

Bridging the knowledge gap

There are a number of factors to consider when choosing a fund manager beyond past performance. These include the level of after-sale service and, increasingly, the role of the manager in providing trustee investment training. Gail Moss looks into this growing trend and asks how trustees can ensure they get the best service

Charity trustees are waking up to the fact that running their charity's investment portfolio is not simply a case of appointing fund managers whom they hope will achieve sparkling returns.

It is no longer enough – if indeed it ever was – simply to accept without question the investment strategies suggested by financial advisers or fund managers. “Under the Trustee Act 2001, trustees have more responsibility than before,” says Guy Davies, director on the charities team at Baring Asset Management. “The Act says that trustees should take the same degree of care over their charity's portfolio as if it were their own money. So they need to become more knowledgeable about investments in general.”

“When charities are looking to appoint an investment manager, it is not just about performance, it is also about the process – say adding alpha – by which the managers get performance,” says Nick Rickard, head of business development at the Charity Financial Services Division of Charities Aid Foundation (CAF).

“Too often trustees appoint new managers who have had a fantastic performance for the past five years, but there is no

guarantee that it will continue like that for the next five years.”

“One striking thing about UK charities is that they don't have a lot of investment expertise, but they do have a large risk budget in terms of exposure to equities,” says Ric van Weelden, senior investment consultant with Watson Wyatt. A charity's risk budget is the percentage of the investment portfolio devoted to growth assets, as opposed to assets which provide income that matches the funding of the charity's aid programme or liabilities (for instance, bonds).

Yet many trustees are conservative to the extent that they are actually assuming too much, or the wrong kind of, risk. For instance, recent research carried out by Watson Wyatt showed that nearly one-third of charity trustees with financial qualifications believe that if they invest in equities, it should be UK equities.

“But UK equities alone are not going to provide enough diversification, so charities should invest internationally as well,” says van Weelden. “Having said that, the increasing correlation between markets means that the benefits of diversifying away from domestic stocks have been reduced, but trustees do need to be educated about alternative sources of diversification, such as property, hedge funds, private equity and commodities.”

However, this is easier said than done. “Many of our charity clients have trustees who are experts in the field the charity supports, but they are not really experts in running the funds,” says Ivo Clifton, head of charities at Rathbone Investment Management. “Clearly some trustees know more than others, but some only have a rudimentary knowledge, and we get asked things like ‘What's a yield?’”

But it is not only the jargon which trustees need to be familiar with. They also need to grasp ideas such as the difference between pooled and segregated funds, and the concept of risk. “The idea that different investments carry different risks is one of the most important things,” says Clifton. “Trustees need to be aware of the whole spectrum, from cash at one end – with relatively little reward or losses – to venture capital and technology at the other end, which carry much greater potential for reward but also greater possibility of losses. In between you have corporate

bonds and equities. Furthermore, trustees have to understand the idea of balancing income between today's beneficiaries and the beneficiaries of the future. The more income they get now, the less potential there is for the portfolio to grow

in the future.”

One way that trustees can deal with this problem is to ask their fund managers to educate them, and there are signs that this is starting to happen. But the question is how they should best go about this.

Clifton suggests that for the bigger charities at least, the main board of trustees could delegate responsibility for managing the portfolio to a financial sub-committee, which would also build up the charity's knowledge of financial markets. And there are several ways that this building of knowledge can be achieved.

The more formal methods include seminars, which several charity managers run for existing and potential clients. However, it is possibly the more informal ways of getting the financial message across which are more successful.

Clifton says that Rathbones are at pains to talk through any changes they have made to investments to their clients. “If we sell a major shareholding, we tell them why we've done it,” he says. “And we also make sure we go to trustees' meetings.” However, the after-sales service tail should not be allowed to wag the portfolio management dog.

“Given the choice between a manager with a good track record and no training, and one with a poor track record and good training, you'd always pick the former,” says van Weelden. “But the choice needs to be separated. You can always get training elsewhere, such as from charity networks.” Watson Wyatt itself offers financial training for charity trustees.

All things being equal in terms of performance, probably the best way to get the names of investment managers who give good trustee training is by word of mouth. However, it is at the tendering stage where charities can find out precisely what form of after-sales service a fund manager offers. The questionnaire which managers must answer as part of their proposal document can include the

question: Do you train trustees?

At the same stage, trustees can also ask to contact the manager's charity clients. Although managers may tend to put forward their most supportive clients, simple questions such as “Does the manager return telephone calls?” can be revealing.

This is an area where external advisers can help, even after fund managers have been appointed. “If our client complains to us that they don't understand what the managers are telling them, or that their written reports are not clear, then we tell the managers,” says van Weelden.

One obvious indicator as to how well the manager can communicate with trustees on a financial level is how they come across at a presentation. But a major problem here is that very often the

presentation is carried out by different people from those who will be dealing with the charity once the manager has been appointed. Once the mandate is up and running, user-friendly marketing staff may be replaced by investment managers who

communicate in business jargon rather than plain English.

Van Weelden suggests that one way round this is to ask to have the final pitch done by the same people who will be dealing with the charity once they take on the mandate.

“Another tip is to ask for client references,” he says. “And you should not ask just for a comment from a client. Ask for a hard copy of a recent client report, so that you can see both the numbers and – more importantly – the narrative.”

But what kind of after-sales service is available to a charity is, as ever, dependent on its size.

“A small charity with £100,000 to invest isn't going to get one of the big houses to take two or three hours to explain how the markets work, whereas if your portfolio is worth £100 million, they'll roll out the red carpet,” says CAF's Rickard. “However, smaller charities should look to smaller managers or brokers to provide this service.”

CAF itself runs a seminar for people with no investment experience, where basic concepts such as equities and funds are explained.