The Investment Manager Interview:

Setting Expectations & Understanding the Performance Cycle

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WAYCROSS

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The Goal

Find Managers Whose Long-Term Investment Style Match the Risk/Return Profile of the Fund

- Interview Dynamics
  - Move away from short-term performance toward evaluating investment processes and philosophy
- Setting Expectations
  - Establish clear, written rules for tracking performance, managing risk, & communications
- Performance Cycle
  - Recognize that even great managers experience short-term market underperformance

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Establish a Project Timeline

- Review manager short list
- Select how many managers you want to interview
- Choose interview dates and times
- Vote on manager selection and determine funding details
- Notify any manager being terminated

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Responsibilities

- Consultant
- Plan Administrator
- Board Members
- Lawyer

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Identify What You Are Looking For

- Review current managers and identify complementary investment styles
- Evaluate long-term performance
- Determine risk tolerance for the asset class

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Measuring Investment Performance

- What performance timelines matter?
- Performance consistency through rolling returns
- Risk tolerance for the asset class
- Current investment Cycle Status

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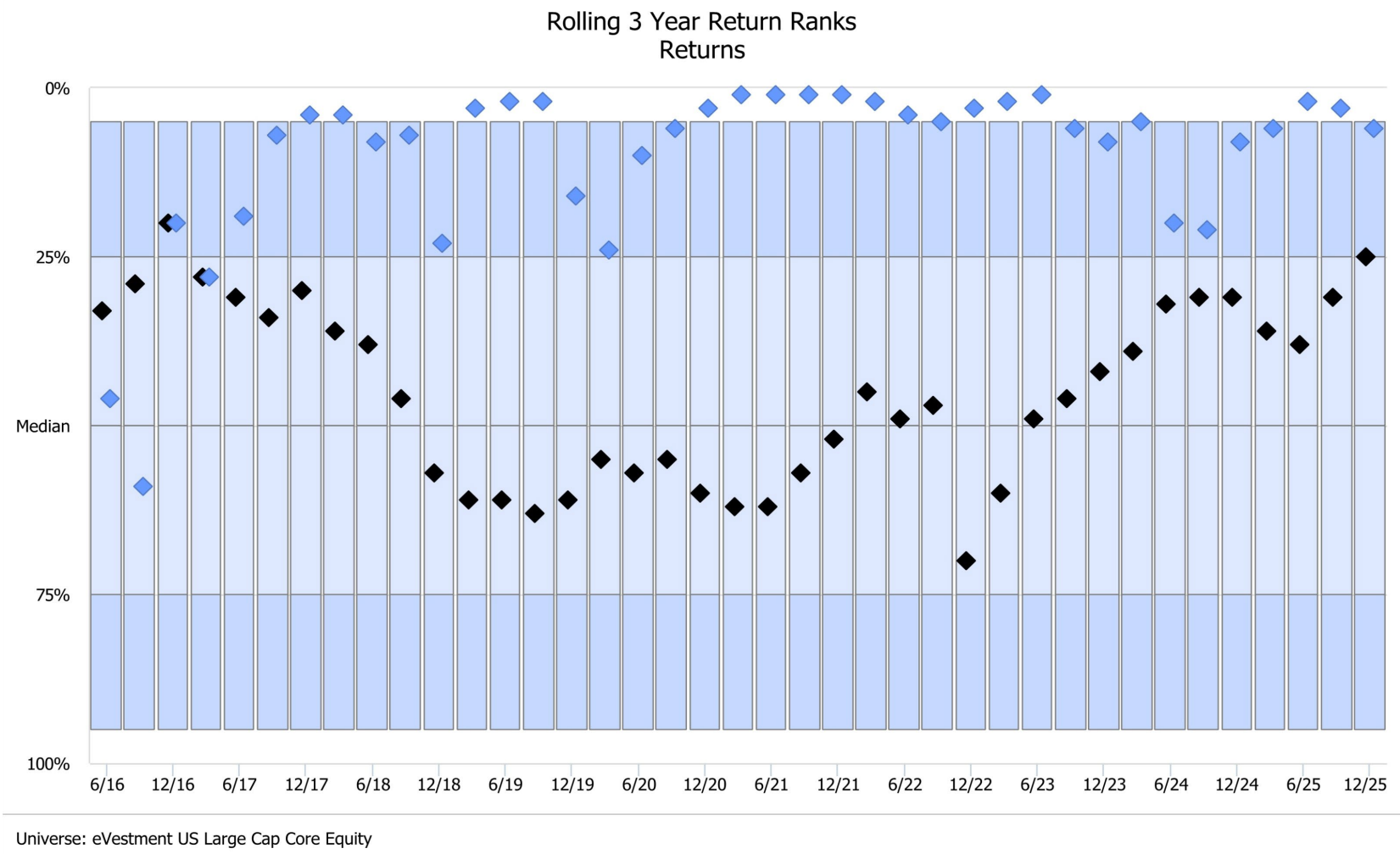
Rolling Returns



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Source: eVestment. US Large Cap Core Equity Universe

Performance Cycle

- Phase 1: Outperformance
  - Managers style fits the market
  - Strong performance can lead to overconfidence
  - Risk of over-allocating based on recent success
- Phase 2: Regression of the Mean
  - Market conditions shift and performance shows
  - Determine whether weakness is cyclical or strategy-related

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Performance Cycle

- Phase 3: Underperformance
  - Manager trails the benchmark
  - Pressure to terminate increases
  - Avoid selling at the bottom of the cycle
- Phase 4: Strategy Recovery
  - Investment style returns to favor
  - Performance recovers
  - Patience and discipline are rewarded

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Fees

- What is the industry average for this mandate?
- Consider the services delivered for the fees charged
- Do 5 bps really make a difference?

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Governance

- Evaluate the Process, Not Just the Returns
  - Focus on whether the manager follows their stated process
  - Avoid overreacting to short-term performance
- Document Everything
  - Define rules, benchmarks, and risk limits to the IPS
  - Establish expectations before hiring

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Governance

- Avoid the “Buy High, Sell Low” Trap
  - Don’t hire solely after a strong performance
  - Avoid firing during a style-driven downturn
- Establish a Formal Watchlist
  - Create clear rules for monitoring managers
  - Keep emotion out of governance decisions

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Interview Tips

- Prepare a set of questions for each manager, incorporating multiple trustees
- Allow plenty of time for each manager
- Make a decision on the day of the interviews
- Document the rationale for hiring the selected manager

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