

Investor Insight

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Managed Funds and the Due Diligence Process

Managed funds continue to be an important part of our clients' portfolios. One of the questions that we are frequently asked is how we pick the investment managers and mutual funds that we recommend. After all, there are more managed funds available today than ever before.

The due diligence process is one of the more important aspects of our role as investment advisors. The objective of selecting future high performers requires ongoing analysis and an understanding of both qualitative and quantitative factors that drive performance.

Past Performance Isn't a Predictor of Future Performance

Our due diligence process is not based simply on the past performance of a fund. It is human behaviour to want to gravitate towards funds that have demonstrated superior returns as there is an expectation that this performance will continue into the future. Additionally, the average investor may not have the appropriate resources or time to conduct an in-depth analysis so past performance can end up being the only basis for an investment decision. But research has shown that past performance is not necessarily indicative of future performance.

What We Look For

We look beyond historical results to understand how strong performance was generated to predict future performance. Based on research and experience, here are some best practices that may be used to assess a fund or investment manager:

Organization — Profitable and stable investment firms with diverse revenue sources and low leverage that have appropriate incentives in place for the investment team and provide investment autonomy.

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Investment Staff — A team of passionate, curious individuals with complementary investing skill sets, having a strong work ethic and the temperament to act on their conviction and learn from their mistakes.

Decision Making — An identifiable and accountable decision maker and a process allowing decisions to be made in a timely matter.

Idea Generation — A broad source of ideas and a focus on unusual and unique insights that are continuously screened and tested.

Security Selection — Security selection reflects the investment manager’s best ideas and is consistent with the fund’s investment philosophy.

Sell Discipline — When making changes to the fund, the investment manager adheres to pre-defined, sell triggers that align with the fund’s investment philosophy. Sell triggers include better ideas replacing marginal ones, full value being reached or a change in the investing rationale.

Research — Strong analysis, not just data generation, with unique and proprietary insight that supports the investing approach of the fund.

Risk Position — An understanding of the risks associated with the benchmark index that is used by the fund for comparative performance; however, performance shouldn’t mirror the benchmark used.

We would be happy to discuss any aspects of our due diligence process or answer any other questions about investment management. Please don’t hesitate to call. We are always here to provide support.