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What makes a successful asset manager?

These days, what separates the good from the average manager is the use of sound principles that focus on the investment process over the long term, rather than the outcome. This is according to Peter Linley, executive director: Old Mutual Investors' Fund.

“Anyone can be lucky in the short term,” says Linley. “The real test of a successful manager is one who performs over time. Gone are the days when having a couple of big teams covering the market may have given you an edge.”

Valuation – science and art

Linley believes the bedrock of a sound investment process is disciplined valuation, however, it is also important to acknowledge other proven factors such as quality, growth and sentiment.

“Valuation is key, but it is subjective. While we continually revisit and test our base-case assumptions, we also seek to gain further perspective by constructing a bull – rising market – and bear – falling market – case scenario for each company. Banks, for example, are currently not only trading at an attractive discount to our base case valuation, but are actually trading around our bear case scenario. The shares are effectively pricing in a potential sovereign downgrade already.”

“No individual can forecast the future accurately which is why we embrace a probability perspective, rather than believing there is just one view and that ours' is the correct one," he says. "We want to understand the different outcomes that may play out over time and assign a probability to these."

He explains there is a good behavioural reason for encouraging investment analysts to focus on three scenarios. "In a single focus investment process, human nature can sometimes result in an individual either falling 'in' or 'out' of love with a share, where personal bias can cloud the investment thesis. We gain more value and insight from analyst's probability weighting in addition to the three scenarios."

Understanding valuation is however a main focus and for good reason. "Value as a style – looking for stocks that appear undervalued by the marketplace – outperforms over the long term, but it can go through lengthy periods of underperformance, as has been the case with value managers recently. Our research into the performance of other factors in the South African equity market over the last 26 years shows that value is not the only factor driving outperformance. Adding other long-term outperforming factors to our valuation ranking improves diversification and provides more holistic insight when picking stocks."

Linley adds that it is also important to constantly analyse the failure and success of decisions. "It's imperative to know if I was right for the right reasons or right for the wrong reasons and so just lucky. Investing is as much about psychology and human emotions as is it about science and math."

Patience

When it comes to companies and their share prices, Linley believes that there needs to be a long-term perspective rather than concerns over returns in a month's time. "Markets across the world are largely driven by short-term behaviour and emotionally-driven decisions destroy returns. To succeed, a successful investment management team needs a sensible investment philosophy and must operate within a disciplined and structured process."

Sound risk management

Throughout the investment process, prioritising risk management is essential. "A fund manager is paid to take on risk on behalf of the investor, so we need to continually guard against unintended risk. In our portfolios, outperformance is not only driven by the winners, but also by avoiding the losers. For example, the risk of capital loss in African Bank was simply too big for us. The worst thing you can do as an investor is hang onto poor performing stocks that in reality have no ability to recover," says Linley.

Intelligent diversification

Intelligent diversification, Linley explains, is essential once all the research has been done. "It's not how many shares you buy, but the diversity of these stocks. Even 20 stocks may not be intelligent diversification if they are all in the same industry or style bucket. Ensuring adequate diversification requires an analysis across shares, industry, style, macro drivers, regions, currencies and more."

He adds that geographical diversification in South African portfolios is a lot easier than it was 50 years ago. "Companies listed on the JSE, including Naspers, British American Tobacco, Richemont, ABInbev, MediClinic, Steinhoff, Mondi and Aspen have a strong presence outside of South Africa."

Ultimately, there are no short cuts to delivering competitive returns over the long term. "A sensible philosophy combined with a disciplined process is part of the fabric of Old Mutual Investors' Fund. As information flows quicker than ever before, it is increasingly difficult to successfully manage an equity portfolio without this combination of attributes," concludes Linley.