

HOW CITYWIRE RATINGS CAN HELP YOUR FUND SELECTION

Neal Underwood, with a little help from our head of research Jonathan Miller, discovers how leading advisers have woven Citywire ratings and their building block, the information ratio, into fund selection processes

Citywire ratings are now five years-old and in their short life have become integral to leading advisers fund selection processes.

The ratings are built as a tool to help advisers. Our starting point is the information ratio (IR). The IR, as opposed to measures such as the Sharpe or Sortino Ratio, is a measure of risk-adjusted performance which makes the distinction between returns generated by benchmark moves and those generated purely by the fund manager.

The excess return is then divided by its own volatility (the tracking error) to show the gain the manager is making for each unit of risk he takes in stock selection. Historically the IR has tracked the performance of funds but Citywire takes it one step further to follow the individual managers.

This aggregated calculation is termed the Citywire Manager Ratio. We have built a database of individual manager's MR which is now six years old. Managers must pass various thresholds of MR to gain an A, AA or AAA rating.

'We are the only ones who follow the people, not the funds,' says our own Jonathan Miller, head of research at Citywire. 'Track records of individuals are stitched together as they move from company to company and take on new funds. The methodology is quantitative, is approved by external actuaries AKG and is maintained by a dedicated team of analysts. Also, Citywire is independent and groups do not pay to be on our radar.'

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David Livingston (right),
Thurleigh Investment Managers

As long as there is an active manager running a retail fund within one of the 24 IMA sectors, they will be in our analysis.

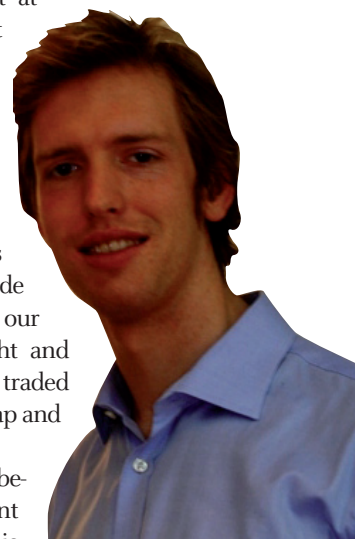
'A crucial factor is that Citywire assigns the benchmark at a fund level, based on the fund's objective and how the fund is being run. We don't have default benchmarks at a sector level. This means that in UK All Companies there will be, for example, FTSE All-Share, FTSE 100 and FTSE 250 benchmarks assigned as appropriate. The specialist sector as well, which is very much a mixed bag of funds, will have appropriate benchmarks assigned at a fund level.'

Using the ratings in fund selection decisions

Raymond Ellis, director of Glasgow-based Scott-Moncrieff Wealth Management, says Citywire's ratings are one of the major criteria he uses in his fund selection process. 'This type of information wasn't readily available [until Citywire started doing it]. Having seen the way they've drawn it together, it's been our main criteria since day one.'

David Livingston, analyst at private wealth management firm Thurleigh Investment Managers, also uses Citywire ratings as a core part of his fund analysis. 'When we started we looked mainly at absolute return funds, on the basis that they can protect downside losses for our clients. For our market exposure we bought and continue to buy exchange traded funds (ETFs), which are cheap and simple to own.'

'However, we are not believers in perfectly efficient markets, and recognise it is



possible for long-only managers to consistently and dramatically beat relevant benchmarks over time. As a result we decided to set up a small internal portfolio of funds, so we would pay more attention.'

The funds in this portfolio, which Livingston refers to as the 'Star Managers Portfolio', are selected using a process which commences with Citywire ratings. The portfolio includes illustrious names such as Citywire AA-rated Robin Geffen's Neptune Global Alpha, AA-rated Giles Hargreaves' Marlborough Special Situations, Richard Pease's New Star Europe and AAA-rated

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Philip Gibbs' Jupiter Financial Opportunities funds.

'We choose the best long-only managers; we used the AAA and AA rating as the starting point, then went to meet with fund houses to see if their process was replicable and non-index constrained,' he says.

Some of these funds are now filtering through into other client portfolios, adds Livingston.

For Ellis, the key advantage of Citywire's ratings over the standard IR is its focus on managers rather than funds and the ability to follow managers even when they move to a new firm. 'It's about trying to find consistency, and there are so many manager changes. That's the difficult thing,' he says.

Livingston says using the ratings is a very crucial part of screening the fund universe. 'Citywire is very useful. We do run the screens quite a lot, especially for certain clients who have certain restrictions. It's a good starting point to see how consistent managers have been at producing performance. We also find it interesting where ratings have fallen, for example. There's value in having that capability online.'

Knowing the limitations

Livingston says that although using Citywire's ratings does not give you the answer, it certainly helps point you in the right direction, although he is cautious about chasing performance.

He cites David Swensen, of Yale University endowment fame, who said that the winners in the past are not always the winners in the future.

All managers recommended by Scott-Moncrieff must have a Citywire rating, and Ellis is not concerned about missing out

on good managers who do not have a sufficient track record to have gained a rating. 'We've been using this criteria for about five years and it has been very accurate,' he says. Even then, he adds, if there were a new fund launched that had no track record but was run by a fund manager who he knew, he would have no problem investing based on the strength of the manager.

Livingston, too, is not overly concerned about missing out on emerging stars with shorter track records. 'We'll rarely invest with a new manager unless we have a good knowledge of them from their past investment days. However, we have no boxes to tick, we are completely unconstrained so it depends upon circumstances.'

He also notes that it is good to see managers who have at least a three year track record; they are more likely to have been through more than one cycle and have managed funds during a downturn. 'It is interesting to see how managers have preserved wealth in times of market stress,' he adds.

Citywire's fund manager ratings identify the individual managers who have the best risk-adjusted personal performance track records over three years across 24 IMA sectors, as well as highlighting the funds they are currently managing.

How ratings work

Citywire ratings are awarded on the basis of achieving, or exceeding, certain performance thresholds based on a manager's 36-month Citywire Manager Ratio across all sectors in which he is active. A manager must have at least 30 months performance out of a 36 month period to be eligible for a Citywire rating. Thus, managers who are relatively new to a sector over one or two years may well be in line for a rating, but not yet eligible to be considered. There are more than 950 active fund managers in Citywire's UK database; less than 20% of these receive a rating.

In addition to Citywire's ratings, Thurleigh also sources research from Bloomberg and the *Financial Times* as well as what Livingston calls 'an eclectic mix of people we know.' He points out that many of Thurleigh's clients are in fact fund managers themselves.

Livingston also recognises that: 'being an equity manager is in theory simple, but in practice is a difficult and in some ways an unenviable task. It is so easy to get carried away with classic investing mistakes such as anchoring or herding and focusing too much on the benchmark as opposed to finding a handful of stocks you love and holding them forever. It's easier said than done.'

He would like to see more unconstrained low fee-paying, long-only equity products coming to the market, so the manager can make full use of his skills without being anchored to benchmarks.

Citywire's latest list of rated managers, as well as up to date factsheets, are available on our website www.citywire.co.uk.