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Chasing Stars

CAMERON HO, FIDELITY PERSONAL INVESTING, 21 DECEMBER 2016

'It's the people who make the organisation', as every HR manager will tell you. But to what extent does the organisation make its people?

Maybe more than you think.

In 2010, Harvard Business School's Boris Groysberg studied the performance of top Wall Street analysts between 1988 and 1996[1]. He wanted to see whether investment prowess is portable – can star stock pickers keep up their winning streak when they switch firms?

Generally, they cannot. After one year, the stars (the top three percent of ranked analysts) that jumped ship were much less likely to maintain their ranking compared to their colleagues who stayed put. After five years, the stock pickers who changed firms were still less likely to occupy the top of the league tables.

These findings suggest that investment success is the product of both an analyst's innate talents *and* the organisation for which he works. Groysberg qualifies his findings by noting that stellar analysts who move to firms with *more* resources suffer no decline in performance; those who move to firms with *equal* resources lose their lustre for only two years. Thus, what a fund house offers its investment professionals – proprietary technology, a collaborative environment, and rigorous training – *does* seem to contribute to their performance.

Granted, Groysberg's study focuses on analysts who work for 'sell-side' investment banks. Their responsibilities and incentives are slightly different to that of 'buy-side' analysts - those employed by Fidelity and other fund managers. But since both ultimately try to pick winning stocks, the core of Groysberg's argument is applicable to fund management: people underestimate the role that the firm plays in enabling its investment professionals.

Almost all of the Select 50 fund managers boast long tenures both at their firms and at the helm of their funds. Thomas Luddy, manager of the JP Morgan US Select Fund, recently celebrated his 40th anniversary at the bank; James Donald has managed the Lazard Emerging Markets Fund since its inception in 1997.

Of course, tenure doesn't guarantee outperformance. But it's nonetheless an intuitive indication that the manager is doing something right, and that his firm's culture is conducive to his success.

A second trend which downplays the importance of a celebrity investor's talent is the steady shift towards team-managed funds. In 2010, over seven-tenths of all U.S. domestic equity funds were led by teams of portfolio managers, up from three-tenths in 1992[2].

Select 50 constituents such as the Old Mutual UK Smaller Companies Fund feature a lead manager supported by a handful of deputies. The Invesco Perpetual Global Equity Income Fund brings together a group of full-fledged regional equity managers under the guidance of Nick Mustoe, the firm's Chief Investment Officer. One of those managers, Stephanie Butcher, is an accomplished investor in her own right – she runs the Invesco Perpetual European Equity Income Fund, which is also on the Select 50.

An exception to these trends may be the most high-profile managers who leave their employers to strike out on their own. Neil Woodford left Invesco Perpetual in 2014, and Bill Miller recently bought himself out of Legg Mason. Are they subject to the same performance degradation which Groysberg's theory predicts?

Time will tell. The evidence is far from definitive, and there are a host of other factors to consider when evaluating funds. Nonetheless, it's interesting food for thought.

Sources:

[1] Groysberg, Boris. Chasing Stars: The Myth of Talent and the Portability of Performance. Princeton, N.J.: Princeton University Press, 2010.

[2] Patel, Saurin and Sarkissian, Sergei, To Group or Not to Group? Evidence from Mutual Fund Databases (March 5, 2015). Journal of Financial and Quantitative Analysis (JFQA), Forthcoming. Available at SSRN: https://ssrn.com/abstract=2047094 or http://dx.doi.org/10.2139/ssrn.2047094

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