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New answers.®



Three business professionals are seated in a modern office environment, engaged in a discussion. The setting features large windows overlooking a city skyline, including the Gherkin in London. The room has a high ceiling with exposed ductwork and teal-colored walls. The individuals are seated in white armchairs on a polished floor. A large green geometric shape is overlaid on the bottom left of the image.

# Lessons in Manager Selection

**Jason Collins**  
Global Head of Equity Portfolio Management

March 2019

# Lessons in Manager Selection

- Don't Buy (or Sell) Past Performance
- Give up Looking for Consistent Excess Returns
- Embrace Short Term Variability for Long Term Success
- Consider Your Own Behavioural Biases
- Identify the Ingredients of Success
- Take a Forward Looking View
- Think about the Total Portfolio not just the Individual Components

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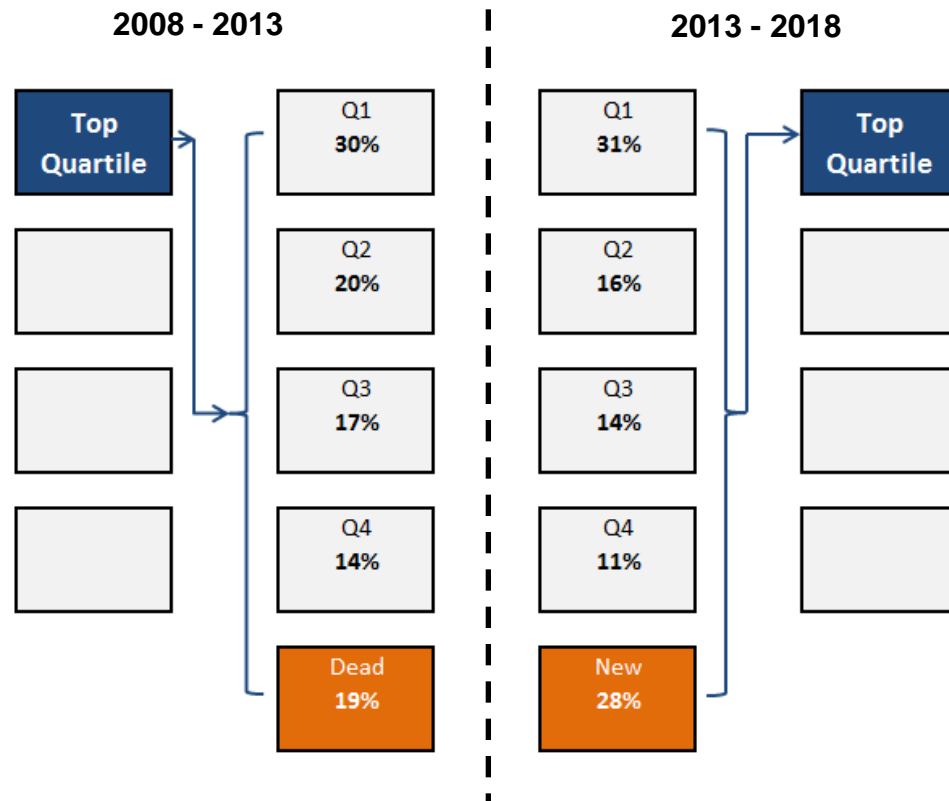


## Lesson #1 - Don't Buy (or Sell) Past Performance

# Past Performance is No Guide

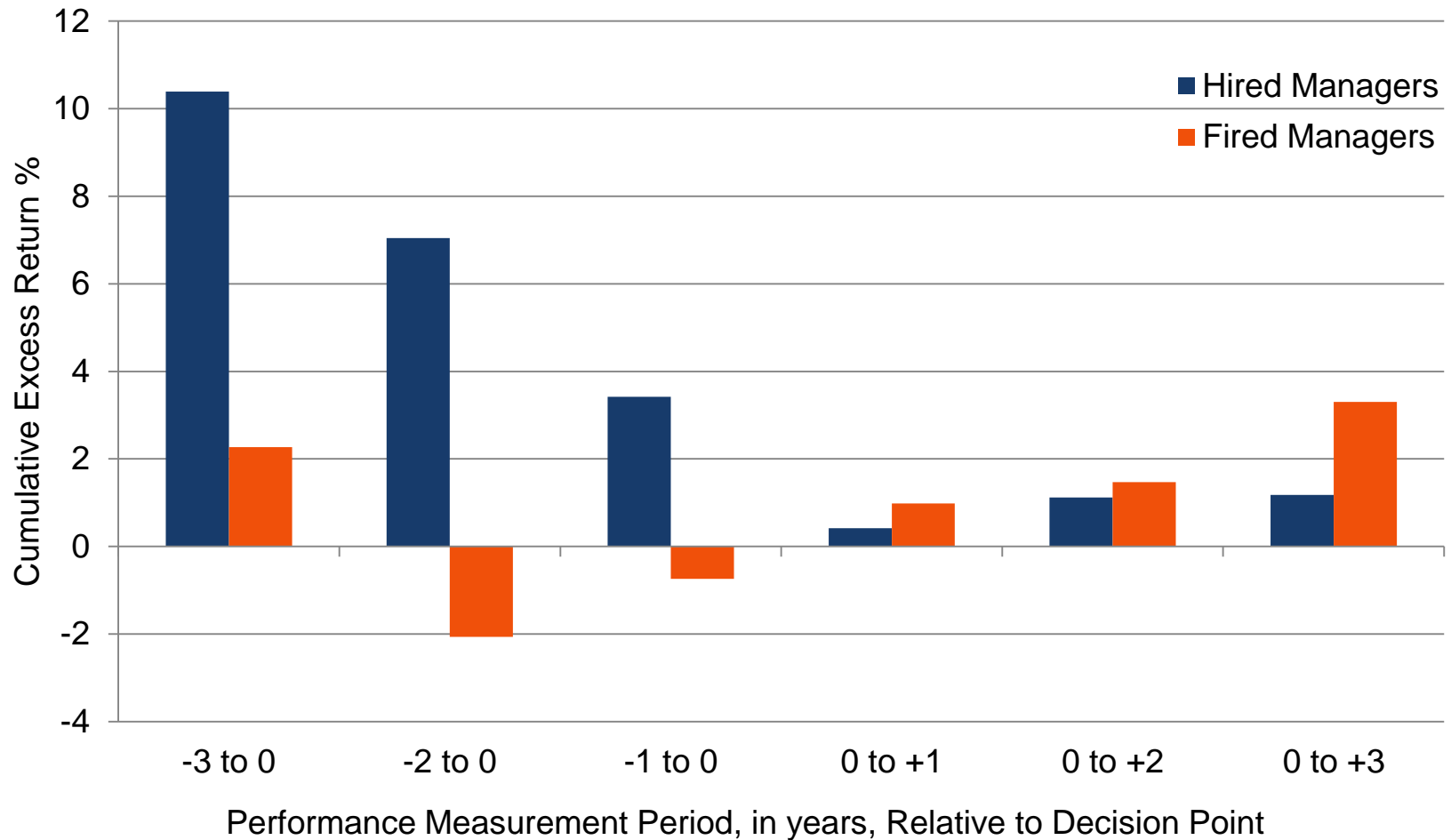
The chart takes the top quartile of *European Equity* managers, based on performance over the five-year period ending July 2013, and tracks their subsequent quartile rankings over the following five-year period ending July 2018. It also identifies where the top-quartile managers over the five-year period ending July 2018 ranked in the previous five-year period ending July 2013.

- Past Performance Not Predictive of Future Performance.
- Forward Looking Assessment and Insight Required



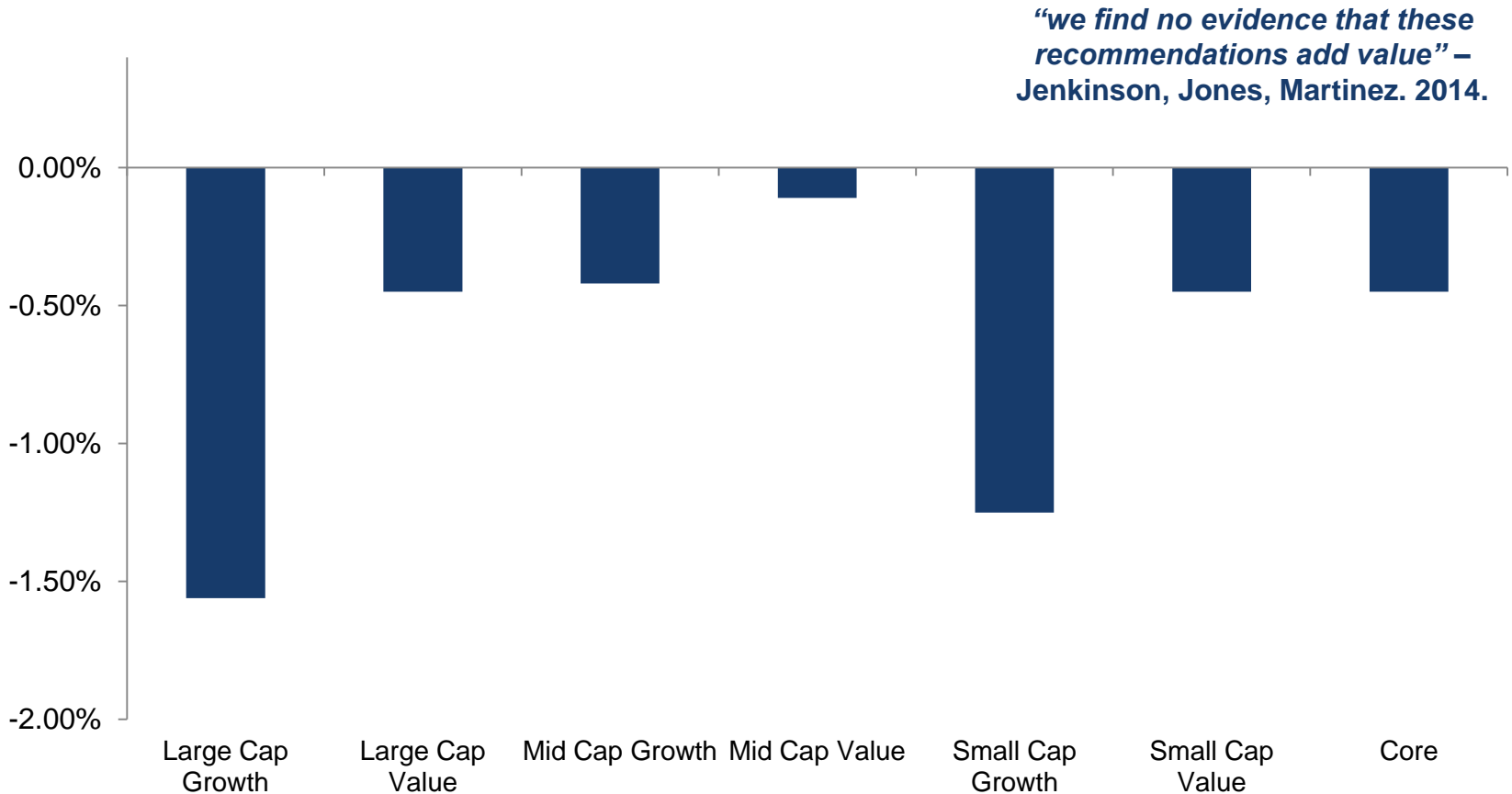
Sources: SEI, Lipper. Universe is Lipper Global Equity Europe universe.

# Pension Funds Buy High and Sell Low ...



Source: Goyal and Wahal, "The Selection and Termination of Investment Management Firms by Plan Sponsors, 2008. A survey of 3,400 US plan sponsors between 1994 and 2003.

# ... As Investment Consultants Fail to Add Value



Source: Jenkinson, Jones, Martinez. Picking Winners? Investment Consultants' Recommendations of Fund Managers. September 2014. Performance measured over period from 1999 to 2011, annualised, net of management fees. Past performance is not a reliable indicator of future results.

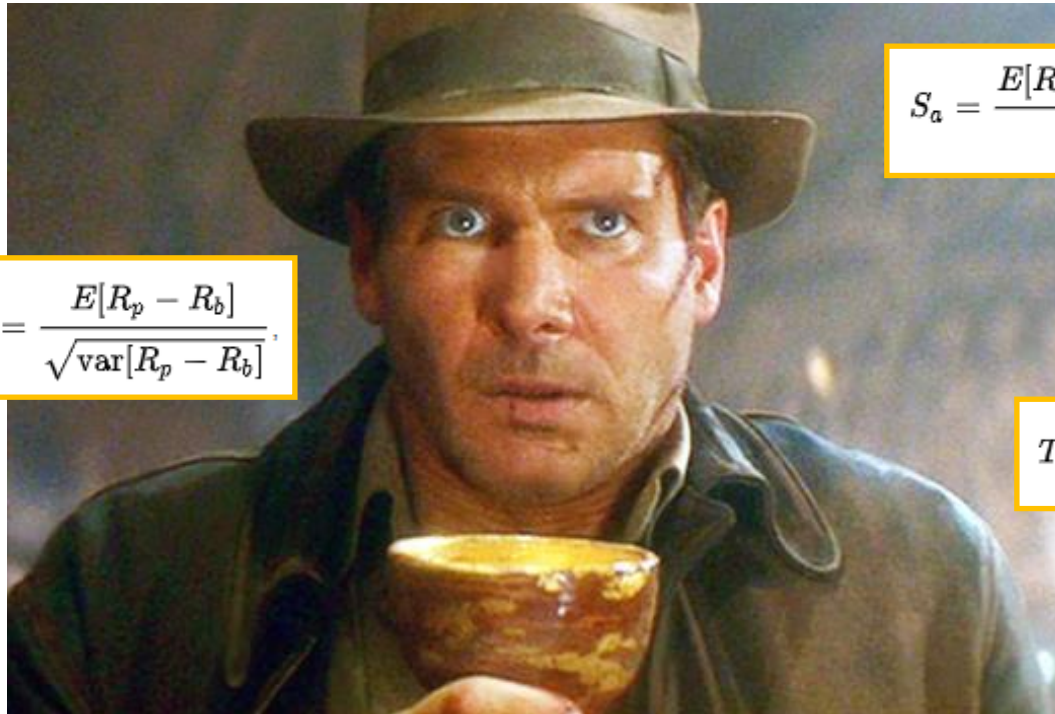


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## Lesson #2 – Give up Looking for Consistent Excess Returns

# Consistency of Excess Returns – The Holy Grail



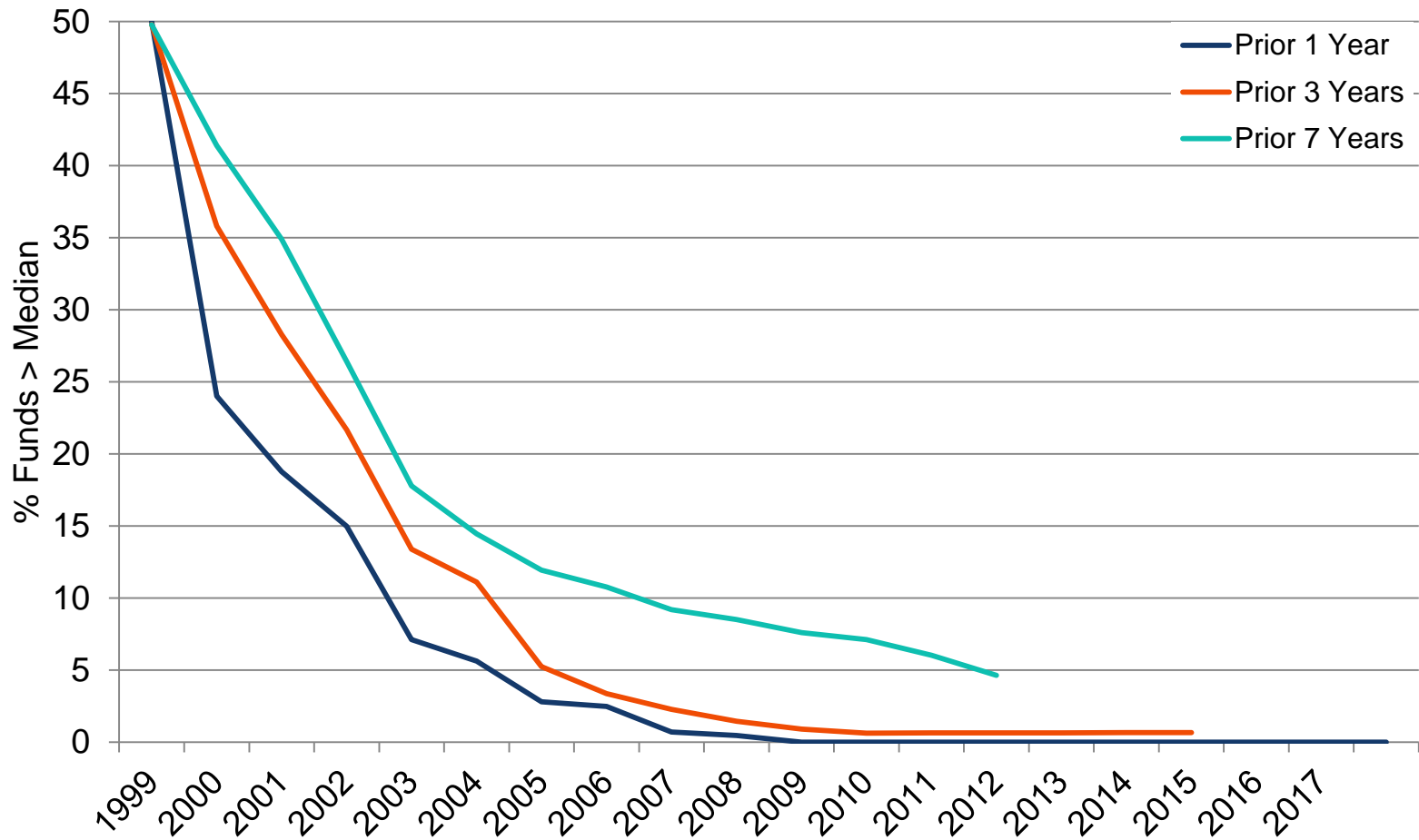
$$IR = \frac{E[R_p - R_b]}{\sigma} = \frac{\alpha}{\omega} = \frac{E[R_p - R_b]}{\sqrt{\text{var}[R_p - R_b]}}$$

$$S_\alpha = \frac{E[R_\alpha - R_b]}{\sigma_\alpha} = \frac{E[R_\alpha - R_b]}{\sqrt{\text{var}[R_\alpha - R_b]}}$$

$$T = \frac{r_i - r_f}{\beta_i}$$



# Consistency of Excess Returns – The Holy Grail




The chart shows the % of UK Equity funds (as defined by Lipper Global Equity UK, Equity UK Diversified and Equity UK Income categories) outperforming the median fund over the prior 1, 3 and 7 years on a rolling calendar year basis. Each year only those funds that outperformed the median over the prior measurement period are included. Source: SEI, Lipper. Past performance is not a reliable indicator of future results.

# Consistency of Excess Returns – The Holy Grail

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Large Cap	Small Value	Small Growth	Large Value	Small Value	Small Value	Mid Value	Small Growth	Large Value	Small Growth	Large Growth
Large Value	Small Cap	Small Cap	Large Cap	Mid Value	Small Cap	Mid Cap	Small Cap	Large Cap	Small Cap	Large Cap
Large Growth	Small Growth	Small Value	Mid Growth	Small Cap	Small Growth	Mid Growth	Small Value	FTSE All Share	Small Value	Large Value
FTSE All Share	Mid Growth	Mid Growth	FTSE All Share	Small Growth	Mid Growth	FTSE All Share	Large Growth	Mid Value	Mid Value	Mid Growth
Mid Value	Mid Cap	Mid Cap	Mid Cap	Mid Cap	Mid Cap	Large Growth	Mid Growth	Large Growth	FTSE All Share	FTSE All Share
Mid Cap	Mid Value	Large Growth	Mid Value	Mid Growth	FTSE All Share	Small Growth	Mid Cap	Small Value	Large Growth	Mid Cap
Mid Growth	Large Growth	Mid Value	Large Growth	FTSE All Share	Large Growth	Small Cap	Mid Value	Mid Cap	Mid Cap	Small Growth
Small Growth	FTSE All Share	FTSE All Share	Small Value	Large Value	Mid Value	Small Value	FTSE All Share	Small Cap	Mid Growth	Small Cap
Small Cap	Large Cap	Large Cap	Small Cap	Large Cap	Large Cap	Large Cap	Large Cap	Small Growth	Large Cap	Small Value
Small Value	Large Value	Large Value	Small Growth	Large Growth	Large Value	Large Value	Large Value	Mid Growth	Large Value	Mid Value

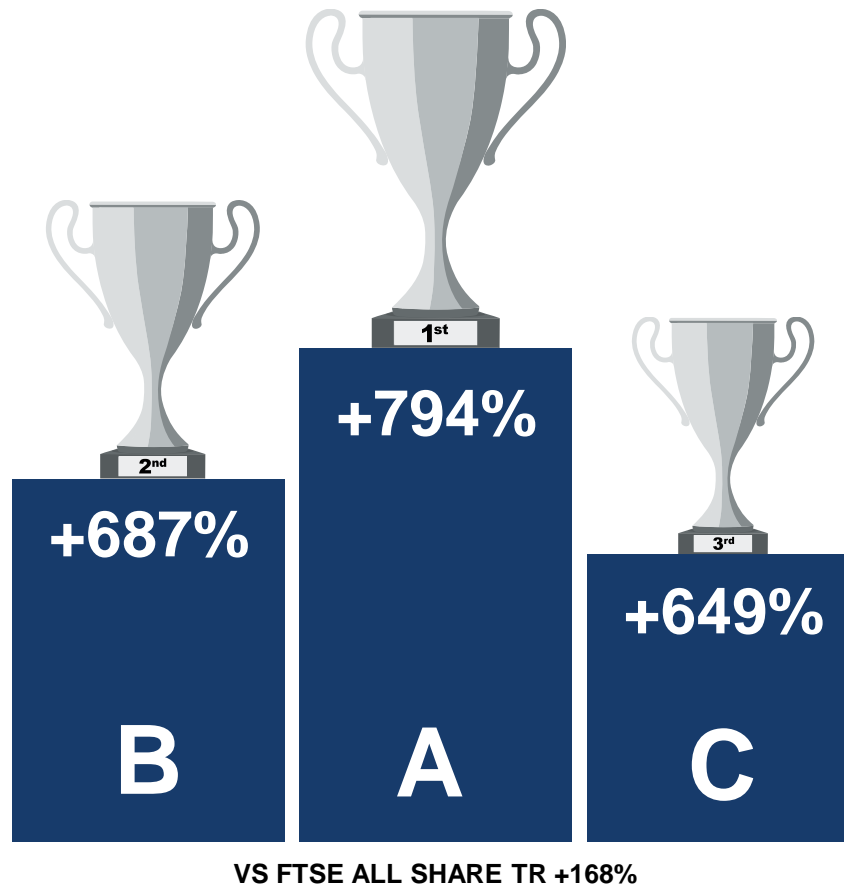
Source: SEI, FactSet – chart shows UK equity style returns in each calendar year ranked from highest to lowest. Past performance is not a reliable indicator of future results.

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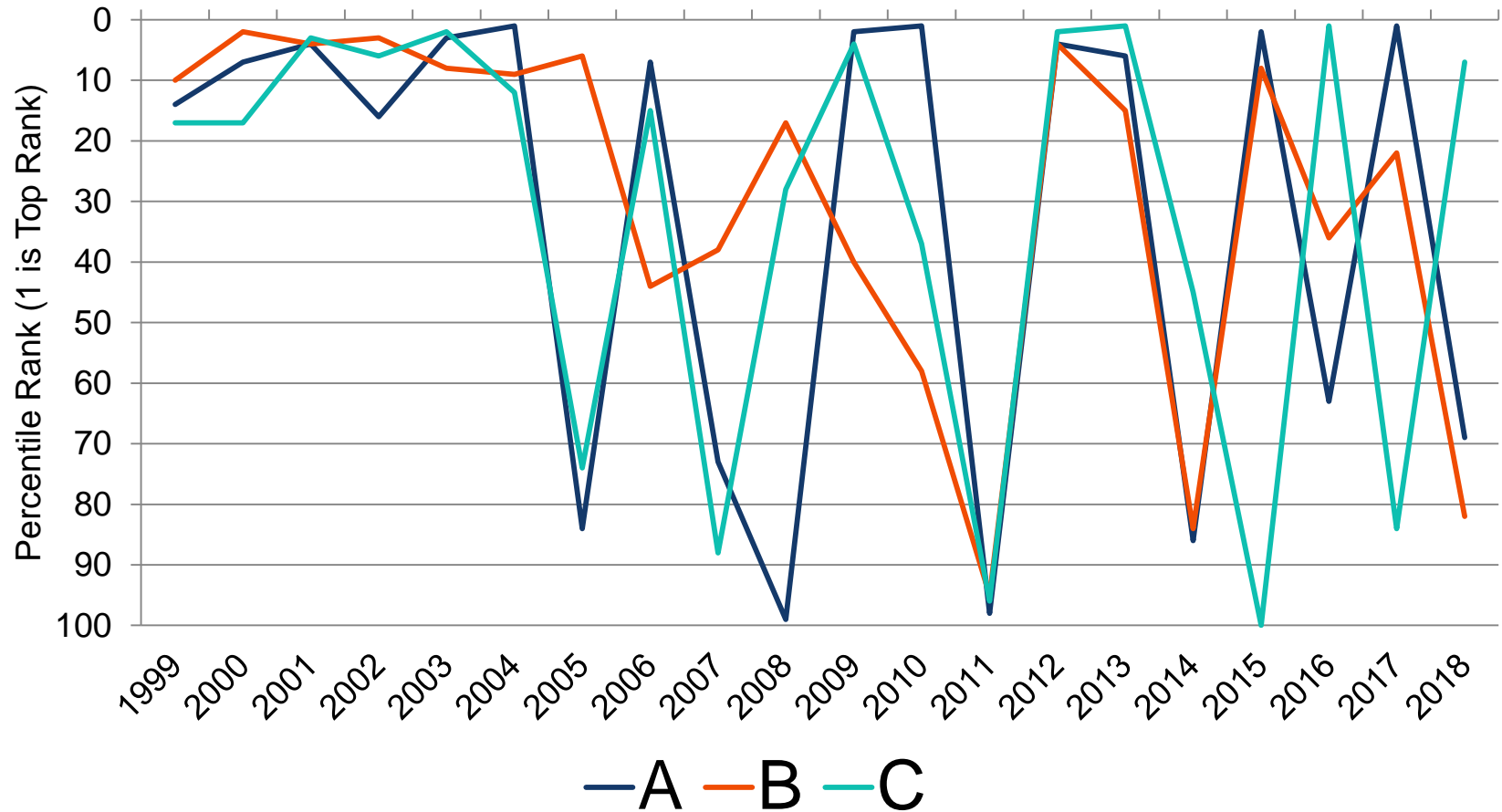
## Lesson #3 – Embrace Short Term Variability for Long Term Success

# UK Equity Winners of the last 20 Years



Source: SEI, Lipper – total returns in GBP over 20 years ending 31<sup>st</sup> December 2018. Universe of UK Equity funds as defined by Lipper Global Equity UK, Equity UK Diversified and Equity UK Income categories.

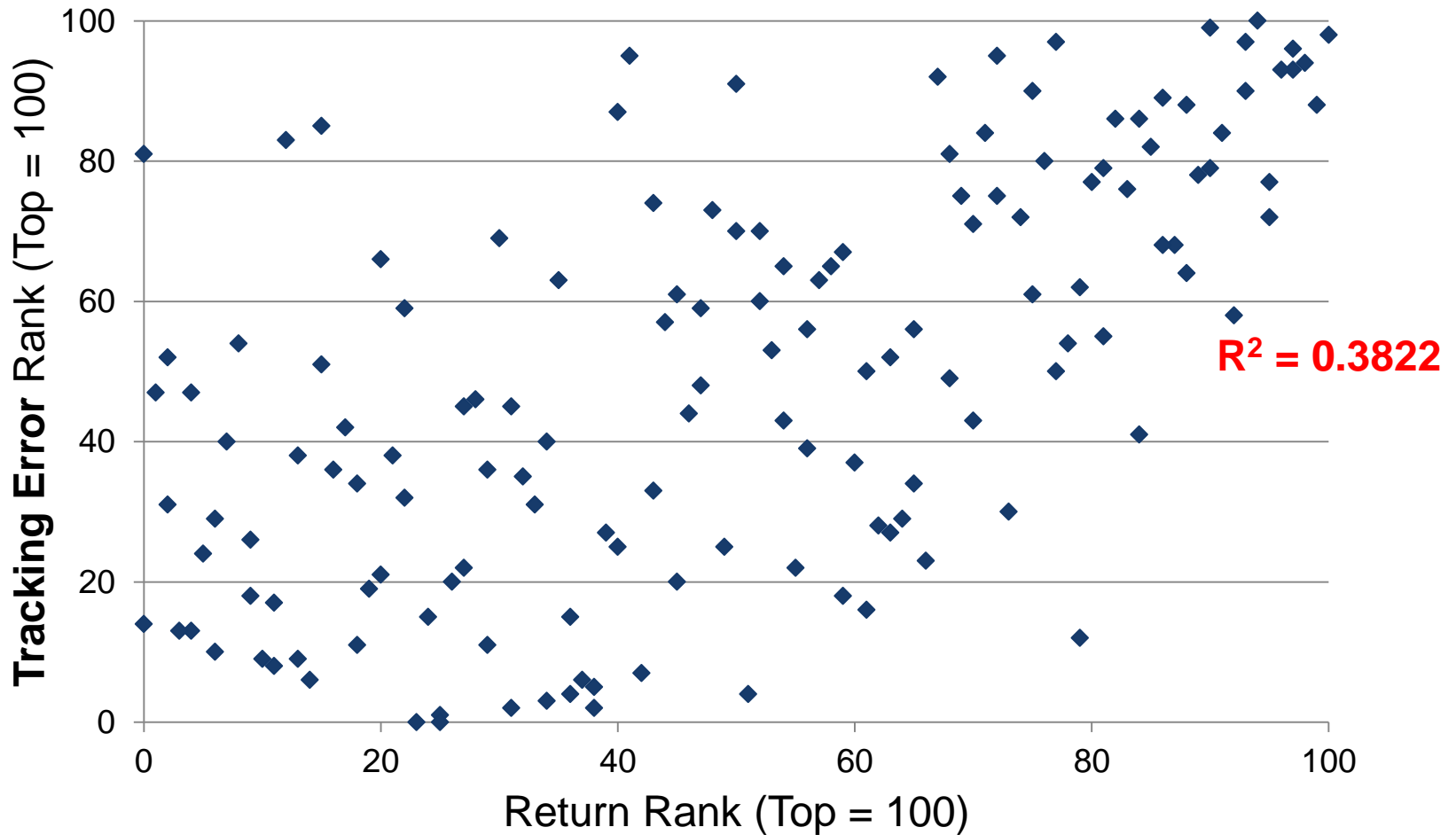
# Consistency of Excess Returns – The Holy Grail



Source: SEI, Lipper – percentile rank based on total returns in GBP over calendar years. Universe of UK Equity funds as defined by Lipper Global Equity UK, Equity UK Diversified and Equity UK Income categories. Past performance is not a reliable indicator of future results.

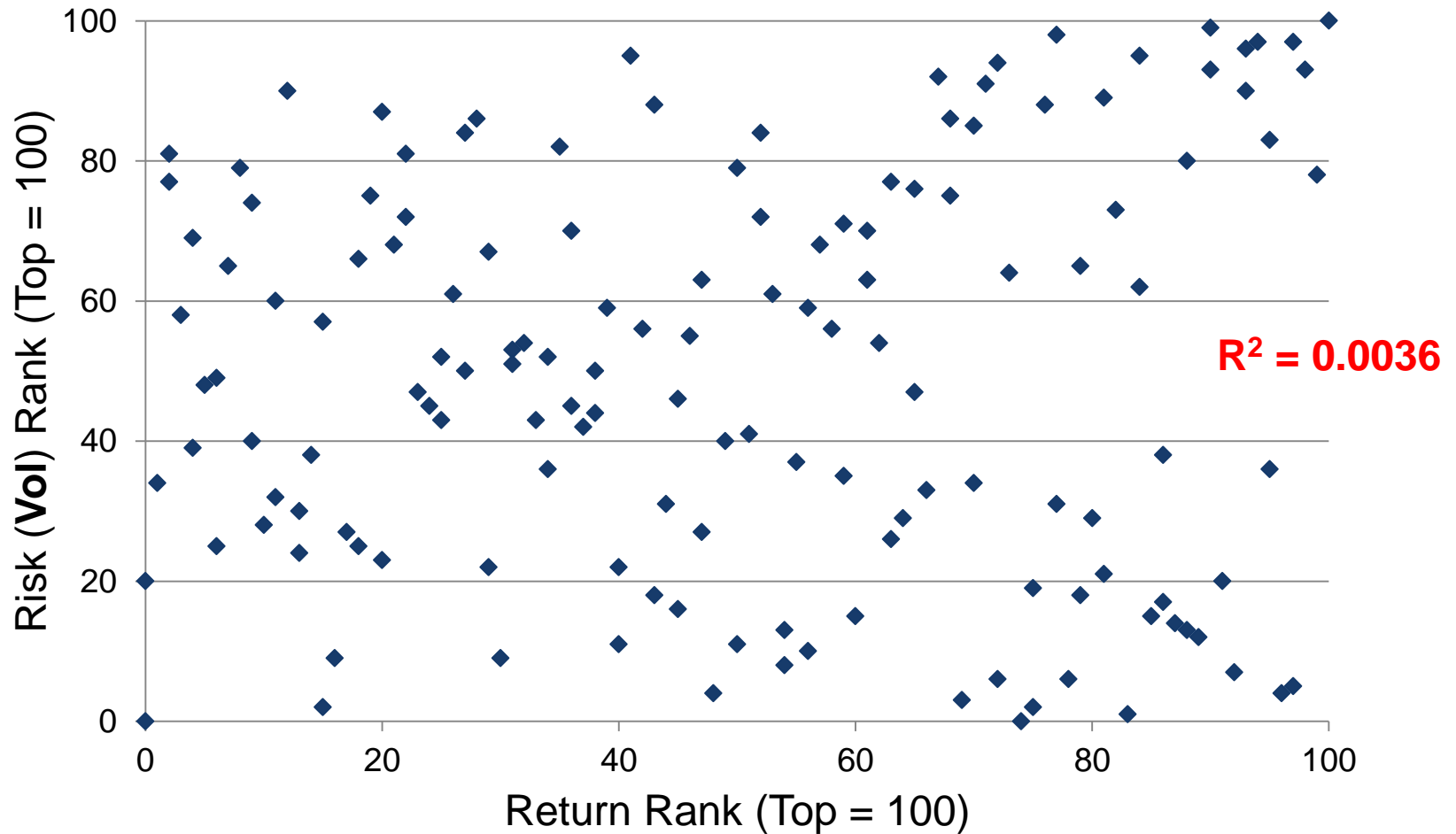


# Consistency of Excess Returns – The Holy Grail



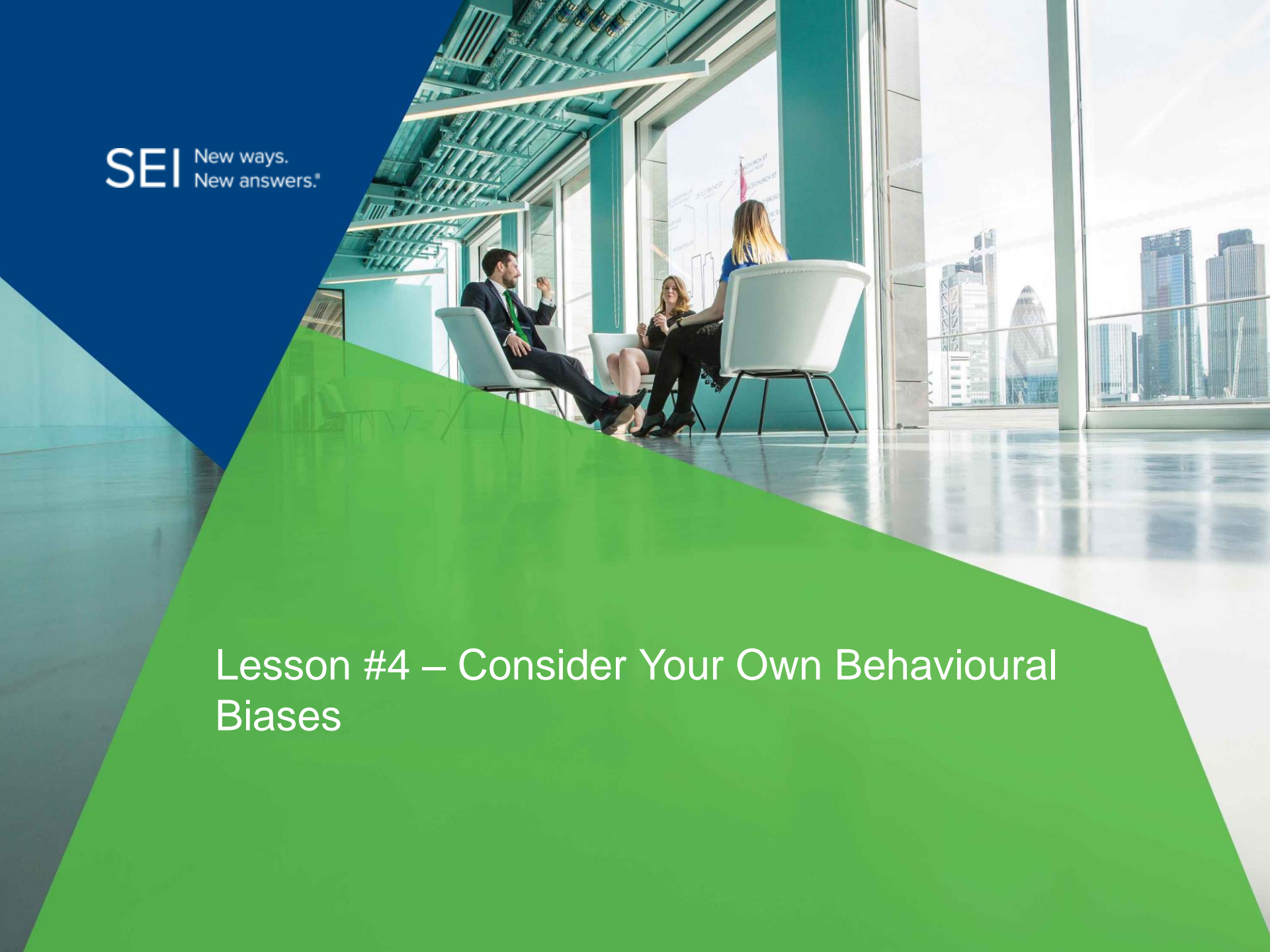
Source: SEI, Lipper – percentile ranks based on total return and annual tracking error relative to FTSE All Share in GBP over 20 years ending 31<sup>st</sup> December 2018. Universe of UK Equity funds as defined by Lipper Global Equity UK, Equity UK Diversified and Equity UK Income categories.

# Consistency of Excess Returns – The Holy Grail



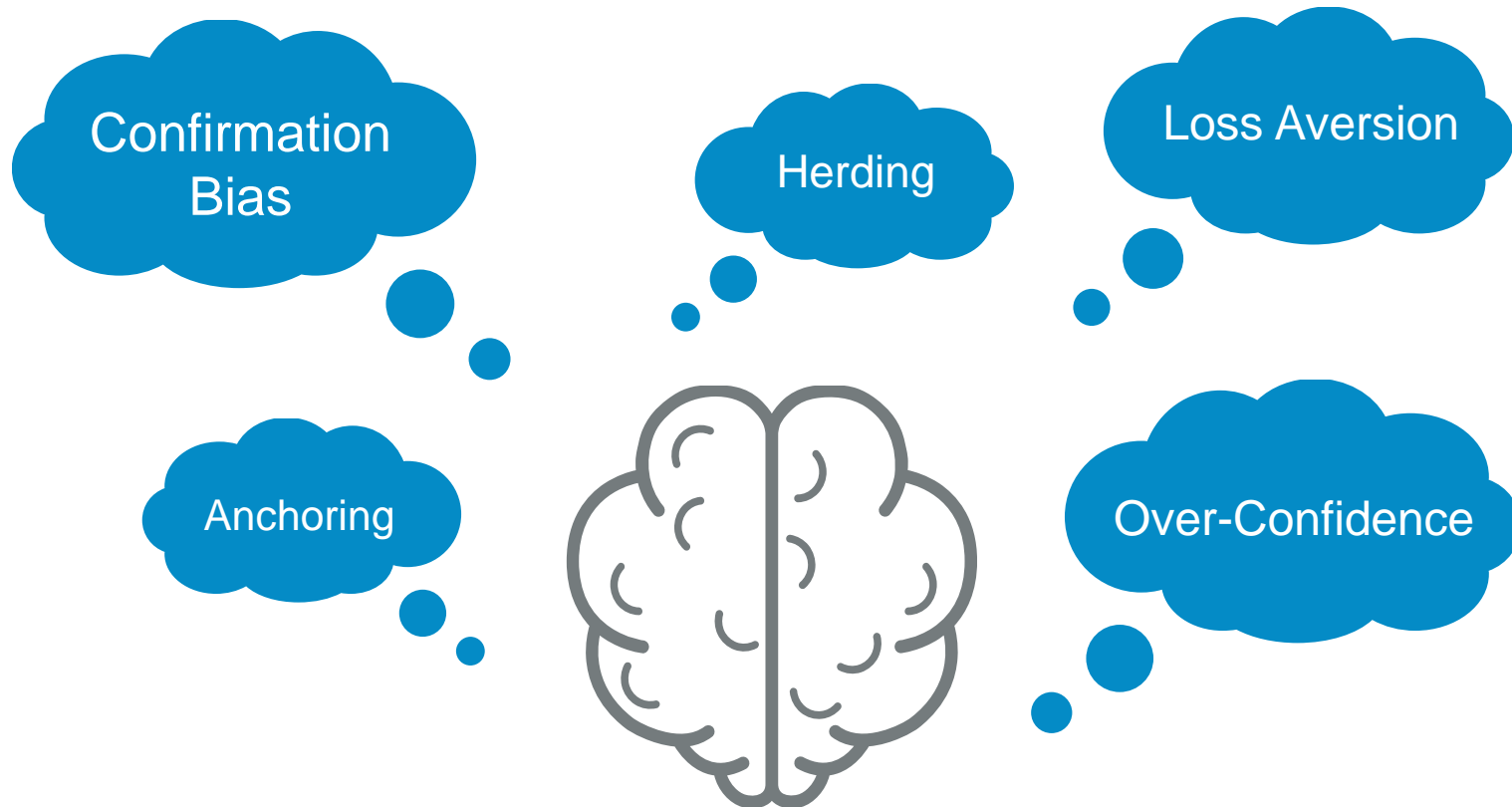
Source: SEI, Lipper – percentile ranks based on total return and annual volatility in GBP over 20 years ending 31<sup>st</sup> December 2018. Universe of UK Equity funds as defined by Lipper Global Equity UK, Equity UK Diversified and Equity UK Income categories.

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## Lesson #4 – Consider Your Own Behavioural Biases

# Irrational Investor Behaviour



*“Human behaviour flows from three main sources : desire, emotion and knowledge” - Plato*

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## Lesson #5 – Identify the Ingredients of Success



The Ingredients are Important!



**Big Mac**

**vs**



**Sushi**

# The Ingredients are Important!



**Calories = 550**

**Fat = 48%**

**Carbs = 34%**

**Protein = 18%**



**Calories = 533**

**Fat = 41%**

**Carbs = 38%**

**Protein = 21%**

# A tale of 2 Retailers



**Ocado**

**vs**



**Greggs**

# A tale of 2 Retailers



Market Cap :	£5.8bn	£1.8bn
Sales :	£1.6bn	£1.0bn
EBITDA :	-£14m	£138m
ROE :	-10.9%	20.2%
Debt :	£338m	£0m
P/E (N12M) :	N/A	22.8x
P/Sales :	4.2x	1.9x
Div Yield :	0.0%	1.8%
EBITDA Growth 5 Yrs :	N/A	+10.6%
Earnings Estimates		
Up/Down % :	7/47%	78/22%
12 Mth Total Return :	+87%	+54%

Source : FactSet taking latest ratios available. Share price return shown for 12 months ending 28<sup>th</sup> February 2019

# A tale of 2 Retailers



**Quality & Stability**

**0**

**+**

**Value**

**-**

**0**

**Earnings Revisions**

**-**

**+**

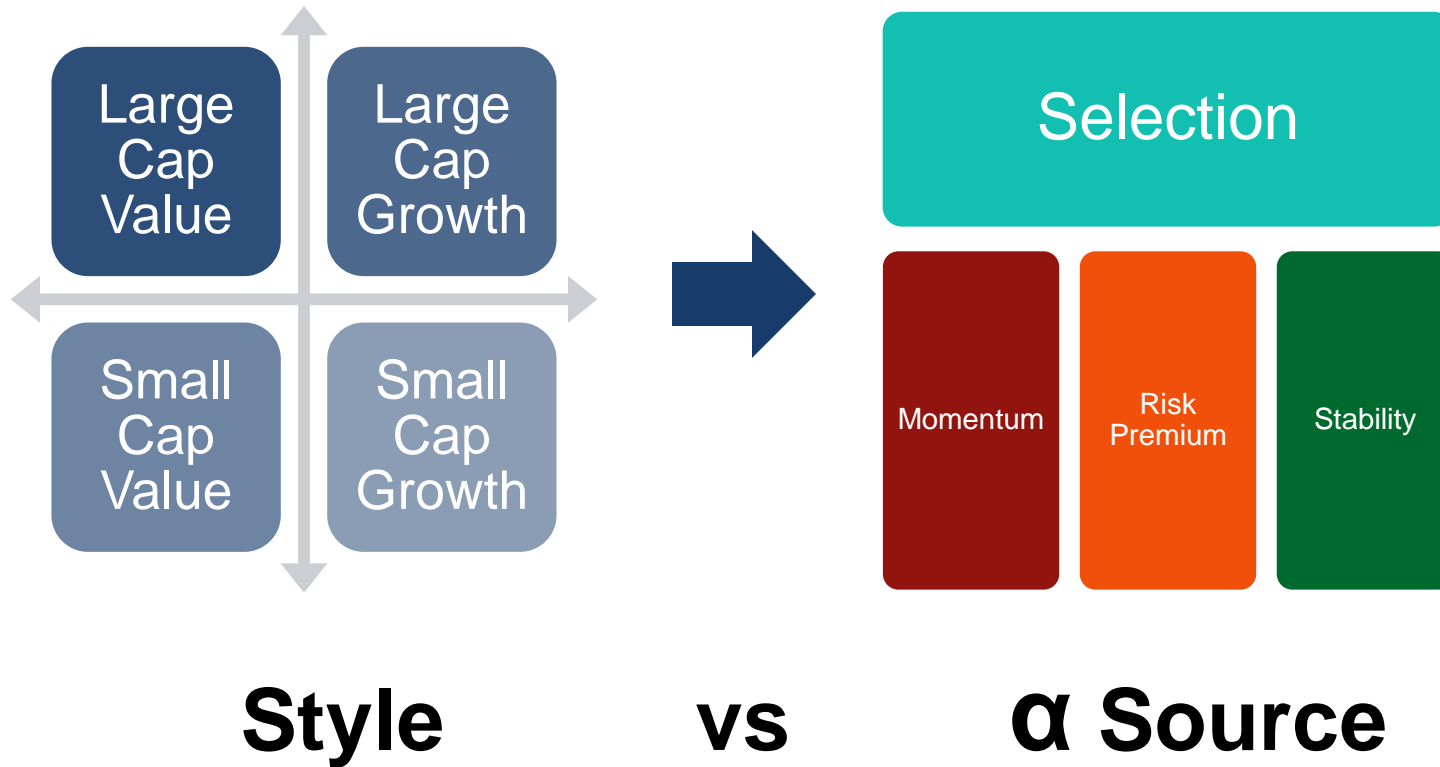
**Share Price Momentum**

**+**

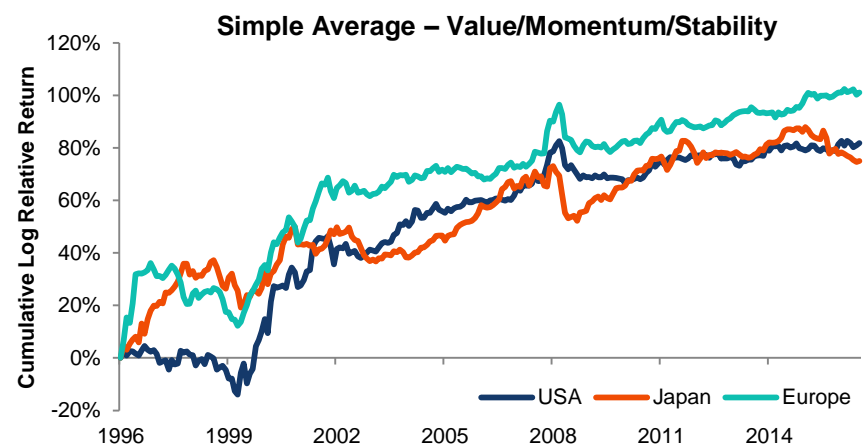
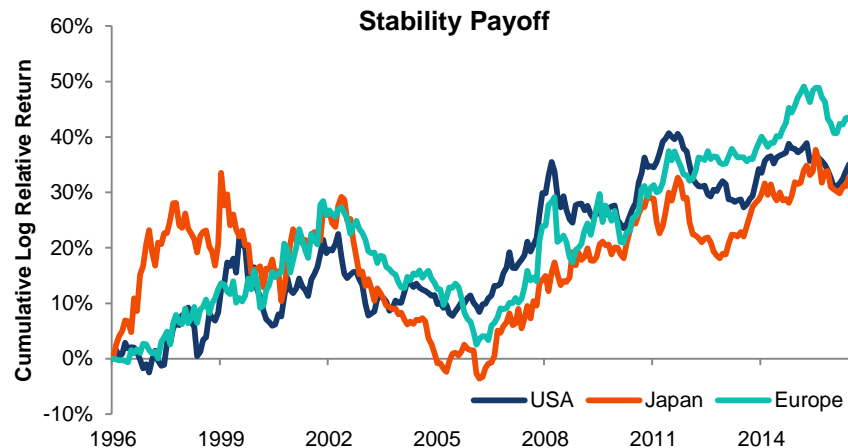
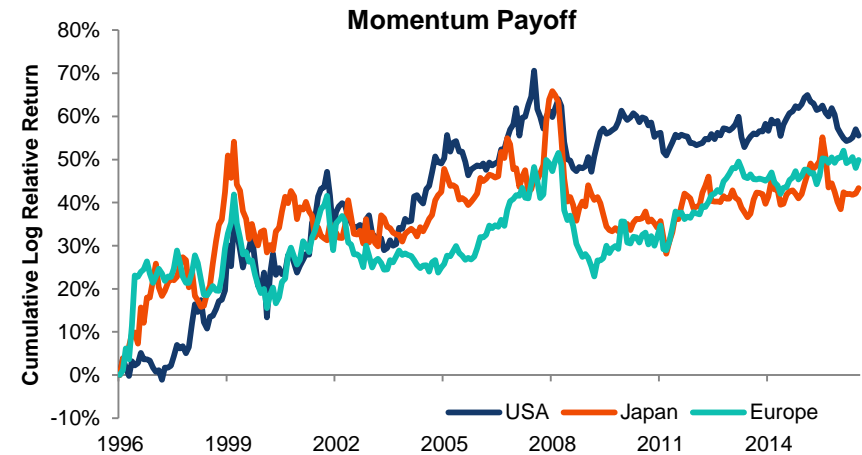
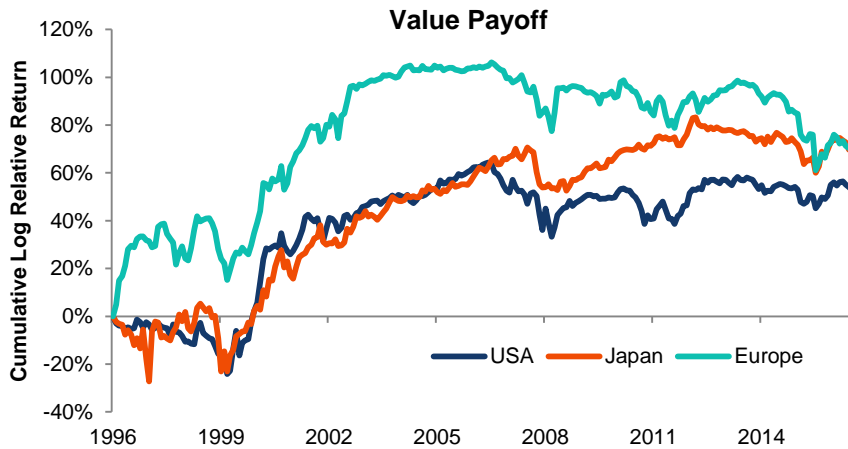
**+**



# SEI Alpha Sources | Beyond Style



# SEI Alpha Sources | Expected Payoffs



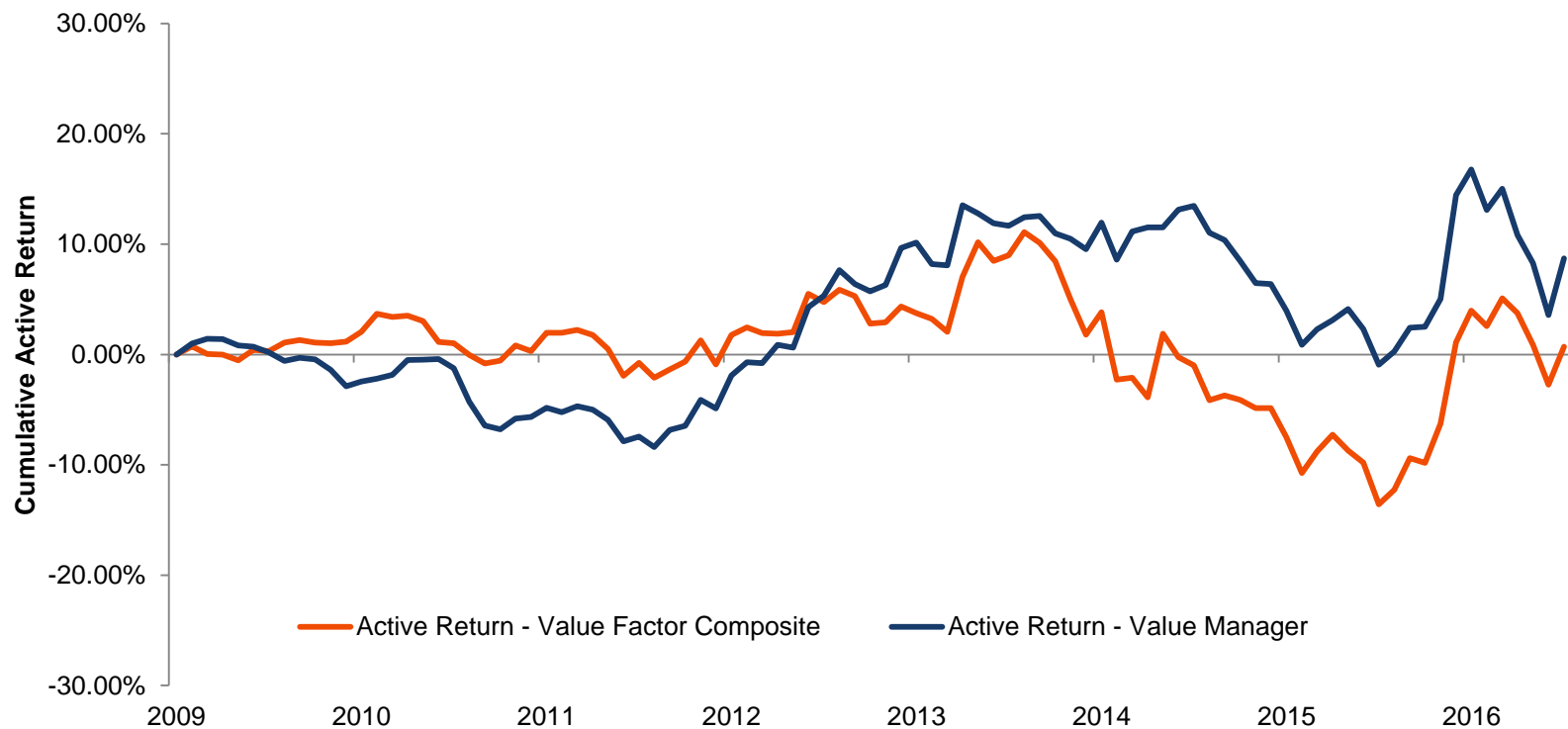
Source: SEI, Factset. The charts show relative returns of factor portfolios against their respective capitalisation weighted benchmarks. Updated to June 2017

Factor portfolios are constructed by ranking universe constituents on each respective metric and equally weighting top 20% scoring stocks. The metrics are composites of underlying ratios, such as book-to-price, earnings-to-price, share price performance, gross profitability, etc. The full list of metrics is available upon request.

Universe: USA = MSCI United States, Japan = MSCI Japan, Europe = MSCI Europe

Past performance is not a reliable indicator of future results.

# SEI Alpha Sources | Key to Manager Research & Selection



Source : SEI, Factset.

"Value Factor Composite" is a bespoke composite of top 30% scoring stocks on Sales Yield, Trailing Earnings Yield, Forecasted Earnings Yield, Cyclically Adjusted Earnings Yield, Enterprise Yield, Operating Cash Flow Yield, and Tangible Book Value Yield. Securities in the composite are capitalisation weighted.

Updated to end of June 2017. Returns are shown relative to Russell 1000 Total Return Index. All in USD, gross of fees.

Past performance is not a reliable indicator of future results.

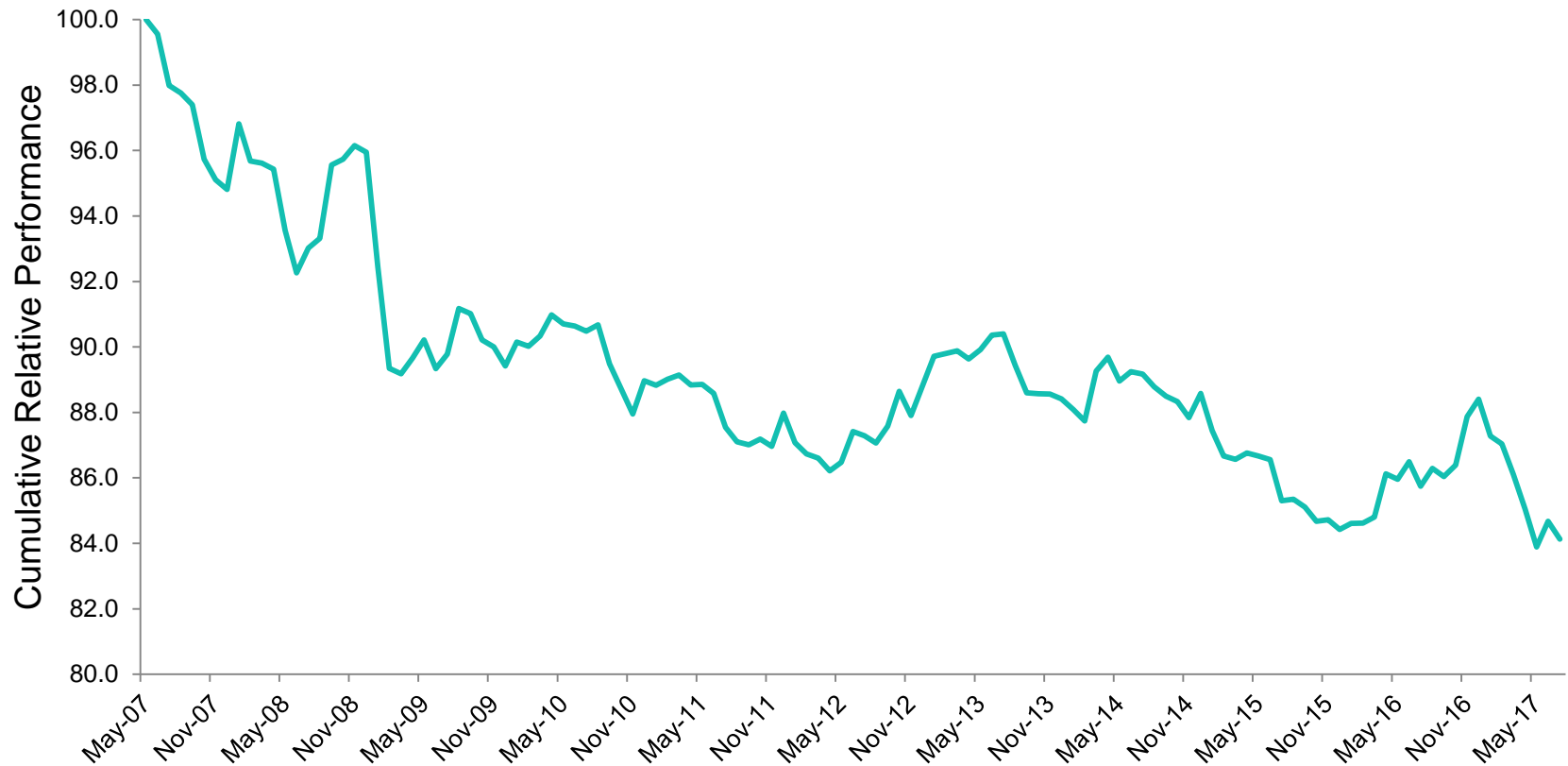
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## Lesson #6 – Take a Forward Looking View

# The Importance of Style & Investment Cycles

## Performance of Value vs US Equity Market since Pre-GFC Peak (Russell 1000 Value TR vs Russell 1000 TR)



Data refers to past performance. Past performance is not a reliable indicator of future results.



# The Importance of Style & Investment Cycles

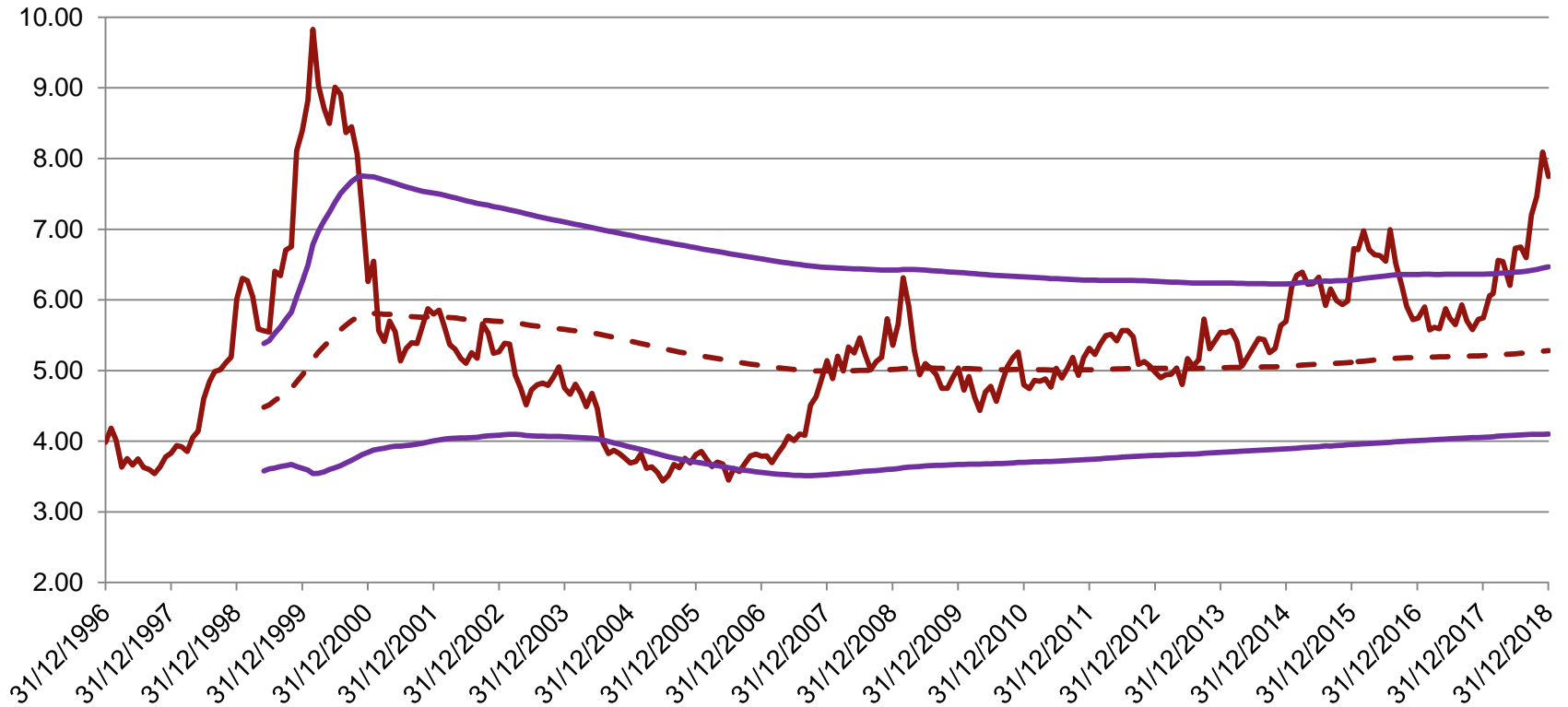
## Performance of Value vs US Equity Market 1997-2007 (Russell 1000 Value TR vs Russell 1000 TR)



Data refers to past performance. Past performance is not a reliable indicator of future results.

# Outlook - Value

## Valuation Dispersions – US Equity



Source: SEI based on data from FactSet, Axioma; updated as of 31/12/2018..

Data shown for S&P United States LargeMidCap Index. Valuation dispersion is measured by a ratio in median values of equally weighted 2nd and 9th deciles, ranked by Book:Price ratio. The charts also show Average (dotted blue), +1 and -1 standard deviation (purple) lines on an expanding basis.

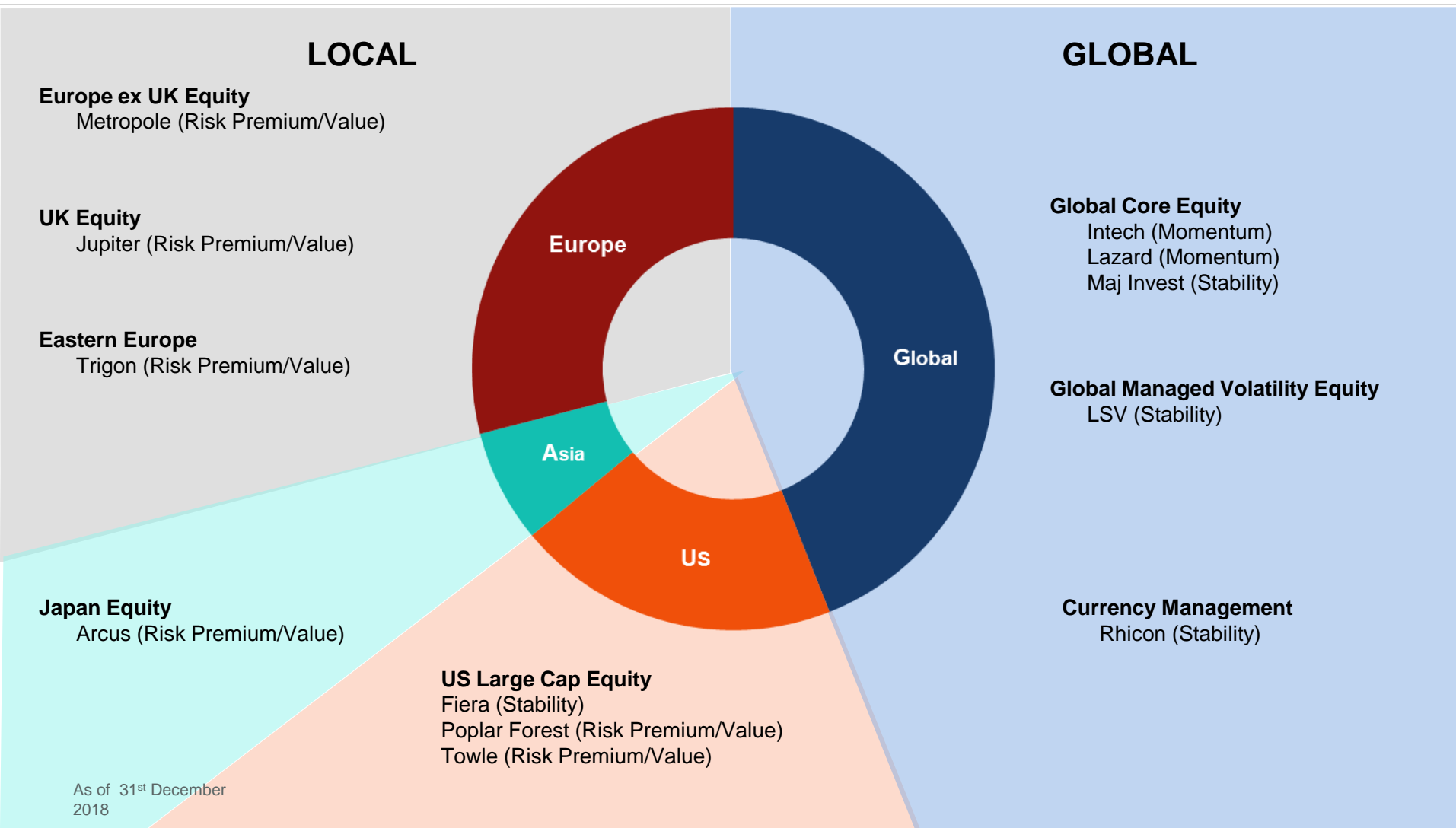
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Lesson #7 – Think about the Total Portfolio not just  
the Individual Components

# Portfolio Management | Specialist Managers – Global Select



# Portfolio Management | Strategic Risk Budgeting

	LSV	Intech	Rhicon	Trigon	Arcus	Metropole	Towle	Poplar Forest	Jupiter	Lazard	Fiera	Maj Invest
Weight	13.2%	5.7%	7.0%	5.6%	15.5%	10.7%	6.8%	13.0%	7.2%	11.2%	3.8%	7.0%
PCTR	5.0%	-0.6%	3.9%	2.7%	13.5%	9.4%	26.2%	28.2%	6.2%	-1.4%	0.1%	6.9%
TE	6.27%	4.69%	6.47%	11.76%	4.57%	5.57%	16.92%	7.34%	4.84%	4.50%	4.32%	5.39%
Beta	0.77	1.05	-0.09	0.72	0.98	1.11	1.20	1.04	0.94	1.05	0.99	0.94

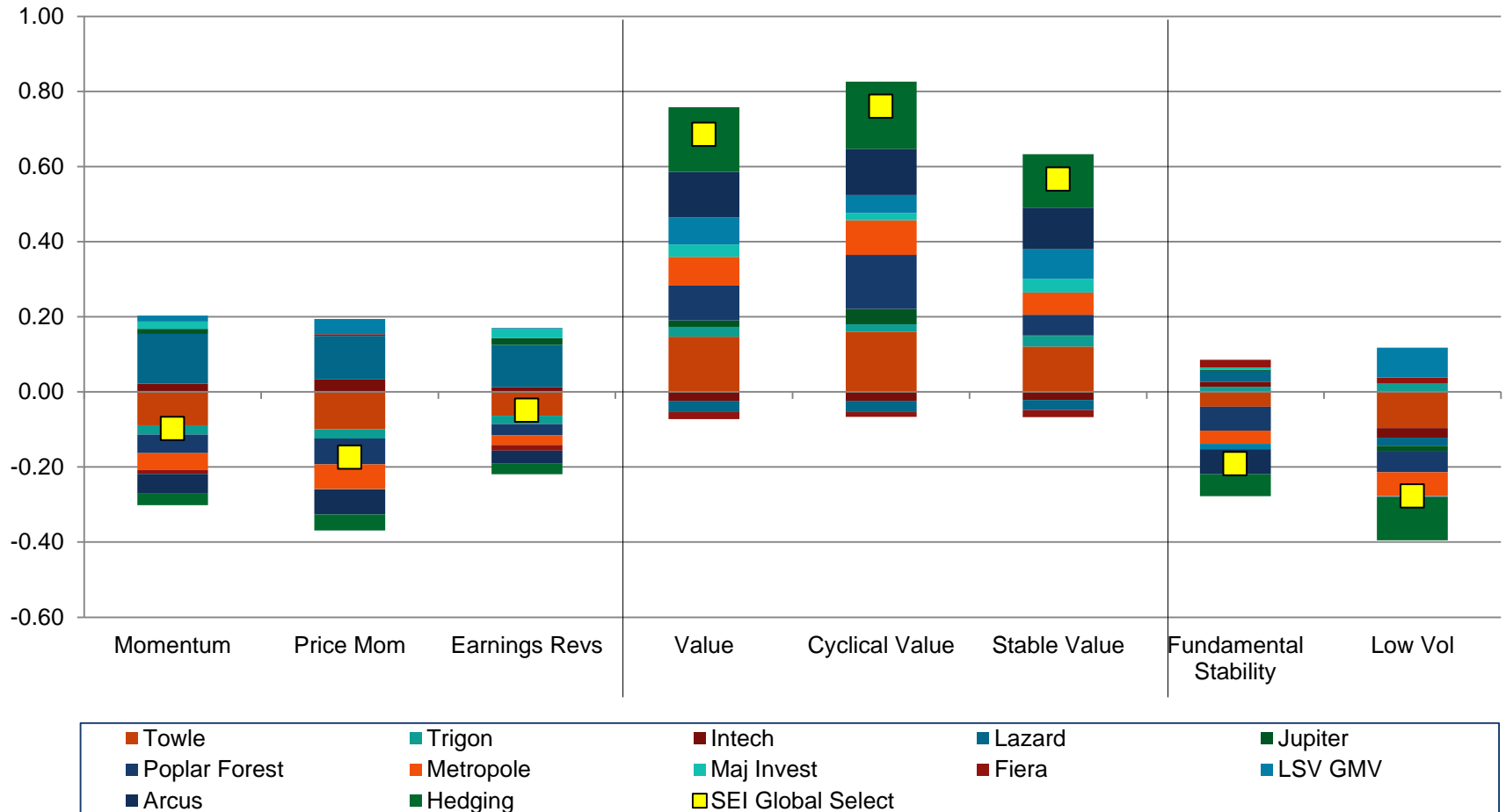
Correlation of Excess Returns	LSV	Intech	Rhicon	Trigon	Arcus	Metropole	Towle	Poplar Forest	Jupiter	Lazard	Fiera	Maj Invest
LSV GMV	1.00	-0.64	0.20	0.20	0.21	-0.14	-0.31	-0.21	0.00	-0.34	0.14	0.23
Intech	-0.64	1.00	0.02	-0.26	-0.27	-0.07	0.22	-0.02	0.01	0.56	0.00	-0.09
Rhicon	0.20	0.02	1.00	-0.13	-0.01	-0.22	-0.23	-0.10	0.03	0.11	-0.19	0.07
Trigon	0.20	-0.26	-0.13	1.00	0.11	-0.27	-0.16	-0.12	0.11	-0.33	-0.03	-0.05
Arcus	0.21	-0.27	-0.01	0.11	1.00	0.36	0.23	0.10	-0.04	-0.32	-0.19	0.20
Metropole	-0.14	-0.07	-0.22	-0.27	0.36	1.00	0.38	0.51	0.08	-0.27	-0.23	0.22
TOWLE	-0.31	0.22	-0.23	-0.16	0.23	0.38	1.00	0.55	0.19	-0.06	-0.18	0.40
Poplar	-0.21	-0.02	-0.10	-0.12	0.10	0.51	0.55	1.00	-0.03	-0.18	-0.10	0.37
Jupiter	0.00	0.01	0.03	0.11	-0.04	0.08	0.19	-0.03	1.00	-0.13	-0.09	0.16
Lazard	-0.34	0.56	0.11	-0.33	-0.32	-0.27	-0.06	-0.18	-0.13	1.00	0.07	-0.28
Fiera	0.14	0.00	-0.19	-0.03	-0.19	-0.23	-0.18	-0.10	-0.09	0.07	1.00	0.12
Maj Investment	0.23	-0.09	0.07	-0.05	0.20	0.22	0.40	0.37	0.16	-0.28	0.12	1.00

- Average Manager Excess Return Correlation = 0.00
- Average Forecast Manager Tracking Error = 6.9 vs Fund = 2.7 (60% Reduction)

Source: SEI as at February 2019

# Portfolio Management | Deliberate Portfolio Tilts

SEI Global Select Equity : Factor Tilts



Source: SEI, FactSet as at December 2018



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## Conclusion - Lessons in Manager Selection



# Lessons in Manager Selection

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- Don't be seduced by past performance
  - Be sceptical of over-confident portfolio managers and unaccountable advisors
- Understand manager's competitive advantage / philosophy / alpha sources
- Ask "has anything changed?"
- Consider valuations
- Think about your own behavioural biases

# Lessons in Manager Selection (Portfolio Management)

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- Consider the total “team” not just the individual “players”
- Use blending to allocate to more active managers with higher alpha potential
- Embrace diversification not “diworsification”
- Consider risk vs capital allocation
- Avoid complacent “buy & hold” manager weightings

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Fixed income securities are subject to credit risk and may also be subject to price volatility and may be sensitive to interest rate fluctuations.

Absolute return investments utilise aggressive investment techniques which may increase the volatility of returns. If the correlation between absolute return investments and other asset classes within the fund increases, absolute return investments' expected diversification benefits may be decreased.

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