

Insights

Balancing Assets Among Multiple Managers

“Diversify, diversify, diversify.” Most investors have heard this refrain dozens of times, yet when they think of diversification what comes to mind are the various investment products, geographies and asset classes that can be included in a portfolio. Yet, there’s another aspect of diversification — through the investment manager — that is not widely known, but can help further diversify a portfolio and, as a result, potentially reduce overall portfolio risk and improve investment performance.

Diversifying Strategies

In many cases, an investment manager will frequently apply the same strategies across multiple asset classes in line with his firm’s investment approach and investment philosophy. In other words, if the investment manager relies on input from the firm’s asset allocation committee as well as research team, the resulting investment approach will likely be quite similar across multiple portfolios.

Another possibility is that the same or similar equity ideas will emerge even among funds or portfolios comprised of different asset classes, since subject matter experts will typically be involved in the same committees. For example, when the same investment manager is involved, the same stocks held in a US equity portfolio may also appear in the US allocation of a global equities portfolio.

Diversifying Styles

From a style perspective, investors are likely to be at a disadvantage, if the majority of the investments are managed by one investment manager. That’s because most investment managers — and often smaller investment houses — use a distinct investment style or approach. For example, the investment manager may use a systematic approach, such as a “top-down” methodology, which consists of first determining capital market expectations, then looking at industries and finally picking stocks that meet particular investment criteria.

If the client holds several investment products managed by the same portfolio manager and this portfolio manager’s investment style is to seek out value stocks, then the investor could inadvertently wind up with a “value tilt” — or an overly large allocation in value investments in his portfolio. This could become a risk factor, if the market environment begins to favour growth stocks.

Managing Performance Risk

Ultimately, investors face performance risk if they place all their “eggs in one basket.” When a portfolio is heavily weighted with one investment manager and this individual’s choices are not favoured by current market conditions, the result could be the portfolio’s underperformance. Even the best managers experience periods of underperformance for various reasons, including poor timing on decisions, portfolio biases considered out of favour in the marketplace and sudden changes to investment management teams.

One of the basic principles of asset allocation is that clients should always approach diversification from many angles. Diversification is not only defined as the division of assets among stocks and bonds, or between large-cap and small-cap equities, but also includes balancing assets among multiple managers instead of relying on one manager with possibly only one point of view. For a more financially sound investment and improved risk management, investors should seek to diversify their portfolio in multiple ways.

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