Kenanga Investors

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Do Fund Managers Need To Reinvent Themselves?

The Edge (28 December 2020)

By Tan Zhai Yun

It is not an easy time to be a fund manager today. Technological disruption is changing the industry, passive funds are eroding the position of actively managed funds, while external factors such as political instability and lower-for-longer rate environment are challenging fund managers to stay on their toes.

One common observation that the fund managers interviewed by Wealth have about the industry now is the speed at which it is operating. Thanks to the internet, information is widely available online, and this has also required fund managers to absorb and react to more information than ever.

“Back then, if you had information that no one else had, it put you in an advantageous position. But, now, it’s a more level playing field because information is widely available to most people,” says John Lau, senior equity analyst at Affin Hwang Asset Management Bhd.

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Ismitz Matthew De Alwis, CEO of Kenanga Investors Bhd, says: “ Fund managers need to be self-motivated, with strong thirst for knowledge, as it is a lifelong journey of learning. Because we are constantly looking for investment ideas, strong deductive skills are needed when researching economies, markes or global events. More importantly, fund managers in this fast-evolving environment must be able to adapt and sniff out new investment opportunities, strategies and asset classes.”

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Having more information does not naturaly mean one will make better choices, says Lau. “ It depends on how we interpret the information. We have to screen out what really matters. For instance, when we look at data, it’s not just about how fast a company is growing but why it is growing and whether it can continue to grow. Those are things we need to process and think about.”

In fact, this ability to interpret information accurately and quickly is key for fund managers, who have to contend with the rising popularity of passive funds and automated investment management platforms such as robo-advisers.

Patrick Chang, chief investment officer of Principal Asset Management Bhd, says “ In the last two decades, we’ve seen how passive funds have overtaken actively managed funds (in size of assets under management), especially in developed markets. I’m a big believer in the fact that you can still deliver alpha through active investments. But I think it’s going to get more difficult over time.”

Chang, who has been in the asset management industry for two decades, believes fund managers will need to stay relevant by embracing technology and equipping themselves with new skills. In addition, given the macroeconomic conditions globally, the days of fund managers’ focusing on just buying cheap stocks are over. The low interest rate environment and various external factors demand that fund managers be more flexible and holistic in their strategies. “This year itself has been one of the most challenging environments that I’ve seen in a long time. If you were to dissect the market this year, there were probably three to four different cycles,” says Chang.“We had the euphoria in February, the risk-off period in March and April [owing to the pandemic], and then we had the euphoria of quantitative easing, which resulted in a rally all the way to October. Now, we are in a different phase of value versus growth. As a fund manager, we need to be extremely flexible in our thought process and ability to cope with the stress.”

These are interesting times, he adds. “That’s what keeps me awake. I do think this is an industry where you need a different kind of mindset to stay in it.”

How to deal with the onslaught of information

How can fund managers handle the influx of information and stand out from the crowd? Curiosity, the willingness to learn and the ability to think deeply are characteristics that the fund managers say are crucial. They should also develop thought leadership, which includes the ability to see what others cannot from the same set of data.

“Compared with our peers in the region, I don’t find as much thought leadership in Malaysia. When you go to an analyst briefing, the average analyst or portfolio manager only cares about expected numbers for the next quarter…They ask about the company’s margins and market share instead of what the company’s appetite to expand is, their plans to increase market share or why they are raising capital,” says Chang.

“Many fund managers rely on brokers to feed them ideas instead of sitting down and thinking about the next best idea, sector or country to invest in. What are the structural plays that they can make money from? These are the things they should be looking for. “If you really want to join this industry, you don’t just need the technical skills like accounting. Thought leadership and the ability to read and sift through information wisely is something you need to start developing too.” He suggests fund managers develop discipline when filtering information. This means reading widely and then delving deeper into particular topics after developing an idea or thesis.

“For example, recently, I’ve been fascinated by the topic of value and growth rotation. So, I researched a lot about it. I drilled down to what kind of sectors will perform at this time. If you drill down to the core of the topic, you will be more disciplined in your approach. It all boils down to what you are looking for. There is too much information, so I can’t read everything,” says Chang.

He encourages his team to read materials beyond financial media and find opportunities for exposure to regional or global settings. The latter can be done by travelling or even attending webinars held by regional or global companies. “For instance, our customer analyst is now looking at global consumers. We asked him to do that because we want him to be able to look at local companies in a different manner, spot some global trends and apply it in a local context if possible,” says Chang.

Similarly, Lau advises fund managers to stay curious and humble. He covers China and its technology industry. It is an ever-changing market, he says, as the past political regimes were vastly different from current one, and technological developments are occurring so rapidly. “We have to always keep our minds open. We can’t say that because something happened 10 years ago, we assume it will happen again. It doesn’t work in China or in the tech space,” he says. This includes being open to learning from younger generations. “In my generation, we are used to YouTube, which has longer videos. Nowadays, people are watching 30-second videos…On things like TikTok or Instagram, we have to rely a lot on our younger analysts as well.”

How to navigate a tough market

Low interest rates in the past decade have resulted in an excess of liquidity. This is expected to persist as economies recover from the pandemic. Meanwhile, fund managers are challenged to seek yield in such an environment. This has resulted, however, in expensive valuations for certain stocks and sectors. “Quality companies are trading at very high valuations…We have to discuss how we can overcome this, as things are not going to get cheaper,” says Lau.

This year, this situation can be seen in tech stocks in the US and healthcare stocks in Malaysia, which have outperformed other sectors. “Quality and growth are becoming more expensive while value stocks are getting cheaper. You can argue that it’s because of [the rising prominence of] technology or the transition from the old to new economy. But I also think it’s because of the presence of cheap money,” says Chang.

Against this backdrop, fund managers cannot just do bottom-up selection and buy stocks that are cheap, he adds. “They also need to have a top-down view. What is your asset allocation strategy? At Principal, our process is driven by a bottom-up process with a top-down overlay, where we take measured tactical asset allocation views for the long term.”

Fund managers also need to become more flexible. “My fear is that everyone in the asset management industry just wants to buy momentum stocks like the tech and healthcare names. It’s quite scary…If you are just using this strategy, you will miss the bigger picture. For instance, in November, people already began looking at value versus growth themes,” says Chang.

Another outcome of a lower interest rate environment is an altered expectation of risk and returns. Clients may expect fund managers to take higher returns, without understanding the potential consequences of doing so. “To be a responsible investor, however, we need to be able to take a reasonable amount of risk for a certain amount of returns. So, there is going to be conflict there. We cannot take excessive risk. Taking risk is very easy. But taking risk off the table can be difficult,” says Chang.

How to embrace technology

Assets in passive equity funds, including index-based funds and exchanged-traded funds (ETFs), exceeded those of actively managed equity funds in the US for the first time in September last year, according to Morningstar.

The popularity of passive funds can be credited to its low fees and outperformance compared with some active funds. Robo-advisers that use an automated investment management system to create portfolios of ETFs are also popular for their low cost and accessibility to technologically savvy investors.

While passive funds have not made quite the same impact on Malaysian markets yet, this could change as the market becomes more transparent and if passive funds begin to outperform active funds. When faced with this trend, fund managers are challenged to outperform the benchmarks that underlie passive funds. One way of doing that is by combining the fundamental analysis with quantitative analysis using technology, says Chang, in a process he calls “quantimental”. “Principal’s global team has started developing quantitative strategies that are able to beat analyst calls and, therefore, beat the benchmark.”

In short, fund managers have to be open to using technological solutions to complement their work. This could be through the use of technology to sift through information and come up with analyses, for instance. Principal has explored quantitative strategies in one of its funds, which uses technology to analyse quantitative factors such as fundamentals and momentum, as well as sift through news flow and other sources of information. Investment decisions are made by the computer system based on algorithms. “The fund manager’s job is to weigh the factors and figure out which ones can be more effective in outperforming the market,” says Chang.

Meanwhile, the Kenanga Global Multi Asset Fund invests in a target fund – TCM Global Index Fund (Cayman) Ltd – that uses artificial intelligence (AI) to identify price dislocations and trade in and out of indices to achieve returns. “AI techniques help construct portfolios based on more accurate risk-and-return forecasts and more complex constraints. It facilitates fundamental analysis through quantitative or textual data analysis and the generation of novel investment strategies. It can help improve the shortcomings of classical portfolio construction techniques,” says De Alwis. In this case, technology helps fund managers in the research and portfolio construction process, as well as in risk management.

“But the use of AI can also create new risks and challenges, such as those resulting from model opacity, complexity and reliance on data integrity. This calls for a more systematic examination of the various techniques and applications involved,” says De Alwis. “We are not opposed to venturing further into more direct uses of AI and we have been using it to assist in our investment risk applications and processes. In the coming years, we will continue to explore AI’s capabilities to further complement our fund managers’ capabilities.”

Will the use of technology such as these require fund managers to adopt new skills? “It requires a different type of analysis. Fund managers can learn coding, of course. They can use it to create a simple model. But quant funds involve a different kind of skills. You need experts who are mathematicians and engineers to create these models,” says De Alwis.

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