PHΩCION
investment services

Considerations to Replace Portfolio Managers Run Aplenty – Investors Must Be Mindful Not to Pull Trigger Without Following Thoughtful Process

Heisler and Nipp (2017) produced a solid text that touches on the broad topic of investment manager selection inclusive of considerations and process about changing managers. In essence, they make the point of there being costs associated with switching investment managers, and that changes should only take place following a thorough process that incorporates both quantitative and qualitative factors. This article touches on Heisler and Nipp's findings

Reasons to Consider Switching Managers

The rational to disengage from a manager are based on a slew of factors:

1. Commonly identified at the top of the list is style drift, whereby the manager"s holdings no longer reflect the style that the investor engaged the manager to administer in the first place. Style drift often occurs when the manager's assets under management grow to the point in which he requires increased liquidity from his holdings.
2. A second situation where one might consider changing managers is when the current manager underperforms relative to similar strategies and risk levels, despite representing a higher overall cost.
3. When key members of a management team leave to begin a new venture, this poses concern. In this situation the investor needs to address the manager with a list of questions in the hope of coming away with a feeling of comfort otherwise he should consider dropping the manager.
4. In the case where the manager faces negative press (for various reasons) that the manager himself must actively deal with, this can serve as a huge distraction that can prohibit the manager from allocating the proper amount of attention to the daily grind of investment management.
5. Operational shortcomings play a vital a role as investors seek safety of their capital and have zero tolerance for ineptitude.
6. Finally, the consolidation of similar portfolios can influence the need for redemption. All that managers can do is ensure that they are as solid as possible from investment and operational bases.

Process Should Determine Whether Benefits Outweigh Costs

Changing managers should be viewed as a big deal and to emphasize this certain costs are associated in its execution. The process to arrive at a decision must be thorough and encompass regular managers reviews. In the case where managers appear to be in violation of one or more of the above mentioned, the investor should consider looking at the list of managers that had been short-listed during previous hiring processes as market conditions, the manager itself and portfolio needs change. Proper manager selection analysis involves quantitative results of return attribution and style analysis, along with the qualitative assessment of investment and operational due diligence. The net expected benefit of replacing an existing manager must exceed the cost associated of terminating the existing manager and replacing him with a new one. Indeed, there are situations whereby it is prohibitive to sell the existing manager, and so in that case the decision by the investor should be to maintain the less skilled manager.

Concluding Remarks

Though the above process is subject to personal biases, investors must remain mindful to act in the best interest of their client. An investor's function is to perform a complete investigation in arriving at a sound decision.

Bibliography

2017, CIPM Program Expert Volume 2, CFA Institute. *Topics in Investment Manager Selection*. Jeffrey C. Heisler, PhD, CFA, and Jeffrey Nipp, CAIA, CFA.