Commentary

October 2016

SEI New ways. New answers.®

Risk Management: Manager Research

- The manager-of-managers approach provides an opportunity to access skilled investment managers and an effective risk management framework.
- SEI's Manager Research group seeks to identify managers that demonstrate consistent results, so our process focuses on a manager's ability to capitalize on its competitive advantage and the associated risks.
- We identify specific re-evaluation triggers for each recommended manager.

The manager-of-managers structure employed by SEI is rooted in a few straightforward beliefs:

- Skilled investment managers can be identified, classified and validated through proactive research focused on defining their competitive advantages.
- The result is a wide universe of talented managers, distinguished by their expected sources of excess returns, which can be used for a variety of portfolio construction objectives.
- A multi-manager strategy empowers portfolio managers to adjust allocations to the underlying investment managers in response to a variety of factors, including macroeconomic developments, fluctuations in risk levels, and others.

In short, the manager-of-managers approach provides a toolbox that can be used both in terms of harnessing skilled investment managers and for risk management purposes.

What We Do

SEI's Manager Research group carries out the sourcing, analysis, selection and ongoing monitoring of investment managers. Manager Research has a global presence with analysts in the United States, London and Hong Kong. This reach extends our ability to understand managers' local peculiarities and provides convenient access to visit them on-site to gain genuine familiarity with their teams and processes.

We are most concerned with identifying managers that can demonstrate genuine skill and consistency. Past performance only provides a partial picture of a manager's ability, so we seek to differentiate market-driven returns from those earned through the manager's efforts in order to gauge a strategy's true value and repeatability. Essentially, our process emphasizes the drivers of a manager's performance rather than the performance itself.

To identify these drivers, we must determine the manager's competitive advantage — and its associated risks — so that we can monitor and measure the strategy effectively.

How We Do It

We evaluate managers with the goal of developing a thesis about how they would be expected to execute a given investment mandate, the environments in which the strategy should outperform or underperform, and areas of concern.

Our qualitative analysis centres on people, philosophy and process. What commitment has the manager made to personnel and other resources? How effective is the investment process at putting the philosophy into action? We use quantitative analysis to confirm, refine or refute our thesis. The statistical measures we employ include risk and performance attribution analysis, among others.

The environment in which managers execute their strategies is also integral to understanding whether they're likely to be effective. For this, we consider managers in cyclical terms — both in the context of the market cycle as well as their own lifecycles.

A significant part of our investment thesis is dedicated to describing expectations for how a manager should be expected to navigate different parts of the market cycle — such as stress, distress, recovery or expansion — and respond to trends or factors — like low volatility, trendless, a sharp shift to higher volatility, flight to quality, or a beta rally.

Lifecycle analysis necessitates a focus on the manager at the firm and strategy levels as two distinct dimensions. We determine whether a firm and strategy are in their emerging, growth, mature or declining stages. This classification carries both practical business implications (such as flexibility on fees at different stages) and performance considerations (impediments to producing excess returns tend to increase as a manager matures). Generally, we seek to hire managers that are closer to the beginning of their lifecycles and recycle managers that are nearing the end, although there are exceptions.

A Spotlight on the Risks

If a manager gains our recommendation, we identify specific areas of concern — or risks to our thesis — upfront in our evaluations. These risks can range, for example, from potential parent company-subsidiary relationship conflicts to key-man risk and personnel turnover, or confirmation bias associated with a strong lead portfolio manager.

These concerns serve as the basis of our re-evaluation triggers, which include:

- Personnel changes — senior departures, new decision makers, or just high overall turnover
- Shifting portfolio characteristics — increased or decreased emphasis on the drivers of excess returns that we identified with the manager's competitive advantage
- Change in corporate structure — merger, acquisition or other corporate action that could affect the status quo
- Excessive asset growth
- Unexpected performance volatility
- Breaches of pre-determined risk guidelines — contribution-to-risk, leverage limits, etc.

This is not an exhaustive list, and not all triggers carry the same weight. Some — like an integral senior departure — come with an explicit bias to terminate our recommendation, while others — like a risk guideline breach — are procedural with the understanding that statistical measures can sometimes generate false alarms. The latter type nevertheless invites a thorough re-evaluation to investigate the breach's validity.

We also re-evaluate managers on a recurring basis for no particular reason at all, as part of our standard practice. Managers that have been funded in our mutual funds or managed accounts are under constant review. We monitor performance daily and conduct performance- and risk-attribution analysis on a regular basis.

Quarterly, if not more frequently, we speak with every manager that we cover — funded or not — in an effort to evaluate their decisions and outlook. Perhaps most importantly, we conduct a full re-certification annually to ensure that our investment theses are still relevant and that we remain engaged on developments, large and small, that might impact our understanding of each manager.

Part of this entails visiting managers at their offices for unfettered access to the full investment team in their working environment. A lot can happen in a year, and the goal of our re-certification process is to make sure that our theses are still accurate. For example, a manager could validate or disprove one of our supporting rationales, which might impact how we evaluate and rank their expected return drivers or scenarios for their expected performance in a given environment. A manager could also generate a new area of concern or mitigate an existing one, which might impact their re-evaluation triggers.

Risk Management: Operational Due Diligence

Our series on SEI's approach to risk management, and specifically our foray into manager research, will continue with a paper that explores our operational and risk due diligence process. That is, we will detail the scrutiny that a manager's operations and controls undergo once they have been selected by manager research.

We also plan to address the following, in terms of their contributions to risk management, over the coming months:

- Asset allocation and constructing portfolios
- Balancing risk for goals-based investing
- Enterprise-level risk management

Glossary

Beta: Beta is a measure of sensitivity to movements in the market. High beta stocks are more sensitive to movements in the broad market. Low-beta stocks are less sensitive.
Macroeconomic: Macroeconomic refers to the broad economy of a country or region, or the global economy.
Qualitative: Qualitative refers to security analysis based on analyst research and subjective views.
Quantitative: Quantitative analysis is based on computer-driven models.

Important Information

Past performance is not a guarantee of future performance. Diversification does not ensure a profit or guarantee against a loss.

Investments in SEI Funds are generally medium to long term investments. The value of an investment and any income from it can go down as well as up. Investors may not get back the original amount invested. Additionally, this investment may not be suitable for everyone. If you should have any doubt whether it is suitable for you, you should obtain expert advice.

No offer of any security is made hereby. Recipients of this information who intend to apply for shares in any SEI Fund are reminded that any such application may be made solely on the basis of the information contained in the Prospectus. This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding the funds or any stock in particular, nor should it be construed as a recommendation to purchase or sell a security, including futures contracts.

In addition to the normal risks associated with equity investing, international investments may involve risk of capital loss from unfavourable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Bonds and bond funds are subject to interest rate risk and will decline in value as interest rates rise. High yield bonds involve greater risks of default or downgrade and are more volatile than investment grade securities, due to the speculative nature of their investments. Narrowly focused investments and smaller companies typically exhibit higher volatility. SEI Funds may use derivative instruments such as futures, forwards, options, swaps, contracts for differences, credit derivatives, caps, floors and currency forward contracts. These instruments may be used for hedging purposes and/or investment purposes.

While considerable care has been taken to ensure the information contained within this document is accurate and up-to-date, no warranty is given as to the accuracy or completeness of any information and no liability is accepted for any errors or omissions in such information or any action taken on the basis of this information.

This information is issued by SEI Investments (Europe) Limited (“SIEL”), 1st Floor, Alphabeta, 14-18 Finsbury Square, London EC2A 1BR which is authorised and regulated by the Financial Conduct Authority. Please refer to our latest Full Prospectus (which includes information in relation to the use of derivatives and the risks associated with the use of derivative instruments), Key Investor Information Documents and latest Annual or Semi-Annual Reports for more information on our funds. This information can be obtained by contacting your Financial Advisor or using the contact details shown above.

SIEL is the distributor of the SEI UCITS Funds and provides the distribution and placing agency services to the Funds by appointment from the manager of the Funds, namely SEI Investments Global, Limited, a company incorporated in Ireland (“SIGL”). SIGL has in turn appointed SEI Investments Management Corporation ("SIMC"), a US corporation organised under the laws of Delaware and overseen by the US federal securities regulator, as investment adviser to the Funds. SIMC provides investment management and advisory services to the Funds. SIEL, SIGL and SIMC are wholly owned subsidiaries of SEI Investments Company.