How Advisors Search for Stand-Out Managers

By Chris Latham September 16, 2013

The days when advisors in need of active asset management had to stick with a handful of industry giants are a distant memory. But wading through hundreds of managers takes skill. Above all, advisors say, they look for managers that excel in performance, transparency and cost.

Although clients rarely ask about specific managers, advisors have to be prepared to justify their choices, according to **Jon Andre**, an advisor with Cincinnati-based **Financial Management Group**, which has about $300 million under management.

"We proactively review our whole allocation plan with clients when they initially come on board," Andre says. "As a fiduciary, our goal is to be as transparent as possible in explaining why we feel that a particular investment is in our clients' best interests."

While Financial Management Group favors passive funds by a 2-to-1 ratio, well-chosen active funds can pull their weight during market downturns by cushioning portfolios from the full decline. That's why Andre looks at returns relative to peers over a 15- to 20-year window, eliminating newer funds right off the bat.

Jon Andre

Andre also watches out for style drift. A fund marketed as large-cap growth, for instance, might get dropped if its holdings don't seem to match that strategy — even if it performs well. Otherwise, he says, his firm's diversification approach, based on modern portfolio theory, could become compromised.

Consistency of performance can also make or break a manager in an advisor's eyes.

A strategy need not beat its benchmark every time, but it must stay close for **Ted Smith** of UBS Financial Services. That's no low hurdle, he adds. When active managers slip to the bottom of their peer group, they typically stay there for several years at a stretch. Smith's Baltimore-based team manages about $800 million for more than 60 families. He takes advantage of UBS's asset-management arm, but less so than some of his colleagues, he says.

Consistently outperforming a benchmark on a risk-adjusted basis is what matters most to **Doug Finley** of **Finley Wealth Management** in Fort Myers, Fla. He picks managers by studying historical statistics for repeatable processes.

"We are agnostic as to the process, strategy or niche as long as it improves our overall portfolio," says Finley, who manages about $20 million for 30 families.

Philosophical Alignment

Since investors want transparency about investment decisions affecting their portfolios, it makes sense that advisors should demand the same of managers. That way, they can explain to clients why their money is doing what it's doing, relaying — as appropriate — the investment philosophy and research methods at work in the funds they own.

Smith, of UBS, meets with key people at asset-management firms before entrusting them with his clients' assets. Andre, of Financial Management Group, has to feel that managers share his firm's overall view on both top-down and bottom-up investing — and he isn't shy about following up with managers for more specific information if that's what it takes to set his clients at ease.

The desire for compatibility is why **Michael Fischer** of **Sequoia Financial Advisors** in Phoenix has been using Genworth Financial's platform since the 1980s. Most of his 100 or so clients have funds in multiple Genworth products, including market-timing and absolute-return strategies. Fischer has direct access to decisionmakers at Genworth, but that's not nearly as important to him as his trust in what he calls the platform's "cutting-edge" strategy and flexibility. "If you looked at a lot of third-party platforms years ago, it was really hard to tell one from another," he says. "Pretty much all platforms now have added these various styles, but a lot of them came late."

Cost Trade-Offs

Fischer, whose firm manages around $160 million, admits that his brand loyalty comes at a price that could probably be beat elsewhere. But he says he absorbs some of the cost of using Genworth instead of passing it all on to his clients.

Cost is one of the big strikes active managers have against them, according to Smith, since returns for the average fund may well underperform its benchmark for long stretches.

For Andre, with all else being equal, a high expense ratio could pull a fund out of the running. "It's very difficult for an asset manager to overcome that," he says.