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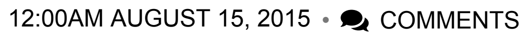
How boutique fund managers beat big end of town

By WILL HAMILTON



Every few weeks it seems like a team of fund managers breaks away from their parent company and seeks to go it alone.

In recent times we've seen outstanding operators such as Charlie Aitken, ex-Bell Potter, John Sevior, ex-Perpetual and Jacob Mitchell, ex-Platinum, all start new "boutique" fund management operations.

What's going on?

Certainly sophisticated investors have had a strong bias towards boutique managers, with a belief that good returns are to be found in the early years of a manager or strategy. That might be when the greatest hunger for excess returns is present and the asset base is smaller and more manageable.

AMG is a US-based fund manager with a Sydney office. It recently wrote a paper, The Boutique Premium: Do Boutique Investment Managers Create Value, looking at more than 1200 funds management firms investing in over 5000 global equity strategies (ex-Australia) with more than $US7 trillion ($9.5 trillion) in assets. The AMG study found that in the past two decades, "boutiques significantly outperformed non-boutiques" in nine out of 11 categories by an average of 51 basis points per annum.

Further, the study illustrated that investing purely with boutiques across all categories (including the two underperforming categories), would have generated 11 per cent greater returns for investors over the 20 years.

In looking at these boutiques against indices, it was again found that the "average boutique strategy outpaced its primary index in nine out of 11 equity categories" by an average of 141 basis points a year after fees.

At a 2014, conference Roland Meerdter from Propinquity Advisors in Maryland, US, discussed the “Myth of the Blockbuster Funds”.

Meerdter discussed the way in which relative to a fund’s size its excess returns decrease, while the market capitalisation of the underlying holdings increases and the tracking error decreases. The finding was that in effect the larger a fund gets the reality of the above means that “tiny bombs” start going into a portfolio.

His advice is that managers need to manage inflows and capacity as potential outperformance reduces through both time and funds under management. The reason for this, Meerdter argues, is: “What constitutes great success for a boutique doesn’t make a blip for large shops”.

The drive towards boutique managers by sophisticated investors is no different in Australia and across other asset classes.

Andrew Papageorgiou, managing partner of Melbourne-based boutique fixed interest manager REALM Investment House, says: “In our asset class at least there is an argument that size really does matter. A smaller fund arguably benefits from better liquidity by virtue of smaller actual parcel size and has the additional benefit of being able to make more meaningful investments (at a fund level) in smaller sectors”, hence performance.

I believe the boutique model has found traction in Australia and it’s interesting to look at why. Steve Hiscock, managing director of fund manager SG Hiscock, says the boutiques have an advantage over the traditional institutional model in delivering outperformance.

Typically, the managers own the business so there is a huge incentive for it to succeed and principals are often very large investors in their own funds, thus creating a real alignment of interest. Boutiques generally have smaller funds under management and this allows them to be more nimble, and exploit smaller niches with demonstrable market inefficiencies. It also means that IPOs and placements can have a bigger impact on their returns.

The focus of a boutique is different: this is their only business. There are no other distractions or business units, and the number one imperative is fund performance, not profit growth. Finally, boutiques tend to have higher conviction in their stock selection, and this means that only the very best ideas find their way into a portfolio. There are no

“stocking fillers” that tend to find their way into the very large portfolios in order to “lower the portfolio risk”.

Hiscock likens professional investors to artists — while the institutional structure tends to constrain the creative juices, boutique managers enjoy greater freedom and flexibility to invest as they truly want to.

It’s worth remembering their own skin is in the game in a way that doesn’t apply at the big end of the funds management town.

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