

# Demystifying 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 benefits 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 explores the research underpinnings of multi-manager strategies. It reviews the different approaches to research that multi-manager providers can take, specifically basing decisions on proprietary, in-house research versus outsourcing to an external research provider, and seeks to determine which approach is more likely to deliver a better result for your clients.



To 'in-house or not in-house', that is the question

The creation, construction and on-going management of a multi-manager process is a formidable task that requires many important decisions and considerations. How many managers should be chosen within each asset class? Who are the managers that deserve appointing? What are the circumstances which would justify the termination of a manager's mandate, and how can manager changes be implemented without prejudicing investors? These and other questions require deep, detailed and insightful research.

In recognition of these complexities, many financial institutions entering the multi-manager market have decided to outsource the all-important research function to external consultants, rather than setting up their own internal research and portfolio management teams. The degree of outsourcing ranges from assisting with the selection of managers (i.e. traditional asset consulting) to complete implementation (i.e. implemented consulting) with any number of combinations in between these two extremes.

Not surprisingly, a number of asset consultants (e.g. van Eyk, InTech, Frank Russell, Mercers) have benefited from the industry trend towards outsourcing research. The following table identifies the

main multi-manager providers and their primary source of research. While these organisations are clearly competent in their respective fields of endeavour and are committed to servicing their clients, the decision by some multi-manager providers to outsource is not without issue. If you are selecting between the various multi-manager offers on behalf of your clients you should be aware of the following issues.

*Primary research providers for multi-managers.\**

Institution	Research Provider
NAB/MLC	In-house
SMF/United	van Eyk
ING/Optimix	In-house
Advance	S&P
IOOF	In-house
Perpetual	InTech
Asteron/Optimum	InTech
ANZ	ING
Sealcorp/Asgard	S&P
AXA	Ipac (In-house)
Westpac/BT	InTech
Zurich	van Eyk
AMP	Mercer
CBA/CFS	Mercer
Suncorp	InTech
Aviva/Navigator	Mercer
Macquarie	van Eyk

**Focus on the Multi-Manager Plan**

Asset consultants typically offer a wide range of services to their multi-manager clients - asset allocation advice; investment manager research/advice; research of industry and client specific investment issues; and (in some cases) running their own multi-manager products. These and other services are undertaken not just for one multi-manager client, but for as many as the consultant is able to service. Each multi-manager client presents the consultant with a

unique set of challenges, as they each have their own specific needs, preferences and requirements through time.

Depending on how well the consultant has resourced its business, providing tailored solutions that meets individual multi-manager client needs could be challenging. The recent trend involving the re-branding of a consultant's offering by some multi-manager providers is in part a recognition of and a solution to this challenge. While this "one size fits all" approach may be an expedient approach for a consultant to service multiple multi-manager clients, advisers who use these multi-manager products should question whether this is a solution that is sufficiently robust and tailored to meet their client's objectives. And whether it provides sufficient differentiation from other multi-manager offers on the market.

Contrast this with a multi-manager approach that is based on proprietary research performed by its own dedicated team. Having a research team devoted exclusively to servicing a single multi-manager client means the team has a far greater awareness of their individual needs and requirements and can tailor their research accordingly, without the distraction of multiple multi-manager clients with competing needs and demands. As a result, an in-house research team is more likely to be able to make recommendations on managers and asset allocation strategies that are truly aligned with and tailored for the multi-manager provider and their advisers' needs. To illustrate this point, many advisers would recommend a particular multi-manager portfolio to meet a real return goal for their clients over a pre-set time frame to enable the client to meet their financial objectives. The vast majority of multi manager portfolios are not designed to achieve a real return and therefore do not comprise of assets such as inflation linked bonds which generate real returns.

Another consideration for advisers when assessing the range of multi-manager offerings is the degree to which the research provider is focused on manager research relevant to the multi-manager offer. Outsourced researchers who offer a range of research services including those servicing numerous clients and/or countries, may potentially be distracted from the research that matters most, namely asset allocation, and manager selection and monitoring. Either at the request of individual multi-manager clients or perhaps for reputational/competitive reasons, some researchers may feel an obligation to cover a broad range of managers,

\* Source: Chant West, June 2003. The information in this article, particularly with regard to other financial institutions, is current as at (the date of publication) and may change.

including those who have inferior investment credentials. The necessity to cover these managers, the distraction that they represent and the subsequent wastage of research resources can compromise the consultant's ability to generate fresh insight.

Advisers should therefore know how frequently the research provider to a multi-manager plan reviews managers and asset allocation. Is it on a continuous or occasional basis? Anything other than continuous is a compromise as the failure to detect early signs of deterioration in a manager's competitive edge and delays in the implementation of necessary manager terminations can be wealth destructive. If the frequency of review is inadequate, manager insight becomes stale.

Because an in-house research team working on behalf of one multi-manager client doesn't have the pressure to be "all things to all people", research can be directed to where it matters most to the single multi-manager offering. Distractions such as reviewing managers who lack the credentials needed to become an incumbent manager are minimised, thereby enabling the research team in place to focus on reviewing incumbent and high interest managers.

### Alignment with the multi-manager's strategic focus

When the research provider is external to the multi-manager provider, they are a step removed from the day-to-day operations of the company. While this may be intuitively appealing, as the research provider can act and think independently without distraction, it does involve some compromise from the perspective of the multi-manager provider.

Separation of the research provider from the multi-manager provider and its staff means the researcher may not be fully aware that the strategic thinking of its client is evolving and that its needs are changing. This can lead to an unfortunate and wasteful disconnect between the thinking of the two groups. There is a risk, if this situation arises, that the research conducted on behalf of the multi-manager provider and the strategy refinements proposed by the researcher are inconsistent with the multi-manager provider's thinking on what is appropriate for their offering and the needs of their investors. For example, the multi-manager provider, based on competitive pressures in the market and feedback from its own advisers, may believe that the multi-manager offering should have a higher return target. The research provider, having a solid

understanding of the issue will dedicate resources to formulating the strategy to meet this need via the use of high conviction managers. If the research provider was not made aware of the desire for higher returns or their importance, they may continue reviewing managers with broadly diversified portfolios and the multi-manager offer would not provide leading edge strategies to advisers and their clients.

Having an in-house research resource helps ensure the research that is conducted is tailored to the needs of their company. Their awareness of the needs of the business, the advisers and the client base is more immediate and they can direct research accordingly.

### Potential Conflicts of Interest

As with any outsourced service arrangement, in this case manager research, it is important to be aware of where conflicts of interest can occur and how they can be dealt with to ensure service standards aren't compromised. Some potential issues that advisers should be aware of when choosing between the various multi-manager offerings are reviewed here:

- Inclusion of in-house fund managers: Many multi-manager providers are large financial institutions that have an in-house funds management business or who partner with other investment managers. It is not uncommon to see the asset management arm of the multi-manager product sponsor or the investment manager partners included in the manager panel, along with the managers recommended by the external research provider. While there may be circumstances where this is justified, it is suggestive of a conflict of interest and potential users of products where this has occurred are entitled to ask why this is the case. For example, would the multi-manager provider be prepared to follow through on a recommendation from the external research provider that its own asset management arm or investment manager partner be dropped from the manager panel? Or worse still, the in-house funds manager may not even be included in the regular review process of the external research provider.

Any manager appointment should be purely on the basis of merit, the "best of breed", rather than being a related party. Additionally, any manager appointment should also be able to be terminated if required, without any side-issues that could prejudice the implementation of such a recommendation.

- Risk of 'front running': front running refers to the scenario where one person receives information ahead of others and is able to take advantage of that information, potentially to the detriment of others. This problem could arise when a research consultant has a number of multi-manager clients who access the same underlying research (potentially including the consultant's own multi-manager offering). When the consultant recommends the appointment or termination of a manager, they have to consider carefully how to get that information to all their multi-manager clients in a uniform manner to avoid any front running activity. Some multi-manager clients may be able to implement the recommended manager changes in a timelier manner than others. Those who are slower to respond to the researcher's recommendations could suffer some implementation slippage, disadvantaging their multi-manager offering compared to others.

### Short term focus

A short term focus can emerge when a researcher may feel compelled, for business protection and reputational reasons, to be overly reactive and sensitive to instances of short term performance weakness. The necessity to be seen to be doing something decisive for multi-manager clients in response to performance slippage may lead to research recommendations that are not in the interests of investors' long term returns. For example, the research provider may have a policy that manager underperformance over a specified period will lead to automatic termination, even though the reason for the underperformance is that the manager's style may be out of favour, effectively selling at the bottom of the market. Alternatively, a researcher may not feel comfortable recommending a manager that they believe has a competitive edge in the long term but is delivering poor short term returns forcing the provider into a "buy high" mentality. This short term focus may lead to the multi-manager provider effectively chasing returns.

### Changing research providers

Advisers who use multi-manager products that are reliant on outsourced research should consider the potential impacts flowing from the decision of a multi-manager provider's decision to change the research provider. The decision to change can occur for a number of reasons. There may be a change in the ownership of the multi-manager provider to another firm who has a pre-existing research arrangement. The research provider may be changed because of poor servicing standards and recommendations. Whatever the reason, it is hoped that any change is predicated on what is in the best interests of investors in the multi-manager product.

However, a more important consideration if change has occurred is what the new research provider will do with the existing manager and asset strategies. While the new research provider may feel that a different manager or asset allocation strategy is appropriate, how much consideration do they give to the cost and tax implications of the proposed changes? All too often, a change in researcher has led to changes to multi-manager strategies without any regard for costs and tax.

### Conclusion

The benefits of utilising specialised multi-managers to implement client recommendations is increasingly being acknowledged by advisers. Client portfolios are constructed from a base of thorough underlying manager research, and advisers' businesses have the opportunity to become more efficient via outsourcing implementation.

What is becoming increasingly clear however, is not all multi-managers are the same. Advisers are beholden to understand their preferred multi-manager provider on issues such as whether they use in-house or external research, what are the resources behind the research, is the offer aligned with adviser and client needs as they evolve, are there conflicts of interest, do they have a short-term focus and how would a change in research provider be implemented. Ignorance of these important issues could be very costly to your clients' returns.

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