

5 Questions to Ask Your Investment Manager

How do you ensure **quality** when making a purchase decision? Whether it's a new car or a meal at a restaurant you've never tried before, the secret to making a smart decision comes down to knowing what questions to ask. Selecting an investment manager is no different.

Not-for-profit (NFP) boards and investment committees must practice care and diligence when selecting (or assessing) an investment manager. This should be a discovery process that focuses on determining the characteristics of the organization charged with managing the investments. But in our experience, this **qualitative evaluation process** has often been a secondary consideration following a meticulous, quantitative (numerical) assessment.

In our opinion, assessing elements of **quality**—such as the organizational structure of people within the culture, a sound investment philosophy, and discipline in applying that philosophy—can be just as essential as conducting quantitative evaluations.

Because quantitative evaluation tools are relatively easy for NFPs to find compared to often more scarce qualitative resources, the following five question framework may be helpful for NFPs who are in the process of selecting an investment manager.

#1: The Who

The board and executive of an NFP have a fiduciary duty to themselves, their donors, and all other stakeholders to select an investment manager they trust to manage their assets in the best interests of their organization.

But trust doesn't develop between organizations; it occurs between people. With this in mind, it's important to begin by asking questions that reveal insights into the collection of people **who** make up an investment firm. Furthermore, each investment firm is unique in their history, ownership, proficiency and team depth. In other words, not all investment managers are created equal.

The following example questions should help to obtain a feel for the culture, experience, and driving force of an investment management firm:

- What is your firm's mission? Values?
- How long have you been in business?
- How many employees do you have and what has been the turnover over the last 1, 3, 5, 10 years?
- Are you independently owned?
- How broad/concentrated is ownership?
- Describe your firm's succession plan regarding key investment professionals.
- Are you held to a fiduciary standard?
- What regulatory body oversees the firm?
- What is your experience with other NFPs?

#2: The What

Investment managers manage money on behalf of their clients in many different ways. Therefore, understanding **what** the manager's specific investment philosophies and processes are is key to finding the right alignment between an NFP and the investment manager they select.

Example Questions:

- What is your investment philosophy and process?
 - For equities? For bonds? For asset mix?
- Do you focus on one investment approach, or multiple approaches?
- What's your philosophy for managing investments for NFPs?
- What are your thoughts on risk?
- What's your view on strategies like shorting or securities lending?
- What are the investment vehicles you use for institutional investors? (e.g., pooled funds or mutual funds)
- Do you offer a balanced portfolio?

3: The How

Every board or investment committee should know **how** their organization's capital is being invested and the reasons behind those decisions. Because NFPs typically look for diversification within their investment portfolio, finding out how an investment manager views diversification and asset mix—and managing risk around these—is vital.

Example Questions:

- What is your current asset mix and how does this align with your investment philosophy?
- Do you apply a consistent approach or change with the times? Prove it.
- Do you have limits (minimum and maximum) for each asset class? Sector?
- Do you manage to a benchmark?

In addition, historical performance can be viewed in order to understand **how** the investment manager has performed through different market conditions over time. While analyzing performance usually falls into the quantitative evaluation school of thought, we do see this information as a solid way to differentiate between luck versus skill over time and it can aid in assessing the investment manager in the future. (That being said, we advise that historical performance should not be taken as proof of a superior investment philosophy nor extrapolated to predict future returns.)

Example Questions:

- What is your historical performance? Over 1, 3, 5, 10, 15+ years?
- How did you perform in very bad market environments?
- Explain your performance during good/neutral/bad market conditions.
- Is your performance GIPS compliant?

#4: The Where

Going hand in hand with knowing how an investment manager allocates capital, is determining **where** they invest and the specific reasoning behind the answers. A diversified approach will usually include various allocations to different regions from around the globe based on risk tolerance and other specific factors.

Example Questions:

- Do you invest outside of Canada?
- If so, where?
- If not, why?
- Are there some regions you will not invest in?

#5: The Why

Once an NFP feels they are in alignment with **who** an investment manager is, **what** they do, and **how** and **where** they go about doing it, they can now ask: **why** should we choose one particular investment firm over another with a similar offering? After delving into the following questions, NFPs should have a good idea about some differentiating factors that may influence their decision. Some of these factors include consideration around community involvement, ethics, fees, and client service.

- Do you give back to your community? If so, how?
- How are individuals compensated?
- Do you invest alongside your clients?
- What do you charge for fees?
- Provide details on how your fees are calculated.
 - Ask for a reasonably accurate estimate of both percentage and dollar amount of annual fees.
- What are other costs associated with our portfolio?
- What can we expect for client service?
- What type of reporting will we receive and how frequently?
- Can you provide references?
- What are your weaknesses as an Investment Manager?
 - What are you doing to address those?
- What competitors would you choose as the next best option to your firm?

This last **why** part of the assessment is much more subjective, but after careful consideration of these questions (and in relation to all of the previous questions) you should end up comfortable with either your current investment manager or your choice of a soon-to-be investment manager.

So whether it's for a Porsche, a porcini mushroom risotto, or an investment manager, we hope you ask a broad range of smart questions to build the necessary depth of knowledge to make a well-informed decision.

Andrew Johnson, CFA
Institutional Portfolio Manager