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The Best Fund Managers – As Voted by their Peers

By Bob Veres
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Everybody is flocking to index funds and ETFs, but in my *Inside Information* newsletter recently, I wrote about something that isn't getting a lot of attention. I have nothing against passive investments, but when I attended several recent conferences and asked polite (and sympathetic) questions of active fund managers I've known for years, I got back a surprising answer.

They told me that they've never had more fun in their entire careers.

What? Isn't, you know, all the money flowing into funds that are, you know, not like yours?

Yes (I was told excitedly), absolutely.

And... That's a *good* thing???

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I talked with people at T. Rowe Price, who said that entire industries are being disrupted. Think: auto industry when Uber will soon have autonomous self-driving vehicles. Who would want to own their own car? Who would want to own the stock of auto companies when sales are likely to be a fraction of what they are today? Or oil companies when solar is suddenly encroaching on their energy market share. Or airlines when auto-piloted drones are being developed as you read this.

Their point is that nobody at an ETF is making basic judgments about which firms or industries are getting disrupted right off the economic landscape—and that's going to have a huge impact on returns these next 10 years.

I talked with people at Caldwell & Orkin, a boutique long-short equity manager, who said that the money flowing into index funds is giving the entire market an artificial uplift, and there are some very unhealthy companies whose stock prices are being propped up merely because the (index-driven) investment dollars are being allocated indiscriminately. Once again, making those judgments is going to be crucial when fund flows turn around.

Bond managers at Osterweis said that fixed-income ETF inflows and outflows are dictating buying and selling decisions for billions of dollars, which means that a patient active manager could wait for forced sales and get as much as a 1% higher annual coupon than was possible yesterday or last week.

Chris Davis at Selected Funds said that the passive and closet indexers can no longer afford any tracking error, which means no matter how compelling an opportunity, they have to walk past it if it's likely to take two or three years to play out. More for him!

David Marcus at Evermore Global said that many of the restructuring plays that he looks at in Europe are not easily categorized in an index until the restructuring is complete. So the index funds and passive managers typically invest after the restructuring is complete and most of the money has been made. Better for him!

You can find my full article at bobveres.com/portfolio-management/3054. Fund managers who have a passion for what they do are really enjoying this environment, and they may well outperform over the next five or 10 years.

How to pick the winning funds

But that begs a really important question: How do you select those funds that will benefit from this period when there are so many unprecedented opportunities for active managers?

I've asked that question more than a few times, and there are answers, but they are far more subjective than objective. The answer, as one fund executive put it to me, is that you want to invest with managers who are passionate about what they do. Another said that you should limit your search to managers who are far more concerned about delivering great returns to investors than they are about marketing their funds.

Great! But... How do you know this? A lot of people say they're passionate about what they do, but that's also a great marketing line. You hardly ever hear fund managers say, "You know, I don't really care about my investors, and I'm kind of greedy, and the company wants me to track an index because it's more profitable that way..."

Some years back, I discovered, totally by accident, one really interesting way to ferret out the truly passionate, smart managers from the pretenders: Just ask them.

No, I didn't do this directly, but my annual *Insider's Forum* conference was putting together a couple of investment panels, and we talked to some of the managers about who I was planning to invite. I was surprised to hear that a manager I greatly respect was not interested in serving on a panel with a well-known manager from a large, prominent fund family. But when I mentioned Michael Aronstein of Marketfield (at a time when Marketfield's returns were soaring), he was quite enthusiastic. "I've always wanted to meet him!" he said. I asked him who else he would be similarly enthusiastic about, and the immediate response: FPA Crescent's Steve Romick. He also encouraged me to include John Osterweis of the Osterweis funds.

The other panelists were happy to be seen with each other in public, and they were not shy about vetoing other managers that I proposed, who they did *not* want to appear next to on a panel. (For our annual conference, I now only allow fund companies to exhibit of they are mutually recommended by these top managers, which greatly cuts down on the clutter in the exhibit hall.)

The managers at the top of their game know each other, and they're better at recognizing people worthy of respect than all the Morningstar screens you could possibly run.

Since then, as you can imagine, I've asked certain questions *(Which managers do you respect? Which managers have a passion for investing?)* when I speak with advisors and fund managers, and gotten some interesting answers. I've compiled them into a list for your entertainment, and possibly as a better way to screen for above-average fund performance going forward.

We are routinely told that active managers in the aggregate deliver returns that are inferior to passive funds and ETFs, but I've never seen anybody use search criteria that included passion and the respect of the other best managers. The closest I've been able to find is an American Funds study which tried to get at the same factor from an objective viewpoint: low expense ratios (which some managers will fight for, because they care more about the performance than an extra zero on their income); turnover (a measure of manager patience), manager tenure, a good incentive structure (managers are not compensated based on short-term performance) and maybe the best indicator of all: manager investment in their own funds.

The American Funds white paper found that managers who met those objective measures beat their peers and beat the indices over time.

I would bet that if you had a list of fund managers who are respected for their passion and judgment by the best fund managers, the added subjective criterion would improve the scores over what the objective screens provided.

Anyway, here's the list, and I want to emphasize that this is in no particular order, so please don't infer anything from the fact that one person is at the top of the list and another is at the bottom. The important thing is that somebody is on the list in the first place. I've limited this to mutual funds that are generally open to investors.

Steve Romick, Brian Selmo • *FPA Crescent*
John Osterweis • *Osterweis Funds*
Chris Davis • *Selected Funds*
David Marcus • *Evermore Global*
T. Rowe Price • *team*
American Funds • *team*
PIMCO • *team*
Tweedy Browne • *team*
David Herro • *Oakmark International Fund*
Charles DeVaulx • *IVA Worldwide Fund*
Michael Orkin • *Caldwell & Orkin*
David Samra • *Artisan Partners*
Jeffrey Gundlach • *Doubleline Funds*
Joel Greenblatt • *Gotham Funds*
Chuck Royce • *Royce Funds*

That's the (very) short list as I have it now, and it is surely not a complete list. I do, however, believe that if researchers were to conduct active versus passive research based on this new criterion—who has the respect of their peers in the small world of fund managers—they might finally see a cohort of active managers beating passive indices.

Now I'm curious what you think. Are there fund managers who should be added to this list? Are there some that you think should be taken off? If we can harvest the wisdom of the crowd, maybe we can come up with a somewhat definitive list of index-beaters. We might even beat our own Morningstar screens.

Heck, we might even beat the market.

Bob Veres' ***Inside Information*** *service is the best practice management, marketing, client service resource for financial services professionals. Check out his blog at:* ***www.bobveres.com****. Or check out his Insider's Forum Conference (for 2017 in Nashville) at* ***www.insidersforum.com.***

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