.

The different types of multi-manager investing

There are three main types of multi-manager investment structures, although there are variations as to the features and sophistication within each of these types. Common to each approach is the combination of investment managers with different investment styles, but they differ in the way they are constructed and implemented:

A Portfolio of Investment Manager Funds

Often implemented via a master trust or wrap solution (to provide consolidated reporting and/or fee benefits), the adviser diversifies their clients’ portfolios across a range of different managed funds for each asset class. The adviser and client still ultimately select which managed funds the portfolio will consist of, although the adviser may seek to implement a ‘model portfolio’ recommended by a research house for efficiency reasons. A ‘model portfolio’ is a blend of managed funds (generally for each asset class) recommended by a research house, that allows advisers to outsource manager research and portfolio construction.

These discretionary fund combinations differ to other key forms of multi-manager investing. The most important difference is that the adviser and/or investor must undertake all transactions required to set up the portfolio initially, as well as making any changes to the portfolio (eg rebalancing back to the target allocation on a regular basis or changing managers).

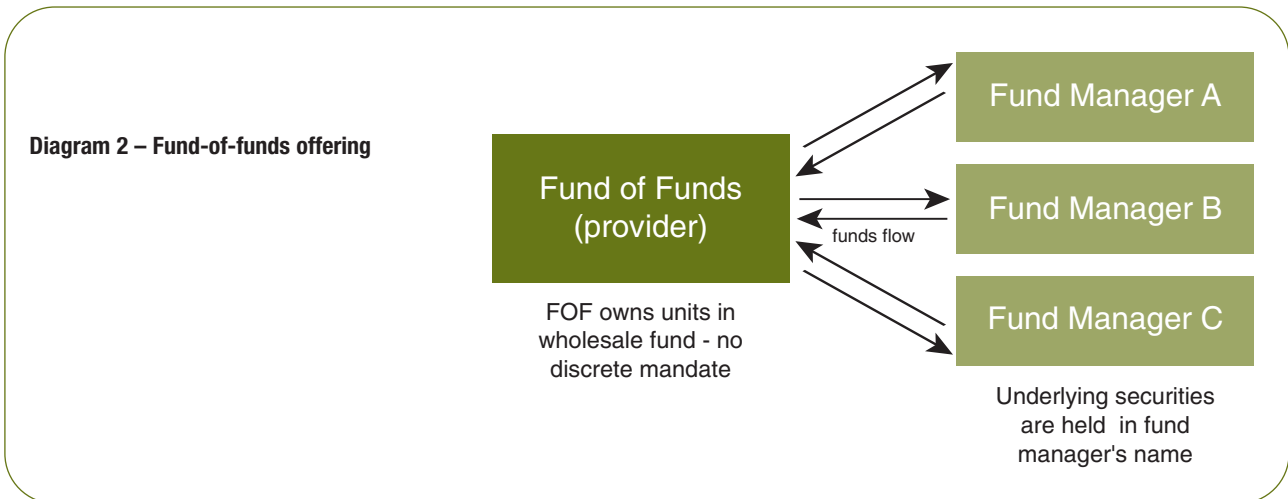
Advisers who realise that their skills are not best suited to the constant research and monitoring of investment managers, outsourcing manager selection via pre-defined portfolios recommended by a research house can create efficiencies in the investment process. However, the adviser is still required to undertake and manage transactions and create Statements of Advice (SOA) each time a change is required to the client’s portfolio – including providing details of fees involved, capital gains tax implications and other issues relevant to the investor’s individual circumstances.

Fund-of-funds

A fund-of-funds (FOF) offering differs from a portfolio of individual investment manager funds, because the client owns units in the FOF vehicle rather than holding a collection of individual funds. The FOF itself then invests in the units of different investment funds (usually wholesale funds) to diversify the FOF across different managers.

The adviser and client have no discretion as to which funds the FOF invests, as manager research and monitoring is outsourced to the FOF provider. The FOF provider also takes responsibility for identifying any changes and implementing them for all clients invested in the FOF, such as changing the underlying funds.

Diagram 2 below illustrates how a FOF offering works:



This means the advisers' time is freed up for more profitable activity, such as providing broad financial advice and deepening client relationships. In addition, any change in the make up of the FOF, such as a new manager fund, does not require a new Statement of Advice, because there is no change to the actual investments the client holds (ie units in the FOF).

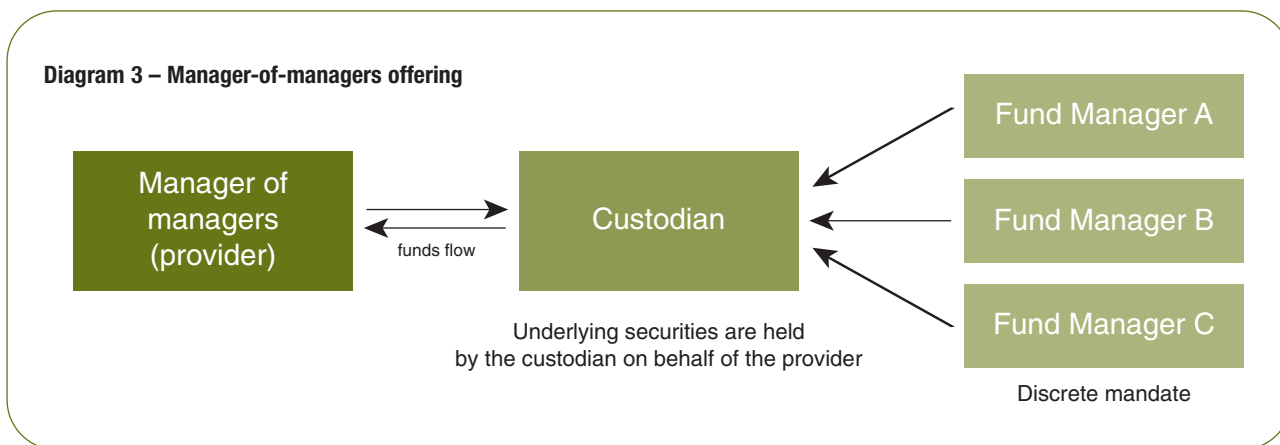
However, a drawback of the FOF approach is that they invest in the units of existing wholesale investment funds along with other investors. Thus the FOF provider has no influence over the investment mandate and, additionally, the funds can be affected by the actions of other investors, such as excessive trading. Another limitation is that because the FOF does not own the underlying securities, there can be inefficiencies when the FOF provider wishes to implement changes, such as a manager change (which will impact the returns that clients receive).

Manager-of-managers

Manager-of-manager (MOM) offers are the most sophisticated form of multi-manager investing. They provide all the adviser and client benefits of an outsourced arrangement, but with some important advantages over a FOF.

MOMs use discrete mandates with underlying managers rather than investing in the manager's existing wholesale funds. The MOM provider still undertakes the investment manager research and implements the portfolio, but can tailor each manager's portfolio to the needs of investors in consideration of the overall manager mix and the portfolio's objective.

Diagram 3 below illustrates how a MOM offering works.



Another key difference is that the individual investment managers do not own the underlying securities, rather they are held by the MOM provider. This has important benefits, and can reduce implementation leakage, or the cost of making strategy changes, when changes to the portfolio are required. In addition, as ownership of the underlying securities is not wed to the choice of investment manager, changes can be made without delay when and as needed, and in the most effective tax manner possible.

Conclusion

This article has highlighted that not all forms of multi-manager investing are the same. Over the coming months, we will explore some of the key differentiators which makes the MLC multi-manager approach optimal, exploding the myth that all ‘multi-managers’ are created equal.

Some of the key areas that we will examine include:

- Adding value through tailored investment mandates;
- Managing change – keeping costs down for investors;
- Science versus nonsense – the art of blending managers;
- Insourcing versus outsourcing manager selection by multi-manager providers.
- Asset allocation innovation.

This advice is intended to provide general information only and has been prepared by MLC Limited (ABN 90 000 000 402) without taking into account any particular persons objectives, financial situation or needs. Investors should, before acting on this information, consider the appropriateness of this information having regard to their personal objectives, financial situation or needs. We recommend investors obtain financial advice specific to their situation before making any financial investment or insurance decision. MLC Limited, 105-153 Miller Street, North Sydney NSW 2060, is a member of the National group of companies.

