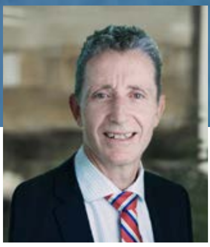
MAGELLAN
EXPERTS IN GLOBAL INVESTING

2020 INREVIEW

THE ROLE OF INVESTMENT CONSULTING

A discussion with Zenith



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Zenith Investment Partners CEO David Wright shares his learnings and insights from three decades as an investment research provider and financial coach.

MARK: David, welcome and thanks for joining us. Can I start by asking you to tell us a little bit about yourself and Zenith Investment Partners?

DAVID: Yes, thanks, Mark. I've been in and around investment research for 30 years. My background is a degree in economics and commercial law. When I started, it was at the height of the last recession that Australia had back in 91/92. So I was pretty lucky in the end to get an opportunity with a research firm and I've been reviewing and researching managed investments – and that's both unlisted and listed – over that time. I'd like to think I've learnt a lot during that period. And you learn a lot really through different market cycles. It's one of the things I have talked about to younger analysts. We've got some well-credentialled and highly qualified people, but the one thing you can't rush is experience. And being able to assess investment managers and products in times of market stress is incredibly valuable. And you only get that by being in the market over a long period.

Zenith Investment Partners is a business that I started with a colleague nearly 20 years ago now, and the business model of Zenith is essentially the same as what we started with. The business is broadly split into two groups: Investment Research and Investment Consulting. Investment research is a group of investment analysts who are analysing and assessing fund managers and products, reviewing and rating them and identifying those we consider to be the best and rating them accordingly. So we're really trying to focus on those managers and products we consider to be 'best of breed' in their respective asset class and that are going to be rated highly recommended, and seek to avoid those we consider to be of low quality.

The other key part of our business is investment consulting to clients. We noticed 20 years ago the need for advice on portfolio construction, management, maintenance and reporting and that's really only gathered pace since the global financial crisis, where, to coin a phrase, a lot of people had their 'pants pulled down' in the big decline of share markets, bond markets – really, most asset classes at the time. Today investments are becoming a lot more sophisticated, there are a lot more managers, there are even new asset classes so both advisers and underlying investors themselves need some help and guidance as to how to best construct portfolios for particular return outcomes while still obviously managing investment risk and volatility. Ultimately people don't want to lose money and if they can reach their investment goals without a lot of volatility, then that's really what we're aiming to do.

MARK: David, thank you for that. One of the things I found interesting is the role of the investment consultant. Perhaps you can expand on the role of the investment consultant as you see it.

DAVID: The investment consulting side of the business is a team of people responsible for the construction of investment portfolios that I talked about before. One of the key things it involves is being an investment coach to financial advisers and ultimately from the advisers to the client.

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What I mean by that is, when you construct a portfolio, you do so with a combination of funds and managers that are best going to maximise your chances of achieving the portfolio's objectives. Now, that might be a conservative portfolio, it might be a high-growth portfolio, but you're selecting managers and funds for specific reasons. In a perfect world, everybody would like all the 'cannons firing' all of the time. Unfortunately, the reality of investing is that that's pretty rare, and so you want investments that are going to complement each other. The role of an investment consultant is certainly to identify, select, combine and manage a portfolio of investments that will deliver, in the best possible way, the objective of the portfolio. But as I said, where the role of 'investment coach' comes in is when a particular investment is not performing, is to remind the adviser and their investors as to why that investment was in the portfolio in the first place. It's human nature to have an emotional attachment and get rid of underperforming investments and usually that's the worst thing you can do because you'll get rid of them at almost precisely the time when they'll start to perform well. So, again, it's really the combination of investments that will get you to your investment objective and if you keep getting rid of investments that underperform for a short period, then that's not going to work. So, it's really about reminding advisers as to why the investment is in the portfolio and what sorts of investment conditions it will again produce good returns in.

MARK: Given the size and number of managers that you have to look at and assess, how big is your consulting team, and what resources are needed to do this well?

DAVID: The research team alone is 16 analysts and they're not trying to review and rate the whole market. We're using a filtering process to try and filter out those managers and funds that haven't performed well for long periods or have had teams leave and go elsewhere. So this is 16 people for whom their whole existence from a work perspective is analysing, assessing, reviewing, researching and rating managers. Then on the investment consulting side, we've got a team of seven investment consultants as well as two investment consultant support people and then client service support in addition. The seven-member consulting team leverages entirely off the research team. So there is nothing in a client or adviser's portfolio that isn't well rated by our research team. But in investment consulting, and I'm part of the consulting team these days, it is our job to select those well-rated products and combine them in a way that they're going to complement each other so that in different investment market conditions your portfolio is still going to perform.

MARK: Magellan is a current manager in some of the Zenith-advised client portfolios. What have you seen and communicated to your clients over the last 12 months, for example, given we've seen a big market rotation, particularly from November 2020 onwards?

DAVID: Yes, we have seen that big market rotation. As I mentioned, we try and build portfolios that are going to perform well in different market conditions so, in the previous period leading up to November last year where the growth investment style outperformed the value investment style, and that was a very long period, we still had value managers in the portfolio. They weren't performing as well as growth, but the growth managers were performing well and so overall, combined with the other asset classes, the portfolios were still providing strong returns. Now, as you said, Magellan is well represented across our client portfolios and indeed even in the Zenith-branded portfolios that advisers and clients can use. And I guess to be fair, we have had a lot of questions, particularly over the last quarter or so, regarding Magellan's performance and I think that really comes from the fact that the Magellan Global Fund has performed so strongly for so long and people get used to that and that's a great thing to get used to. But the reality is any active manager, and this is a test really of how active Magellan is, is going to experience periods where their performance is very different from that of the broader share market and other managers. So, for a long time, that difference has been on the positive side. It just so happens that the last, I guess, 12-month period it's been, not negative, but it's underperformed the market. So, when people are so used to Magellan outperforming it's raised questions. As I said before, our role is in part a financial coach where we talk through this with clients and remind them of Magellan's role in the portfolio.

MARK: So what do you look for in the data that you filter and in your manager analysis?

DAVID: What we look for, not just in Magellan's case, but all managers' cases, is that the manager is true to label, and so what does that mean? It means that what the manager is telling us in terms of how they manage the portfolio of companies and stocks, they actually do. So, if a manager describes themselves as having a growth investment style, then we would expect to see growth-type companies in that portfolio. We do check that; we get full portfolio details from every manager that we review and rate. That's really, really important when you're constructing portfolios, because we're blending managers of different investment styles. If they're not being true to label in their investment style, the entire blending breaks down. And that's kind of the worst thing that can happen, because, if a manager doesn't stick to their style and convinces themselves that, OK, this stock or a range of stocks is now on my radar, the manager has worn the pain through the market conditions not suiting them. What typically happens then is the market turns and so they don't participate to the same degree as they would have if they had remained true to their style. This is what is called style drift. So that's the thing we look for across all international and Australian equities managers. Magellan has a very experienced investment team, and that's critical. What we're looking for is investment professionals who have been through a range of different market cycles and have the confidence and conviction in their investment process when things aren't going so well that it will play out and return to great returns for investors in the future. That experience and conviction and remaining true to style is critical in our assessment.

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MARK: And that almost goes back to your first point about you having to ensure that, as part of your role in the investment consulting team and CEO of the business, that experience shines through.

DAVID: Exactly right. As I said at the start of the interview, there's no substitute for experience in seeing different market environments, both up and down. Let's be honest, really since the GFC, we've mostly had a positive or bull market experience. So there are some investment personnel in the market who have never seen an extended downward market, never seen a bear market. And that's, again, something we'd be pretty sensitive to because downwards or even sidewards moving markets are where a lot of managers demonstrate their true skill and ultimately protect investors against a bigger decline than the market itself. I should mention that not only are we looking at team process and experience, but we are looking at performance, volatility, drawdown, consistency of returns and virtually every sort of performance and risk-related statistic. Pleasingly, Magellan has done what you've said you would do in protecting investor capital investments to a greater extent than the market.

MARK: Thanks David. Are there any final thoughts you'd like to leave us with?

DAVID: I think that the investment environment is going to be a lot tougher than the recent past and so you really do need quality investments and highly experienced investment managers in the portfolio to be seeking out the additional returns for investors.

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