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INTRODUCTION

WHY CARE ABOUT STYLE?

The manner in which investment managers go about running their portfolios affects everything from risk to return, as investors should be aware

Lots of market commentators talk about style. The Morningstar ratings attempt to put investment managers into particular style boxes. Style indices, such as the Russell 3000 in the United States, are widely quoted and used as benchmarks. And yet to many investors, the notion of an investment manager's style is just too esoteric, one step too far removed from the already complex business of investing.

This is unfortunate. As investors try to come to grips with risk, they would be well advised to start to understand what style actually means. Style is all about risk. An investment manager's style dictates what sorts of investments it will typically favour and which it will avoid. For investors, this is critical information. Certain types of investment are inherently more risky, as many investors in small-cap tech stocks discovered in 2000 and 2001. Also, different economic and market conditions favour different sectors and different types of stocks.

A value manager may find it very difficult to find attractive investments during the heady days of a tech boom, but rather easier when economic prospects are less certain and companies with solid balance sheets come to the fore.

SPECIALISATION

So why can't a single manager adopt all styles, choosing whichever suits the current "season"?

You might just as easily ask why it is that Australian men have won nine Wimbledon singles titles, on grass, but only two French Open titles in the past 40 years, while Spanish men have won six French titles, on clay, but only one on the grass at Wimbledon. The answer is simple: specialisation and training. Consistent ground strokes and sheer mental toughness are required to prevail at the French Roland Garros tournament. These are learned over years of playing on slow, baking clay courts as aspiring Spanish players make their way through the junior ranks. Australians on the other hand, weaned on slicker surfaces

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Scott Donald, Russell Investment Group

with a lower bounce, take more naturally to the serve-volley game that is most effective on grass. It is the same game, but different skills are effective in different environments. Even the grip of the racquet is different, twisted anti-clockwise in the case of the clay-courter.

Similarly, investment managers pursue styles that help them to prosper in certain market conditions. These can be overt, such as when a manager expresses a desire to invest primarily in small cap stocks, or they may arise as a result of other beliefs and processes.

Many value managers, for instance, have their 'value' style embedded in the quantitative screens they use to identify interesting companies, and in the types of analysis they undertake. They may not even call themselves value managers. They may believe that tag does not adequately describe what they in fact do. There may be many nuances that such a simple tag cannot hope to express. The key for investors to recognise, though, is irrespective of how the investment manager chooses to describe their approach, if it contains explicit or implicit biases towards certain types of stocks, those biases will influence performance.

Investors, then, need to know what different styles will mean for their portfolios. Some, including many pension funds, will aim to be style neutral, meaning they will try to ensure that they do not have bias towards any one style in their portfolios. This doesn't necessarily mean simply appointing a value manager and a growth manager, or a large cap manager plus a small cap manager, though for many this is as far as it goes. Sophisticated investors will try to capture the subtle nuances of style of a number of different managers, as they evolve through time. This takes more expertise, access to information and attention to detail, but does take account of the wide range of dimensions of risk in the markets. Multi-manager funds have developed to deliver this expertise to a wider range of investors.

TIMING

Other investors will aim to time their exposure to different styles, believing they can pick the cycle. As beguiling as this temptation is, far fewer succeed in this activity than might be expected. It takes considerable dispassionate analysis, a preparedness to trust your own judgement and a modicum of luck to make such timing strategies work.

Almost all the research suggests that the vast majority of investors who undertake this activity would be better off 'setting and forgetting'. The impact of transactions costs and taxes, not to mention inertia and mistakes, weighs heavy on the investment results they enjoy.

It seems sensible, then, to see style as a way to describe the risks of a manager's strategy. In what circumstances will it succeed? When will it fail? Is there a way to offset the risk of one style against the risk of another? How does that affect your overall investment strategy? Style then becomes a handy tool to help you build a robust strategy that can cope with the many gyrations of the markets.

Scott Donald, director, marketing and product development, Russell Investment Group

CORPORATE STATEMENT

Russell, global leaders in multi-manager investing, provide investment products and services in more than 36 countries. Russell manages over $110bn in assets, of which $30bn is run from Europe. In its institutional business, Russell advises clients such as pension funds, endowments and coporates representing more than $1600bn worldwide. Individual investors gain expertise to Russell's expertise through strategic alliances with leading financial institutions who provide wealth management, retail funds distribution, insurance wrappers and other services around Russell's multi-manager funds.

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