Picking Funds in a post-COVID World:

2020 has been emotional. We have had all the fear and greed that any market participant could hope for. We have seen a one of the fastest bear markets in history followed by one of the strongest recoveries.

The sheer speed of the moves makes it tempting to think that, with a bit of patience, things will return to “normal”. But things are far from normal – we are in the midst of a brutal recession and one of the most significant societal hiatuses in history. It is impacting everything from how we work to how our children are educated, how we relax to our relationships with family and friends. This level of upheaval is significant, and we must adapt, as ever, to flourish.

This has many ramifications at a micro level and the market has been quick to discount some of these changes. The British Airways to Zoom trade; Microsoft and Amazon taking over everything. It does, however, also have a profound impact at the more macro, portfolio level.

The last decade has been characterised by the rise of the ETF and passives generally. The majority of “me too” active funds, with a low tracking error and active share, are desperately trying to claw out index plus returns to somehow justify their fees. As many of these, increasingly homogenised, active funds have come to be shown to be painfully inactive, ever more benchmark aware and risk averse, clients have understandably been drawn to low cost passives. This is a trend that will undoubtably continue as any fund that has an overly dogmatic process of “screening” will be replicated by a low cost alternative. The rapid rate of industry consolidation will not alleviate the fundamental issue that clients should not have to pay active fees for beta returns.

There are some fine exceptions, but they often have a strong style bias towards growth or value. The former have been hugely rewarded for their boldness with stellar returns and inflows to match. Those with a value bias I applaud for their sheer bloody mindedness in a market that has offered nothing but false dawns.

Looking forward we face a challenge – do we continue to support the increasingly extended large cap growth trade or take the, intellectually more satisfying, contrarian value position. There can be few investors who are not aware that Amazon is doing well in retail or that Netflix is quite popular; certainly, my mum is. Equally, can we really justify owning Deutsche Bank just because its deeply flawed business model is so lowly valued by the market.

It is quite clear that we are entering a new economic and market cycle. Consequently, it is not enough to simply extrapolate the past or to scamper to the other side of the boat, hoping for style mean reversion. The secret in this new cycle will be to find active managers that have the intellectual flexibility to generate returns in all market environments; that can build differentiated portfolios with a high active share, capable of complementing rather than replicating the Beta of passive offerings. These are managers who have the confidence to show visibility on their process, articulate changes to portfolios and explain how they are adapting to evolving markets. Above all fund managers need to make themselves available to clients, to provide the connection that is so important to long term durable investment relationships, rather than hiding behind a wall of product "specialists".

The winners in the post Covid world will be those that are willing to keep an open mind and are prepared to work that bit harder; that have the conviction to take counter intuitive decisions to benefit from the myriad anomalies. It is by being flexible and embracing the new investment cycle that we will deliver the long term returns that investors so richly deserve. The great challenge is to seek out these new funds and start to rebuild the hugely valuable relationships between fund managers and clients that have been so diluted in recent years.

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