Global equity investing: Insights into a better portfolio

Angela Ashton | PortfolioConstruction Forum | 29 April 2014

"Global Equity Investing: Insights into a better portfolio" by Towers Watson, April 2014

Towers Watson has just published a compendium their insights into critical areas of global equity investing. It's well worth a read.

Firstly, it contains useful insights into the way Towers Watson's research professionals assess and monitor active managers. Much of this is timeless, providing non-professional researchers with a valuable framework to use when thinking about fund manager selection.

In particular, Towers Watson discusses the importance of a manager's investment philosophy. They note (and as a former professional fund researcher, I agree) that many managers really just present a slogan or a marketing statement instead of a real philosophy. A real philosophy should get to the heart of why a manager thinks they should outperform. Without a strong understanding of their own strengths and belief systems when it comes to investing, they can go off track very easily. Towers Watson also notes the importance of ensuring a manager's investment and portfolio construction process works logically and consistently with the stated philosophy. Often, managers who just construct a philosophy because the FSC Questionnaire requires one, tend to lose track of their philosophy quite quickly. This should become fairly obvious in a thorough research review. (That may sound negative, but any experienced researcher will be aware of managers who have done this!)

Another issue Towers Watson talks at length about is the peril of using past performance as a guide to future performance. They point out that it takes about 15 years for a portfolio manager to prove, with some statistical significance, that s/he actually has some skill. However, it is rare for managers to go through 15 years without significant change in their environment - the business they work within may change, the FUM they manage will change, the team they work with may change. This can render a long track record fairly meaningless. So, a qualitative assessment of skill is needed too. Of course, this also makes fund manager monitoring more difficult - poor performance may not be a reason to sack a fund manager.

Towers Watson also comments on their view on different types of funds. They like concentrated funds, but think that quant funds may be losing their edge. Interestingly, they are very keen on smart beta products. They describe the three basic building blocks in building equity portfolios as being 'bulk' beta, alpha and smart beta. Smart beta is their catch all term for the many different index-like approaches to equity management that aim to take advantage of some risk premium (value, size etc). There are hundreds of permutations, and they do not expand on which approaches they believe to be worthwhile. Suffice to say, however, although there are quite a few converts to smart beta funds, not all commentators agree that they are anything more than another passing fad.

In all, the Towers Watson compendium is a useful resource for all of those who are interested in how an institutional consultant thinks about issues that many practitioners face every day. Of course, you don't have to adopt every word as gospel – but checking your portfolio construction philosophy against those of other professionals is always a worthwhile exercise.

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