

Summary

After completing a review of your financial practice and deciding that you need the support of a DFM, the next part of the process is to select the most appropriate DFM to partner with. We would recommend that you use a decision-support scoring system to evaluate the short-list of DFM candidates that covers the following five factors: Partner, People, Process, Performance and Pricing. Using a decision-support system will ensure that DFM candidates are treated on an equal-footing basis, that a consistent set of criteria is used to evaluate the DFM candidates and that the final choice of DFM is based on the best objective (as far as possible) aggregate score.

Introduction

You have just completed a review of your financial practice and have come to the conclusion that you need the support of a Discretionary Fund Manager (DFM) in one or more of the following areas:

- Required licence and experience managing model portfolios.
- Added rigour to investment and operational processes.
- Freeing up time to service existing clients and build new relationships
- Obtaining access to cost-effective investment products.
- Ensuring clients are invested in appropriate risk-profiled solutions.

The next part of the process is to select an appropriate DFM to partner with.

We would recommend that you use a decision-support system to evaluate the short-list of DFM candidates that covers the following five factors:

- Partner
- People
- Process
- Performance
- Pricing

In the following sections we will explore these five factors in more detail.

We will list each of the five factors as well as its sub-factors; suggest how to score each of the sub-factors; and finally how to derive the aggregate score for each of the DFM candidates. The five factors are not meant to be prescriptive or exhaustive – you may elect to use your own factors and sub-factors.

Using a decision-support scoring system will ensure that DFM candidates are treated on an equal-footing basis, that a consistent set of criteria is used to evaluate the DFM candidates and that the final choice of DFM is based on the best objective (as far as possible) aggregate score.



Factor 1: Partner

Sub-factor 1: Is the DFM completely independent or does the DFM form part of a corporate?

- 0: The DFM forms part of a corporate and typically includes investment funds that are tied in some way to the corporate entity.
- 1: The DFM forms part of a corporate entity, but mostly acts independently.
- 2: The DFM is completely independent and choices are made exclusively for the benefit of clients.

Sub-factor 2: Does the DFM have adequate assets under management?

- 0: The DFM has less than R5 billion of assets under management.
- 1: The DFM has between R5 billion and R10 billion of assets under management.
- 2: The DFM has at least R10 billion of assets under management and can easily afford the necessary experienced investment and operational teams and sophisticated systems.

Sub-factor 3: Is the DFM willing to partner and grow with you as an advisor?

- 0: The DFM has strict criteria and only partners with advisors above a certain asset size.
- 1: The DFM offers a few different partnerships with advisors.
- 2: The DFM offers a broad range of partnerships catering for CAT I to CAT II advisors.



Factor 2: People

Sub-factor 1: Are the DFM's investment and operational teams qualified and experienced?

- 0: Most of the investment and operational team members are not highly qualified and have less than 3 years of relevant experience.
- 1: Most of the investment and operational team members are highly qualified and have between 3 and 5 years of relevant experience.
- 2: Both the investment and operational team members are highly qualified and have more than 5 years of relevant experience.

Sub-factor 2: How accessible are the investment and operational teams?

- 0: The investment and operational teams are not accessible.
- 1: The investment and operational teams are somewhat accessible.
- 2: The investment and operational teams are very client-friendly and accessible.

Sub-factor 3: Are the investment and operational teams adequately staffed?

- 0: The investment and operational teams have very few members and no back-up members.
- 1: The investment and operational teams are adequately staffed; but have few or no back-up members.
- 2: The investment and operational teams are very well-staffed and have adequate back-up members.



Factor 3: Process

Sub-factor 1: Is the process robust and are you confident it will work in most market environments?

- 0: The process is difficult to understand and it relies on certain fund managers or certain market environments to outperform.
- 1: The process is understandable, but relatively complex and may or may not outperform in different market environments.
- 2: The process makes sense, is relatively easy to understand and lends itself to outperform in different market environments.

Sub-factor 2: Are regular performance reviews of funds and portfolios performed?

- 0: Funds and portfolios are reviewed on an ad-hoc basis and infrequent feedbacks are provided.
- 1: Funds and portfolios are reviewed and feedbacks are provided on a quarterly basis only.
- 2: Funds and portfolios are reviewed at least monthly and monthly or quarterly feedbacks are provided.

Sub-factor 3: Does the DFM have access to adequate systems?

- 0: The DFM mainly uses Microsoft Office as an analysis and reporting system.
- 1: The DFM subscribes to some off-the-shelf analysis software.
- 2: The DFM uses expensive systems such as Bloomberg, FactSet and Morningstar Direct; and has also developed its own proprietary analysis tools.



Factor 4: Performance

Sub-factor 1: Are the portfolios consistently outperforming peers over most rolling 3-year periods?

- 0: Portfolios consistently underperform peers over rolling 3-year periods.
- 1: Portfolios sometimes outperform peers over rolling 3-year periods.
- 2: Portfolios consistently outperform peers over rolling 3-year periods.

Sub-factor 2: Are the portfolios consistently outperforming peers over most rolling 5-year periods?

- 0: Portfolios consistently underperform peers over rolling 5-year periods.
- 1: Portfolios sometimes outperform peers over rolling 5-year periods.
- 2: Portfolios consistently outperform peers over rolling 5-year periods.

Sub-factor 3: Do the portfolios display smaller drawdowns than the ALSI?

- 0: Portfolios have larger drawdowns than the ALSI.
- 1: Portfolios have similar drawdowns than the ALSI.
- 2: Portfolios have smaller drawdowns than the ALSI.



Factor 5: Pricing

Sub-factor: Does the DFM proposition offer value for money?

- 0: The DFM fee is above-average and no value-added services are offered.
- 1: The DFM fee is competitive, but few or no value-added services are offered.
- 2: The DFM fee is competitive and the value-added services result in value for money.

In Summary

We recommend that advisors consider the above five factors with its underlying sub-factors before making a choice between DFM candidates. The aggregate score per DFM may be derived by equal-weighting each factor (after calculating an equal-weighted score for each sub-factor).

Using a decision-support scoring system will ensure that a consistent set of criteria is used to evaluate the DFM candidates and that the final choice of DFM is based on the best objective (as far as possible) aggregate score.

If you would like to have access to a user-friendly Excel-based decision-support system that incorporates the above factors, please contact us at dfm@analytics.co.za, and we will gladly send it to you.



Daniel Schoeman MSc, CFA

Daniel is currently CIO of the Analytics multi-manager funds of funds. He has more than 19 years investment and portfolio management experience, and has previously worked at three of the largest multi-managers in South Africa, first at Investment Solutions, then joined Momentum MultiManagers which later merged with MCubed to form Advantage Asset Managers. His main responsibilities include economic research, tactical asset allocation, investment manager research, portfolio construction, monitoring and risk management, system development and innovative investment research. He is also a member of the Investment Committees of some of the largest advisor networks in South Africa, providing investment consulting services to these groups on an on-going basis.

The information and opinions contained in this document are recorded and expressed in good faith and in reliance on sources believed to be credible. No representation, warranty, undertaking or guarantee of whatever nature is given on the accuracy and/or completeness of such information or the correctness of such opinions. Analytics will have no liability of whatever nature and however arising in respect of any claim, damages, loss or expenses suffered directly or indirectly by the investor acting on the information contained in this document. Furthermore, due to the fact that Analytics does not act as your financial advisor, we have not conducted a financial needs analysis and will rely on the needs analysis conducted by your financial advisor. We recommend that you take particular care to consider whether any information contained in this document is appropriate given your objectives, financial situation and particular needs in view of the fact that there may be limitations on the appropriateness of the advice provided. No guarantee of investment performance or capital protection should be inferred from any of the information contained in this document. Portfolio Analytics (Pty) Ltd and Portfolio Analytics Consulting are authorised financial services providers. Analytics (Pty) Ltd is an Authorised Financial Services Provider. FSP No. 631.