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Peeling back the curtains on private money managers

Michael Nairne, Serious Money

Private money managers are often shrouded in secrecy.

Illustration by Chloe Cushman for National Post

There is a mystique that surrounds the investment affairs of the wealthy.

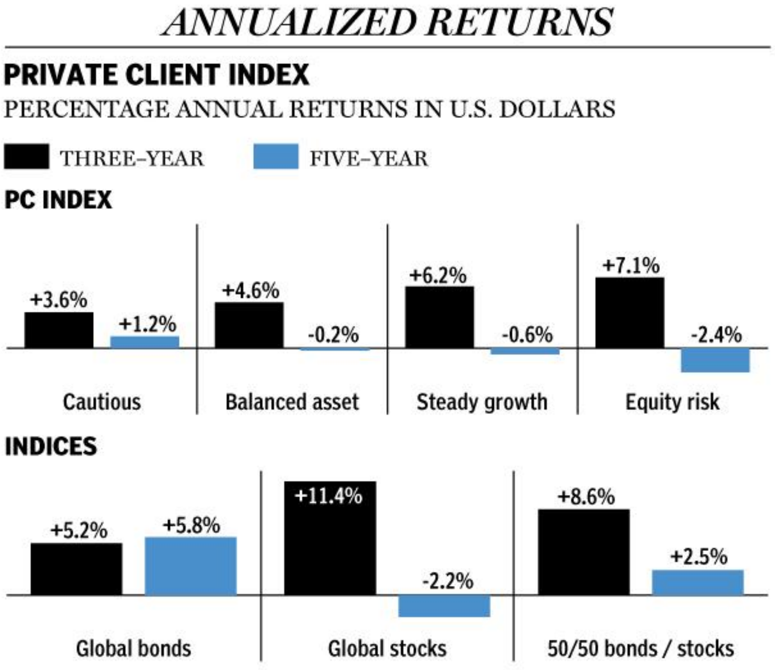
Instead of pedestrian mutual funds, they can access discretionary private money managers with hefty million or multi-million-dollar minimum account requirements. Unlike the fund world where performance is mercilessly on display day in and day out, the track records of private money managers are often shrouded in secrecy.

In fact, many private money managers go to great lengths to project an aura of exclusivity — their performance results are only available for review by “qualified” parties, preferably over cappuccinos in a tastefully appointed private meeting room.

The critical question of course is whether this is marketing hype or whether private money managers really do deliver superior performance to their well-heeled clients.

It was of great interest then when one of our clients directed us to a global investment consulting firm, Asset Risk Consultants (ARC) Limited, located in Guernsey, Channel Islands. ARC compiles and publishes a Private Client Index (PCI) that tracks the net of fee performance of a number of private investment managers. In fact, a review of the firms whose performances are part of the PCI includes some of the biggest players globally in private money management.

ARC goes one step further in building the PCI. It recognizes that different investors have different risk tolerances and that you need to aggregate portfolios of similar riskiness to create a proper index. Hence, it breaks down its PCI performance into four categories of portfolio risk ranging from Cautious (i.e. conservative) all the way to Equity Risk (i.e. very aggressive).



SOURCES: ASSET RISK MANAGEMENT LIMITED, MORNINGSTAR

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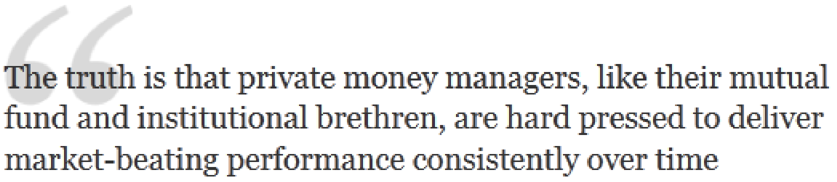
The accompanying table above sets out the PCI annual returns in U.S. dollars for the three and five years ended June 30, 2012. These are excellent periods to examine, since the five-year numbers encompass both the global market crash and recovery while the three-year numbers focus on the recovery alone. The index returns of global investment-grade bonds and global stocks as well as a hypothetical portfolio comprised of 50% of each of these assets have been included to provide a basis of comparison.

It doesn't take a math wizard to recognize that the returns of global private money managers, as a group, are nothing to write home about. After five long years of investing, their typical wealthy client is in the red. Only conservative investors have eked out a marginal gain. And despite their bevy of experts, extensive economic prognostications and elegant financial models, over the past three years of recovery, their clients' portfolios have lagged behind comparable global benchmarks. In fact, an investor in a simple 50/50 mix of global bond and stocks who rebalanced annually would have been way ahead.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To be fair, the performance of the PCI's reflects the average private money manager. There were a number of managers who outperformed over the past three and five years. The question is: Will they continue to do so in the coming years? Most academic studies find that the performance of investment managers is rarely persistent. Yesterday's winning manager can be a loser tomorrow and vice-versa.

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Unfortunately, there is no index of private money manager performance in Canada. However, Morneau Shepell Asset & Risk Management Ltd., a pension consulting firm, publishes a quarterly performance review of the pooled funds of Canadian pension managers. Most of these firms also offer private money management, so the pooled results are a pretty good proxy of Canadian private client performance.

Over the past three and five years, excluding fees, the median annual returns of the diversified pooled funds have been 7.3% and 2.1% respectively. In comparison, a simple mix of 40% Canadian bonds and 60% Canadian stocks (based on the DEX Universe Bond Index and S&P/TSX Capped Composite Index) achieved returns of 7.1% and 2.8% — very similar results. Money managers don't work for free, however, so once you net out their fees and costs, performance again lags.

The truth is that private money managers, like their mutual fund and institutional brethren, are hard pressed to deliver market-beating performance consistently over time. Neither a marble office nor expensive artwork can safeguard an affluent investor from this simple fact.

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