

Excess Returns

Monthly insights for investment marketing and sales professionals



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The potential portfolio impact of market or “top-down” forces is a legitimate concern among many investors. Yet some investment professionals fail to address this topic effectively — even during periods of market turmoil. This first issue of our newsletter explores top-down communications strategies for “bottom-up” investment managers.

With best wishes,

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The Downside of Bottom Up

Let me be clear from the start: I have nothing against bottom-up investing. Intuitively, it makes more sense to me than top-down investing. The title of this article really should be “The Marketing Downside of a Rigid Bottom-Up Mindset.” But I am getting ahead of my story.

Here is how the idea for the article came about. **My irritation with bottom-up managers who refuse to acknowledge top-down portfolio influences had been building for years.** But then one day this past summer, it came to a head. I was listening to a mock finals presentation by a portfolio manager. She was doing a great job, until I asked a straightforward question that anyone managing money for a living should be able to answer: “Can you please comment on the macroeconomic factors affecting your portfolio?” **“This is not relevant to us,” she said, a bit huffily. “As a firm, we do not make macroeconomic calls. We invest exclusively based on bottom-up research.”**

Enough, I thought! I’ve been listening to this “we just don’t do macro” nonsense for years. So I called her on it aggressively: **“Help me understand what you just said. Our pension fund is contemplating a \$100 million investment with your firm and you’re telling me that the economy is ‘not relevant’ to you?!** We have pensioners who may not be able to retire when they had planned due to this recent recession — and many people have experienced real hardship because of it — and yet you say you and your firm don’t care about big-picture market forces?”

The portfolio manager continued to dismiss the question while I continued to push for some form of answer, probing for potential top-down factors affecting the portfolio. In real life, there would have been no such arduous back and forth. **In real life, the potential client merely would have felt puzzled and annoyed, very likely resulting in the business going to a competitor.**

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Alpha Partners is an investment marketing firm specializing in research and presentation strategy. Our goal is to create alpha (excess returns) by helping investment firms win, keep and diversify assets under management.

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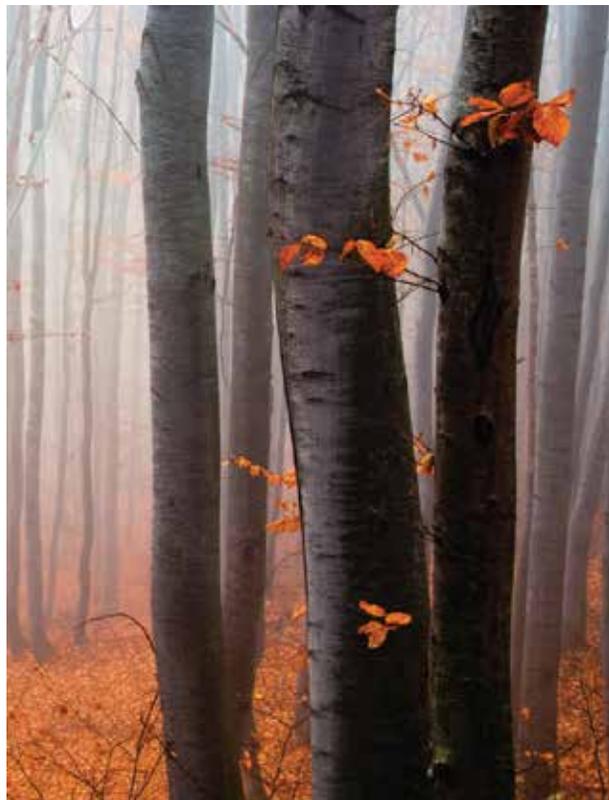
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These macroeconomic questions will continue to arise whether your firm invests in stocks, bonds, private equity or hedge funds, whether you represent a global multi-strategy hedge fund or a concentrated, US-only investment manager.

If a portfolio manager focused on researching specific investments from the bottom up cannot (or is unwilling to) address top-down market influences, then that manager is unlikely to build and retain investor confidence. **So how can bottom-up investment firms do a better job of telling their story? Here are a few specific suggestions:**

- 1. Understand that “bottom-up research” by itself is commonplace.** Most investment managers (and this tends to be the case across asset classes) follow a bottom-up discipline. And yet many of these same managers put forward “bottom-up research” as a decisive competitive advantage — as if all their competitors were wild and crazy macro guys swinging for the fences with every perceived shift in interest rates or commodity prices.
- 2. Provide performance attribution.** Some investment firms that claim their performance is driven primarily by bottom-up decisions still cannot show this through attribution analysis. They disavow the impact of macroeconomic forces and yet cannot prove that their portfolio is not driven by those same forces.
- 3. Acknowledge that macroeconomic forces matter and that you are aware of them.** In the example noted earlier, I am not asking the portfolio manager to make a “macroeconomic call”; I simply want to see if she is aware of the macroeconomic influences that could affect performance. Even if macro factors do not play a major role in your decision process, it is intellectually suspect to maintain that such factors are irrelevant.
- 4. Stay focused on the portfolio.** Thoughtful, clearly articulated macro views still sometimes fail to address what matters most to investors: the portfolio. It is frustrating to navigate through dense commentary about a firm’s economic, market and sector outlook without any, or with very little, explanation of how all this relates to portfolio composition. It’s like tuning into The Weather Channel and getting the weather of the world when all you want to know is if you need an umbrella today in Boston.
- 5. Show how bottom-up decisions sometimes point to top-down themes and vice versa.** If you have a lot of companies representing a certain sector or industry in your portfolio, you should be able to talk about top-down themes that might be leading to this concentration. You can explain how industry headwinds and tailwinds signal where to dig deeper, what to avoid or bottom-up opportunities created by excessive top-down pessimism.



Elevating dogma above common sense, some portfolio managers refuse to acknowledge the impact of the forest (economic and market forces) on individual trees (specific investments).

In the end, I advised my client to reinforce the bottom-up nature of her firm's strategy (the investment potential of individual trees) while paying her respects to top-down influences (the health of the forest). By doing this, she can answer macro questions respectfully and get right back on track telling stories about specific investments. She also may gain a decisive advantage when competing against the many others who still bang relentlessly on the bottom-up-only drum.

The Cost of Jargon

A friend recently shared the following consultant feedback from an important new business meeting. "The trustees," he said, "felt that our company used too much jargon. One trustee had to ask us to explain 'top-down' and 'bottom-up' early in the meeting." **That's right: some people flat out do not understand what we in the investment world mean by "top-down" and "bottom-up."** Even with a sophisticated audience, you should completely avoid such terms or briefly explain what you mean the first time you use them.

Down the Hatch, You Say?

Compounding the confusion created by jargon, there are experienced investment professionals who claim "*bottoms-up fundamental research*" as their #1 competitive advantage. As in "Drink up!" or "Down the hatch!" or other hearty encouragements one might hear in a pub as one polishes off a pint of Guinness.



"Bottoms-up" is what should happen in a pub; it's not an investment strategy.