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The Art and Science of Solving the Investment Management Problem

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Investment management is both an art and a science. The science is the quantitative and fundamental analysis that investment firms utilise to build models as part of their proprietary tools. These models are usually based on similar principles depending on the asset class (for instance, anchored in quantitative analysis for fixed income and fundamental analysis for equity). This part of the investment process is easily scalable and repeatable, given that models can be improved upon and archived for the next generation of portfolio managers and analysts. To ensure that businesses can continue to repeat their overall investment process, there is a need to be systematic in the skills transfer of the “art” element of investment management to ensure a repeatable, sustainable, and consistent client experience. In this article, I consider “the art” as the deep understanding of all the available information and how that interacts to drive asset prices.

The Actuarial Control Cycle (ACC) is a helpful tool popularly used in problem-solving in Actuarial Science. The ACC is a “conceptual framework that is useful in describing the processes needed for the development and ongoing management of a financial enterprise, product or scheme. It is based on a simple problem-solving algorithm, that is, define the problem, design the solution and monitor the results”. The purpose of this article, therefore, is to highlight knowledge-sharing as “the art” side of investment management that is defined as a problem to be solved. Additionally, the article emphasises the use of a systematic framework as a guide to ensure that the client experience - in terms of investment performance, reporting quality and knowledge sharing - is repeatable, sustainable, and consistent.

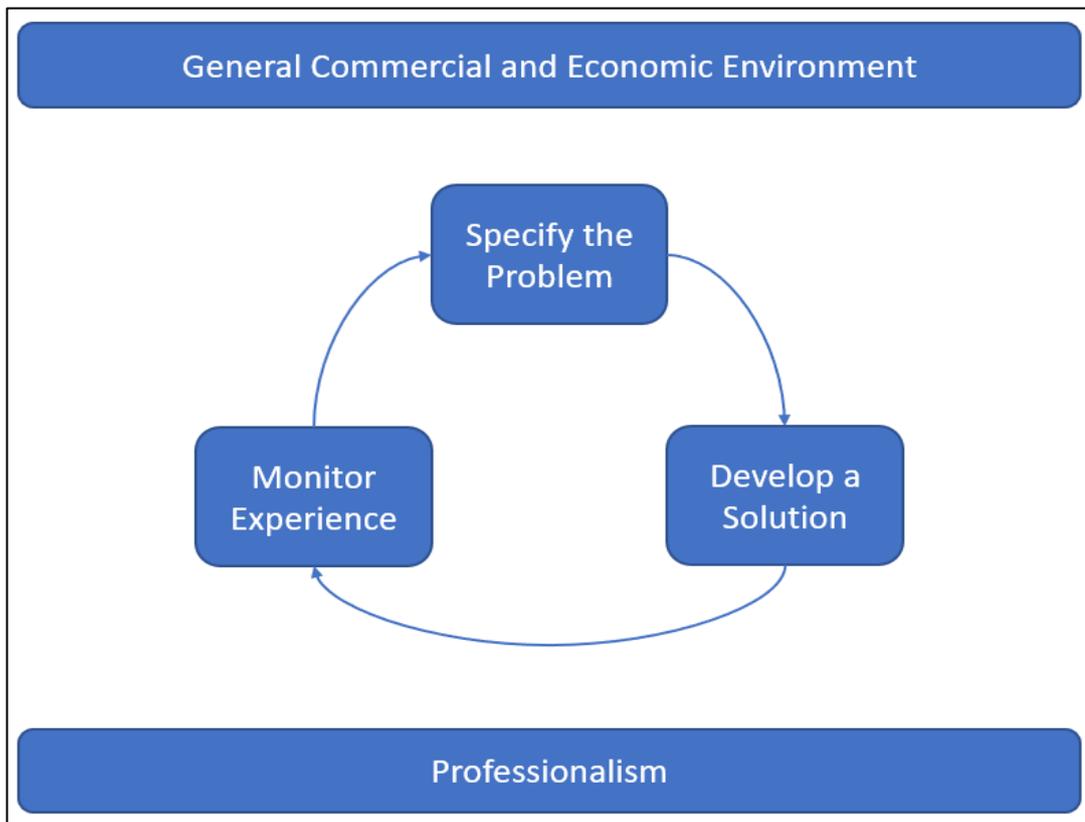


Figure 1: Actuarial Control Cycle (Source: Society of Actuaries)

¹ Society of Actuaries – Actuarial Toolkit ([Society of Actuaries Actuarial Toolkit \(soa.org\)](https://www.soa.org/actuarial-toolkit/))

General Commercial and Economic Environment

The first step in problem-solving is understanding the general commercial and economic environment. Investment management is anchored on the macro-economic environment where problem-solving includes assessing the political landscape, monetary and fiscal policy framework, and how these factors feed into inflation, growth, productivity and sentiment, and the regulations. The guiding principle in investment management is the Core Investment Philosophy. Our Core Investment Philosophy ensures that we cover the broadest sense of the operating environment, given that the philosophy is anchored on macroeconomics. The general commercial environment becomes applicable when assessing prospects for the asset management firm itself in terms of commercial viability.

Specify the Problem

As managers of multi-asset income funds, being active in the asset allocation process ensures that the portfolios do not rely on a single return driver irrespective of where we are in the macroeconomic cycle. This approach is essential because of the cyclical nature of the different income instruments that form part of the applicable asset classes for a specific mandate. For instance, Monetary Policy impacts the attractiveness of fixed versus floating-rate bank negotiable certificates of deposits depending on whether we are in a hiking or a cutting repo rate cycle. And even then, one needs to assess what is already priced in the market regarding the complete expected cycle.

In “specifying the problem”, the investment process should be structured so that the operation can be repeated by the next generation of portfolio managers and analysts and is consistent in removing the risks of style drift and is sustainable given the different stages of the macroeconomic environment. This is a problem that every asset management firm that aims to build a legacy beyond the founders and initial staff should aim to solve.

Develop a Solution

In developing the solution, the initial and important stage is to gather as much information as possible. The information-gathering process will also ensure that different iterations of the solutions are assessed. Some would label this as scenario analysis, a valuable method for stress testing the solution. The solution needs to address both the art and the science of investment management from a skills transfer perspective, with the art component becoming the critical focus. Being systematic in the skills transfer on “the art” side involves implementing a deliberate programme that all the senior members of the investment team buy into. This becomes a more straightforward exercise where it is embedded in the company culture, and all human capital that joins the organisation is aligned to that culture.

Regular investment team meetings must support the culture; a supervision programme that involves regular check-ins between the seniors and their juniors, the development of an internal “curriculum” on how to understand instruments from a quantitative and qualitative perspective and to provide the developing team with an opportunity to present to the broader investment team. This approach, therefore, builds the skill to generate a view and for that view to be tested and debated by the broader investment team.

These may seem like obvious steps. However, the success of this exercise depends on sticking to the process such that it becomes an integral part of how the investment team forms their views. The process needs to be embedded in the company mission (that defines why the organisation exists), the vision (that describes what the organisation aims to achieve) and the core values (that define how the organisation will achieve the vision).

Monitor the Experience

The final stage of the ACC is developing approaches to monitor the success or failure of the process. Monitoring the experience entails having a mechanism that can measure the success or failure of the process. The overall outcome of this process is the client experience and upskilling of the investment team. This means that we should expect a systematic and gradual improvement in the client experience and growth in terms of the skills of the junior members of the investment team. If the client experience is not improving, then the system has failed in repeatability, consistency and sustainability, in which case the cycle in the ACC repeats. To ensure the process continues to improve, the above steps need to be revisited.

Conclusion

The investment process needs to be systematic to ensure the continual improvement of the client experience and organic skills transfer in the investment team. Much focus is on the quantitative and fundamental tools that are easily repeatable. More attention needs to be spent on developing talent internally to build their confidence and capabilities when implementing the “art” of the investment process.

Glacier Research would like to thank Nomathibana Matshoba for her contribution to this week's *Funds on Friday*



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