

What makes a good fund manager?

Is education important or does experience count for more?

IN an infamous experiment carried out over two years ago, Lusha, a chimpanzee in Russia, was asked to pick cubes representing companies. From the 30 available cubes, she picked eight of them. One year later, the portfolio of stocks picked by Lusha grew three times, outperforming 94 per cent of the Russian investment funds in the same period.

Lavishly-paid fund managers were criticised. Oleg Anisimov, editor of the magazine *Russian Finance*, was reported to have said: "Everyone is shocked. What are they getting their bonuses for? Maybe it's worth sending them all to the circus."

Clearly, in the unlikely event that they might grudgingly admit so, not everyone will agree that such monkey business is the norm. Yet, what makes a good fund manager will always be a subject of contention.

Simon Davies, executive chairman of Threadneedle Investments, a London-based asset management firm, weighed in on this debate at a seminar organised by Singapore Management University's (SMU) Centre for Asset Securitisation and Management in Asia (CASA).

Mr Davies, who has more than three decades of experience in this industry, joined Threadneedle just one year after it was established, and has helped grow the firm's assets under management from £22 billion (\$44 billion) to more than £70 billion.

Recounting his experiences, Mr Davies said that as a newly-minted graduate working in this industry, he had held the initial view that education mattered more for success in this industry. However, after years of first-hand observation and interaction with people – including many with professional qualifications like CFAs and MBAs – he now believes experience counts for more.

Information and insight

According to Mr Davies, the key to winning in the stock market depends on two 'I's': "Information is what you know has already happened in the market, and so does your competitor; the other 'I' is what you are using to try predict the future."

Elaborating on information, he noted that many stocks, especially the large caps, the index stocks, are already very well-followed by the investment community.

"Anybody who builds asset management on superior information has increasing problems because companies and governments have realised that you can't have unfair information advantage. They are now very careful... so getting information before the market is very difficult," said Mr Davies.

It is of course tempting for those hungry for that insider information advantage to try, and Mr Davies' friendly advice is to refrain from doing so. Regulators have been clamping down hard. Moreover, the definition of illegal information advantage has been expanded.

So how might fund managers find an edge over their peers? One means would be to look at under-researched stocks – the "hidden gems", as many analysts call it.

Here, a fund manager's formal training will help in the selecting, analysing and interpreting of historical data, which might then produce better predictions. Education is thus important for the first 'I' (information), said Mr Davies.

Nevertheless, does better information alone lead to better stock picks? Here, Mr Davies thinks the second 'I' will provide a stronger basis for good decision-making – insights that draw from previous experiences of business and economic cycles.

He noted that for at least two centuries, seven-year economic cycles have happened with regularity. "So having a feeling of how things play out is very useful. It is not about superior insight or intelligence, but more on knowing what will happen."

Quoting John Templeton, a pioneer of the mutual fund business, he said: "Understanding the history saves you a lot of money." Experienced fund managers are better at sniffing out when things go wrong and how, he added.

Caveats to the case for experience

Mr Davies recognises, of course, that nothing

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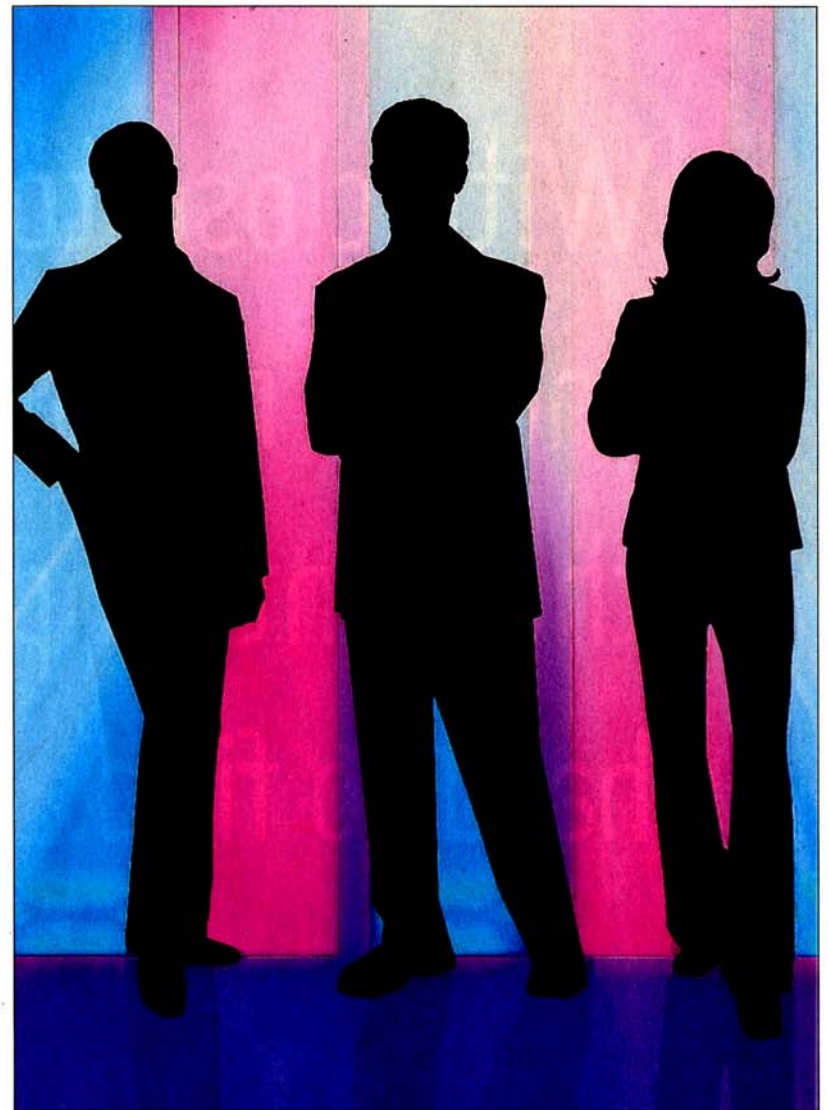
– Simon Davies, executive chairman of Threadneedle Investments, on putting together a team to manage a fund

is absolute, and so he offers a few caveats to the premise that places "experience" above all.

As a novice joining the fund management industry in the early 1980s, Mr Davies found himself in the company of seasoned colleagues who had built their experience from the decade earlier. "Their experiences from the 1970s were mainly bad experiences," he said. "It was a period when everything that could go wrong (in the world economy), did."

These experienced colleagues were scarred by their experience and developed an inherent cynicism and disbelief towards anything positive that came their way subsequently, Mr Davies said. "As the world economy got better with more good news throughout the 1980s, they were all caught out by it". So experience, in this case, was not good.

In a similar vein, as an economics student, Mr Davies was taught that wealth distribution would be more equal, and that the world would be a fairer place. "Thatcher showed up, and there was a sharp reverse," he said, referring to the former British prime minister whose pro-business policies got the wider economy growing but hit plenty of blue-collar jobs and widened income inequality.



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Moreover, experience need not be gained by going through these incidents personally. "You can read about them from books," he said, adding that business schools today focus too much on economics but not enough on history.

To illustrate, he drew parallels between the 19th century investment mania in US railway stocks and the Internet bubble just before the turn of the new millennia. Early investors reaped all the returns and the later ones were left holding the baby for a long, long time.

His next caveat was that there are some

current developments that were simply never experienced by anybody before – no matter how rich their experiences might be. "We are tremendously enthusiastic about China, but during that development, there (was) no road-map, no history of a non-democratic Communist country embracing capitalism without changing its political system. There is no experience to draw upon," he explained.

Judgment and respect

The investment business is as much an art as it is science.

More often than not, even the sharpest and most accurate calculations and predictions will be thrown into disarray when external events happen unexpectedly, Mr Davies noted. "If you look at other professions versus the investment profession, there is a lower correlation between higher academic achievement and future success."

Nevertheless, he was quick to add: "That is not that education does not matter, but it probably tells you that we are a profession where experience probably matters more... provided you learn from that."

In any case, the fund management industry has developed such that investors are not forced to choose between education and experience – funds today are managed more by teams put together for the optimal mix of both. The halo of some "rock star" managers, of which the history of the industry is littered with quite a few fallen ones, no longer shines as bright.

"Have some bright CFAs and put them to work with people with years of experience," he recommended. "The key to this is that they must have mutual respect for one another." If all else fails, there are the chimpanzees.

This article was first published on May 24 on Knowledge@SMU, an online research portal of the Singapore Management University