Evli Podcast Series 2

Transcript

Episode 3: The rankings

Petter: Hello and welcome to the second series of The Evli Podcast, which explores the role of legacy in our industry, talks about why it is important and dives into Evli's interpretation of the concept of legacy. I'm your host, Petter von Bonsdorff.

We started this series by talking about the very prestigious rankings awarded to Evli's head of fixed income, Mr. Juhamatti Pukka, and senior portfolio manager Mr. Jani Kurppa by Citywire's Eurostars comparison. We sat down with Juhamatti to get his thoughts on the ranking and discuss what it meant to him and to us as a company.

And now, to know more about what really goes into designing such a ranking, how the system works and how rankings have grown in popularity over the years, we have decided to meet the very brain behind the rankings, Nisha Long from Citywire.

Nisha has spent 14 years at Citywire and is responsible for cross-border investment research at Citywire. So, for the final episode, I made the bumpy journey on a February flight from Helsinki to Citywire's headquarters in London to interview our very special guest, Nisha.

Nisha Long: Thank you, Petter, and it's a pleasure to be here with you today.

Petter: Thank you. So, we're going to talk a little bit more about the short history of the rankings. Why were they created? I mean, there are a lot of rankings around and why were they created the way they are now?

Nisha: So, Citywire launched its fund manager ratings more than 18 years ago and it's actually the only firm to exclusively rate the managers, rather than a fund. So, we do this because we strongly believe that the track record of the fund manager is the most important consideration when selecting an actively managed fund. And, I just want to point out a number of reasons for this.

For example, as you know, fund managers move round frequently, so a fund's performance may have been generated by someone else who is no longer on the fund. And, we've worked out, actually, that the average tenure of a manager on a fund is roughly around four and a half years. But, the average lifetime of a fund is around 10 years. So, you can imagine you will have two or three manager changes in the lifetime of a fund, on average. So, the way our ratings work, we've got a unique career database, which takes into account the fund manager's career moves and sabbaticals, and it will tell you if their placement is any good. Especially if the new manager has a Citywire rating.

Now, this ratings measure measures performance across all funds that the manager is running and does give a clear indication of a manager's performance against their direct competitors. Now, I want to point out here that less than 25% of all active managers achieve a Citywire rating, so you can be sure that those adding value are being identified. At the end of the day, the fund manager is making the day-to-day decisions on the fund and it will have an impact on performance, so we believe the manager is the key to the fund's performance.

Petter: That's very interesting. Now, you were talking about the database and so forth. How many geographies were first included on the list?

Nisha: So, when we first started, we started in the UK, which quickly progressed to all around Europe. So, we have France, Germany, etc.. But, today, we are truly global, tracking managers in the US, Latin America, as well as Asia, South Africa and also the Middle East. So, now it is truly global. Just to give you an idea, we cover 16,500 managers globally, running around 30,000 funds between them.

Petter: So, you are processing an awful lot of data.

Nisha: There's an awful lot, definitely.

Petter: Which parameters were considered when you designed the ratings and which are being covered today?

Nisha: So, the manager's track record is scrutinized by a methodology, which has been approved by an independent actuary, and the ratings take into account the three-year performance record – which is updated every month. It is purely a quantitative analysis and is based on the information ratio, which is a measure of the risk-adjusted performance.

Petter: Information ratio…

Nisha: Yes. So, however, we call it the Citywire Manager Ratio, as it takes into account career moves and all funds a manager runs. But, the basis behind it is the information ratio. And, we do cover the whole market, meaning every manager is eligible for the rating. So, investors can have the confidence in our objectivity across the ratings. As I mentioned before, we cover 16,500 managers in around 42 countries – and across 280 investment sectors.

Petter: As in business branches, investment sectors?

Nisha: Yeah, investments sectors such as in bonds, the asset classes, equities, mixed assets. Also, alternative uses as well. I can tell you now it is not easy to get a rating. We individually benchmark each find a manager runs, so we are unbiased towards the fund manager companies have benchmarked themselves against and it is very important that we do this, and I am just going to give you a recent example, where a global equity manager was using a European equity benchmark to measure their performance and, with the European markets at the moment, they were outperforming like anything. And, they claimed a high active share. But the reality is they used the wrong benchmark. It didn't complement their strategy; it wasn't the right one. So, for us to benchmark individual funds is very important and the transparency is key in all of this.

Petter: So, you do look at all of the underlying portfolios?

Nisha: We do, absolutely. To see if the manager is doing what they are supposed to be doing. But also, if there is any style drift, etc. You know, we will try and capture that in our analysis of the benchmarking process.

Petter: So, if the three years looks good for the manager, what happens?

Nisha: So, if a manager's three-year ratio is positive, they will receive a rating. So, this is showing that they are adding value against their benchmark or the market. But then fewer than 25% of managers we track actually receive a Citywire rating and this select group, we will either give them a Citywire Plus rating, and A rating, Double A or the top Triple A rating. Only the top 10% of managers in this elite group will gain the highest Triple A rating. So, you can see that we don't just give it out to anyone.

Petter: So, it is actually the top 2.5 of all…

Nisha: Yes, it is quite a high benchmark to overcome, to get that Triple A rating. Now, each rated manager will receive one universal rating reflecting their performance on every fund he or she runs across the 42 countries that we currently track in our database.

Petter: Now, the rankings industry has grown in the past 20 years that I have been in the fund industry at quite a rapid pace. Can you talk a little about the rankings industry?

Nisha: I've been in the industry for about 14 years, so I have seen quite a lot come and go, especially in the European industry. So, for the ones I have identified in Europe there are around 17 key players in the market offering some sort of rating or ranking product. And this continues to grow. One of the benefits is that they can help dissect all the products out there. There's tons of products and it can be quite overwhelming, with the number of funds and managers that investors have to choose from. But, by using ratings that are based on, for example, our manager ratings, you can easily identify if that manager is capable of adding value to a portfolio or not. As I said, there are many ratings agencies out there, but no one quite looks at the fund manager the way we do, so it is a measure of manager skill that we bring forward.

And I just want to mention that there are benefits of newer ratings products out there, for example now, ESG, SRI – we hear those buzzwords everywhere. So, these ratings have really sparked interest – even my interest – over the past few years. And a lot of agencies are trying to break into the space, as you can imagine. But, as you can also see, the definition of what is ESG investing is is changing all the time and what is ESG to one person, might not be for another person. So, it can be very difficult to know which provider has the best rating in this field. And there is a lot of underlying due diligence is still needed, I believe, in this area. So, even though there are new products coming out there in ratings agency, it is finding the right one which will suit what you are trying to do.

Petter: May we look under Citywire's lid and ask if we can expect something from you?

Nisha: At the moment, it is an active area of research and we are looking into it. You will be one of the first people to hear about it.

Petter: Ok, thank you. I am thrilled. Now, any which way, we are talking about the vast space of rankings and thinking about which ranking is credible what it takes to be a leader in rankings. I would like to think that this is part of the job, actually, that a fund selector should be doing himself or herself.

Nisha: Absolutely, yeah. Looking at each product individually, seeing what they can bring to the table. It is so important to actually have that research, but not trusting fully what they are doing. You need to understand it yourself before implying this. So, for me to gauge which ratings agency is credible, is to see how people actually use the rating and how they are doing it. So, as I mentioned before, there are around 17 key players in the market offering some kind of rating product.

Now, we've conducted research recently, and we have done it for the past three years on a yearly basis on European fund selection professionals. 74% of them use Citywire ratings in their process. And I can see that as Citywire being a credible player in the ratings industry. Just to share a few examples, which also came out of this survey, of how fund selectors are using this to search for new investment opportunities. As a verification tool of the quality in the fund selection process, it adds a bit of kudos to their selection that they have perhaps made the right choice. And also to filter, to identify the best manager.

Now, I use it myself, it's a good tool to have in the fund screening process to find the skilled managers who are truly active and can add value. And then the fund selectors can put a quantitative overlay on this with their own methods on top of that. But I think the starter point is a very good screening process to see if the manager can add value.

Also, I just wanted to mention the mark of prominence in the market, those surveyed also said that Citywire's rating would also increase their likelihood of investing in a fund manager and their funds, which I think in itself is a mark of credibility.

To come back to your question, others, they rate funds, which is ok, and helps dissect strategy. But it often doesn't take into account manager turnover on a fund. Now, movements, as you can imagine, can really dent a fund's performance. For example, we have seen in the news a lot star managers who leave their funds and those funds then suffer hefty outflows, which has a direct hit on performance. But if a new manager they bring in is, for example, Citywire rated, then you obviously need to see how that manager progresses, but it is a mark of 'ok, this manager is good who they have brought in', because we have been tracking their track record.

So, you can read into all this by analyzing the ratings of a manager that they have achieved over the years, and also the consistency of receiving that rating.

Petter: And going a little bit into the future here, we talked a little bit about the world of rankings and I'm still looking forward a little bit. Is there still the demand for ratings and is the world going to be a boom in the future, do we have room for more ratings? Sometimes there is quite a lot of noise.

Nisha: Yeah, it could be overcrowded. Now, as you can imagine, we will continue to see new products as the market evolves. For example, as I mentioned before, the ESG space. But quite often than that, in my experience in the last 14 years, what I've seen is these new agencies close after a couple of years is that they haven't really established themselves in the industry, and they are not really offering anything new in the market that isn't already there. Also, the newer ratings providers may not have the 20-year knowledge of funds and managers that we have accumulated through our unique database of fund managers. I don't know of anyone else who does what we do.

With this does come the reputation and consistency of rating managers. We wouldn't still be doing this if it wasn't a mark in the industry that people actually use this. As I said, with any new ratings firm they have to establish themselves. Obviously, that takes a lot of time but also it's important to look at performance metrics. A long-term view is obviously very important and, as I said, we have been going for a very long time. So, you can see, as fund managers move from one company to another and take on new funds, the focus on the individual is completely there. But, as I said, the risk of cluttering the space is hard. Fund selectors need to know what they are looking at and dissecting the new ratings providers out there, and do they really have time to look at everything? It's a lot.

Petter: But you have some quite extensive online fund manager fact sheets.

Nisha: Yes, so with these they give a selection specialist. So, if you are selecting funds it gives you deeper performance analysis, alongside looking at the fund manager ratings track record that you can also see in those fact sheets. Now, this record can give you an insight of the tenure of managers in a particular sector and the long-term consistency can also be established from the ratings analysis So, for example, if a manager has consistently held their rating through market peaks and troughs, this is an indication of their skill and their ability to add value above the markets. In a bear or a bull market. This is a true indication of an active manager being truly active and not being, for example, a closet tracker just tracking their index, where just benchmark returns are achieved. Nobody really wants that from an active manager.

Petter: No, that seems to be a bit out of fashion. Then again you have been working with one metric, which is the infra ratio. I like the model, in the sense that it is very simple. Are you looking at any new metrics or parameters that you could take onto your rankings?

Nisha: The core will always be the manager ratio, because, as you know, that is a standard that everyone understands and it is the amount of risk a manager takes on top of how much added value they have on their funds. But, one metric which is going to come in, actually, in effect this year is addressing the parental leave or extended time spent away from work.

Now, as you know, parental leave is cited as a common barrier to career progression and extended periods can really dent your work, and often put employees outside the changes that have happened while you were away and also the industry as a whole. Now, as you know, many asset management firms are increasingly adopting back to work initiatives, which I think is absolutely great. To ensure that career breaks don't affect future growth, but as you know there are still challenges in this. So, at the moment, what Citywire is doing is taking into account extended leave. So, with data rolling over should the manager in question have a sufficient 36-month track record and haven't taken more than eight months out of active management in one go. So, that is the process at the moment. However, there is a large number of female fund managers, and some male, who would have a 12-month gap due to taking maternity or paternity leave, or any other kind of leave, maybe sickness or whatever. Now, this would effectively remove a third of their eligible ratings period, as we're looking at a three year. So, you are penalising managers for taking that time off and they have already had a strong track record, why can't they keep it? So, we are modifying our ratings methodology and still preserving the integrity to be objective as a rating system.

This is going to come into effect this year. Managers who take a 12-month period of maternity or paternity leave, can continue their track record as long as they have 36 months of experience against the same benchmark during their career, and had been rated by us in the previous period up to the point where they take their leave. So, they had to obviously be good before they took their leave and then they can carry on from their track record.

Now, this modification will help those managers who have built a really strong performance track record before taking their time off. They don't have to start all over again, which is not great for anyone. And, again, they can rebuild it once they get back to work. So, hopefully this will come into effect during the first half of this year.

Petter: I think this is very innovative, hardly anybody will oppose it, I guess.

Nisha: I hope not! Absolutely, it will make it more credible and it just takes into account people who do move around or need time off that they can. They won't be penalised for it.

Petter: Now, you have been looking at a lot of companies and almost, would I say, big data about fund management companies. What are your observations about what companies should bear in mind while grooming their in-house talents?

Nisha: For me, there are a number of points on this. I have looked at so many asset management firms, seen a lot of fund managers come through and also drop off after a year. We are keeping track of all of these kinds of movements. I think it's really about nurturing the talent with the correct training procedures in place, letting them have their autonomy and also with ensuring integrity.

Now, I think it is important to instil that it is always putting the client ahead of themselves in what they're trying to achieve. Are they trying to be true to their strategy, how can you get these younger people coming in to show that their voices also count in the decision-making process? Yes, they might make mistakes, but people should be there mentoring them and saying, 'okay that's fine, let's move on'. I think people learn best from their mistakes, anyway.

But, it is also about tenure of a manager at a company. Now, if the culture is good, managers will stay and produce good results and you will find that they stay with you longer. Low turnover on a fund is essential for the consistency of a strategy and performance. And I say this because recently I conducted research looking at manager turnover in funds in the equity space. Now, I wanted to mention this because I extracted performance data from our database, after collecting data for 20 years over the past 20 years of manage of manager information. And what I found is funds that have one or more manager changes on a fund in the past 20 years, the average 20-year total return of that fund was lower on the fund when compared to a fund that had no manager changes. That is quite damning and that is just taking the last 20 years' performance.

So, manager change wasn't so great. So, the longer the manager was there the better the performance. So, tenure, therefore, is very important, especially if there is a good manager on the fund. So, companies need to bear this in mind. The longer you keep it, it is good for their products as well, so it is keeping your managers happy to a certain extent in what they are doing.

Petter: Yep, that is important and is also what we are aiming to do at Evli. And, I think we have done so, because we have quite long tenures at Evli.

Well, thank you, Nisha, it was very interesting to hear about the rankings and the ratings. I think what is very important here is something that we like very much at Evli, and that is the systematic way that you have been conducting, year after year, in working on the manager ratios.

I also think that we can all agree that the benefits to the investors in reducing their own research work is quite a lot. We also touched upon what is going to be really interesting in the coming months and years, which is the ESG and SRI ratings. What are we going to get out of that? Because sometimes it seems to be quite a noisy place, when we have the various ratings coming up or not coming up.

The final point that I would like to take up here is the management companies allowing managers to have the autonomy and integrity to conduct their own investment strategies, and if they have a systematic way of working, results will issue automatically.

Thank you very much, Nisha, for this, it was just it was superb to be here and thank you everybody for listening in. This is the last in the series and we would like to wish everybody happy listening, because you are probably going to come back to the Evli podcast in the future, as well.

This ends the second series of The Evli Podcast. We've been discussing the fact that every has two fixed income portfolio managers, Mr Juhamatti Pukka and Mr Jani Pukka, who are highly rated by, for example, Citywire.

It is uncommon for a company of Evli's size to have such well rated managers, so we wanted to bring it to the fore.

In the first pod, we discussed with Mr Juhamatti Pukka, one of the portfolio managers, what he understands about legacy and his role for the clients and for the company. In the second pod, we discussed that legacy is the culture that connects people and company, and results in continuity to clients. That that discussion was conducted with again Mr Juhamatti Pukka and also the CEO of Evli, Mr Maunu Lehtimäki. Finally, to get the perspective of the very people who make the ratings, we met with Dr Nisha long from Citywire, to talk about the ratings and how they are made. Thank you very much for listening to us. I'm your host, Petter von Bonsdorff.

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