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**How do you choose your fund managers?**[^ TOP](#)

It is apparent after doing due diligences at various fund managers, and also through researching their portfolios, that you get many different types of managers.

Layman investors often perceive fund management as a purely quantitative science, but it can often rely on more qualitative factors. An important part of the investment process is ensuring that you understand how your money will be managed, and to ensure that you are comfortable with that method.

There are funds available where the method of composing the portfolio will be an exact procedure, including ETFs and tracker funds. Each investor will know exactly when shares will be bought and sold, and the rationale for their inclusion/exclusion. The mandates of the funds are clearly stated, and all the fund manager does is implement the mandate as accurately as possible. Most funds, however, include an amount of art in their process. It is here where one needs to be more aware of how the manager will construct the portfolio.

When analysing equity funds composition, and how they are managed one can see that most managers are aware of their benchmark in the assessment of their portfolio, and many of them are influenced by the benchmark when constructing their portfolios. These managers will often create their portfolio with a relatively low tracking error (variation from the benchmark), by up-weighting shares which they like, and down-weighting shares that aren't as attractive.

Having a portfolio that isn't too different from the market goes a long way to ensuring that you aren't singled out and embarrassed. Any poor absolute performance will generally be mirrored by the market, and the manager will be able to show that 'everyone' has lost money. These managers have procedures in place to minimise their business risk (i.e. the risk that they underperform their peers, and subsequently are subjected to clients withdrawing their investments), with the result that they rarely shoot the lights out, but also don't have their portfolio imploding in relation to most managers.

On the other side are those managers who have the conviction to construct their portfolios without looking either at their peers, or at the market. They construct their portfolios from a clean slate, and only include those shares that they find attractive, and don't have a problem leaving out a company that forms 10% of the index (provided that they feel that it is over valued). These are the managers who stick their necks out and as such take a big knock if

they are wrong, but who also are able to produce outstanding outperformance when their stock selections are correct. As an investor into these kinds of funds it is great when your manager is producing exceptional alpha, but painful if/when returns are significantly below the market and average manager.

While managers who display the skill and fortitude to stray from the pack have been able to produce alpha over the long term, they aren't everyone's cup of tea. The few skilled managers do produce superior returns, but often the investors into these funds don't get the same returns, and even end up with returns far below the average manager...

Behavioural aspects form a crucial part in deciding on which manager is best for you. If you know yourself well enough, then you should be able to decide which type of manager to use. For those investors who can't stomach being different from the crowd, then it is probably best for you to stick to those managers that don't deviate too much. By being different from the crowd we have seen clean slate managers produce returns that are different from the crowd (unsurprisingly), and when the difference is negative we have all too often seen investors panic, and sell out, or switch to the latest 'hot' 'clean slate' manager, only to experience the same effect. Alpha doesn't come in straight lines, and investors seeking alpha need to ensure that their manager is skilled enough to produce alpha, and then they need to have the patience and endurance to sit through the tough times, and reap the rewards in times of plenty.

Emotions play a role in all investments, and often detract from performance. It is for this reason that we often see that the better managers and investors are the ones who are emotionally detached from their portfolios.

What type of investor are you?

Kind regards,

Mike Browne

[mike@seedinvestments.co.za](mailto:mike@seedinvestments.co.za)

[www.seedinvestments.co.za](http://www.seedinvestments.co.za)

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