A study on assessing and critiquing ways of selecting equity fund managers

دراسة حول تحليل و تدقيق في طرق اختيار مدراء محافظ الأسهم

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ABSTRACT

The research could be premature to some of the financial industries such as the UAE, as mutual fund management as a brand and business is still in the pioneer level of the industry cycle. The research might be more applicable to the institutions and high net worth individuals that would like to gain exposure and obtain alpha from abroad markets that have a developed Mutual funds business such as US,UK or some of the Asian countries. The external fund investment is very broad as it can touches upon any investment asset class. During this research focus was on the equity part that might share some similarity with the other asset classes. The objective of the research is to provide a framework or a process to assess and critique the selection of external funds in the mutual fund industry. Also, to get a ranked criteria during different market conditions that will provide is the criteria is static during market conditions is it more of a dynamic and how much does market cycle affect the fund manager criteria.

The research has been conducted through covering the available academic research of fund manager selection criteria and books that are written by researchers who research mutual funds and rate them. After consolidating the available criteria from academia, provided a short explanation for each in the literature as a summary. After all of the data gathering and critique, 8 criteria were selected to be rated by external parties. The approach to get the results was to do a questionnaire that will be focusing on eight criteria and three market conditions (Trough, Middle, Peak) market cycle. The aim of providing different market conditions is to stress the criteria whether it will hold as a rank through the three market conditions. The questionnaire will be sent to external parties that have a good network with through my work via an e-mail. The data sample will not be wide as the perception that quality of the sample response is highly regarded in the questionnaire. The questionnaire was done in a way that only a skilled investor professional due to the level of required information.

The results came inspiring as two out of the eight criteria been rated as the same importance during different market conditions. Also, six out of eight criteria failed to succeed and were volatile through different market conditions. Explained that 2 criteria could be dependent and work well during the long-term approach of investing and six

failed to be persistence and help in the long-term. Furthermore, six out of eight criteria showed it works in short-term market specific condition.

The recommendation came from the four sources questionnaire result, Questionnaire rater feedback, industry leaders, and personal experience. The combination of four sources concluded a rounded research touching different parties to provide proper criteria to help in selection of equity fund managers. In conclusion the available information through academia was limited and too specific which I tried to bring a full comprehensive research to help in understanding and investing in external funds in a more fundamental way.

الدراسة قد تكون في مراحل متقدمه من حيث الموضوع و المعنى. و لكن في الدول ذات الاسواق المتقدمه تعد هذي الدراسه من الامور التي تطرح و تتداول بشكل يومي في مجال الاستثمار و المحافظ الناشطه. مجمل الدراسه عن كيفية اختيار مدراء محافظ الأسهم العامه و ماهي الخصائص المثال لكي تساعد المستثمر في عملية الاختيار و المقارنة.

كي اتوصل على ماهي الخصائص المثبت لاختيار مدراء المحافظ كان يجب ان اراجع جميع المراجع و الدراسات التي وضحت ماهي الخصائص و بعد جمعها قمت بتحليل الخصائص بمساعدة بخبرتي في هذا المجال على و قد دونت الايجابيات و السلبيات لكل خصله. بعد ذلك قمت باستفتاء عام شمل مختصين في مجال اختيار مدراء المحافظ و عل ضوء ذالك قمت بتقييم مدى كفاءة و جودة كل خصله.

و في النهايه ابدية رايي في مر هو اهم الخصائص التي يجت ان تتوفر كي يكون مدير المحفضه يؤدي بشكل جيد و يصبح من ضمن العائد المتوقع للاستثمار. المستفيد الاكبر من هذي الدراسه اصحاب رووس الاموال الخاصة و المؤسسات المختصه في الاستثمار و بدرجه اقل الافراد لانها تستهدف الاستثمار طويل الأمد مع قابلية للاستثمار لوقت طويل.

Contents

CHAPTER ONE

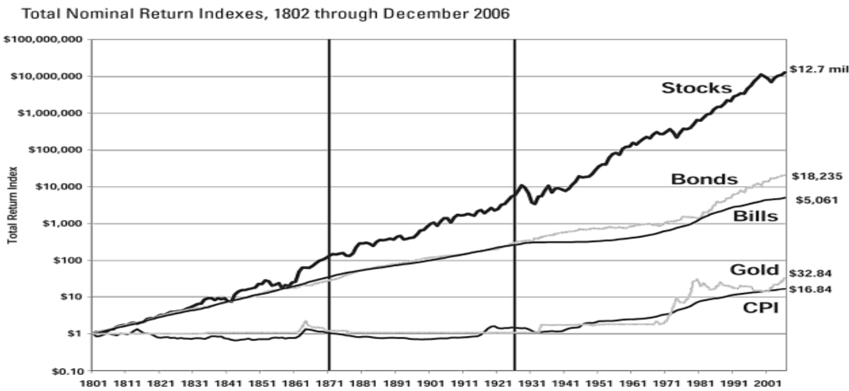
The first chapter will be introducing the research paper and providing a bit of background about the equity fund management industry. Also, will provide information about the rational and who will the research benefit. In addition, will state the objective and short conclusion of chapter one by the end of the chapter.

1.1. INTRODUCTION:

Investing and growing capital is one of the key things that any person in the planet is tempted to explore. Invest as a word means buying something today that provide after a time a return that is higher than the invested money. Prior investing the investor need to identify his needs and level of risk tolerance. Some professional investors call it investment policy statement that can be constructed by a professional experienced portfolio manager. To provide more objective and direction in the research simplified few assumptions, by stating a study to provide comparison of historical empirical evidence provided Professor Seigel. Equity as an asset class has delivered the strongest annual return compared with the other asset classes as empirical evidence shows by Professor Siegel. Equity has been in most occasions with institutions and retail investors the dominant asset class within their portfolios. However that doesn't eliminate the importance of portfolio theory of diversification and creating efficient portfolio with fixed income and commodities exposure. Through this paper I will be highlighting investing in equities through equity fund managers. The start point of doing so for any investor is how to select a proper fund manager and will make a better fund manager than the other is it through performance or other qualitative reasons.

Professor Siegel Analysis from book *Stocks for the Long Run* with an average of rate of return 16.7% annually data collection from (1802-2006)[1].

[1] Professor Siegel Analysis from book *Stocks for the Long Run* with an average of rate of return 16.7% annually data collection from (1802-2006)



Leveraging on the empirical research done by Professor Siegel to invest in equities, the proper way of doing so, is to invest through mutual funds as markets can be difficult for an average person to understand. Citing the phrases from Don Philips, in Morningstar Mutual funds, "Mutual Funds embody the American Ideal … whereby the individual is treated to the privileges of the elite".

1.2. MUTUAL FUND OVERVIEW:

The industry is simply, professional group of people that think they have the capability and experience to run money on behalf of other organization and retail. To establish a mutual fund company first it must be regulated by the domicile of the company securities commissioner such as the SEC in United State FSA in United Kingdom. The second step is to setup is basically setting up the structure and operational aspect to have the capability to run capital on behalf of the investors. Investing in Mutual fund can be complex and mind blowing due to the variety of investment approaches and strategies and philosophies. What a smart investor should do is to look for simple common sense explanations that drive mutual fund to perform John V. Bogle "*The art of investing in mutual funds … rests on simplicity and common sense*"[2]. The key aspect is to understand that for evaluating Fund managers two key concepts are key Qualitative & Quantitative analysis. The concept might not be new, however the detailed analysis and research that will be provided, will show that few qualitative or quantitative analysis overweight others and potentially highlighted as higher relevance than the other. Through time mutual funds, have been developing however, few that stood as a standout and

[2] John V. Bogle "*The art of investing in mutual funds … rests on simplicity and common sense*"[2].

continued to perform and maintain stable organization structure and team during the boom and bust periods of the economy during different market cycles.

Like anything in this world, Mutual funds have their positives and negatives:

ADVANTAGES:

1. Provide better diversification tool to investors
2. Provide investment objectives
3. Reduce shareholder transaction costs
4. Provide shareholder services
5. Provide professional management to the portfolio of investment

DISADVANTAGES:

1. Guilty of extra trading costs
2. Fund expenses
3. Conflict of interest side.

1.3. INDUSTRY HISTORY

Taking step back to understand the industry of mutual funds the origins of Mutual fund it goes back to 1868 in London the first of what is called now as closed end-fund and the first mutual fund organization started in US in 1924 by the name of Massachusetts investment trust and just four months later State street investment trust followed. The industry grew rapidly during the 1980's to 2000 in 1974 the asset were around $35.8b in 1996 to $3.5tillion and in 2000 reached $6.8trillion, infact mutual funds are becoming one the biggest financial institutions and closing down on commercial banks rapidly as you can see from the evolution of the asset size.

Due to the complex way of investment in Mutual funds and the newly innovation in technology and approaches Fund houses tend to have different styles and asset classes which makes it difficult for the ordinary investor to understand. This issue has been well taken by Morningstar & Mercer consultancy houses. They tried to simplify the investment approaches and styles of the investment house and created three major investment types (a) Growth, (b) Value, (c) Core. However, the devil in the details, understanding those strategies will require extensive due diligence and researching expertise. Understanding the styles and the strategies helps in setting up expectations and avoiding the "Sell low Buy high" concept.

1.4. Research Outline

The research rationale is to screen literature reviews and academic researches that have been done in the past to collect criteria to select equity fund managers. In the past many researches were done to focus on one or two factors that influence the decision and can lead to selecting a fund that generate substantial excess return over a benchmark. However, my aim is to collect those researches and critique them in an objective way through my personal experience in the field of selecting equity fund managers and industry experts to measure the importance of the criteria. Conclusion will be driven in the end to show whether evidence can be driven that some criteria are more important and provide more evidence than the other.

Few things that tempted me to write about such a thing, is the low level of maturity in the mutual fund industry in UAE. Also, the current market cycle, as we are reviving from a down cycle which a lot of the mutual funds struggled to justify their way of investing and the failure to capital preserve for their clients. The retail will always blame the low level of clarity and the misrepresentation by the mutual fund industry in the UAE, which is partially right. However, not understanding the mutual funds strategies and the shortfalls and assessing the track record and return generation is retail duties. The flip side of the coin the fund management industry in UAE have low level of disclosure and haven't been the honest think of the best interest of the client. Many of the UAE mutual funds were ran by unprofessional investors more like traders and style drift even though they have fiduciary duty toward their clients to maintain seeking the agreed on return profile and level of risk.

1.5. Research Beneficiaries

There are a lot of interests and useful information can be obtained from the research due to the growing industry and the persistence of returns that are generated by managers that successfully created excess wealth for their clients.

1- Institutions and Investment banks will be major point of interest from such research. The reason is to create products such as fund of funds or single fund strategy to meet requirements of such client or client.
2- Retail is important in this equation to benefit from broad equity market exposures by investing in mutual funds. The expertise and the level of sophistication in the fund management have developed during the time and reached a level where it can add value and be trusted if enough due diligence is done to avoid the traps. The more mature the financial industry in the world the more mutual funds industry will grow.
3- Investors seeking exposure to Emerging markets to the likes of India, China, and Brazil. The language and knowledge of the market might be hurdle, in which case investing in Mutual funds might be a better solution.

The research will provide a framework to the retail and institutions to invest in the mutual funds in UAE and even incase of investing abroad in other markets through mutual funds. The industry is a high growth phase, and can provide a lot of benefits to the investors.

1.6. OBJECTIVES

The Objectives of the academic paper are:

- To asses and critique approaches in selecting equity fund managers
- To provide a framework and process to invest in equity fund managers
- To identify fund managers that can fit the expectations and deliver positive excess return over time.
- To cover the published researches that covered criteria to select equity fund managers

1.7. LIMITATIONS

1) The amount of research that has been done to regarding investing in external fund management is limited
2) The scope of the research doesn't cover risk management and portfolio construction in investing in external fund management.
3) The sample size of the research is limited due to the required level of participants in answering the questionnaire

4) The research provides a framework of how and why would you invest in external fund manager however it doesn't provide you the operational aspect of how to invest in external fund managers.

1.8. CHAPTERISATION

Chapter two:

- Terms and Definitions that will cover the major terms that will be covered in the literature review and provide a short definition
- Literature review that will provide short summary of each criteria that was found during reading researches and provide a critique from other researches or personal experience

Chapter three:

- Empirical data and data analysis will cover the tools and approaches to help analyzing the data.
- Methodology outline will provide explanation of the questionnaire that is used to collect data to help achieve the objectives
- Models will cover the used tables and documents to support the data analysis and results section

Chapter four:

- Data analysis and results covered the results from the questionnaire and the used tools to present the results
- Data Analysis and results had also short commentary to explain the results of each investment criteria during the different market conditions.

Chapter five:

- Findings and remarks will provide highlights of two types of results, general results from market conditions and specific results related to each criteria.
- Recommendations will cover basically the recommendation post the results and findings.

1.9. CONCLUSION

The introduction started by stating why we invest and what is the most profitable asset class based on empirical evidence. Then went to describe what the most suitable way of investing is and what the reason is for that. Also, went through the evolution of mutual funds historically and how did the industry grow through time. Furthermore, touched upon the advantages and disadvantages to make it clear for the retail what are they buying into and know their risks and benefits. Investing in mutual funds can be broken into two bold categories, passive investment and active investment. Passive investment is simply, buy and hold into entire market index; however there are evidences that active management works well, and a probability that is lower than 50% of the manager can beat the benchmark over a period of time. With enough due diligence and proven criteria to select fund manager an investor can invest in successfully good funds. The research was made to target those retail that want to invest in funds and want to know how to select successful fund manager that can beat a benchmark and create excess return. Also, it will fit the institutional investors and investment banking that looks to create fund of funds and structured products that can target the successful fund managers.

The objective is quite simple, as in the end is to simplify and consolidate all the research that has been done to select fund managers based on that or that, is to have them all in one questionnaire and sent to professionals to provide their ranking and short description. In the end to select fund manager will always be the discretion of the investor however it will narrow down the assumptions and provide a good starting point to develop that framework into a catered way that suits everyone.

CHAPTER TWO

In this chapter will be covering the literature reviews, by providing a 1) short summary of each research paper and relevant books that is related to the selection of equity fund managers. Furthermore, will provide some 2) personal detail for each and support it with agree or disagree researches to provide a proper critique. In conclusion 3) decide qualified criteria and disqualified criteria to go to the next step of critiquing and assessing through questionnaire.

2. LITERATURE REVIEW:

2.1. INTRODUCTION:

The literature review will touch upon criteria to select fund managers. The researches that have been done previously were to look at single criteria and assess whether it would be a good criteria to select fund manager. The intention is to go through as much as possible researches from Journals and Books and critique them in a way to provide an agreement or disagreement. The topic is broad and will be covering different aspects such as investment styles, size, tracking error, and information ratio, alpha, relative and absolute. Criteria is important when investing into funds, so by then you can create a discipline process to select and manage your funds. Historically its been challenging to invest in funds based on purely historic performance or the quality of the fund manager. Having said the literature reviews will be structured to start by stating the research and short description more like abstract then provide more explanation and end it by stating the critique of the criteria from my personal experience in investing in equity funds.

The idea of structuring the literature review in this way is to provide two angles one what's in the research and what the conclusions that drove the criteria are. In addition is to stress the criteria from experience and provide a personal rational to the criteria whether it could fit to be criteria those investors such as retail or institutions depend on in selecting the appropriate funds.

2.2. TERMS AND DEFINITION:

Investment Style: Growth, Value, or Blended which basically helps understand the fund expectation during market environment. Growth fund will look into high P/E and P/B stocks that are cyclical nature. Value looks at low P/E and P/B mainly Defensive nature.

Market Size: is the exposure of the fund toward company capitalization, which is known for Large, Mid, or small cap.

Tracking error: Measure how does the portfolio return differ from the benchmark return. The higher the tracking errors the more difference return profile than the benchmark. The lower the tracking error the more portfolio return profile will be similar to the benchmark

Benchmark: is a term used to measure a fund with, for example Equity manager in US is measured against S&P 500 so is S&P 500 is the benchmark.

Alpha: is another investment term that is related toward, how much excess return is generated on top of the benchmark. For example Portfolio A generated 4% benchmark 2%, alpha of 2% is generated.

Relative and Absolute: Is a term used to look at funds style; Relative fund means is more aware about the benchmark and has a defined benchmark that they want to beat. Absolute funds are funds that focus on more capital preservation and invest purely on generating return unconstrained.

Information Ratio: This ratio will identify if a manager has beaten the benchmark by a lot in a few months or a little every month. The higher the IR the more consistent a manager is and consistency is an ideal trait.

$$\textbf{Information Ratio} = \frac{(R_p - R_i)}{S_{p-i}}$$

EXPERIENCE AND QUALITY OF THE FUND MANAGER: As per Morningstar Fund Spy[3] experience should be addressed interm of the exposure and through which time of investing as in, the fund management house and the type of mandates that are assigned. A known track record within a known fund manager is much more granted than a track record with less known asset management firm. Also the quality of the fund manager could be determined by meeting him or reading through the shareholder reports. Is he capable of explaining his investment thesis and discussing his approach. Also, is he comfortable of going through his historical investment decisions. Can he explain his investment decisions thoroughly and in a clear fashion way.

In support of Morningstar Dr. P. Bhuvaneswari published a research on Stock Selection ability of India mutual fund managers under conditional models[4] that the managers quality is important by getting the right stock selection ability through their historical track record. Also, mentioned that the ability of the fund manager will drive the final performance of the fund which supports Morningstar's claim that experience and quality

[3] MorningStar FundSpy, Chapter 7, Page 70-71

[4] Dr. P. Bhuvaneswari (2011) Stock Selection ability of India mutual fund managers under conditional models

of the fund manager is key in identifying good managers. Furthermore, [5] added another supporting data that quality of the fund manager and experience is important to differentiate between the good stocks from the bad stocks in a way by buying the one that will have higher chance to appreciate and sell the one that will have lower chance to appreciate.

Strongly agree with the way how in the MorningStar Fund spy book has identified that quality of the track record is important. From experience you could find great track records when you look at how its been accomplished some with $20m Asset under management and invested in few stocks that ran strongly. The other could be $20B that has been ran to create strong performance. Also, the type of the market and the challenge of that type of asset is really important, when you look at markets and you assess how effective can Active management be in that market versus Passive. The quality manager with strong track record in efficient market could be appreciated more than a track record with complete inefficient market. Example Developed market vs Emerging markets, Developed market is more efficient with higher coverage and disclosures than in Emerging markets. In the end experience and quality of the fund manager should be taken into consideration when track record is evaluated.

Furthermore, as a critique to the criteria is that by that you might eliminate in your screening an opportunity set that has lower track record and reasonable quality. The start portfolio manager that will be recognized at a later stage surely he will start with lower quality firm and investment mandates but will grow with time as he prove his capability. Having said that, any researcher that will screen a fund manager and apply these criteria will have a sample bias. In the end will affect the selection of the opportunity set, the recommendation is to have a dynamic screening to look into those kind of opportunities and have a due diligence to look into the quality of the fund manager and the experience that he gained through managing that investment mandates.

[5] The Value of Active Mutual fund Management: An examination of the stockholdings and trades of fund managers (2000)

INVESTMENT TEAM BETTER THAN PEER ON AGGREGATE: As per MorningStar Fund spy [6] Successful fund would maintain their competitive advantage of being able to attract and retain skilled and talented portfolio managers and analysts. That should be linked to a firm that has clear vision, incentive, opportunity, empowerment, and community. Maintain high stability and linked to performance structure. Also, having a career ladder in the firm help motivating the investment team. Also, it helps a lot to have the investment feel appreciated by the directors and managers through increase empowerment and responsibilities going forward.

Another criteria that comes strongly in my conviction, investing in funds that has strong investment team on aggregate and better than its peers is like buying a quality product. The investment team can create the ideas and rational on investment which create an edge over their competitors in being early to exploit opportunities from research and idea generation. Also, the communication and incentive important to keep everyone motivated and interested in working for the best of interest of the client and employee.

My critisim of the criteria is minor; as I think it is one of the most important things when you look into invest in equity Mutual fund is the investment team. However, a talented team will be extremely difficult to manage and have them all satisfied. Aside from the man management burden that will need to be applied, when a highly talented team fails to achieve their goals, many disconnect might arise, even its very difficult to compensate them during time where business isn't doing well, which will end up having a staff turnover and letting go some of the investment team.

ETHICAL MANAGER: As per Morning Star Fund spy[7], Ethical manager is as important of identifying skillful manager. Due to the fact that ethical manager will require to maintain clients interest above his own and company interest, their will be cases where the fund will have a limit or it might hurt the fund performance. Closing the limit means passing income to other competitor which typically difficult decision. It shares the same concept that empirical evidence show good corporate governance companies do better than bad corporate governance.

[6] Morningstar Fund spy, Chapter 7 P72
[7] Morning Star Fund spy, Chapter 7 P74

It could come important in certain conditions, such as during periods where the fund did well and massive interest starts to be piling up, and the strategy can't take anymore assets. The ethical manager might reject and think of the best interest of the clients before the employee or himself. Also, from professionalism standpoint if the money managers focus on the well being of the financial system and avoid manipulation, the system will be less vulnerable to fraud and investors confidence will stay strong. Generally the ethical manager could come important from organization and team stability. The more ethical the portfolio manager and the organization the more stable and long-term relationship could be maintained. Many examples occurred during the decade that portfolio manager has been asked to leave the organization due to insider trading or unethical activity from market prespective and personel. Furthermore, examples could be highlighted that low ethical manager could trade to benefit a client over client. Another example could be that unethical manager could affect his employer reputation in someway which will lead to jeoportize the business and the force the business to be unstable and operational risk might occur.

From experience, highly ethical manager are the one with the most discipline process and more documented researches and meetings. The ethical managers could be spotted by being process oriented and try to be thorough in their decisions and more long-term view. Also, exhibit fewer turnovers in the portfolios and rely on team approach and full disclosure between the portfolio manager and the clients. In the developed market with asset management firms that have long track record and a culture more possibility that you could find an ethical managers.

SHARE THE GAIN SHARE THE PAIN POLICY**:** By Morningstar FundSpy[8], Does Fund manager invest in the funds they manage, this could be critical as it provides confidence and believe that the fund run and managed in the best interest of the clients. Many think that their fund manager invests in the same fund they are investing in, but in truth not many. "Does the chief eat his own cooking?"

[8] Morningstar Fund spy, chapter 2, page 11-12

One of the important criteria's is to invest in a fund that the portfolio manager or the founder of the fund is invested in it as well. The importance could be seen in the commitment to the fund by the investment team will be higher. Also, from experience, when the firm employee participates in the fund, the fund managers will be passionate to achieve return targets and grow the business. Furthermore, under bear markets, the seeded capital would help the business to sustain and stay operational, especially under high levels of withdrawals.

My Critique, having seed money invested by the CIO or the portfolio managers provides more stability to the organization overall and during difficult periods. Furthermore, the investors will have more confidence in investing with a fund that the fund manager invested his personal money and savings in, provides clarity how much he believes in the asset class and they type of investing. The issue comes if the way that the organization and the fund is ran wrongly, it will be difficult to see a change in the mindset or organization team. The fund manager and founders due to the close relationship might not act on the best of interest of the investors due to financial behavior or to avoid losing more businesses and fully disclosure to his clients. On another angle, and from experience noticed few good businesses are ran by the founders and have grown substantially however, that amount of growth needed a change in the organization structure and culture. Once that occur and it fails to comply with the changes, drastic affect happen on the organization as a whole, will see many key members leaving in disagreement of the organization and how it is ran. In addition, might create a key man risk, incase of a retirement and the invested money have grown in the fund, it might affect the fund performance and the clients incase that amount is diluted. All in all, by and large it is better to have the fund manager and founder to invest in the asset class provides commitment and stability. However, it should be under a known rules and guidelines to account for any potential risk that might arise.

INVESTOR UNDERSTANDING FUND INVESTMENT PHILOSOPHY AND PROCESS**:** By Morningstar Fund spy[9], To understand fund philosophy and process could eliminate short-time volatility of the fund performance and map expectations of what market

[9] Morningstar Fund spy, Chapter 6, Page 45

condition did the strategy outperform or underperform. Analyzing the fund could be complex as the qualitative understanding will be followed by past performance, which provides evidence weather the perceived strategy does provide the expected performance as in is it going to out-perform in an up market or a down market.

In support to Morningstar criteria, [10] the research states that it is important to know the exposures of the portfolio and know in-sample historical positioning of the portfolio. Also, states that the fund managers were successful in owning buying stocks that rise more than stocks that they sell. However, to appreciate that needs to know and understand the portfolios positioning and not the performance only.

Another criteria that has been highlighted in Morningstar fund spy book, for investor understanding the fund philosophy and process is key in determining the expected underperformance and outperformance. The importance is how the fund manager can communicate clearly interm of how he exploit inefficiencies in the market and how is the market dynamic that is available that allows him to exploit value. To simplify it, can he explain why he invested the way he is that is philosophy and can he explains the how and that is the process. In the industry the general theme in analyzing fund strategies will focus a lot on those two and the fund manager need to be ready to go through the different parts of philosophy and process. The more clarity in communicating and providing supporting data the higher the rating will be given to that manager.

My critique to the MorningStar criteria is that, it doesn't have empirical evidence; most likely it was built upon an experienced portfolio managers questionnaire which doesn't have any quantitative evidence of the hypothesis that understanding the philosophy and process is a good indicator of the fund. The process and philosophy is something very effective if only it goes hand to hand with delivering good results. The difficulty lies with in the researcher who does the due diligence in assessing and rating the process and philosophy. Understanding the process and philosophy is a complex task and can lead to severe results. The rating to process and philosophy will require in-depth expertise in the asset class and different strategies.

[10] Detecting Performance Persistence in fund Managers: Book Benchmark Alpha analysis by Rajesh K. Aggarwal, Gavin Georgiev, and Jake Pinato (2005)

TIMING SKILL AND FUND STYLE**:** Diana P. Buiono Martin Martens: Mutual fund Style Timing Skills and alpha (24-Nov-09) [11], As per the study Mutual fund who demonstrate strong timing skills and alpha are a better choice than the one who doesn't. The timing skill is considered of market cap size, Value or Growth style tilts, and market timing. Also the Alpha generation shows that it better to select fund manager within the top deciles than the bottom top deciles.

On the contrary to Diana P. Buiono and Martin Martens study, [12] stated that overall, the measurement of timing activities using ex-post analysis find returns that doesn't reveal new information about fund manager abilities. The disagreement came by the timing performance measured by Treynor-Mazuy model is linearly related to the timing performance measured by the Hindrksson-Merton Model.

Somewhat agree and disagree with Buiono Martin about his research that Style timing and market cap is key and investing in Top dicile is much better than low dicile. The first part about style timing and shift between value and growth depend on the market conditions. Is a skill that can be difficult to measure however, you can say that certain manager have a thorough analytical view of the economy and can know where the economies growing or contracting and position accordingly. However, it's a skill that many managers suffered consequences when things turn around fast and he get caught in his call. However if it did work and his call is right as his timing was suitable he is going to gain big gains and will outperform considerably against his peer and benchmark.

The other aspect that if you are invested in top decile you are in a better position than investing in the bottom decile. I would take it case by case, some managers became all of a sudden out of favor and underperform massively and vice versa however if you look at it from a market cycle perspective lets say 3yr,5yr performance it will be easier to differentiate if they can add value or not in a long-term period. However again I disagree with providing general terms as seen from experience that managers underperform due to style bias for 3-4years in a row then burst into strong performance on wards. The timing

[11] Diana P. Buiono Martin Martens: Mutual fund Style Timing Skills and alpha (2010)
[12] Selection, timing, and total performance equity funds: wasting time measuring timing, Sebastian Krimm, Hendrick Scholz, and Marco Wilkens (2008)

that when you look at the fund performance going to bias your conclusion massively, which I personally and from experience try to not be influenced strongly by it.

MANAGEMENT FEES AND EXPENSE RATIO**:** John A. Haslem M.Kent Baker, and David M. Smith (Identification and Performance of equity Mutual Funds with High Management fees and Expense Ratios) [13]Management Fees and Carhart (1971) Study on Negative returns Vs Higher for actively managed funds the reason for that is after certain capacity fund managers are tempted to open excess capacity than the fund strategy can carry. The excess over capacity will be charged at a higher cost than the open capacity which will lead to the fund not easily outperforming the benchmark and on top of that expensive charges.

In complete agreement with what John, Kent and David on their research that identified those high performing funds get pressured by investors and fund house senior managers to open for extra capacities to be managed even though they are advised to not open and it might affect the performance. To compensate for that some managers open up capacity for extra fees that is hard to justify and create excess return with the fees. That will end up creating by affecting negatively on the profession and on the fund house by creating hurdle and pressure to generate value beyond their capability and their process. Charging higher management fees is never a good sign incase of fund that has reached capacity but willing to obtain for extra charges.

In the end a lose to lose situation might occur by managers underperforming the benchmark due to expensive fees and investors not benefiting from the fund due to expensive fees that is eating the fund performance. The result will occur that major outflows will occur from the fund ending the fund in a situation defending their expensive charges and regretting taking that extra capacity that they can’t take on board.

My critique, from my experience the fees are split in two ways, base fee and performance fee. The hedge fund style or the high return funds ask for low base or no base at all and require massive performance fee. The stable low volatility absolute driven funds are more

[13] John A. Haslem M.Kent Baker, and David M. Smith (Identification and Performance of equity Mutual Funds with High Management fees and Expense Ratios) (2008)

into base fee. The performance profile of the fund and the asset class need to be analyzed, to understand how much is it worth, like when you value a real estate, how much are you willing to pay for a return in this case “excess return”. The fund performance can be perceived if its viewed as Gross return, it must be viewed for performance measurement perspective as Net return ie subtracting the performance fees. From my experience there are funds that can provide net of fees return that provide excess return over a long-time period. The best choice is never been the one with the highest fees or with the lowest fees. The best choice is the one that can provide strong net of fees returns and can be done through a discipline process that can deliver excess return over a period of time.

CONCENTRATED FUND AND HIGH TRACKING ERROR**:** Global Equity Fund Performance, Portfolio Concentration & the fundamental Law of Active Management (Joop Huji & Jeroen Derwall)[14] Concentrated Funds with Higher levels of tracking error Display better performance than their More broadly diversified Counterparts based on Kacperczyk, Sialm, and Zheng (2005) Find that managers of funds who concentrate their holdings in specific industries perform better after controlling for risk using various performance measures. With manager who demonstrates superior stock selection and long-term horizon can benefit extremely from holding concentrated funds with high tracking error.

Somewhat agree and disagree with Portfolio concentration and the fundamental law of active management, in principle, it meant that given a portfolio manager with strong stock selection skill and given a long-term holding, high tracking error (deviate away from the benchmark) and holding fewer names than the benchmark. The agree part is, simply to beat a benchmark simply you need to deviate from it to an extent where you can have high active risk embedded in the portfolio. Also, to beat a benchmark someone need to have a bit of contrarian view and not follow the herd which end up having a high conviction names that the only reason for them to be in the portfolio is that will deliver strong returns and not because it is in the benchmark.

The Assumption that has been taken by Joob Huji & Jeroen Darwell, that someone can build successfully a portfolio of high tracking error and high concentrated portfolio is the

[14] Global Equity Fund Performance, Portfolio Concentration & the Fundamental Law of Active Management Joop Huji & Jeroen Derwall (2010)

right way to beat a benchmark, however that is too simplistic view and can be flowed if you got 2-3 names that blows up due to many reasons. The correlation between the names can persist going forward. The actual risk metrics might be too risky for some type of investors.

My critique to Joob and Jeroen darwell, is in the long-term the skill to select winner and have concentrated that perform in a way better than the benchmark and somewhat differently should be hand on hand with how long does an investor hold for short-term struggle in performance. Am leaning toward what is the max drawback analysis that those strategies could provide to make sure that someone can take that as criteria for a strong and good performing portfolio. If any investors have an alpha targets in a calendar year it might be difficult to hold to such kind of performance profile. However if its been extended to 3yr or 5yr measure, it could deliver strongly and the assumption of holding high tracking error concentrated portfolio is a good choice. From my experience the tracking error and concentrated bet, should be measured as what

HISTORICAL PERFORMANCE**:** The Goetzmann-Ibbotoson Study3 [15]. Tested the repeat–winner hypothesis over two-year, one-year and monthly intervals from 1975 to 1987. Investing in winners slightly increased the chance outperforming the return of the all fund average. Mutual funds over two periods revealed that past top performers had a 60% chance of being winners over the subsequent two years. While the repeat winner pattern may not be a guide to beating the market, it does appear to be guide to beating the pack over the long term. In addition [16] research stated that historic performance can provide some guidance by stating that past performance can be a good evidence to show the strong stock selection skill of the manager.

Somewhat agreeing with the analysis and in-depth research that Goetzmann and Ibbotson did about “Do winners repeat?”. Purely from quantitative analysis and looking on the performance as per the study that was running long period of 1975, period where many cycles minor and major occurred to the equity managers. That lead to important

[15] (William N. Gotzmann and Roger G. Ibbotson, “Do winners Repeat?” The Journal of portfolio management (windeter 1994, pp) 9-17.

[16] The value of active Mutual Fund Management: An Examination of the Stockholdings and Trades of Fund Managers (2000)

observation from performance standpoint, can you look at performance and give probability on screening a good manager from a bad manager. I believe you could do so, a top performer can stay as top performer in the long-only equity due to the no leverage and more efficient market than the money market and hedge funds. The performance as per the study is simply if you look at 3yrs performance a manager that performed two out of the three has higher chance to perform more than a 1 out of 3 years.

Stepping back, the study was looking into the US market for 12years, and was screening the long-only equity managers and whether an assumption could be observed. The sample size is large and massive analysis has been done to prove that, however someone can raise a question is that still valid and whether the more sophisticated market information and increase level of competition might affect the analysis. It would be very important to distinct that the research that has been done provided a probability which wasn’t that high to confirm a bold statement that you can take of a grant. The probability was 60% back in the days that the DJIA was much less sophisticated and competition among equity managers wasn’t as high as the present time.

From experience, the analysis is in-depth and provides an edge when we look at the current equity managers, performance is key in analyzing a fund manager, it will be the evidence that it provides whether the manager is as good as what his process and philosophy describe. Also, whether the performance that has been generated delivers as expected ie value manager outperform in a down market, gives more conviction in a manager than a value manager that outperform in an up market.

Furthermore, active risk needs to be assessed hand-on-hand with the performance that has been done and how much of an Information ratio and Tracking error the fund provided. Simplifying it, basically when a portfolio outperform, how much did it outperform and how much T/E did the fund exhibit, which can be measured by the Information Ratio. The higher the information ratio and higher Sharpe ratio the better the fund performance. It means that the fund performed extremely well in low risk and low volatility has been exhibited. All of this analysis should be done once historic performance has been taken as criteria.

FUND SIZE AND PERFORMANCE: Rao DN and Rao SB in their published journal "Does fund size affect performance of equity mutual funds?"[17] proved by empirical evidence that funds with smaller fund size outperform more than funds with bigger fund size. The analysis has been done on the Indian equity market through the mutual funds and number 244 funds as a sample size. The first step for them is that they reviewed the research that has been done by Wilson et al (2007) in "How does fund size and affect Mutual fund behavior". The analysis by Rao and Rao has been extended to be tested against styles and market cap. The test where conducted to see whether fund size can be confirmed that it affect the performance regardless of the market cap and style. Furthermore the conclusion was that no clear evidence that shows that the fund size can have a significant degree on outperforming the market combined with market cap and investment style.

The general idea of testing the fund size against the performance initially could sound viable and has a potential to qualify as a criteria to select a fund. However through the study Rao and Rao presented it didn't appear that the hypothesis held and it has a statistical significance. The fund size for a short-term and under huge market volatility can help however, when there is a clear trend of the market as in, the economy is doing well and the corporate earnings are positive with momentum, fund size wouldn't matter, if someone will apply buy and hold for 1-3years period. The whole idea of funds to have small fund size, is easier to get into a stock or sector without signaling to the market. If you take like for like investment style and compared fund size and what affect it will have on performance its most likely that only during trading and if you extend for a long-term period it might be minor and can lead good or bad result that need to be tested ie if you waited more holding a stock it can have more of an upside before you sell it off and vice versa.

My critique will be on Rao and Rao journal to start first, that the sample size that has been picked is about one single country funds and didn't involve different markets and different nature that might react differently. Also, the period that has been selected is a period where trend of the market was upward slopping as in it was in one trend that

[17] Rao DN and Rao SB in their published journal "Does fund size affect performance of equity mutual funds?" (2010)

doesn’t differentiate between fund size as a sample size that might be looked as a sample bias. Also, the liquidity of the market might be important in this kind of study. The liquidity of the market will affect how easy if small or large fund size can be traded easily within the market

The cost of Active Investing: Kenneth R French followed the likes of V. Bogle (2007) and Sharpe (1991) that have advised that investing in low cost fees funds and passive fund with low tracking error provides better result for a long period of time. The study have been conducted in the US equity market from 1980 to 2006 and found that investors spend on average 0.67% pursuing superior returns. The research is targeted to benefit the investors by being long-only investor with passive investment that invest in an index tracking portfolio and avoid the seek of excess value “alpha” over the benchmark. The study measured four components, fees, experience investors pay for mutual funds, investment management cost, fees paid for hedge fund and transaction cost for switching between funds. All of the four-component cost is compared to a single long-only passive fund over the same time period. The economical reason for active investment can go beyond creating value, its sole principal is that the equity market is inefficient and doesn’t reflect the business economical value and professional investors try to find the true intrinsic value and correct the mispriced securities.

Furthermore the critique for Kenneth study is the time-period and the market that has been measured is can be considered by most investors is the most efficient equity market. Having said that, a market being highly efficient is a market that active management find it difficult to beat.. Also, the measured group was over all the active fund managers which disregarded some or handful names that beated the benchmark substantially over that period and maintained top quartile for a long period of time. The skill of the active managers can be exhibited in more clarity over 3-5yr period as it need to be viewed over a market cycle and identify whether they can add value in a net of cost return.

The market as Trynor black portfolio management rule, the market passes through cycles the more the investors move toward passive investment and less active investment, the more inefficient the market become and more chance for active management to create alpha. It is simply says, the passive investment override the fundamentals of the companies and are based on historical backward performance of the companies. Thus, it creates opportunities for active management to adjust the mispriced securities and increase the efficiency of the market. In Kenneth study that aspect wasn't covered which is a flag of critique that can be raised.

2.3. CONCLUSION

It is important to highlight the difficulty of collating all the criteria and critiquing each, due to different time-period and data samples. To simplify we have to take the assumption of that study on that time-period worked and the evidence is visible in the study. The literature review was difficult to critique mostly due to the complexity of the data analysis and the thought process where done by the likes of Bill Sharp and Kenneth R. French. To be a critique someone need to be giving it from his angle and support it by empirical evidence if available. Having said that, during my literature review, it was difficult to find a study that collated all the criteria and stress test the importance of each. Given all the available data and with the help of the external parties that are portfolio managers and researches in the current industry of investing fund, I will create a questionnaire to stress test and rank those criteria. After screening the researches and academicals books that have been done historically focused on looking at specialized criteria to select fund managers and found 11 criteria 9 qualified and disqualified 2 ranking. The base of the decision was due to the research study and what time period adding to it my experience with such type of investment. The aim of the study is to find suitable criteria with a high to low rank when investors or researchers look at the fund manager and base a decision. The criteria could be subjective or doesn't cover all the aspects due to shortage of resources or avoiding the duplication of doing other work. During the literature review collated all the criteria an provided explanation with summary to each criteria. For every criteria I have created from my experience a critique paragraph that explain why it qualified or disqualified. The number of criteria that qualified was based on strong argument and empirical data that is supported by the research or the academicals book.

All in all, the literature review was a tiring exercise but worth covering each bit by each, the researches where done extremely well and documented in the most sophisticated way.

The results came very well, and the criteria that qualified stands strong and have enough evidence from empirical stand point to be dependent and in the end I collated those criteria and showed why they could be collated together to be ready for the questionnaire.

Chapter three

During this chapter will cover the 1) research methodology and how it will help in navigating through the research to provide proper framework to achieve the objectives. In addition, will cover where the 2) source of the data and how it will be used to provide the supporting tools for Results and findings.

3. Methodology:

3.1. Introduction

To qualify this research into a meaningful and evidence driven, it will be hard to measure and prove statistically. The research will be measure and critiqued through a questionnaire approach, that will be sent to leaders within the industry such as portfolio managers that manage various strategies in equity space. The portfolio managers will be variety that managed regional funds and single country funds. The sample size would be as big as possible to make the questionnaire results meaningful and can drive conclusions. First the questionnaire will include criteria that have been found in academic researches and journals. Also through reading Morningstar book which is one of leading consultancy to invest in funds. The criteria will be tested in three different scenarios during up down and middle market cycles. Each sample will have eight criteria to be rated 1-3 (1) is most important (3) Least important ranking for the three market conditions. It has been constructed in this way to make the research intuitive and to get as much clarity to the criteria when does it work and how important it is during the market cycle.

The idea to get questionnaire might not be as exciting as to prove statistically through T-test or chi-square however due to unique circumstances about selecting fund manager criteria qualitative judgment will be the most important factor and how important it is to the investors is what going to be presented. The eight criteria will be ranked however that doesn’t mean if criteria is consistent throughout the different market conditions and rated 1 is the one that to be considered as strong criteria for selection and if it’s been ranked 3 through the different market conditions if least important and should be taken inconsideration however they will be less of importance and that is important distinguish.

3.2. EMPIRICAL DATA AND DATA ANALYSIS

The concept of empirical data and data analysis is to provide evidence based on empirical analysis, that is, dependent on statistical data or observable results. The term refers to the use of working hypothesis that are testable using observation or experiment in this sense of the word, scientific statements are subject to, and derived from, our experiences or observations.

First reversed engineered the methodology by starting the thought process by what the end result need to look like to provide support to fulfill the objective. The best course of action is to create a questionnaire based research that will have criteria that are selected from the available research journals and relevant books. The second step is to send it to participants that are portfolio managers and experienced researchers in the equity fund management industry to rank and provide their feedback.

The question that might be raised, how will I have an access to get responses from such a distinguished group? The answer is simply due to the benefit of me working as a researcher of equity strategies for several years in a known established institution that looks into investing in equity strategies, lots of contacts been made and might be helpful in completing the exercise. The aim is to collate the industry experts and capitalize on my contacts in the industry to get accurate responses that have high value in determining the criteria rank. The methods that will be used, is Microsoft word to construct the questionnaire template. For distribution purpose and follow up Microsoft office will be used to send the questionnaire via e-mail to the participants. The participants will be portfolio managers that are managing money over a regional mandate and single country mandate.

The responses will be analyzed by Microsoft excel to provide a statistical view of the responses such as graphs and histograms. The data will be sliced and diced, if the sample size and responses is appropriate to it will have different view and sub grouped in a way such as regional mandate responses are evaluated alone and single mandates alone. If they are combined how it does differ from splitting them apart.

The Data will be presented in user-friendly that will have mostly a graph and observation to highlight the results and ranking. The quality of the sample size is important more than the quantity as the responses are coming from leaders in the globe in managing equity money. The sample size might be difficult to be maximized however will be sending to all the available contacts. The quality of the sample size will be taken into consideration significantly as the number of participants might not be as important as the quality of the responses.

3.3. METHODOLOGY OUTLINE

The main element that will be discussed and researched is criteria to select Equity fund manager. The criteria will be obtained through academic researches that have been done in the past. The assessment and ranking will be done by external participants who have exceptional experience within the industry of managing equity mandates. First the criteria has been reviewed and identified in the literature review. The second step is to create a questionnaire that has three scenarios of a market cycle; 1) **A:** Bottom of a market cycle, 2) **B:** Mid of a market cycle, and 3) **C:** Peak of a market cycle. Last step is to obtain the data and graph it in a way to show which of the criteria can persist through different market condition and can measure the importance of that criteria in the selection process.

The questionnaire as mentioned will be sent as a dry draft to internal and external participants, the internal participant will be within the organization and the external will be off the organization. The aim is to get an initial feedback is to be reasonably clear for the other external and internal participants who will be ranking the criteria.

In the end the conclusion will clarify during different market cycle does the mentioned criteria holds or one should be looking different through the market cycles. Also, it will highlight on average which among the mentioned eight criteria has a higher importance over the other.

3.4. MODELS

The research will be dependent on more simple quantitative judgment due questionnaire the empirical evidence and models to analyze the data will not be key element. The key elements that will drive success as a framework for the methodology. 1) Successful questionnaire 2) Quality responses, and 3) Enough data sample for data analysis.

As a matter of fact, the questionnaire will be the model of the research, as it will require the participants to add ranking from 1 to 9 as from best to worst. Then they will be required to add the criteria in three-market cycle conditions bottom, middle, and peak. The purpose is to have more genuine statistics to analyze and more in-depth data that have for every criteria three dependencies to be evaluated.

At a later stage in data analysis, distribution frequency table will be used to analyze the data, and provide statistical graphs of the result. The template is created in Microsoft excel to provide the data presentation such as graphs and histograms. The template is simple is basically plotting a matrix on the x-axis is the criteria or market condition and the y-axis is the rating of the users to the criteria. There will be initially three tables, each table will be for every single market condition ie one for the trough, middle, and peak. The data presentations will be important to know how the data will be presented. The data can be presented by the strategies that are ran by the questionnaire participants, by the market cycle position, by the group on aggregate.

There will be three tables, each market cycle will have different response and then compared to each other to see the differences and observations.

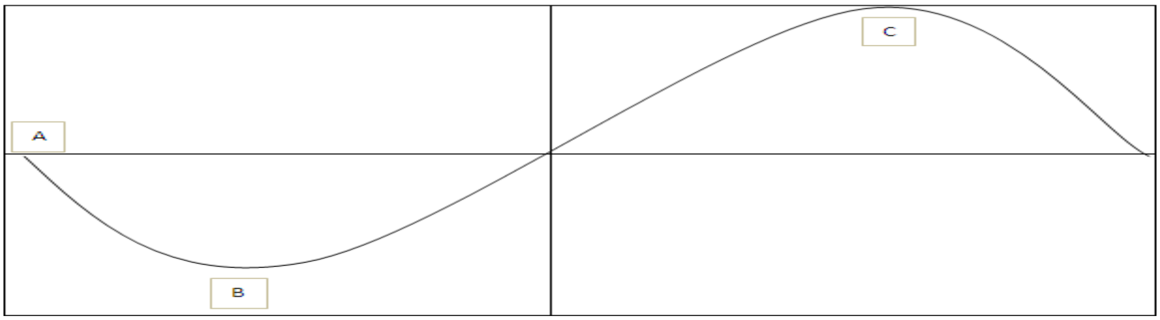
3.4.1. QUESTIONNAIRE:

Questionnaire: The mentioned criteria are to be ranked by external participants where they will presume three periods in the market cycle (bottom, Mid, Peak) to be considered. The equity market that has been taken as test subject is Dow Jones Industrial Index. The market cycle market conditions are three A) Middle, B) Trough, and C) Peak. The ranking will be from 1-3 (1 is the most important 3 is the least lowest) it will be ranked by importance and during each market cycle scenario (A-B-C)

Criteria	Description	Ranking (1-3)			Comment
Experience and	- Worked and created track record in known Asset	A	B	C	(Provide short description of your rating)

quality of the fund manager	Management firm - Exposure of PM to different mandates and investment regions - Academic designation such as MBA, CFA, PHD				
Investment team better than Peer on aggregate	- Quality of the investment team - Investment team is better on aggregate than the peers - Compensated at a better level than their peers				
Ethical Manager	- Work in the best of interest to the clients - Close the fund limit even if Asset under management linked to the fund manager bonus				
Share the gain share the pain policy	- Investing in the fund that fund manager manages - Provide seeding to the fund before the investors - Stay put in the fund during volatile down markets				
Investor understanding fund investment philosophy and process	- Does the fund manager communicate the fund philosophy and process properly to the investors - Does the fund manager allocate enough time to meet and explain the portfolio exposure over-time to the investors - How good is the fund manager explaining the fund philosophy process and historical exposures of the fund				
Timing skill , fund style , and concentrated fund and high tracking error	- Shifting through the market cycle style tilts (Growth to Value) and vice versa. - Control market cap through the liquidity of the economy and risk aversion - Fund manager that can run high tracking error from the benchmark.				
Management Fees and Expense Ratio	- Charging excess management fees after issuing that the fund closed - Will affect the fund to outperform the benchmark on net of fees - Will create pressure on the fund style to take more risk to fulfill the high management fees				
Historic Performance	- Top performers have higher probability to perform in the next two years - Top quartile performers exhibit persistence in being their for over 5years period - Historic performance can lead to find higher probability of winners for a 2-5years of time period				

Market Cycle: A) Middle, B)Trough, and C) Peak

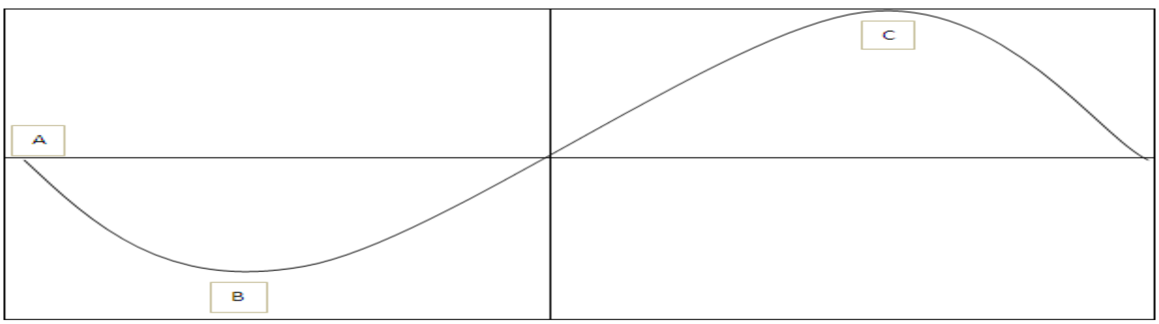


Initially the below questionnaire were sent to test the ranking of the following criteria during different market conditions. However, due to the dry run results and advices it’s been changed instead of ranking them to measure and assess the importance to the criteria. Importance degree where sent to measure each criteria. As you can see below the initial questionnaire that been changed to the previous questionnaire.

Criteria	**Description**	**Ranking (1-8)**			**Comment**
		A	B	C	(Provide short description of your rating)
Experience and quality of the fund manager	- Worked and created track record in known Asset Management firm - Exposure of PM to different mandates and investment regions - Academic designation such as MBA, CFA, PHD				
Investment team better than Peer on aggregate	- Quality of the investment team - Investment team is better on aggregate than the peers - Compensated at a better level than their peers				
Ethical Manager	- Work in the best of interest to the clients - Close the fund limit even if Asset under management linked to the fund manager bonus				
Share the gain share the pain policy	- Investing in the fund that fund manager manages - Provide seeding to the fund before the investors - Stay put in the fund during volatile down markets				
Investor understanding fund investment philosophy and process	- Does the fund manager communicate the fund philosophy and process properly to the investors - Does the fund manager allocate enough time to meet and explain the portfolio exposure over-time to the investors - How good is the fund manager explaining the fund philosophy process and historical exposures of the fund				
Timing skill and	- Shifting through the market cycle style tilts (Growth				

fund style, and Concentrated fund and high tracking error	to Value) and vice versa. - Control market cap through the liquidity of the economy and risk aversion - Fund manager that can run high tracking error from the benchmark.				
Management Fees and Expense Ratio	- Charging excess management fees after issuing that the fund closed - Will affect the fund to outperform the benchmark on net of fees - Will create pressure on the fund style to take more risk to fulfill the high management fees				
Historic Performance	- Top performers have higher probability to perform in the next two years - Top quartile performers exhibit persistence in being their for over 5years period - Historic performance can lead to find higher probability of winners for a 2-5years of time period				

Market Cycle: A) Middle, B)Trough, and C) Peak



The models that are used to create and spread the questionnaire and finally analyzing the data were Microsoft Office, Excel, and Outlook. Microsoft Office used to create the questionnaire and format it in a user-friendly way. Microsoft Outlook used to receive and send responses to the users. Lastly Microsoft Excel is to create graphs that can be presented in the findings and remarks.

The simplicity of the used model to help providing meaningful results that can be understood. You could see below the provided models to provide the required data analysis:

To gather the Middle market condition responses:

Middle	Experience and quality of the fund manager	Ethical Manager	Investor understanding fund investment philosophy and process	Timing skill, fund style, and ability to run concentrated portfolio	Investment team better than Peer on aggregate	Historic Performance	Management fees and expense ratio	Share the gain share the pain policy	Average
1									
2									
3									
4									
5									
6									
7									
8									
9									
10									
11									
12									
13									
14									
15									
16									
17									
18									
19									
20									
21									
22									
23									
24									
25									
26									
27									
28									
29									
30									
Total									

To gather the Trough market condition responses:

Trough	Investor understanding fund investment philosophy and process	Experience and quality of the fund manager	Ethical Manager	Investment team better than Peer on aggregate	Timing skill, fund style, and ability to run concentrated portfolio	Historic Performance	Share the gain share the pain policy	Management fees and expense ratio	Average
1									
2									
3									
4									
5									
6									
7									
8									
9									
10									
11									
12									
13									
14									
15									
16									
17									
18									
19									
20									
21									
22									
23									
24									
25									
26									
27									
28									
29									
30									
Total									

To gather the Peak market condition responses:

Peak	Experience and quality of the fund manager	Investment team better than Peer on aggregate	Ethical Manager	Historic Performance	Timing skill, fund style, and ability to run concentrated portfolio	Investor understanding fund investment philosophy and process	Share the gain share the pain policy	Management fees and expense ratio	Average
1									
2									
3									
4									
5									
6									
7									
8									
9									
10									
11									
12									
13									
14									
15									
16									
17									
18									
19									
20									
21									
22									
23									
24									
25									
26									
27									
28									
29									
30									
Total									

Each table contain ratings from 1-3 for each criteria that is rated by the users. The 30 user response been recorded in the table to observe the results and start graphing the findings. The tables provided data to analyze the responses in a way to view each criteria and how much as a total been rated (lowest is best highest is worst). The three tables are to provide responses during different market condition and to see the difference perspective of the users during different market conditions.

3.5. Conclusion

The methodology to choose questionnaire is to provide a meaningful result with low number of sample size and high quality in the sample size. The described methodology might look simple and less of stats and empirical evidence, however, to make things looks simple is one of my goals in producing a comprehensive research. The difficult part of the research was to get the academic research criteria and getting quality responses. Almost any person that has an investment interest or background can provide a response to the questionnaire about selecting fund managers however; to get the response from experience fund managers or researchers will give more quality in the result.

The outline of the methodology is basically to get enough data and plot a questionnaire that doesn't take much of the time of the participants to get the highest number of responses. The researched criteria wasn't cherry picking as the skimmed through books and academic journals of known economists and professors beside the ones that are unknown as well. The aim was to get everyone's input and consolidate it and critique it by my experience in selecting equity strategies.

All in all, the models that will be used is simple statistical model that will be generated in Microsoft excel. The graphs and histograms will be generated in a user-friendly way, to make the reader or observer in a much more appealing way to grasp the idea and results.

The questionnaire conducted manually to assure the results are delivery in a good quality. The level of complexity and in-depth level of understanding is required to answer the questionnaire. The reason was that the questionnaire was targeting assessing and critiquing a proven or suggested criteria by experts in the fund management and selection industry.

CHAPTER FOUR

During chapter four, discussed data analysis and results; 1) All the criteria during the three each market condition 2) specific criteria during different market conditions.

4. DATA ANALYSIS & RESULTS

4.1. INTRODUCTION

The results will critique and assess the criteria that were presented by the academia such as Journals and books to select equity fund managers. The way is to identify through questionnaire the importance of the criteria through different market condition. The analysis went through different stages as stated in the methodology two versions of questionnaire the first was rough draft and the other is the actual post the modification from the rough draft.

The questionnaire results where targeted to assess each criteria on its own during different market conditions (Middle, Trough, and Peak). The responses came variable and will be explored shortly in the Findings and Remarks. Taking step back the rough draft was to rank the criteria through different market conditions, however due to the avoidance of subjectivity and importance of the academia work changed from ranking to assessing the importance of the criteria.

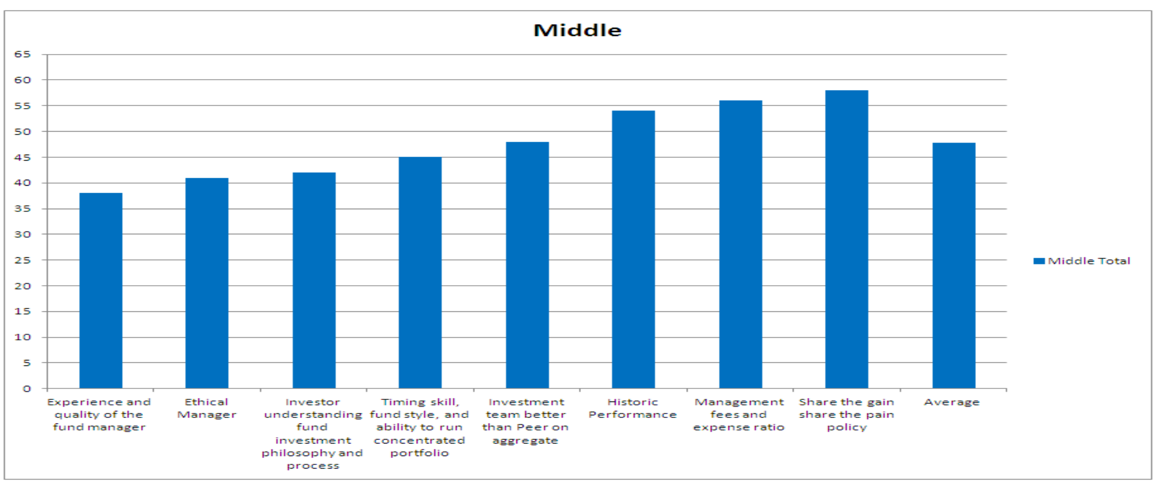
The questionnaire responses came all from investment professionals who worked in different asset classes such as Alternative Investments, Internal Equity, and External Equity. That has different specialization in managing money and in managing funds. The questionnaire provided a good sideways by providing and covering the academia research. The second part is to provide the feedback of the questionnaire users and my own experience in the selection of equity fund managers which will be done in Recommendations section.

4.2. MODELS DATA SUMMARY

The models where adequate enough to provide meaningful results that will be reflected in the findings. The three tables where used to enter the rating for each criteria. Each criteria will have a total in the bottom of the column that adds all the rating. The raters where 30 investment professionals so the range will be (30-90) the lower the rating the better. Also, added average in the end to measure the raters how do they think of the market condition and the 8 criteria as a whole. That will help to understand which market condition among the 8 criteria is most important to least important. The rating came as a feedback from the questionnaire. Each market condition will have list from 1-8, 1 most important 8 least important.

In Summary the users rated the criteria in Middle market condition from most important to least important the following:

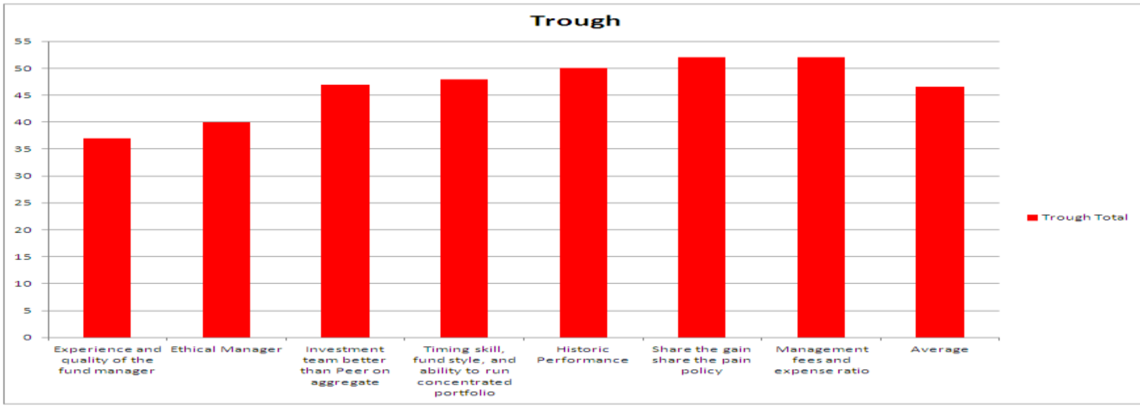
1- Experience and quality of the fund manager
2- Ethical Manager
3- Investor Understanding Fund investment philosophy and process
4- Timing Skill Fund Style and Ability to run Concentrated portfolio
5- Investment team better than peer on aggregate
6- Historic Performance
7- Management Fees and expense ratio
8- Share the gain share the Pain policy



Trough market conditions from most important to least important the following:

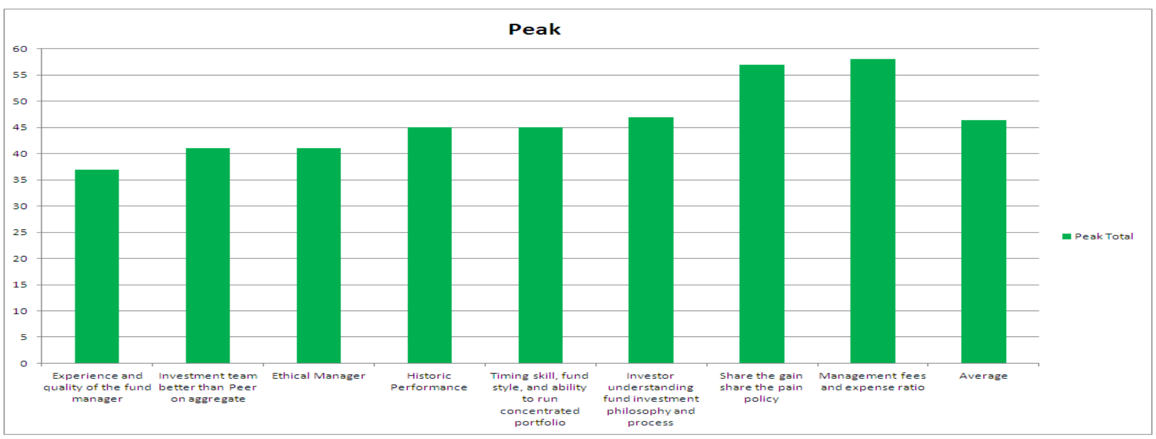
1- Investor Understanding fund investment philosophy and process
2- Experience and quality of the fund manager
3- Ethical Manager
4- Investment team better than peer on aggregate

5- Timing Skill Fund Style and Ability to run Concentrated portfolio
6- Historic Performance
7- Share the gain share the Pain policy
8- Management Fees and expense ratio

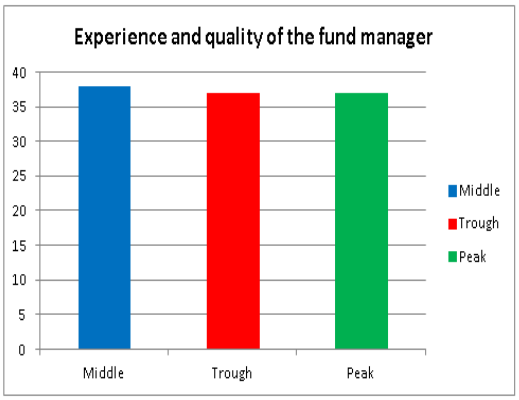


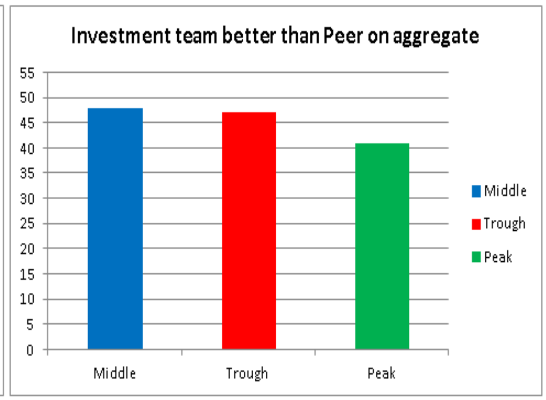
Peak market conditions from most important to least important the following:

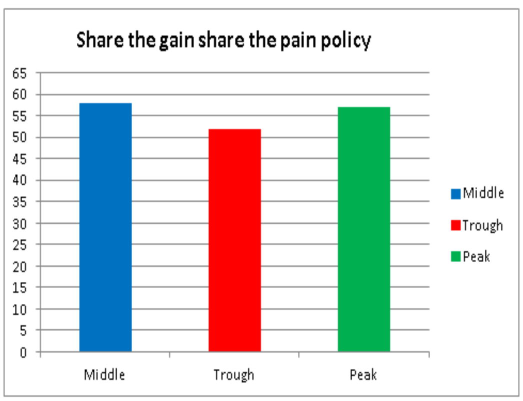
1- Experience and quality of the fund manager
2- Investment team better than peer on aggregate
3- Ethical Manager
4- Timing Skill Fund Style and Ability to run Concentrated portfolio
5- Investor Understanding fund investment philosophy and process
6- Historic Performance
7- Share the gain share the Pain policy
8- Management Fees and expense ratio

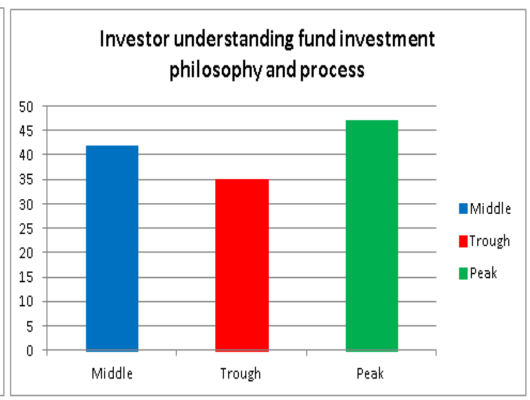


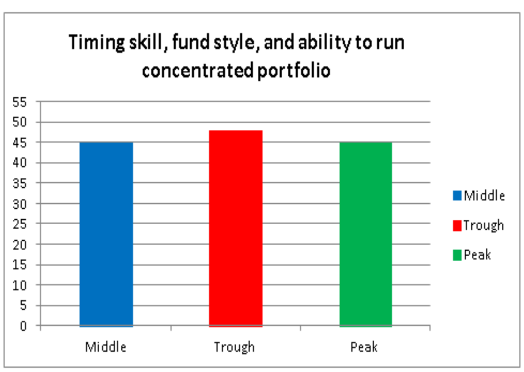
The second part of the data summary models came as graph for each criteria during the market condition. The aim is to see if there is a consistency of the importance level during market conditions and it could be that there isn't any consistency. Each Bar graph will have three colors, Blue Middle, Red Trough, and Green Peak to make it easier for the readers to see the difference. Furthermore on the Y-Axis is the 30 responses rating that was done with a range (30-90).

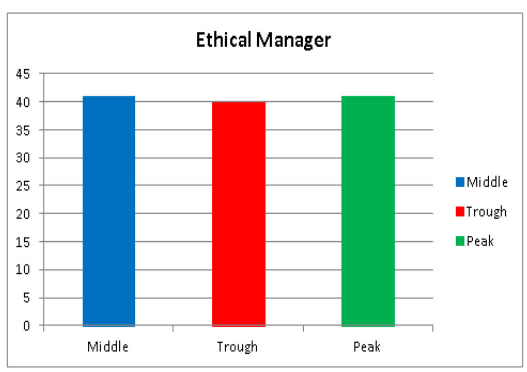


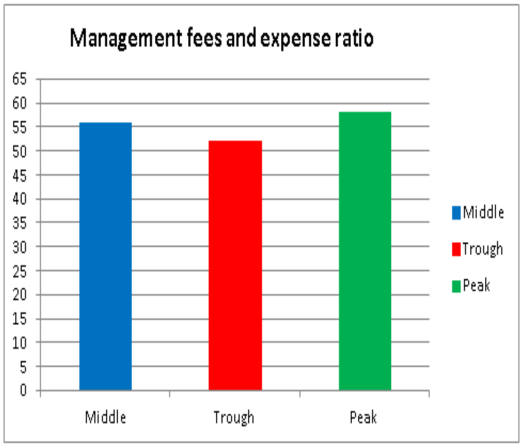











Management fees and expense ratio
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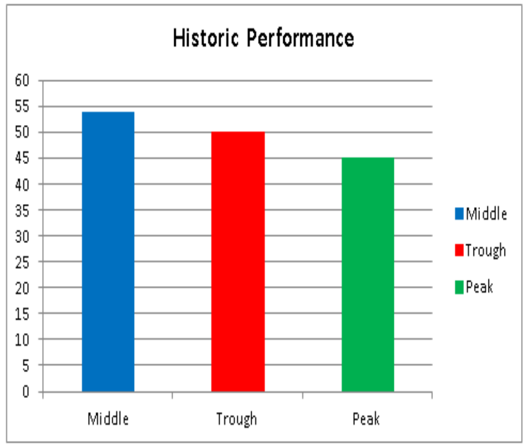
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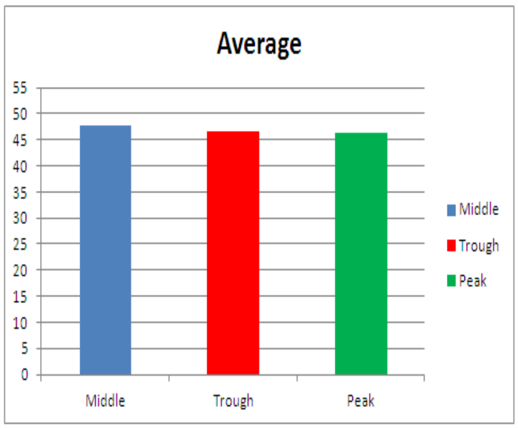
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CHAPTER FIVE

Chapter five will highlight a general and specific findings and remarks. Also, will provided the recommendation that came from four sources 1) Academia research papers 2) Questionnaire feedback 3) Industry leader 4) Personal experience.

5. FINDINGS AND REMARKS

Laying a framework and a summary to what did the research cover before viewing the findings and remarks. The objective is to assess and critique criteria of selection equity fund managers. The methodology was to create a questionnaire to rate the criteria to provide a data supported review of the criteria. In addition, added to the questionnaire something you might call a “twist” does the rating for the criteria changes during market conditions or stay consistent.

5.1. GENERAL FINDINGS AND REMARKS

- Trough is the period that criteria of selecting equity fund manager were the most important relative to Peak and Middle market cycle. On average the rating were 1)Trough, 2)Peak, and 3)Middle.
- During the different market conditions two criteria that exhibited a consistency during the different market conditions; Experience and quality of the fund manager and Ethical manager. The rest didn’t show consistency during the different market conditions (Middle, Trough, and Peak).

5.2. STATISTICAL FINDINGS AND REMARKS

- Created Chi-square test on one of the consistent criteria during different market conditions. Added four nominal (Gender, Investment Region, Occupation, Investment experience). The aim is to add more in-depth statistical layer over the criteria to see if any of the nominal group exhibit statistical significance.
- The research has 8 different criteria and 3 market condition, which means 24 scenario on four nominal tests would overload the study and research. For showing statistical view of the criteria I took random sample of only one criteria during single market condition.

Gender * Experience and quality of the fund manager Trough				
		Experience and quality of the fund manager Trough		Total
		Most important	Less important	
Gender	Male	21	4	25
	Female	4	1	5
Total		25	5	30

Chi-Square test showed that there isn't strong statistical significance of Gender being different in assessing the criteria during trough market conditions.

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	.048[a]	1	.827

Occupation * Experience and quality of the fund manager Trough				
		Experience and quality of the fund manager Trough		Total
		Most important	Less important	
Occupation	Analyst	12	5	17
	Portfolio Manager	13	0	13
Total		25	5	30

Chi-square test exhibited statistical significance that Analysts and portfolio manager rated differently the criteria during trough market conditions.

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	4.588[a]	1	.032

Investment region * Experience and quality of the fund manager Trough		
	Experience and quality of the fund manager Trough	Total

		Most important	Less important	
Investment region	Developed Markets	12	4	16
	Emerging Markets	13	1	14
Total		25	5	30

Investor region of expertise (Developed Market, Emerging Market) didn't show any statistical significance that the rating will be indifferent.

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	1.714[a]	1	.190

Investment experience * Experience and quality of the fund manager Trough

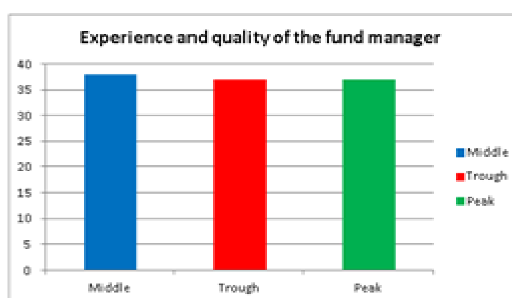
		Experience and quality of the fund manager Trough		Total
		Most important	Less important	
Investment experience	Less than 5years	8	3	11
	More than 5years	17	2	19
Total		25	5	30

Investment experience showed weak statistical significance showing that investment experience didn't differentiate in rating.

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	1.407[a]	1	.236

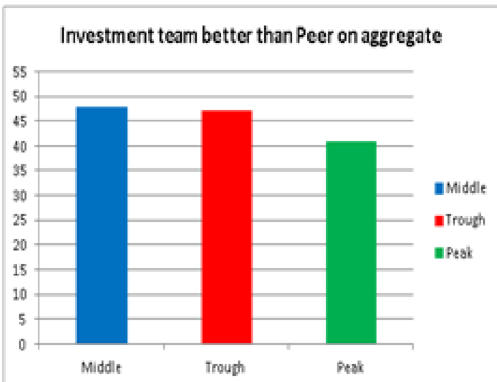
5.3. SPECIFIC CRITERIA FINDINGS AND REMARKS

- Experience and Quality of the Fund manager, is the only criteria that stayed consistent as the most important to be considered during the selection of equity fund manager. During Trough and Peak it

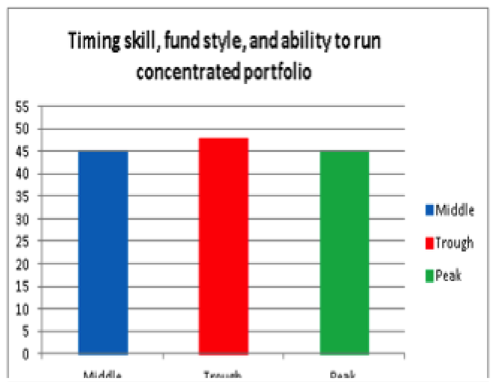


is been selected as more important than at middle cycle market condition.

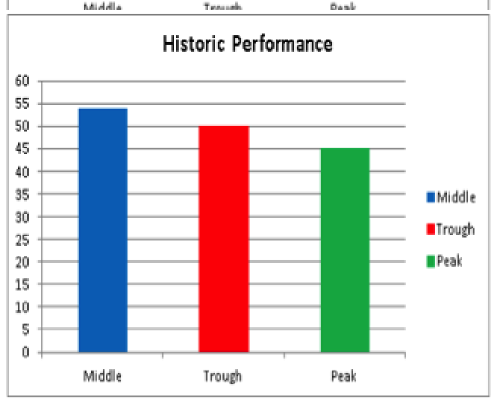
- Ethical Manager, Another criteria that came second and been consistent during two out of three market conditions to be considered. Noted that during Trough time it's more important than during Peak and Middle Cycle



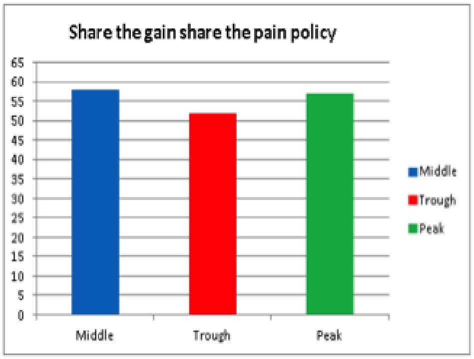
- Investment Team better than peers on aggregate, apparently in Peak market condition its been rated higher than both Trough and Middle market conditions. However the criteria was rated differently during each market condition that provides low consistency when considering the criteria.



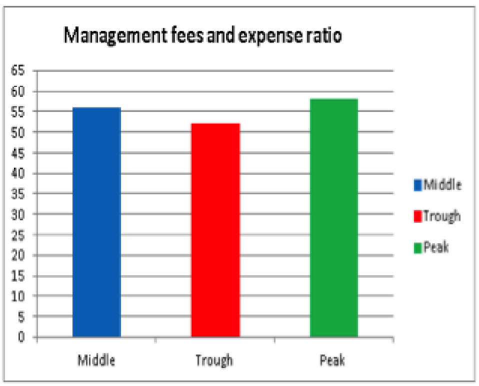
- Timing Skill, Fund Style, and ability to run concentrated portfolio. Rated highly during middle and peak market conditions and almost equal rating in both market conditions. However in Trough was looked weak as per the rater. Another criteria that didn't show consistency during the different market conditions However provided meaningful reason to depend on it by being stable during two out of three market conditions.



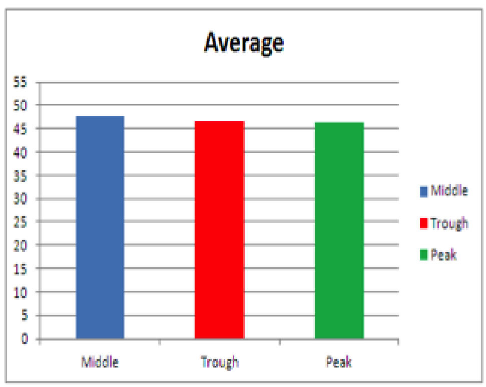
- Historic Performance, another criteria that didn't show consistency through the market cycle. Peak market condition was the best as per the raters and the worst is in the middle market condition. Trough came closer to the middle market condition rating than the Peak. Historic performance



- Share the gain share the pain policy, couldn't hold through the different market condition as a constant factor. However, the factor been rated as a low importance. During Peak market condition it was rated as a reasonable important however through Middle and Peak market condition its been among the least important criteria.



- Management Fees and expense ratio, another criteria that didn't hold during the different market conditions. The highest rating was given in the trough market and the worst in Peak market condition. In the Middle cycle also been rated as a low importance. The criteria on average been rated the worst through the different market conditions.



- Average, is simply the average of all the rating during the market condition. Found it interesting to see on average what is the most to least market condition that is rated. Apparently raters saw that Peak followed by Trough and Middle market condition from most important to least important. However, not much of difference between the three market conditions.

Summarizing the remarks and findings, few surprises came along however just to state the facts, two criteria was highly rated and consistent during different market conditions. Few of the six factors showed stronger linear relationship in the rating however not constant rating during all the market conditions. Also, another factors exhibited weakness and inconsistency during the different market conditions. The findings and remarks could be stated the least is surprising given that management fees and expense ratio came the least important among all the eight criteria.

Two criteria showed consistency and highly rated during the different market conditions. Were 1) Experience and quality of the fund manager. 2) Ethical Manager. The least two criteria that were rated as the least important 1) Share the gain share the pain policy and 2) Management fees and expense ratio. On average raters thought that during Peak market conditions criteria were more important than Middle and Trough market conditions.

5.4. RECOMMENDATIONS

Taking step back, to provide a strong research I will state in this section the other criteria that should be considered in selection of equity fund manager beside the eight criteria that were found in the academia. In the beginning the eight criteria that were found were assessed and critiqued by supported data as seen in the findings and remarks. To provide more depth in the research and value, will be adding personal level experience and the users who responded to the questionnaire.

The industry way of selection equity fund manager is by far more complex than what is written in the academia or expressed in a data supported studies. The industry looks at multiple criteria and try to assess them all at once for each of the fund manager given the way the academia have done it, they take a single factor and try to provide a meaningful amount of data to support it, and however it might be true if you apply it for all the equity fund managers. However, the industry screens and filter the manager until they get to a handful number which can passes most of the academia criteria by then you end up with not much of conclusion then checklist that those criteria are there but which one could be seen that have an edge over the other, or which is the most appropriate for the retail investor or institution.

Questionnaire recommendation

1) If investor thinks of Long-term investing with fund manager that demonstrates the following criteria; 1) Quality and experience of the fund manager, 2) Ethical fund manager
2) If investor thinks of Short-term investing Short-term investing the other six criteria are suitable depending on which market conditions he is investing.

To provide more color to the recommendation, there will be three type of guidance to what is the industry like to see in equity fund manager selection process.

1) Questionnaire users feedback
2) Known Industry leader in selecting equity fund manager
3) Personal Experience and process

Will start with the questionnaire user feedback; The question was in the questionnaire what other factors to what other than the presented criteria would you think needed to be exhibited in the equity fund manager.

Questionnaire feedback recommendation

1. Organizational stability, more than one user responded it is important to spend enough time to assess and understand the organization and make reasonable assurance that the organization exhibit low turnover in the staff. More emphasis where told to look through the structure of the board or partnership and make sure that the investment team is been treated in fair and beneficial toward performing strong. Also, another point where mentioned that the investment should be incentivized more toward the performance ad not the asset amount to be more focused on the performance rather than the asset under management.
2. Risk Management, it is important that the asset management have adequate tools to support the investment team to have a strong risk management framework and measurements to the portfolio exposures. The importance of the mentioned criteria is that to avoid strong market swings and being caught in the wrong side due to natural financial behavior bias.

3. Historic performance should be according to the process and inline with expectation; the performance should exhibit a known pattern due to the explained process and make sure that the fund performance came in expectation with the fund process.
4. Focus on the active return of the fund, information ratio and active return is more important than performance as a stand alone, to obtain a alpha with high active return profile is more favored than high TE fund with low active return.

From the industry leader perspective, Russell published a process to select equity fund manager, that had a deep understanding and track record why did they built it the way it is now, its called the tangible and intangible of the 4Ps process. Russell is an organization that has 40yrs of experience in selecting skillful managers to run create fund of funds product for retail and institutions. Skimming through their latest disclosure of their process in the CFA institute 2010 June Edition: *Avoiding the Pitfalls: Best practices in Manager Research and due diligence by Brian Tipple, CIO, Russell Investments*[18]. Initially Russell published the Alpha Engine Focus process that combines People, Philosophy/Process/Portfolio and Performance. Then added on top of it another layer called it the intangible factors called the new 4Ps. The Alpha Engine focus is the traditional due diligence element in researching fund managers. The newly published 4Ps deal with the intangible factors, Passion, Perspective, Purpose, and Progress. To provide more color on each of those factors.

Industry leader "Russell" Recommendation

1. Passion, is to look through the day how does the fund manager prove that he is living what he does and doesn't do it for the sake of doing a normal day job. Does he wakes up early morning to review his home office computer reports that run on daily basis before going to office. When he reaches office at 8:00am was his team an hour ahead of him reviewing any market news and ready to update and discuss that news. Once he is done for the day at 5:00pm does he spend a bit of time with his family and go back to his home office to look at fundamental researches and plan what are his next moves.

[18] *Avoiding the Pitfalls: Best practices in Manager Research and due diligence by Brian Tipple, CIO, Russell Investments, CFA Institute*

2. Perspective, managers who knows their limits and know when is it time to sell, example if manager thought that he done really well during the last 2 or 3 years and his team struggles to bring new ideas. He goes back to his client and notify them that he think that its best to keep your money and wait until he find interesting ideas and good time-period to invest his style because he think he is more likely to underperform during that period. Basically it means that a manager is well aware of his capabilities and limits.
3. Purpose, it means that it is important to measure the managers patience and tenacity. Best explained as how much can they endure and wait during underperformance time without altering the investment team and philosophy. Also to measure the commitment of the manager and success of the fund by having high patience and believing in the process away from the Short-term market volatility.
4. Progress, is a characteristics that a manager willing to progress and evolve during different market conditions. Example is that few managers are never comfortable or always worried about what is going to happen. Those managers are willing to adapt for changes and always try to modify his process in a way to make it more efficient or at a bigger scope. This could happen by manager coming to existing or perspective clients to provide any change in the process or potential change in the process.

My experience comes handy in this research due to my exposure to investing in equity fund manager in the last two years. Investing in equity fund managers is complex due to the significance of the decision to invest in a fund due to the cost of investing and the timing of the investment. Investing in external funds share is as similar as investing in the other asset classes such as, fixed income, and hedge funds. It will almost share the same process. From my experience the first step starts by a general framework what we need to do, what is the target that is required to be delivered ie what is the required alpha on a calendar year or three years. Once that is established, make sure to look in-depth of the current fund as a whole what is the exposures that is available and correlation matrix between the existing fund returns helps to identify the saturation of return coming from a single time –period of factor.

Once the existing is understood and the alpha target is known and given, start screening for funds as a simple screen by looking through third party tools that record monthly returns of the fund or communicating by your self. Once you get all the funds returns screen them to get the best profiles and short-list the managers. Once the short-list is established, now the process starts which I will go in-depth in identifying what are the major criteria to select the equity fund managers.

My **personal recommendation** for criteria to help in the selection of equity fund manager should be the following:

1 – Philosophy: Does the fund house or the fund manager use well established philosophy? The philosophy is the "Why" part of investing. How the philosophy did got established did the fund house or fund manager run through the market inefficiency and historical market dynamic before establishing the philosophy. Does the fund manager have clear distinction of what are the main inefficiencies in the market that he thinks he can exploit and generate excess return that in the long run can be in a better position than the market.

2 – Process: Does the fund house have discipline process that is followed rigorously? The process deals with the "How" part of investing. How is the research done and how is the responsibility of the research spread to the investment team. Furthermore, the stock selection and sector/country allocation how is conducted. Last part should be known and discussed how does the portfolio is constructed and risk management is applied as a framework on the portfolio.

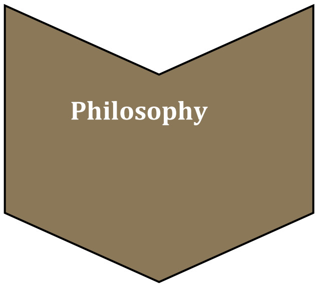
3- People: Does the fund house have the adequate talent and stability to apply the established philosophy and process. How is the investment team structured and compensated? How is the investment team commitment to the fund and motivation for future progression. Most important is the investment team stability which touches upon the "Organizational stability" in general how stable is the organization and historical incidents with dealing with employee and more important with the investment team.

4- Performance: First is their evidence of generating excess return over 3 years period of time? If that is yes, then look for evidences that supports the philosophy and process of the fund house, is the generated performance supports the philosophy and process as if does it show that there is a pattern and reasonable assurance of performing well when expected. That is important when you try to know what the time-horizon of your investment is and how much of volatility and maximum drawback you can accept in your portfolio.

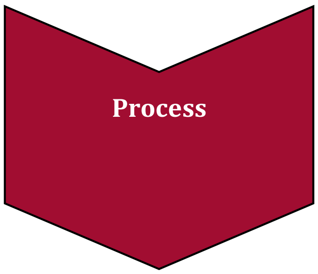
All in all to identify what is the best investment from my opinion, you should do your proper due diligence and gather data as much as possible by following the structure I described above: 1) Philosophy, 2) Process, 3) People, and 4) Performance. After gathering the necessary data then start putting your opinion of how effective each part and rating each to come up with either a percentage or level of conviction to support your investment decision.

To conclude the recommendation, looked over academia criteria to select equity fund manager and assessed them and critique them, in the end came back two criteria that showed stability during different market conditions and rated highly which are 1) Experience and Quality of the fund manager and 2) Ethical fund Manager. The feedback from the questionnaire takers the following 1) Organizational stability, 2) Risk Management, 3) Focus on the Active return, 4) Historic performance understanding. Industry experts in researching equity strategies … Personal experience understanding and rating the following: 1) Philosophy, 2) Process, 3) People, and 4) Performance.

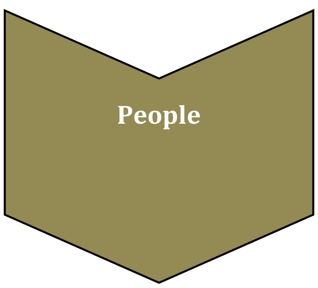
Personal Recommendation



Philosophy: Does the fund house or the fund manager use well established philosophy? The philosophy is the "Why" part of investing. How the philosophy did got established did the fund house or fund manager run through the market inefficiency and historical market dynamic before establishing the philosophy. Does the fund manager have clear distinction of what are the main inefficiencies in the market that he thinks he can exploit and generate excess return that in the long run can be in a better position than the market.



Process: Does the fund house have discipline process that is followed rigorously? The process deals with the "How" part of investing. How is the research done and how is the responsibility of the research spread to the investment team. Furthermore, the stock selection and sector/country allocation how is conducted. Last part should be known and discussed how does the portfolio is constructed and risk management is applied as a framework on the portfolio.



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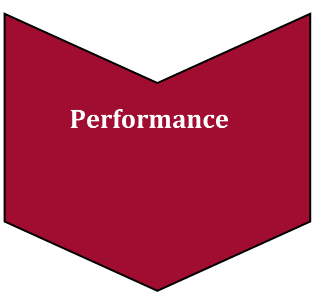


Performance: First is their evidence of generating excess return over 3 years period of time? If that is yes, then look for evidences that supports the philosophy and process of the fund house, is the generated performance supports the philosophy and process as if does it show that there is a pattern and reasonable assurance of performing well when expected. That is important when you try to know what the time-horizon of your investment is and how much of volatility and maximum drawback you can accept in your portfolio.

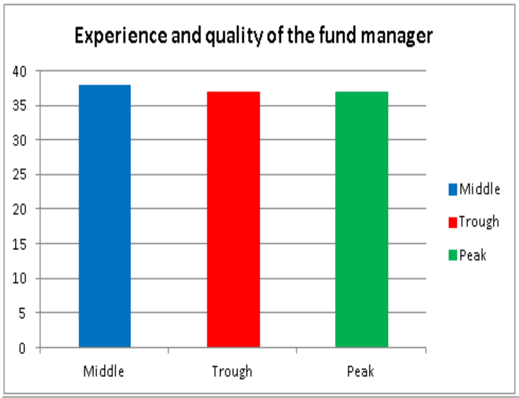
CONCLUSION

The research target is to provide a new way of investing to the retail and institutions in UAE and other countries by investing in fund management through specialized professionals. Given the complexity and the wide variety of investment fund professionals a criteria or a proper due diligence framework is required to assess and evaluate the available funds.

The objective was clear to assess and critique approaches in selection of equity fund manager. To do that went through the available academia and created a rating questionnaire rating what is the importance of each during specific market conditions. After that provided personal experience criteria that evolved a four parts process that could be followed for proper due diligence and criteria. In addition, added another leg in the recommendation section regarding the view of the industry leader of selecting equity fund manager by reviewing their latest process.

All in all, the research is to provide clarity and a new way of investing to the retail and institutions. For few it might be difficult to understand, however the industry is growing fast and soon it might overcome commercial banks from the Asset under management and be the number one business in the financial markets.

Appendix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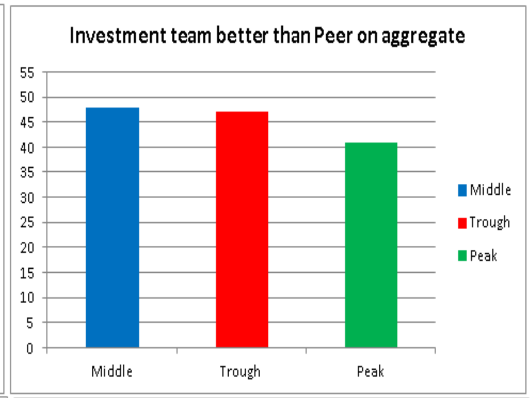
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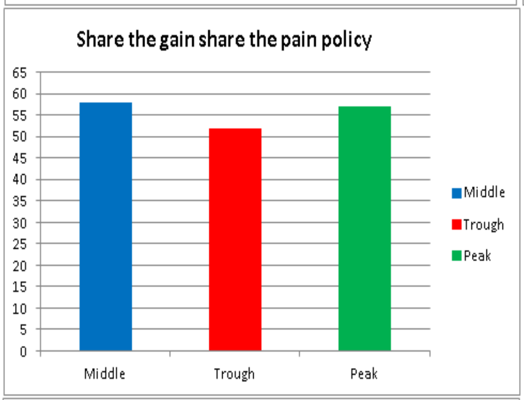
Share the gain share the pain policy
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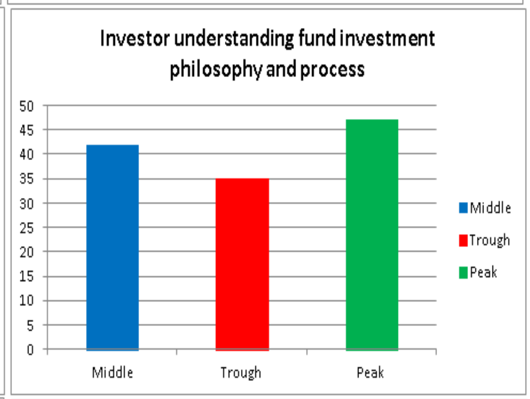
Investor understanding fund investment philosophy and process
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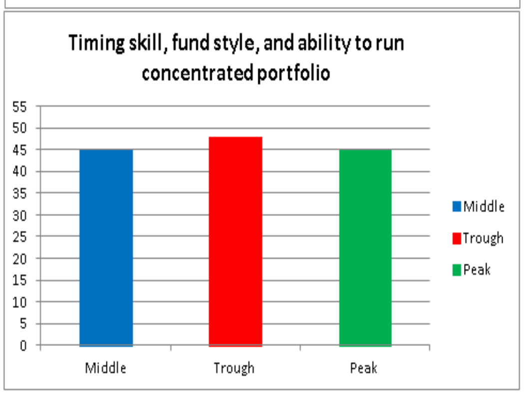
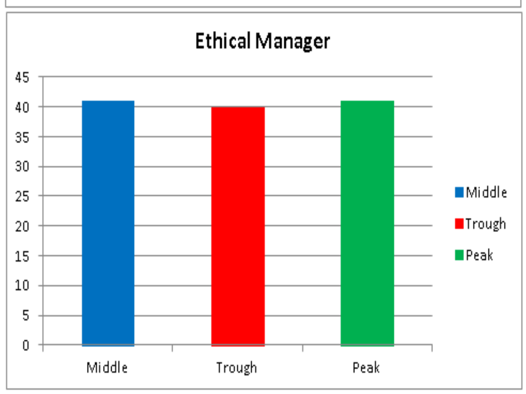
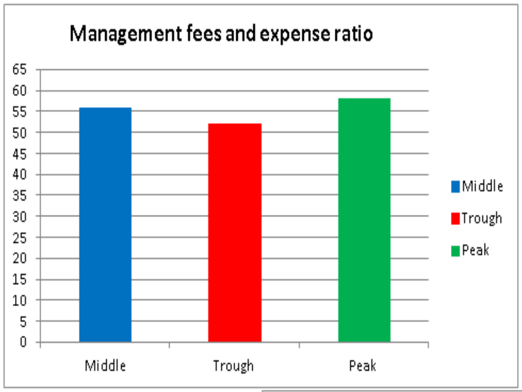
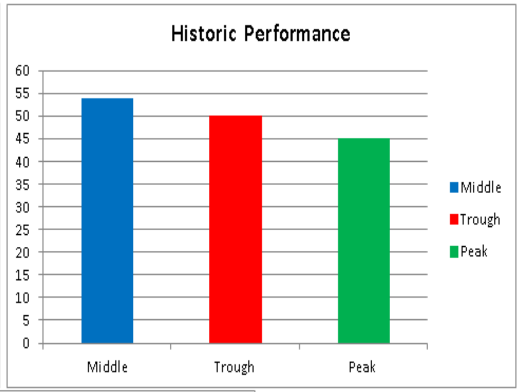
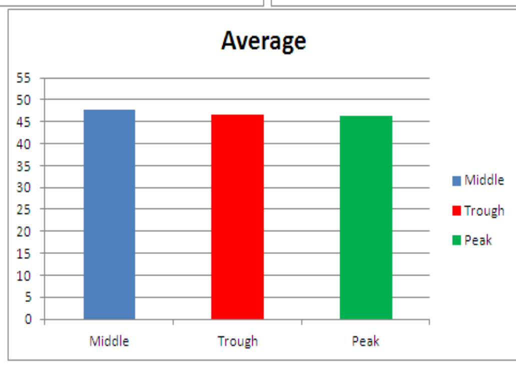
Trough
Peak

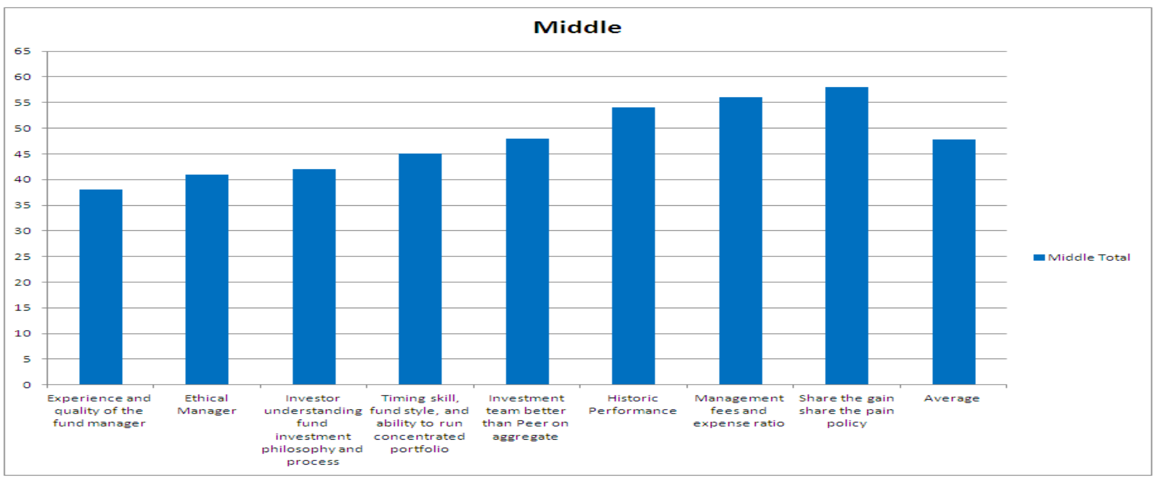

Timing skill, fund style, and ability to run concentrated portfolio
55
50
45
40
35
30
25
20
15
10
5
0
Middle
Trough
Peak
Middle
Trough
Peak

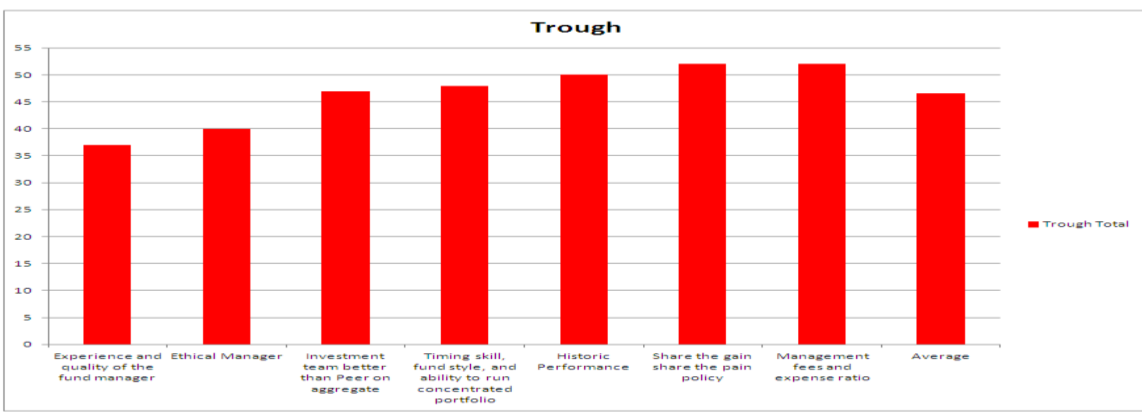

Ethical Manager
45
40
35
30
25
20
15
10
5
0
Middle
Trough
Peak
Middle
Trough
Peak

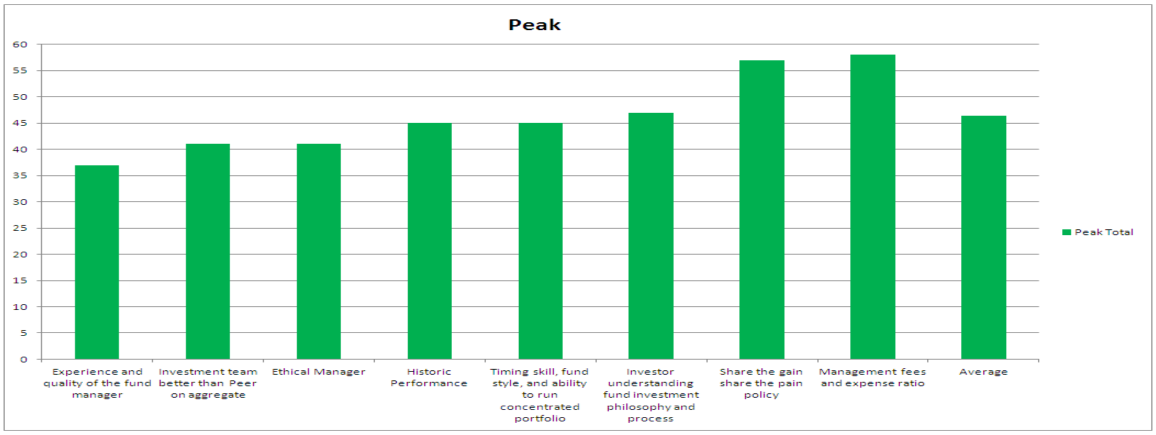

Management fees and expense ratio
65
60
55
50
45
40
35
30
25
20
15
10
5
0
Middle
Trough
Peak
Middle
Trough
Peak


Historic Performance
60
55
50
45
40
35
30
25
20
15
10
5
0
Middle
Trough
Peak
Middle
Trough
Peak


Average
55
50
45
40
35
30
25
20
15
10
5
0
Middle
Trough
Peak
Middle
Trough
Peak


Middle
65
60
55
50
45
40
35
30
25
20
15
10
5
0
Experience and quality of the fund manager
Ethical Manager
Investor understanding fund investment philosophy and process
Timing skill, fund style, and ability to run concentrated portfolio
Investment team better than Peer on aggregate
Historic Performance
Management fees and expense ratio
Share the gain share the pain policy
Average
Middle Total


Trough
55
50
45
40
35
30
25
20
15
10
5
0
Experience and quality of the fund manager
Ethical Manager
Investment team better than Peer on aggregate
Timing skill, fund style, and ability to run concentrated portfolio
Historic Performance
Share the gain share the pain policy
Management fees and expense ratio
Average
Trough Total


Peak
60
55
50
45
40
35
30
25
20
15
10
5
0
Experience and quality of the fund manager
Investment team better than Peer on aggregate
Ethical Manager
Historic Performance
Timing skill, fund style, and ability to run concentrated portfolio
Investor understanding fund investment philosophy and process
Share the gain share the pain policy
Management fees and expense ratio
Average
Peak Total

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