

PROFESSIONAL BUYER

CITYWIRE

MAY
20

2019

ISSUE
62

CITYWIREUSA.COM

FOR PROFESSIONAL BUYERS

Show your work

**MERCER'S SEAN CHATBURN
AND DEBBIE CLARKE WANT
MANAGERS TO EXPLAIN HOW
THEY SPOT ANOMALIES**

20
YEARS
CITYWIRE



Drilling DOWN

Managers hoping to impress Mercer's Sean Chatburn and Debbie Clarke need to explain precisely how their investment thesis works

VICKY GE HUANG

An innovative investment idea may be enough to win over some investors, but it takes a lot more to turn that idea into a successful strategy.

As the leaders of Mercer's investment research units, Debbie Clarke and Sean Chatburn have certainly heard their fair share of strategy pitches from portfolio managers, with one memorable encounter involving a manager describing how he had camped out in his car for two days to prove a theory about one of his stocks.

However, no matter how innovative the idea or how persistent the manager, Clarke and Chatburn need to see the detail if a strategy is going to make it to the top of the recommended list on Mercer's \$265 billion discretionary platform.

'How are the portfolio managers coming up with individual stock ideas? What is the due diligence that they're doing on the idea? How

creative is the idea?' asks Chicago-based Chatburn, head of Mercer's North American equity manager research. 'We spend a lot of time and energy on the creativeness of the ideas that the manager is coming up with, but that's just one component... If you come up with an interesting idea, then you have to construct a whole portfolio of interesting ideas.'

'To me, you can have the best idea generation or portfolio construction in the world, but if you haven't got good business management supporting that, it will be more challenging to get a high conviction rating from us,' adds Clarke, the firm's London-based global head of investment research.

This pursuit of strategies with innovative idea generation run by solid portfolio management teams is a guiding principle throughout Mercer's manager research process, which is carried out by a team of 150 people based in offices around the world, from Chicago and London to Singapore and Sydney.

The numbers are pretty staggering. Mercer's

RÉSUMÉ

SEAN
CHATBURN

2010 – present

Mercer Investment Consulting,
Head of North American equity research

2007– 2009

Neuberger Berman,
Equity research analyst, healthcare

2004 – 2006

Roxbury Capital Management,
Equity research analyst, generalist

Global Investment Manager Database includes more than 34,500 strategies run by 6,000 asset managers. It is free to get on the platform, but in order to get a Mercer rating, managers have to get through Clarke and Chatburn's stringent selection process. As of the end of April, just 11,473 strategies had received a Mercer rating, and of these, just 2,819 had been awarded the group's highest rating, an A.

Chatburn says that each year, his team carries out more than 2,000 portfolio manager meetings and produces more than 4,000 associated documents. That research is used by Mercer's clients, including financial intermediaries, corporates, hospitals and sovereign wealth funds, who can access Mercer's research database, seek advice from its investment team or outsource the entire portfolio management process to the firm. 'If we give our clients' money to an asset manager, we want that asset management firm to be run in a way that ensures our clients' money will still be managed by the same people in five or 10 years' time,' Clarke says.

'We really want to see good, strong business management, and by that we mean our clients' interests and the asset managers' interests need to align.'

EXCEPTIONAL ENCOUNTERS

Asset managers looking to access the firm's vast research and client network not only need to meet the Mercer team's requirements on idea generation and good management. They also need to demonstrate an ability to exploit market anomalies.

Chatburn recalls meeting one portfolio manager whose commitment to finding these market anomalies was on a whole new level. At the time, the portfolio manager owned the stock of a trucking company that was being bought by a rival, and he wanted to know how the integration of the businesses was going.

'He drove his car to a truck stop and lived in his car for a couple of days watching the trucks go by to see what name was written on the side of the trucks,' Chatburn explains. 'That was his way of trying to prove whether the integration was successful or not.'

The portfolio manager ultimately discovered that the integration was progressing far slower than the management was claiming during its conference calls with investors.

While unique ideas speak to the team, knowing how to implement them in portfolios and during changing market conditions is also key.

Indeed, another memorable

encounter for Chatburn was with a portfolio manager just before the eruption of the global financial crisis. The manager, who had \$500 million in assets at the time, specialized in an arbitrage strategy that bought niche companies with dominant market positions that the manager believed were trading at a reasonable discount.

'What we thought was really interesting about the strategy was the temperament of the portfolio manager. They were not easily spooked or shaken by near-term market noise in a stock, and over time they have demonstrated an ability to be kind of unshakable in the face of near-term uncertainty,' Chatburn says. 'And that has really helped strategy returns.'

Indeed, more than a decade on from Mercer's first investment with the manager, the strategy now has \$2 billion in assets and generated roughly 300 basis points per annum of excess returns versus the Russell 2000 index gross of fees, according to Chatburn.

FOLLOW THE LEADER

The breadth and size of Mercer's platform has allowed the team to track managers as they join new firms and take on new strategies. Clarke recalls tapping into Mercer's global footprint to track a manager who had left a UK-based fixed income shop to join a Singapore-based boutique.

'He went to set up the equity team, and frankly it didn't work out,' she says. 'He then went to a strong Asia-based firm doing Asia and China, so we were able to follow where that manager went and have somebody local go research them. We perhaps wouldn't have found him if we didn't have that big team.'

Chatburn adds: 'Because we have a global reach, it gives us a unique perspective on larger asset managers, as we have various points of contact around the globe.'

'As a research team, we're able to share the insights that we're learning about an asset manager and how that compares or contrasts with what is being said about the same organization in different geographies.'

Mercer's size has also allowed the team to partner with established asset managers to test out new ideas. Clarke and Chatburn believe that this has helped them to offer innovative products to the firm's clients.

For example, three years ago a client approached Clarke and her team to discuss a secure finance strategy, which would generate income by investing in both fixed income and private debt holdings. This product didn't exist at the time, so they canvassed portfolio managers to try and find the best solution.

'That was really driven by us recognizing a

RÉSUMÉ

DEBBIE
CLARKE

2005 – present

Mercer Investment Consulting,
Global head of investment research

2003 – 2005

Towers Watson,
Senior investment consultant

1983 – 2003

F&C Asset Management,
Portfolio manager

\$265 BILLION
ASSETS UNDER
MANAGEMENT

34,500+
FUNDS ON PLATFORM

FUNDS WITH MERCER RATING
11,400+

FUNDS WITH
MERCER'S A
RATING
2,819

INVESTMENT
TEAM
150
PEOPLE

client need and then talking to managers. Managers would come to us and say, "Yes, we think that we can deliver this and we can put together a portfolio," Clarke says. 'We have done a lot of research in that area. We now have our own delegated fund, and it has been very successful for us.'

DROP THE DEAD WEIGHT

Doubts over a fund's management team will always sound alarm bells for Clarke and Chatburn, and a lack of focus and clarity from an asset manager will raise some serious questions.

'As they grow, some portfolio managers start to move away from their core wheelhouse, moving into new asset classes. They may still be equity strategies, but they are outside the scope of what they were really good at initially,' Chatburn explains.

'Where we see this really run into trouble is when they start trying to move into new asset classes by bringing on new investment teams, perhaps managing fixed income strategies when their core fitting was US equities,' he adds. 'The further you get away from your core competency, the more we start to see organizations really suffer and by extension, clients' performance.'

One of Clarke's worst manager meetings happened three years ago in Ireland. It was a particularly jarring example of a portfolio manager lacking clarity in their approach. Despite having delivered good performance, the managers could not peel back the layers of their complicated investment process and express themselves in clear terms.

'They probably spent 20 minutes talking, and I

had really understood nothing of what they had said. Do I carry on with this meeting, or do I stop it to try to get back on track? So I said, "I'm really sorry, but you just talked at me for 20 minutes and you showed me a bunch of slides, which frankly I don't understand." Clarke explains. She then asked the managers to point to one stock in their portfolio and walk her through the process from there.

'We stopped the meeting after about 45 minutes, because they just could not explain clearly what they were doing. And I thought, "If you can't explain it to me, you're never going to be able to explain it to my client, so I'm done," she says.

Clarke attributes her own communication skills to her upbringing as a 'military brat.' She attended 10 different schools during her childhood and teenage years as a result of her father moving the family around while he served in the British Royal Air Force. 'That helped me to develop the ability to be adaptable and to talk to people I didn't know and ask questions of them to get to know them,' Clarke says.

And as any manager who has been through Clarke and Chatburn's investment process can attest, it's this focus on asking difficult questions that helps the Mercer team to unearth the truth in any portfolio manager's pitch. ■

