HENDERSON ROWE

INVESTOR Q&A

10 Questions to Ask Your Investment Manager

Henderson Rowe is disrupting the UK market by delivering institutional-quality investment solutions directly to the private clients. In this Q&A, **Charles Astor**, an Investment Manager at Henderson Rowe, speaks with **Jason Hsu**, Chief Executive Officer for Rayliant Global Advisors, Henderson Rowe's parent company. Charles asked Jason about some of the things retail investors should be asking their managers. This Q&A is based on a conversation recorded in July 2019; selected text has been edited for clarity.

Q Why isn't more of my money in low-cost ETFs?

A: When it comes to developed markets, ETFs are an excellent and inexpensive way to get exposure. If your investment manager isn't talking to you about ETFs, they are doing you a disservice and may not be focused on your net-of-fee performance.

Q Are high fees correlated with better investment outcomes?

A: It's empirically proven that there is no positive correlation between the price of a product and the outcome it's likely to create. All too often, high fees and exclusivity are used as a marketing tool to boost the perceived prestige of a portfolio and do not reflect its future performance. By the same token, one shouldn't assume that a more affordable product will perform worse. In fact, lower fees mean the portfolio already has a head start in terms of net-of-fee performance.

Q Would I be better off without a professional investor?

A: There are many things that we need to do better as an industry, however, the answer to this question is still usually "no". The portfolios of investors who do not work with an adviser perform, on average, about 6% per annum worse than those who do.

Q Do institutional portfolios perform better than private client portfolios?

A: The reason for this distinction is that institutional clients are focused on long-term evidence-based investing. They want to understand how a particular strategy operates, the environments in which it will perform, and the associated risks. Generally speaking, institutional quality solutions behave as they are designed to because they are underpinned by in-depth research.

Retail solutions tend to be less robust, and they are often based on a manager's instinct rather than empirical evidence. It is often challenging to obtain an adequate explanation of the research underlying retail products, and some retail funds expressly refuse to disclose their strategies.

No institution would invest money into these types of strategies, which might occasionally perform well, but for which performance cannot be adequately explained, replicated, or predicted with any degree of certainty.

All in all, institutional quality solutions "perform better" because they're more likely to perform as expected, even if certain retail strategies may randomly outperform over certain short-term time horizons owing to luck or circumstance.

Q Can I achieve good portfolio performance by picking top-rated funds?

A: This approach doesn't work. In fact, five-star funds are known to perform slightly worse than three-star funds. Research shows that funds on consultants' "buy lists" do worse in the next three years than those on consultants' "sell lists".

Q How can investors distinguish good from bad products?

A: There's no single way to make this distinction, but there are a few helpful proxies. One area that we have already discussed is fees. Any product with high fees warrants extra scrutiny. Even a top-performing product will be bad if its returns are consumed by excessive fees.

Another common proxy for a bad product is its complexity. Why is it so complex? Each layer of complexity usually represents an additional person getting paid. The top-level fees for complex products might seem reasonable at first, but their upside rarely materialises…at least not for the investor.

A final proxy is to understand the sales commissions associated with a product. Investment products that are associated with high commission payouts – such as investment-linked life insurance policies – are very good for those who are selling them. But they are usually bad for the people buying them.

Q Does acting on news and forecasts result in better performance?

A: There is an idea that, if an investor closely monitors news and forecasts, they can then use this information to achieve better performance. However, in developed markets, this idea is mostly a fallacy.

Academic research shows that even with perfect knowledge of, for example, where GDP growth will be at the end of the year, there is no correlation between that knowledge and the stock market. This is because what we don't know is already known to some other industry participants. So even if you listen to a forecast on its release, it has almost certainly been incorporated into securities prices.

Q Do successful business-people make good investors?

A: As a successful entrepreneur, you would probably be best served by doing the exact opposite of your instincts when it comes to investing. Anytime you have intuitions that markets are likely to go down, or you feel uncertainty and fear…don't act on it. Research shows that if you feel a certain way, other people probably feel the same. If you're reacting to news then you're already too late, and other people

have already overreacted to it. To take this idea a bit further, you might even want to buy if you're inclined to sell, and vice versa.

Q Are there investment products that have no downside?

A: Even when we look at very successful managers, such as Warren Buffett, there's volatility, which means that they experience downturns just like the rest of us. Our research did uncover a few funds that reliably went up over time, with little to no volatility.

The best performing of these was the Madoff Fund, which climbed 1% per month…until in one month it fell by 100% and its investors lost everything. There's a lesson here: as a practical matter, funds with relentlessly positive performance over time are probably Ponzi schemes.

The most important part of investing is to understand the risks. The way capital markets work is that you get long-term rewards because some people are afraid of short-term volatility. Most people know that if they hold an investment, then it will go back up.

Global growth has always resulted in growth reflected in asset prices. However, there will be a lot of people who can't stomach a 15% decline in any period of time.

Those are the people who give the growth opportunity to others at a discount. That's the trade-off, the risk and the reward. If you don't want that trade-off, then you can't participate in long-term growth.

Q What separates good retail investors from bad ones?

Based on our experience, there is no correlation between investment results and wealth, social status, or education. Surprisingly, research shows that doctors are the worst when it comes to investing.

Generalising a bit more, men are worse investors than women. Apparently, testosterone levels are negatively correlated with investment outcomes. Men are more likely to have extremely high conviction in a small number of stocks, building highly concentrated portfolios – even though that's almost never effective.

Unfortunately, this tendency can also translate to investment professionals, with over-concentration being one of the biggest mistakes in retail investing.

Fascinatingly, people who have lost the login for their 401K plan or trading account seem to outperform the broader retail market over time. Having bought a sensible basket of stocks, they couldn't access their account when they were fearful and wanted to trade.

Maintaining discipline and not trading in the face of short-term noise will do you a world of good, and may be among the most important investing lessons.

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