

MRM-Horizon Review

A Publication of MRM-Horizon Advisors, LLC

Choosing The Right Money Manager

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A successful money manager search can have a meaningful impact on both the growth of your assets and their preservation, when a difficult economic environment takes hold. The best and the brightest managers consistently reward their investors with appropriate rates of return for the amount of risk incurred.

Investors today face an overwhelming array of choices in deciding how and where to have their assets professionally managed. Few investors, however, spend adequate time or effort in evaluating those who will guide their hard-earned assets. Selecting a good money manager can have a meaningful impact on your portfolio. Hiring mediocre managers is often a waste of time.

In our star driven culture it would be ideal if we could have our money personally managed by a Peter Lynch or a Warren Buffett. How does one go about locating and choosing a competent money manager? How does one separate the truly talented from the wannabes?

The Search Process

In these times of instant access to information, coming up with a list of candidates to consider as your portfolio manager is all too easy. Your business associates, financial contacts, legal and accounting professionals, or any number of published rating services can supply you with the raw material to begin your search.

To most investors the most visible and alluring initial attraction is a dazzling record of performance. But as beauty is only skin deep, outlandish performance can be fleeting. The last thing you should consider about a money manager is his past performance.

Let's assume that your search has uncovered the next superstar. What then? To achieve a comfort level that will make you feel good about investing your nest egg with a manager, you should be prepared to do considerable homework. Failure to perform thorough due diligence can be costly.

When considering a money manager's suitability to shepherd a portion of your assets, there are three primary areas of concern that need to be addressed: the attractive-

ness of the strategy and the sustainability of its return profile; the integrity of the manager; and the manner in which the manager runs money.

Investors often commit substantial funds to a manager having done little or no due diligence in any of these areas. Even the most elemental evaluation process will often raise questions and concerns that either preclude an investment, or at least require further clarification. The following list of considerations is by no means complete, but provides a good starting point.

Investment Strategy

In this age of specialization, it is important to understand the strategy the manager is pursuing and to gauge his ability to implement it profitably in any market environment.

—**Economic rationale.** Is the strategy grounded in understandable economics? Why does a risk-reward benefit exist? Hopefully, it involves an inefficient market in which the manager has a definable "edge" through a unique legal, accounting, or research capability.

—**Experience.** How experienced is the manager in implementing his strategy? Is he a recognized expert in his chosen strategy among his peers?

—**Size constraints.** Is the strategy capable of employing ever increasing amounts of capital efficiently? How has the performance record tracked the growth of the manager's assets.

—**Taxability.** Every strategy carries with it its own inherent level of tax consequences. With the significant difference between short and long term capital gains rates, it pays to consider after tax rates of return when comparing the attractiveness of various strategies.

—**Risk control.** Ask about risk control procedures. What environment is most/least favorable to the strategy? How do they take advantage of favorable conditions and how might that approach change in bad times?

The Manager

—**Integrity counts.** Warren Buffett once said, “It is impossible to make a good deal with bad people.” Your concern is to insure that the manager and his employees are people of integrity. There are a number of commercial services that will delve into a manager’s background and uncover any regulatory or legal problems. If these searches uncover any incidents, the manager should be asked to explain, in detail, the circumstances. (It should be noted that the SEC only requires that the most recent five year regulatory record be made public.) If the manager is an investment advisor, request a copy of the Form ADV, Parts I and II.

—**Visit.** You should visit the manager in his environment. Is his organizational structure appropriate for the level of funds he is managing? Have he and other principals been managing money for many years competently?

—**Performance.** Is the performance record he is touting really his? Exaggerated performance is as prevalent in the investment business as the common cold.

—**Information flow.** Does he volunteer information easily? If the manager is not tolerant of your need to understand his investment process before you invest, he will be even less likely to patiently explain to your satisfaction how he lost your money.

—**Consistent message.** Since hindsight is 20/20, request and read past client correspondence. Does he do what he says? Does he admit when he is wrong?

—**References.** Do his references check out? Previous employers, clients, and his professionals should be called. Check with outside contacts not supplied by the manager if possible. Continue turning over rocks until you are satisfied there are no snakes under them.

—**Transparency.** Will he allow you to look at his current portfolio (or at least the top positions)? Most managers will. Do the positions mirror the stated strategy?

—**Idea generation.** What are the research sources? Where do ideas originate and what is the in-house procedure that culminates in an investment?

—**Personal commitment.** How much does the manager and his team personally invest? What other investments do they have?

—**Motivation.** How hungry is the manager? Does his motivation and energy level indicate continued engagement in the day to day grind of asset management? Is

he a committed investor or merely an asset gatherer? Focus and dedication are prime determinants of success in the managed money arena.

How Does He Run Money

Many managers come from an institutional background, and unfortunately perpetuate that style when managing individuals’ assets.

—**Cash.** How does the manager view holding cash. Cash should be a function of lack of suitable investment opportunities. Your manager should be willing to hold cash, pending attractive opportunities.

—**Concentration.** How many stocks does the manager own in a portfolio. As you are not buying an index fund, you want only the manager’s best ideas in your portfolio. Most managers can not intimately understand more than 35 investments at any one time.

—**Turnover.** A manager who turns over his portfolio more than once per year has little conviction in his investing, and is trading your money tax inefficiently.

Post Investment Monitoring

The above list of considerations should provide a good starting point for your money manager evaluation. However, as long as funds remain invested, due diligence should be an ongoing process. Organizations, styles, strategies, and assets under management are constantly evolving and a manager must anticipate and adapt to his changing environment to continue being successful. The following considerations are signposts to potential further action once you have made an initial investment.

—**Consistency.** Are quarterly reports, and other client correspondence on time and consistent with what you believe to be normal operations?

—**Accessibility.** In a stressful investment climate, is the manager, or one of his top lieutenants, available to answer your concerns and questions?

—**Continued focus.** As assets grow in the wake of good performance, does the manager remain motivated? Is he on vacation more than he used to be? Has he become involved in any outside distractions?

—**Style drift.** Have you been surprised by anything the manager has done or said? Surprises often indicate a straying from stated strategies. More money has been lost through style drift than by any other single cause.

—**Comfort factor.** Are you getting what you thought you were buying? Are you comfortable? If you are not, the manager should be able to dispel your discomfort or you should consider terminating the relationship.

MRM-Horizon Advisors welcomes your due diligence and stands ready to answer any questions that you might have. We wish you success in your manager search.

Summary

A successful manager search can have a meaningful impact on both the growth and preservation of your assets .

Incisive due diligence is critical to the preservation and performance of your assets. An NASD official once wryly replied to my question, “How much due diligence is enough?” by saying, “If nothing goes wrong, you have done enough. If something does go wrong, you obviously haven’t done enough!”

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