



# 20 years of evolution in manager research

2021



## Proposition excellence

Our approach to manager research can be traced back to Roger Urwin, our Global Head of Content and founder of the investments business. It is built around a **goal** of identifying managers with sustainable competitive advantages. A key word is “sustainable”, demonstrating **an explicit focus on the long-term sustainability of the asset management business and investment teams, and a focus on long-term performance outcomes.** Consequently, from its outset, our manager research process placed significant emphasis on understanding business sustainability, incentivisation and retention structures and the alignment of interests between different stakeholders, notably the alignment between the key investment professionals and the client/end saver.

Our goal is translated to **success factors**, providing the structure and discipline to form robust and repeatable research assessments. Over the years we have refined and developed the success factor framework, which is still used today and is shown in *Figure 2*. We explored the key areas underlying the success factor framework in some detail in our 2007 paper, *The Search for Alpha*. While this paper is some 14 years old, and the framework has changed a bit, the content remains highly relevant today.

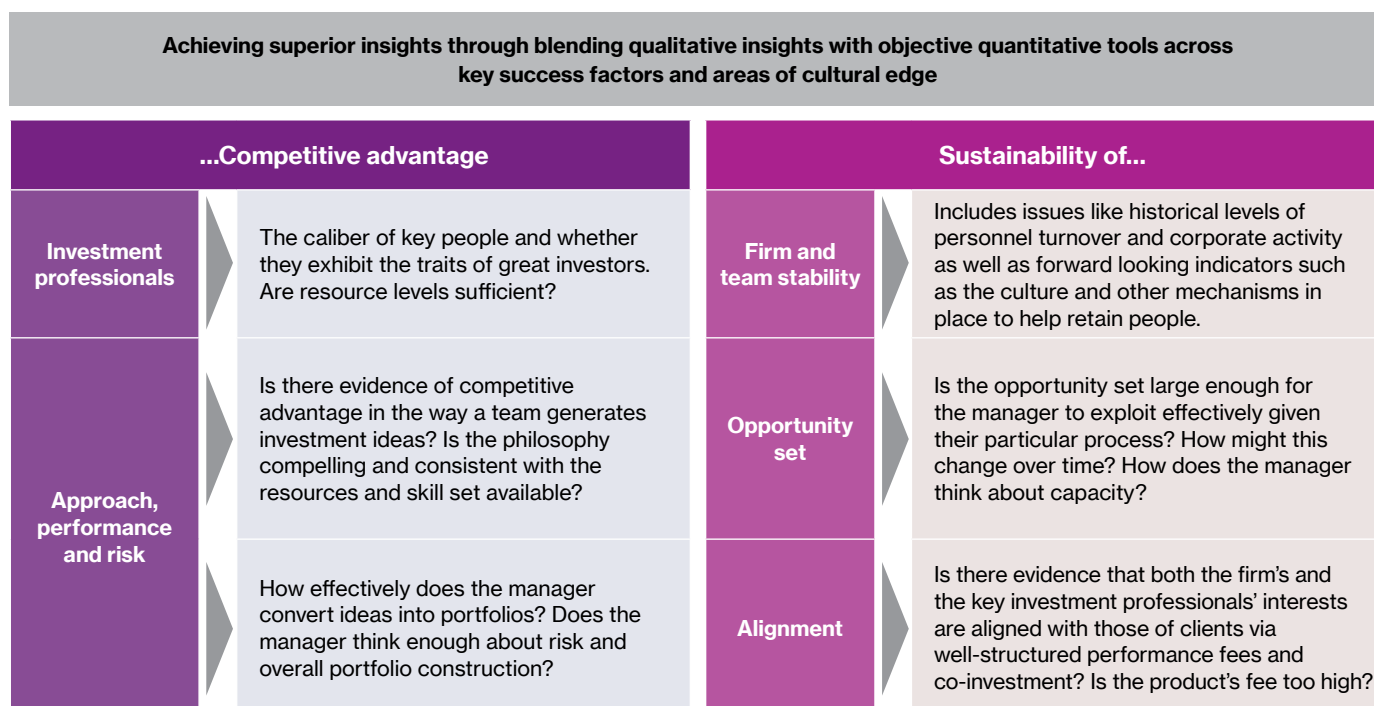
To deliver “proposition excellence”, we have developed and refined our approach to assessing asset managers against these success factors over the years.

**Our philosophy is that the most reliable way of assessing investment teams and processes, and thus identifying tomorrow’s high-performing managers, lies in thorough qualitative research, supported through quantitative and performance analysis.**

We note the **dangers of placing too much weight on historic performance as an indication of manager skill**, acknowledging survivorship factors and high “noise to signal” that challenge simple quantitative techniques to manager research.

Arguably the hardest part of a manager research assessment is assessing the investment professionals, both as individuals and as a collective. To ensure our qualitative research insights are captured robustly, we have developed the relevant nomenclature to identify and compare great investors. While it is easy to focus on the tenure and prior experience of the portfolio manager(s), and this clearly provides valuable information, we believe the most successful investors share common traits. As outlined in *Search for Alpha* and the 2011 asset class specific follow-up, *Assessing investment skill in equity managers*, we seek to identify those investment professionals displaying passion, intellectual curiosity, self-awareness and integrity, amongst other traits.

Figure 2. **Manager research success factor framework**





## Proposition excellence

A more recent evolution in our process has been the formalisation of assessing asset managers' **culture**, neatly summarised by *The asset manager's guide to assessing and evolving culture* and *Measuring culture in asset managers*. How can culture affect investment performance? Good performance is the result of a solid investment strategy, but it's driven by the people and culture that shape it.

**We have found that without a culture that is inclusive, encourages collaboration, balances individual talent and team and puts a strong emphasis on clients, the upside for strategy success diminishes as complexity or competitive dynamics emerge.**

We measure culture across three main areas:

- The employee value proposition (how a firm treats, engages and retains its employees);
- The client value proposition (how a firm treats and measures success for its clients), and;
- Leadership (having ethical leaders with integrity who carry and evolve the firm's culture over time).

We have observed a strong link between culture and the sustainability of competitive advantages, resulting in greater perseverance of our research ratings.

Another key part of our manager research process is how we maximise the insights of our team when applying the process. Over the years, we have incorporated a **range of techniques designed to eliminate bias in our assessments and maximise the cognitive diversity** that exists within our manager research team. These include:



**Independent thought emails** – To minimise anchoring, manager researchers are required to send thoughts email summarising key observations from an asset manager meeting prior to any discussion between them (or others).



**Devil's advocate** – To protect against confirmation and sunk cost biases, the penultimate step in our investment process is the "devil's advocate" review. A researcher with limited background on a manager is required to pick apart the investment thesis and collate challenges from all team members, which are ultimately debated and addressed prior to assigning a research rating.



**Building diverse teams** – We have spent significant time to ensure we are building diverse decision-making groups, assessing across endowed and acquired traits. For example, our manager research is currently 45% female and 48% non-white and has steadily approached our target of being representative of society and the end saver.



**Invest Connect** – Invest Connect is Willis Towers Watson's asset manager information sharing website launched in 2019. We use Invest Connect to request, store and organise information on key products used by our clients. Through collecting proprietary data and asking specific questions, Invest Connect has allowed us to systematise how we assess and monitor certain success factors, effectively improving the level of objectivity in our process.

## Innovation and product design

Our manager research approach is underpinned by client centricity and a culture of innovation. The confluence of these factors has a profound impact, particularly over the last decade. Rather than confine ourselves to the opportunity set of the products created by the asset management community, we engage to identify, design and build better components. We **work with best in class managers to design the solutions that isolate a unique skill and/or opportunity set AND meet the needs of our clients**, ensuring that new ideas complement their broader portfolio.

Is innovation “code” for complexity and esoteric? No. Innovation isn’t confined to market niches, although we often find exceptional risk-adjusted return potential in those strategies that sit between areas. We believe innovation can and should span all markets. Indeed, an excellent demonstration of our innovation is covered by the 2018 piece *Better equities*.

Most active equity strategies underperform; we estimate over 70%. Active equity strategies are typically over-diversified and suffer from high fees. Legendary investor Sir John Templeton put it simply: *“If you want to have better performance than the crowd, you must do things differently than the crowd.”* We have engaged skilled stock pickers to proactively create mandates/products that isolate and leverage their particular skill, namely managing concentrated high active share equity portfolios where performance is driven by the quality of their best ideas.

A more recent example was applying the same concept of over-diversification to hedge funds, as detailed in *Hedge funds: a new way*. We have engaged hedge fund



**Ideas are like rabbits. You get a couple and learn how to handle them, and pretty soon you have a dozen.”**

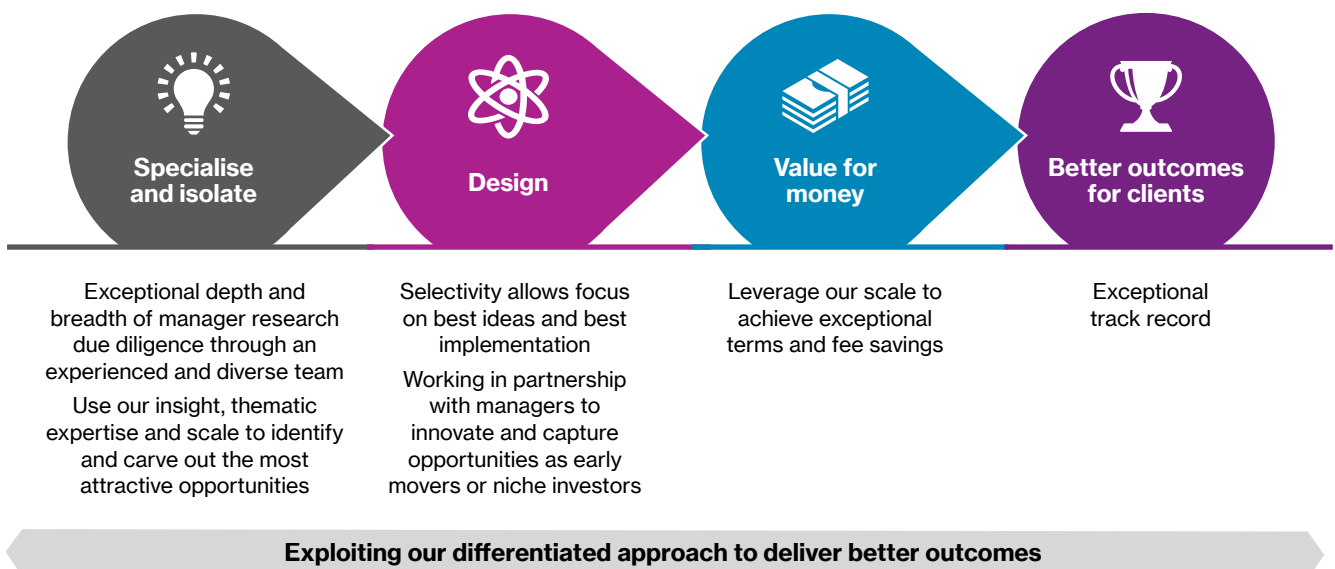
John Steinbeck

managers to build products that isolate their particular area of expertise and deliver “bang for buck”. The exceptional contribution to portfolios through the Covid-19 volatility validated this approach and addressed the growing discontent towards hedge fund strategies. Even more recently we have engaged to help design climate solutions, such as reforestation strategies or helping to develop the financing markets for solar panels and thus increasing renewable energy sources.

Working in conjunction with best in class managers, we now have a track record of developing **over 200 innovative new solutions in the last 20 years. In our experience, these new solutions have delivered differentiated exposures and performance outcomes to our clients.** Through effective engagement and collaboration with asset managers, we have founded that innovative ideas are just like rabbits!

Figure 3 displays our approach of engaging managers to develop best in class solutions and the steps in product design.

Figure 3. Innovation and engagement to identify or create the best solutions



### System engagement and investment purpose

Our manager research process is evolving to reflect an ongoing re-framing of the investment industry purpose and effectuating system-level change. In the areas of Sustainability (and Stewardship) and Inclusion & Diversity we recognise that our responsibility extends beyond just our engagement with a sub-set of assets managers. We can and should play a meaningful part in helping to support systemic change, acknowledging this will ultimately deliver better investment returns to the end saver, a more representative (and consequently more credible) investment industry and better world into which savers will retire.

In our view, investment should be defined as a three-dimensional framework, supplementing risk and return with impact. Impact is defined broadly in terms of the impact on other stakeholders. *Figure 4* illustrates the different stakeholders in the investment industry ecosystem and their goals. We have embedded this reframed investment purpose into our manager research process.

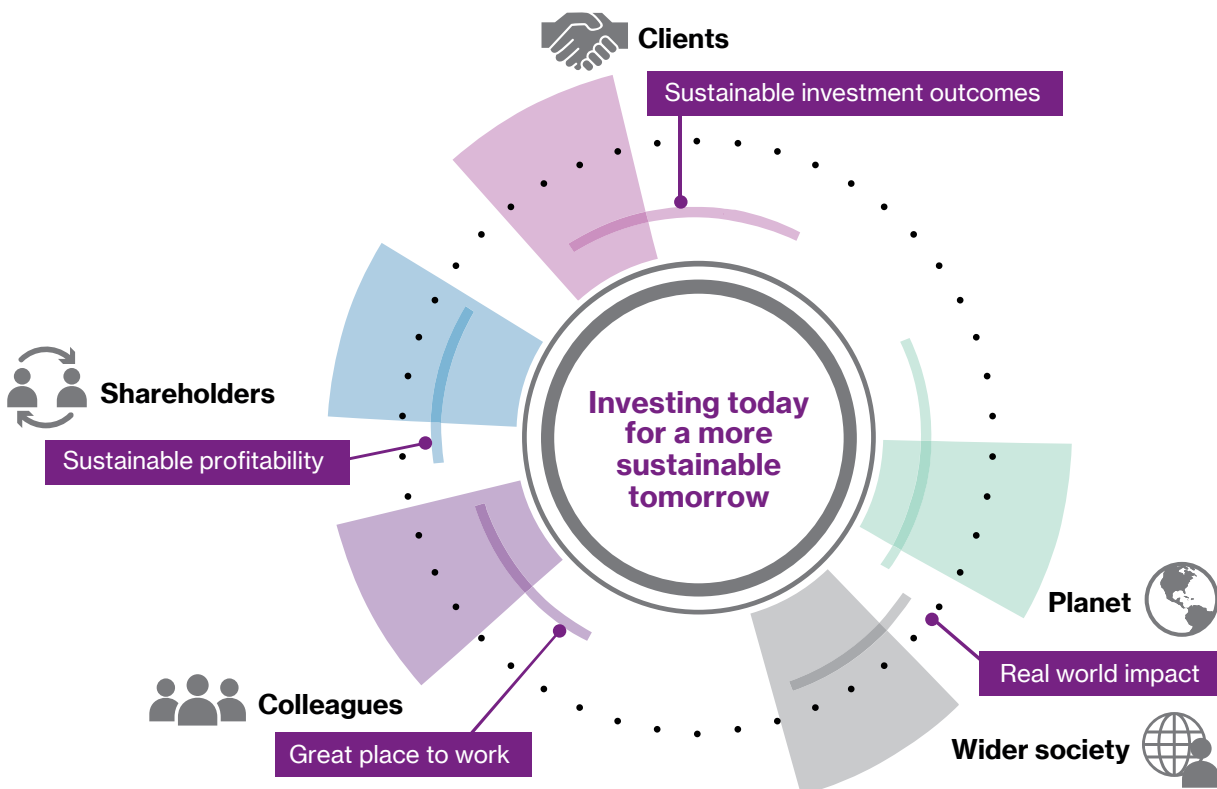


### Our manager research process incorporates an explicit assessment of diversity, with a goal of identifying those asset managers with optimal diversity.

In recent years we have developed a more robust approach to assessing diversity, blending an objective assessment of diversity data with the deeper and more nuanced aspects gleaned through our qualitative research. However, we are selecting from amongst an industry that has largely failed in the area; 1.3% of asset managers are ethnic diverse owned, 5% female owned according to recent studies from Bella Research Group and the Knight Foundation. We need to help change the system.

Through the development of a robust data-driven approach, we have been able to supplement belief driven arguments with harder data to support a positive link between Willis Towers Watson's assessment of diversity and performance outcomes.

Figure 4. Willis Towers Watson's investment purpose





We published our findings in *Diversity in the asset management industry* to reinvigorate the debate. Our research findings and engagement are beginning to illicit a reaction, including a greater desire to improve the diversity characteristics and participate in programmes designed to attract women and ethnic minorities to our industry. We see this in the progress we have made in improving the diversity of the asset managers comprising our client portfolios.

We are an active participant in various industry-wide groups designed to help deliver change and standardise diversity reporting. We carefully monitor which asset managers are playing a leading role. For example, we recently joined the Institutional Investing Diversity Cooperative, a 20+ consultant-wide initiative, aimed at improving asset management data and transparency and creating some commonalities across firms.

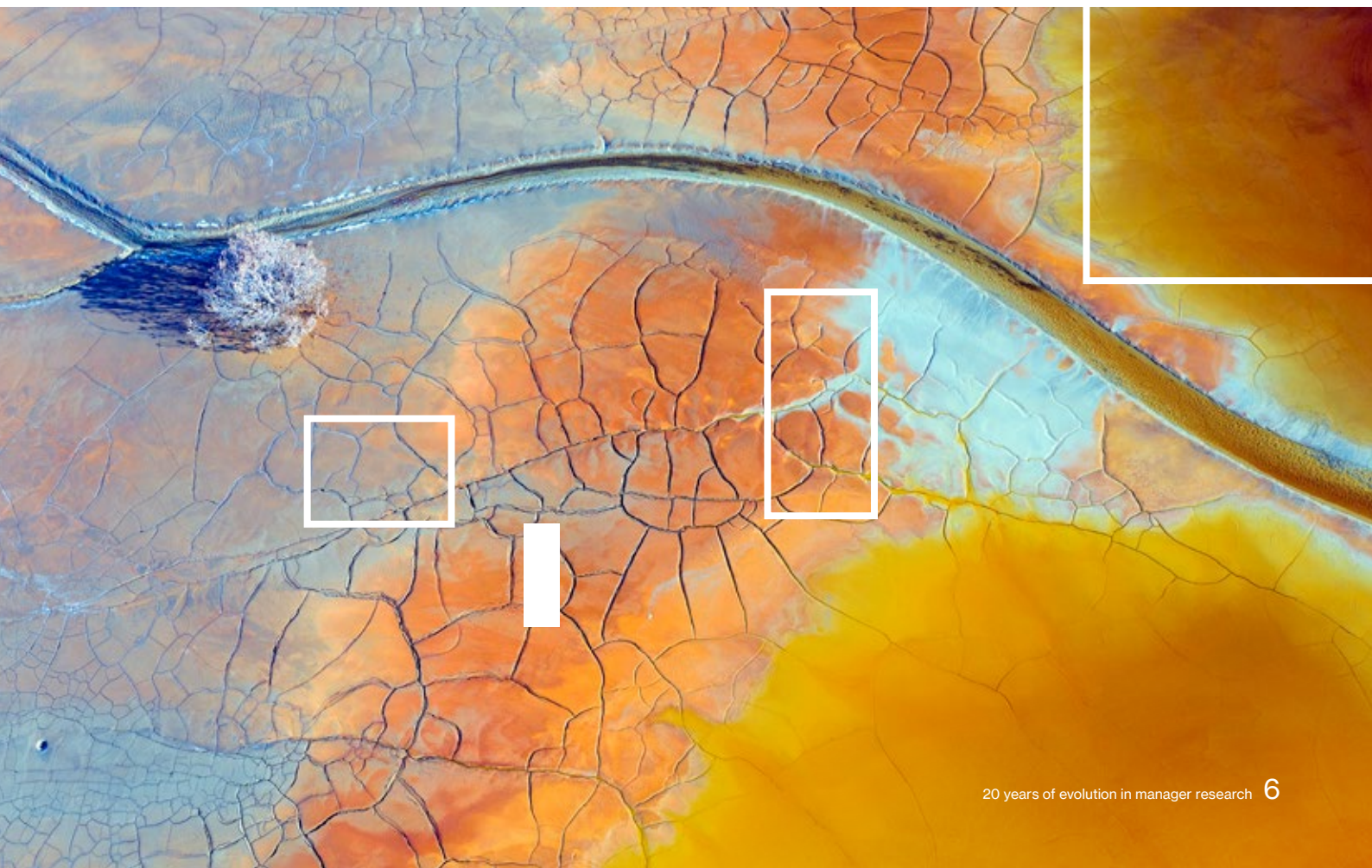
Sustainability/ESG is an integrated and significant part of our manager research process. We have developed and refined our assessment framework over the years, with significant developments around Climate factors more recently. We think that understanding this transition will be one of the biggest sources of alpha across all asset classes. This opportunity is likely to be greatest in the next few years as the data is not yet well understood and prices have not yet fully reflected the likely path for the world.

In April 2021, we pledged to target net zero greenhouse gas emissions by 2050 at the latest, with at least a 50% reduction by 2030, in our fully discretionary delegated investment portfolios.



**Playing our part to help ensure a just transition to net zero requires us to do more than just react to the changes underway. In our view, stewardship will represent an important part of driving systemic change.**

We assess managers' ability to reflect climate risk in their decisions when selecting securities, and we regularly engage with the asset management industry regarding their stewardship practices. We believe it is our role to help establish best practice and continually engage with the industry to keep improving standards.



## Driving differentiated outcomes

Our manager research process culminates by pulling together the three different components, leveraging proposition excellence and our engagement model to identify asset managers capable of sustainable competitive advantages.

Has it worked? In short, yes. We have consistently managed to identify active managers capable of delivering outperformance over the long-term, benefitting from our differentiated approach and focused application of resource to push boundaries of research excellence; 200+ hours are typically conducted prior to assigning our top rating. And while we have had mistakes, *Figure 5* details our model performance track record, displaying the outcome an investor would have obtained had they invested equally across preferred (highest rated) products in these asset classes.

Similarly, our success in manager selection can be observed in clients' outcomes. *Figure 6* shows the performance track record of our delegated clients, with these clients' portfolios typically comprised exclusively of our Preferred rated managers.

**Our manager research process has evolved significantly over the last 20 years. We have benefitted enormously from a culture of challenge and a willingness to adapt. The exchange of ideas and critique from external sources has helped to shape this evolution. We look forward to continuing this over the next 20 years.**

Figure 5. Annualised model outperformance over 20 years to 31 December 2019

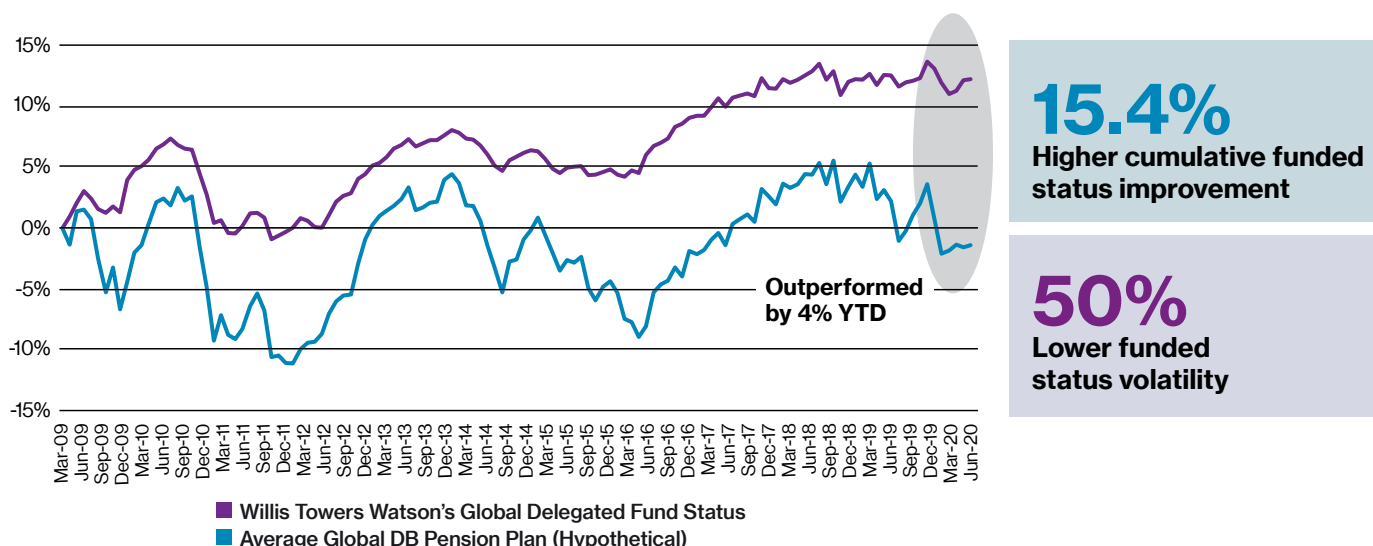
	Periods to end 2019:		
	20 years (Jan 2000-Dec 2019)	10 years (Jan 2010-Dec 2019)	7 years (Jan 2013-Dec 2019)
Equities (gross)	1.41	1.34	1.41
Bonds (gross)	0.94	1.13	0.84
Diversifiers (net of manager fees)	1.18	0.73	0.22

Sources: eVestment and investment managers

Performance for Equities, Bonds and Diversifiers presented in this document reflects model performance an investor would have obtained had they invested equally across preferred products in these asset classes. It does not represent performance that any investor actually obtained. Model performance is displayed gross of manager fees and gross of Willis Towers Watson fees for Equities and Bonds as client specific fee levels vary, with Willis Towers Watson clients often paying significantly below rack rates, making it impossible to provide accurate net performance. If manager fees and/or Willis Towers Watson's fees were reflected, the performance shown would have been lower. Model performance is displayed net of manager fees and gross of Willis Towers Watson fees for Diversifiers given the tendency to report on a net basis and to allow for performance fees. All returns are compared in their base currency against benchmarks in their base currency. Please see "Methodology" and "Disclosures" on the following page for additional information.

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Figure 6. Cumulative change in funded status over time





## Methodology and disclosures

### **Methodology - equities, bonds and diversifiers model performance**

Analysed 'preferred products' for active long only Equities, Bonds and liquid Diversifiers from 1 January 2000 to 31 December 2019. 'Preferred products' includes Positive, 1 and Preferred rated products.

The ratings history was taken from the Dream database (a proprietary application that, among other things, stores historical ratings of investment managers and products that have been rated by Willis Towers Watson and its predecessor firms). It should be noted that product renaming/mergers/splits will impact the ratings history which has not been independently verified. The ratings reflect all managers rated during such a time period. Ratings are forward-looking.

Ratings were mapped to the performance of the product match we believe to be the most appropriate within the eVestment database. Where a suitable performance stream was not available on eVestment, reasonable efforts were made to use returns from other available sources but ratings without performance were excluded from the analysis.

Relative returns are calculated relative to the appropriate benchmark (see below).

Performance in product base currency compared with benchmark return in the same currency; for Hedge Funds, we use return in base currency compared with HFRI fund weighted index in USD as Hedge Funds are normally assumed to be perfectly hedged to a currency.

Fee information for Diversifiers is sourced from eVestment. In the minority of cases where no fee information is available in eVestment, we use "Expected fee %" from internal research to supplement the missing info. If no fee information can be found from either source, assumed mandate default fee % is used.

Performance is assessed from the quarter following the rating creation up until the quarter end date following the rating having been downgraded or changed to unrated. This removes the benefit of hindsight as the rating is set in advance of performance being known.

Asset class returns are calculated by annualising the average relative quarterly return data within the specified period for the named asset class, for example the three year Equities number includes all available quarterly relative returns for positive, 1 and preferred rated products in the period 1 January 2017 to 31 December 2019.

### **Disclosures - equities, bonds and diversifiers model performance**

The aggregated manager model performance shown is for the stated time period only; due to differences in the managers selected by or for client accounts, the timing of such selection, and market volatility, each account's performance will be different. Manager returns are shown either gross or net of manager fees, but before trading costs, custody charges, and other direct or indirect charges. The returns shown assume the reinvestment of dividends and other income. Aggregated manager model performance does not reflect the deduction of any fees related to Willis Towers Watson's services.

The aggregated manager model performance presented reflects model performance an investor may have obtained had it invested in all products within a category and does not represent performance that any investor client of Willis Towers Watson or any other actually attained. The aggregated product model performance presented is based upon the following assumptions: investors equally allocated capital across all applicable products at the start of each quarter; each product was open to new investments during the applicable period. See Ratings study – methodology regarding the approach utilised in performing this study.

Certain of the assumptions have been made for modelling purposes and are unlikely to be realised. No representation or warranty is made as to the reasonableness of the assumptions made or that all assumptions used in achieving the returns have been stated or fully considered. Hypothetical aggregated returns have many inherent limitations and may not reflect the impact that material economic and market factors may have had on the decision-making process if client funds were actually managed in the manner shown. Actual performance may differ substantially from the performance presented. Changes in the assumptions may have a material impact on the returns presented. Other periods selected may have different results, including losses. There can be no assurance that Willis Towers Watson or any rated product will achieve profits or avoid incurring substantial losses.

The Positive/1 and preferred rated Equity universe represents managers following active equity-focused investment strategies that Willis Towers Watson has reviewed and rated most likely to add significant value on a risk-adjusted basis net of all costs, but not necessarily recommended for investment by clients. The return distribution reflects all managers rated during such time period and possibly, but not necessarily, recommended by Willis Towers Watson. Return distributions are not, and are not intended to represent, actual performance of any Willis Towers Watson client.

The Positive/1 and preferred rated Bonds universe represents managers following active fixed income-focused investment strategies that Willis Towers Watson has reviewed and rated most likely to add significant value on a risk-adjusted basis net of all costs, but not necessarily recommended for investment by clients.

The Positive/1 and preferred rated Diversifiers universe represent managers following a variety of liquid alternative asset classes strategies, including but not limited to Direct Hedge Funds, Real Estate, Infrastructure, Multi Asset and commodity Smart Beta & insurance-linked investment strategies that Willis Towers Watson has reviewed and rated most likely to add significant value on a risk-adjusted basis net of all costs, but not necessarily recommended for investment by clients.

Willis Towers Watson seeks to identify skilled managers, however there is no guarantee that Willis Towers Watson will be successful.

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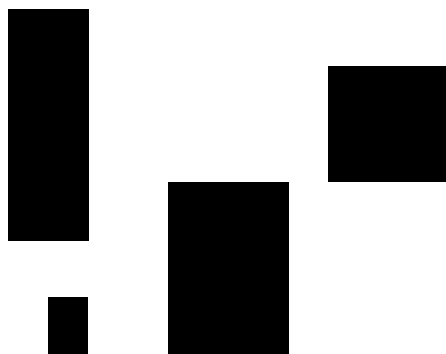
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