# How to choose an active investment manager

Passive portfolios such as an index fund involve an investment manager buying the same stocks, or a representative sample, of the particular index they are tracking.

When the index makes a change to its constituents (the stocks within the index), so does the investment manager. Hence, the performance of the fund should then match the performance of the particular index it tracks.

Active investment managers do not rely on an index to make stock decisions, and they aim to outperform an index (or a specific benchmark). Hence, they are actively involved in managing the portfolio.

Active managers make stock buy and sell decisions through conducting a detailed analysis of the company behind the stock. That's why you need to find an active manager that you trust to make buy and sell decisions on your behalf.

## The three ingredients of success through active

Having conviction that your fund has employed top talent to manage the portfolio is vital.

In fact, our research[1] confirms that talent is one of three key ingredients required for achieving investment success via active investing. The other two are low costs (you'll keep more of your returns when you pay lower fees) and patience (active investing is focused on achieving long-term outperformance, ignoring short-term volatility).

## Let's focus on talent

There is a myriad of active managers around the world, offering an even greater number of actively managed funds. So, how do you know whether a fund has employed a skilled manager?

**Talent is one of three key ingredients required for achieving investment success via active investing**

Your financial adviser will have gone through a detailed selection process before presenting fund recommendations to you. Their process would have considered whether the manager is appropriate for the fund's mandate.

1 Daniel Wallick, Peter Westaway, Giulio Renzi-Ricci, Thomas Paradise, 2017. *Active Management: the importance of cost, talent and patience.* Valley Forge, PA.: The Vanguard Group.

But, it's always wise to discuss the following six areas with your adviser, to ensure you are fully informed. After all, you'll be handing your hard earned money over to the investment manager.

1. Firm – What is its history? Is the firm stable? Ask whether the ownership structure, ethics and incentives indicate a focus on its clients, and not on themselves.
2. People – What is the tenure and experience of the investment team including its analysts? Does it have depth? Does it have a high staff turnover? Low staff retention can be a warning sign that something's wrong.
3. Philosophy – Is the firm able to clearly articulate how they view the market and find investment opportunities that others don't?
4. Process – How does the firm make buying and selling decisions? Does this make sense to you?
5. Portfolio – Does the portfolio reflect the characteristics of the manager's philosophy and process? Ask your adviser if the risk profile aligns with the strategy.
6. Performance – Discuss the fund's long-term performance with your adviser. Ask them to show you how it compares with its benchmark and peers, and how it fared during different market cycles. Finally, ask how and when the investment manager's firm, portfolio and performance is monitored.

## Internal versus external management

Don't be surprised if your adviser has recommended a fund that has outsourced the portfolio's management to an external firm.

At Vanguard we often appoint external managers for our active portfolios, rather than automatically awarding the mandate to ourselves. This gives us access to a talent pool that spans the globe to ensure we find an exact match between the investment manager and each fund's mandate.

Whichever choice we make, internal or external management, it is focused on giving you the best chance of investment success.

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