Advisor Resources

Looking under the hood: Evaluating quantitative managers for your client portfolios

Quants, artificial intelligence, algorithms, big data. No matter how you phrase it, technology in the financial industry is here to stay. This is especially true in the equity asset management space, where "quantitative" solutions are attracting interest from investors.

In a consumer driven industry, the focus on the value equation — what am I getting for the fees I am paying — has even mom and pop investors taking an interest in the quant world. Do you truly understand how they work and the methodologies driving these strategies? How can you ensure that you are recommending a quant manager who meets your clients' goals?

A quantitative approach to investing can provide a well-defined framework to help asset managers navigate through emotion and behavioral bias. By utilizing a data-driven approach, they have the ability to make effective and consistent investment decisions.

Not all quantitative strategies are created equal. When evaluating quant managers for your clients' portfolios, consider these six factors:

1. The alpha model selection — how much is back testing versus investment thesis?
One of the critical ways to evaluate a quant manager is to understand how much of their process is based on economic reality versus an attempt to optimize a back test. Look for quantitative managers who have a transparent, explainable process grounded in economic intuition. When talking to them, the focus should be on the future and how they outperform the market going forward rather than simply looking at results of a back test.

2. How is the consistency of the model?
Check to see if the manager is dynamically reweighting or adding factors to their stock selection model. If you are evaluating based on historical performance, it is somewhat meaningless if that model is significantly changing throughout time. Ask the manager about their process for adding a new factor or making changes to their model. Look for a manager in which the addition or removal of factors is bonded in an intensive research process.

3. How and when will the manager override or touch the model?
How does the manager deal with risk to the model? Do they blindly follow the model without second guessing any of the individual names? Are they willing to override a decision because they understand limitations to quantitative models?

Quant investing is on the rise. Identifying the right managers and processes is key when evaluating for your clients' portfolios.

Let's connect

1-844-BMO-Fund (266-3863)

bmogamviewpoints.com

bmo-global-asset-management

bmogam.com/betterconversations

Continued

4. What data sources are being used?
While big data and alternative data are enticing sources in today's market environment, there are a number of limitations to this data. Many have short histories and are subject to data mining. Look for quant managers who have long data histories, broad coverage of a large universe of stocks and are capturing characteristics of companies.

5. How are risk controls being used and integrated?
It's important to make sure the manager has good risk management practices. Ask them how they think about risk. How many different layers of risk management are they building in? Look for managers who think about risk in terms of their ability to measure it versus the risk that can't be measured. You want to make sure they aren't viewing risk management as just a check box activity that needs to done.

6. What tools and systems are being used—bought or built?
Some quant managers will buy or rent the systems and tools they use while others will build proprietary systems. Or, you may see a mix of proprietary and purchased systems. Make sure you understand the type of system the manager uses and why they selected the system. If it is proprietary, ask who developed it and how it's maintained. Whether the manager buys or builds their system, the key assessment is how they integrate the data into their process.

Quant investing is on the rise. Your ability to identify the right managers and understand their process will help you align your clients' investments with their goals.

Continue the conversation

This six-step evaluation is discussed in more detail in the ***Better conversations. Better outcomes***. podcast episode "Rise of the quants." Learn more about the world of quantitative investing and hear from our portfolio managers at **bmogam.com/betterconversations**.

Visit the Advisor Resources section on our website to access more of our viewpoints. Sign up for the Better Conversations Newsletter for additional ideas to power your practice and exclusive, behind-the-scenes content at **bmogamviewpoints.com**.

BMO Global Asset Management