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An exercise in character analysis

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Does it make a difference as a fund manager how well qualified you are? This intriguing question is raised by an new piece of academic research that looked anew at the question of whether a manager holding a CFA (Chartered Financial Analyst) or MBA is likely to produce superior returns in a fund. I am grateful to the publication Index Investor for alerting me to the findings of a recent research paper* on this topic by Oguzhan Dincer, Russell Gregory-Allen and Hany Shawky.

Reviewing the available literature, the authors report that previous studies have found no clear or consistent relationship between the qualifications of a fund manager and the returns of a fund. What they do find however is that there is a significant relationship between qualifications and the risk profile of a fund. This is that funds where an MBA is one of the portfolio managers tend to display above average risk, while those managed by a CFA tend to be of below average risk.

Notwithstanding my general view that statistical analyses of this kind have limited utility, this is an intuitively appealing result. The reality is there are a myriad of problems in trying to find meaningful correlations in fund performance data. Once you have taken account of survivorship bias, the limitations of the particular data set or time series that has been chosen and the existence of other potentially significant factors besides those included in the regression analysis, you rarely stray far from the simple conclusion: “garbage in, garbage out”.

But there is something about this result that strikes a chord, if only because it resonates with the caricatures most of us carry in our minds. An MBA, we tend to think, will be someone who essentially wants to believe in any product or service that he or she is involved with, has an overriding ambition to get on and is not afraid of selling (including most obviously themselves). A CFA, by contrast, is someone who probably makes up in analytical technique what he or she may lack in social and networking skills, and probably shouldn’t be let out of the office for fear of frightening the clients.

The former typically aspire to become investment bankers or management consultants, while the latter are more likely to find fulfilment as financial analysts, corporate treasurers or actuaries. The former will be “glass half full” optimists, and the latter are “glass half empty” sceptics who are never happier than when finding the hole in a balance sheet. (I have rarely met an MBA, incidentally, who will admit to really grasping the principles of financial accounting).

What would be more natural therefore that the MBA fund manager should be the one who takes the greater risk in running a fund; and what more appropriate than that the CFA should be the one who adopts the lower risk profile? But given that across great swathes of the fund business the ability to gather assets is just as important as the ability to make exceptional returns, who is to say which is the most desirable set of skills?

From a business perspective, a good presenter will always have the edge in the short term over a much deeper thinker who can detect genuine value, but lacks the necessary communication skills. There is no law of economics that says a good bullshitter cannot make as much money in the short term out of fund management as the cerebral thinker. Over time, profound investment talent deserves to come to the fore, but the history of the past 40 years suggests that it is far from being the only route to success.

The biggest problem with this issue, however, is simply the evidence that neither qualification is sufficient or necessary to succeed as an investor. Many great investors have managed to beat the markets without either an MBA or a CFA, or even in some cases any qualifications at all. I can detect little evidence that firms that have the pick of the graduates from the best universities are consistently capable of training the best fund managers. Indeed, to the extent that formally trained investors are constrained by false models such as the capital asset pricing model, it can be a positive disadvantage to have secured the investment profession's most demanding qualifications. If your mind has been trained to think only in terms of alpha and beta, you are almost certainly dead on arrival as a fund manager.

My own experience has been that value-adding fund managers are the exception rather than the rule. It is more important to entrust your money to someone whose age, experience and tolerance for risk matches your own than it is to look closely at any qualifications. Integrity and commitment – about which both the MBA and CFA are silent – matter more than either set of letters after your name, reassuring though the latter, in particular, may be.

**Are you smarter than a CFAer?*

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