

FE fundinfo Alpha Manager Ratings



**ALPHA MANAGER
RATING** 
Powered by FE fundinfo

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Methodology

FE fundinfo Alpha Manager Ratings rate the performance of a fund manager over their career, including all funds they have managed, and places worked. They are designed to distinguish fund managers who have consistently performed well over the longer term.

The robust methodology is comprised of two key components:

- Risk adjusted Alpha/Sortino (with track record length bias)
- Consistent outperformance of a benchmark overall

The data series for a manager

The calculation runs from the 01/01/2000 and considers IA unit trusts and OEICs, Investment Trusts, and offshore collectives for sale in the UK.

The data series for a benchmark

When calculating the benchmark, the same process is applied as when calculating the data series for the manager. The difference is that sector average data is used in place of the fund data. We call this benchmark the peer group composite.

Alpha (risk adjusted)

In a simple model, returns are generated by 2 sources - market movements (Beta), and stockpicking. Beta is the measurement of how the market performance affects the fund performance. For example, if the market changes by +/-10%, how much does the fund change by? A Beta of 1 would imply it would jump by +/-10%, and a Beta of 2 would imply it would jump by +/-20%.

Alpha is a measurement of the fund manager's ability to stock pick. It is the extra returns they generate over and above the market returns, once the market effects on performance have been removed.

High Beta is great in up markets, and terrible in down markets. Alpha is best in both.



If a manager consistently picks the top 20% stocks (of a sector), they will be rewarded with above average performance. The amount of additional returns they receive by doing this depends upon the volatility (or standard deviation) of the returns of underlying stocks – e.g. if the variation in return is vast for the stocks of a given sector, the top 20% of stocks would deliver much higher returns than most. In contrast, if a sector has a much smaller spread of returns, the top 20% stocks will deliver a proportionately small extra performance bonus.

So, to create a level playing field across different assets, Alpha is risk-adjusted by scaling it by volatility, so that we get an indication of where in the stockpicking range the manager fits.

Sortino

We recognised in our calculations that Alpha is only as good a measurement as the correlation of the fund to its benchmark. With a low correlated benchmark, a pure Alpha calculation will exaggerate the true Alpha value, as it explains all uncorrelated parts as Alpha-generated returns (positive or negative). In reality, the manager has invested in other markets, and those markets also generate risk and return ('non-zero'). This is particularly noticeable in managed and absolute return style funds.

As such, we have now released a new extension to the rating process, in addition to usage of Alpha, which recognises this. Our Alpha is now essentially weighted by benchmark correlation, with the remainder (of the weight) coming from Sortino¹. The result is essentially a sliding scale between risk-adjusted Alpha and Sortino, where correlation determines the point on the scale.

For a manager with perfect correlation the result is purely the alpha calculation (risk adjusted), and for a manager with zero correlation, the result is purely the Sortino ratio.

¹ Sortino ratio is a risk return measurement very similar to the Sharpe ratio, though it measures its risk purely from downward returns.



Risk-adjusted Alpha, with track record bias:

Using the manager history, and the attendant benchmark, Alpha is calculated for each manager over the full period available since 01/01/2000. Any flat periods are ignored. The Alpha values are then scaled by volatility, (as mentioned in the section on alpha above). These scores are then arranged into a percentile array.

At this point we introduce the 'career bonus' factor. Anyone whose available track record (after taking out blank periods) meets the following criteria, has their percentile score enhanced by the following %:

- 5-8 years 5%
- 8-12 years 10%
- 12 years + 12%

If, as a result of enhancing the adjusted Alpha percentile scores with career bonus factors, the top score exceeds 100, the whole series of manager scores will be rescaled back within the range 0-100.

Outperformance of benchmark

Assuming the available track record is >48 months, each manager track record will be split into 10 discrete and equal periods of whole months.

In each period, it will be determined if the manager has outperformed their benchmark. The number of outperforming periods will be divided by the total number of periods and expressed as a %.

Composite rating

Each of the above scores are then weighted and combined.

The weightings are as follows:

- Adjusted Alpha 77%
- Outperformance of market 23%

If a manager is listed as co-manager on any funds, this will only receive half the weighting compared to any fund that they are listed as lead or primary manager on.



Exclusions

Not every manager series is considered for rating. The following are excluded:

- Any manager who is not currently managing an IA unit trust/OEIC.
- Any manager with an active track record of less than 48 months.
- Any managers of cash funds, protected/guaranteed funds, or funds within the IA pensions sector.
- Any management team (i.e. non-personal).
- A fund is excluded from a manager rating if it is managed by four or more people.
- Any manager whose track record exhibits excessively high or low Beta (<0.4 or >1.5).
- Any person who only manages one fund and is deputy or co-manager (as distinct from lead manager). If they are deputy or co-manager of more than one fund, then the following rules apply:
 - If 2 funds, then at least one must have a size of $>£100m$
 - If 3 funds or more, then at least one must have a size of $>£50m$
 - If managing a single fund as lead, the manager must have a fund size of $>£40m$
 - Must be managing more than 1 fund and be the primary manager of at least 1 of those.
- Where an individual holds the role of deputy manager on a fund this will not be considered for the rating.
- Any target maturity, physical property, passive or tracker funds will be excluded.

FE fundinfo Alpha Manager designation

Over 1600 managers have been analysed for this rating. The top 10% of scoring managers that still meet the calculation criteria are deemed FE fundinfo Alpha Managers. In the event of a draw at the dividing line, the manager with the longer track record will prevail.

Review of ratings

The ratings are reviewed in January of each year, using numbers up to the preceding year end.

