portfolio construction forum

Research Review: More insights into fund managers

Ron Bird | University of Technology Sydney | 19 January 2018 | 1.00 CE

The holy grail is to find active managers who can add value. The combined insights that these two papers suggest avoiding large managed funds, especially those under the control of managers who are concurrently running SMAs alongside.

1. The Mismatch between Mutual Fund Scale and Skill

– Yong Song | SSRN | August 2017

Actively managed investment funds face a decreasing return to scale as their potential returns are diluted by the amount of funds that are managed (Berk and Green, 2004).

In this paper, the author demonstrates that there is a mismatch between skill and scale in actively managed equity investment funds. The proposition from both the author's model and the empirical evidence is that unskilled managers generate performance from exposure to non-market factors and this performance encourages investors to place more money with the fund.

The author further postulates that it is these overly large funds managed under the control of relatively unskilled managers is a major contributor to the seeming poor performance of active equity managers.

2. Tailored Versus Mass Produced: Portfolio Managers Concurrently Managing Separately Managed Accounts and Mutual Funds

– Fan Chen, Hardy Johnson and Sabuhi H Sardarli | *The Financial Review*, Eastern Finance Association | October 2017

The authors compare a matched sample of separately managed accounts (SMAs) and mutual funds (MFs) with the same portfolio manager and investment style. They find that concurrently MFs consistently underperform their SMA counterparts and generate more negative return gaps. Fund characteristics and liquidity betas fail to fully explain the underperformance. Event-study analysis found that the weights placed into top (bottom)-performing stocks increase for existing SMAs (MIFs) and negative return gaps increase for the MIFs after the onset of concurrent management. The authors find that higher compensation collected by SMA fund managers is associated with more unseen managerial

actions which positively contribute to the SMA return gap. The results suggest that when managers concurrently manage both SMAs and MFs, they favor the SMAs over the MFs.

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