

"A well-defined investment process is crucial for managing the behavioural aspects of investing"

The art and science of investment: Why process matters



Gary Moglione
Portfolio Manager

29 July 2024

In the world of fund selection, picking funds is a blend of science and art. Every investor prioritises their research differently, but the most common framework involves the 4 P's: philosophy, process, people, and performance. Unlike the marketing mix of product, price, place, and promotion, this framework helps in assessing funds comprehensively. People and performance often weigh heavily in an investor's decision-making process.

A high-profile manager with a strong track record is an easy sell for any asset management company. Philosophy reveals the manager's fundamental beliefs guiding their decisions and helps investors distinguish between different investment styles. However, the investment process, which is sometimes overlooked, is crucial. We have invested a lot of time in developing our own process and analysing those of investment managers worldwide.

An established investment process is vital for mitigating emotional biases that often affect investment decisions. Behavioural finance has shown that emotions like fear and greed can lead to irrational decisions. A structured process helps investors remain disciplined and avoid impulsive choices based on short-term market movements. By sticking to a well-defined process, fund managers can ensure their decisions are based on analysis and strategy rather than emotional reactions.

Consider the 2008 financial crisis. Many investors, driven by fear, sold their investments at significant losses. In contrast, those who adhered to a disciplined investment process, such as Warren Buffett, who famously advised to "be fearful when others are greedy and greedy when others are fearful," made rational decisions that ultimately led to long-term gains. Buffett's commitment to his investment principles allowed him to spot undervalued opportunities during the downturn, demonstrating the importance of a solid investment process in countering emotional biases.

A robust investment process also promotes consistency and objectivity. Behavioural biases such as overconfidence, herd behaviour, and loss aversion can cloud judgement and lead to erratic decision-making. A systematic approach enables fund managers to apply the same criteria and methodologies to each decision, thereby reducing the influence of personal biases. This objectivity is essential for achieving long-term investment goals and maintaining investor trust.

Clear and transparent investment processes enhance accountability. When fund managers follow a documented process, it is easier to review and evaluate their decisions. This accountability ensures that each investment choice is based on sound reasoning and predefined criteria. Transparency builds investor confidence, as they can see that their money is being managed systematically, rather than being subject to whimsical or emotionally driven decisions.

Market volatility often triggers strong emotional responses, leading to decisions that may not align with long-term strategies. A disciplined process helps fund managers navigate volatility by sticking to their investment principles and strategies. This steadiness is crucial during downturns, as it prevents panic selling and encourages a focus on long-term value rather than short-term losses. Managing volatility with a structured approach enables fund managers to better protect investor capital and achieve more stable returns.

The impact of the COVID-19 pandemic on markets in 2020 underscored the importance of managing volatility through a disciplined process. Fund managers who maintained their investment processes avoided panic selling and instead focused on rebalancing portfolios and identifying opportunities in undervalued sectors. This approach helped protect investors from permanent loss of capital and positioned funds for recovery as markets stabilised.

The quality of investment decisions improves significantly with a well-defined process. Behavioural investing highlights how cognitive biases like anchoring, confirmation bias, and hindsight bias can distort perception and analysis. A systematic process involves rigorous research, data analysis, and adherence to investment criteria, leading to more informed and rational decisions. This disciplined approach ensures that each investment is thoroughly evaluated, reducing the likelihood of errors caused by cognitive biases.

In conclusion, a well-defined investment process is crucial for managing the behavioural aspects of investing. It should allow the portfolio manager sufficient freedom to implement their judgement, but it must also be robust enough to mitigate emotional biases, ensure consistency and objectivity, enhance accountability and transparency, manage market volatility, and improve decision-making quality. By focusing on a structured process, fund managers can achieve better investment outcomes and maintain long-term investor confidence.

Market Review - week ending 26 July 2024

- » Global equities fell 0.8%
- » The major US equity index experienced its first single day decline of over 2% since February 2023, marking the end of one of the 10 longest runs without one in the index's history
- » Brent crude fell 1.8% to \$81.13 per barrel
- » Gold fell 0.6% to \$2,387.19 per ounce

US

- » US equities fell 0.8%
- » It is now most likely that Vice President Kamala Harris will secure the 1,976 delegates needed to win the nomination at the Democratic convention, which begins on August 19
- » The US Q2 GDP report showed growth running at an annualised 2.8% (vs 2.0% expected), up from 1.4% in Q1
- » The US core PCE (Personal Consumption Expenditure) index for June rose 0.2% month-on-month in line with expectations
- » The Richmond Fed's manufacturing index was down to -17 in July (vs -7 expected), its lowest level since May 2020 during COVID-19 lockdowns

UK

- » UK equities rose 1.7%
- » UK composite PMI numbers surprised to the upside at 52.7 (vs. 52.6 expected)

Europe

- » European equities rose 0.3%
- » President Macron noted that he would not appoint a Prime Minister until after the end of the Paris Olympics (on the August 11), as the left-wing New Popular Front alliance agreed to put forward Lucie Castets, an official for the city of Paris and relatively unknown, as their candidate for prime minister
- » The Euro Area composite PMI (Purchasing Managers Index) fell to 50.1 (vs 50.9 expected), with the German figures particularly disappointing at 48.7 (vs 50.6 expected)
- » The IFO's Business Climate indicator from Germany fell to 87.0 (vs 89.0 expected), its third consecutive monthly decline
- » In France, The INSEE Business Confidence index fell to 94 (vs 99 expected), its lowest level since February 2021

Rest of the World/Asia

- » Global emerging market equities fell 1.6%
- » Japanese equities fell 5.6%
- » Japan's Tokyo CPI (Consumer Price Index) core measure increased from 2.1% year-on-year to 2.2% in July, in-line with market expectations and marking the third consecutive month of re-acceleration
- » Chinese equities fell 2.3%
- » The Chinese central bank unexpectedly cut their seven-day reverse repo rate for the first time in almost a year, lowering it by 10bps to 1.7%
- » The Bank of Canada delivered a 25bp interest rate cut to 4.5%, the second consecutive meeting where they've cut rates

Market Performance - week ending 26 July 2024

Cumulative returns					
Asset Class / Region	Currency	Week ending 26 July	Month to date	YTD 2024	12 months
Developed Markets Equities					
United States	USD	-0.8%	0.0%	15.1%	20.8%
United Kingdom	GBP	1.7%	1.6%	9.5%	12.6%
Continental Europe	EUR	0.3%	-0.4%	8.3%	12.7%
Japan	JPY	-5.6%	-3.9%	15.4%	21.0%
Asia Pacific (ex Japan)	USD	-1.8%	-1.1%	7.3%	7.4%
Australia	AUD	-0.6%	2.0%	6.3%	11.3%
Global	USD	-0.8%	0.4%	12.2%	17.5%
Emerging Markets Equities					
Emerging Europe	USD	-2.0%	0.8%	16.3%	24.5%
Emerging Asia	USD	-1.7%	-1.5%	9.4%	8.7%
Emerging Latin America	USD	-2.7%	0.9%	-14.9%	-9.7%
BRICs	USD	-0.6%	-0.2%	6.1%	3.5%
China	USD	-2.3%	-2.9%	1.7%	-9.7%
MENA countries	USD	-0.3%	2.8%	-0.7%	-1.7%
South Africa	USD	1.4%	1.7%	6.4%	3.3%
*India	USD	0.0%	2.2%	13.6%	23.5%
Global emerging markets	USD	-1.6%	-0.9%	6.5%	6.6%
Bonds					
US Treasuries	USD	0.3%	1.4%	0.5%	2.7%
US Treasuries (inflation protected)	USD	0.0%	1.0%	1.7%	3.1%
US Corporate (investment grade)	USD	0.2%	1.5%	1.6%	6.0%
US High Yield	USD	0.3%	1.7%	4.4%	11.1%
UK Gilts	GBP	0.1%	0.8%	-1.9%	4.5%
UK Corporate (investment grade)	GBP	0.1%	1.3%	1.2%	10.0%
Euro Government Bonds	EUR	0.2%	1.5%	-0.5%	4.2%
Euro Corporate (investment grade)	EUR	0.4%	1.3%	1.8%	7.1%
Euro High Yield	EUR	0.1%	1.0%	4.1%	11.0%
Global Government Bonds	USD	0.4%	2.1%	-2.2%	-0.2%
Global Bonds	USD	0.2%	2.0%	-0.9%	2.2%
Global Convertible Bonds	USD	-0.4%	1.5%	0.3%	1.5%
Emerging Market Bonds	USD	0.2%	1.3%	2.7%	8.0%

Cumulative returns					
Asset Class / Region	Currency	Week ending 26 July	Month to date	YTD 2024	12 months
Property					
US Property Securities	USD	0.1%	5.5%	4.7%	7.2%
Australian Property Securities	AUD	-2.8%	3.7%	12.2%	21.6%
Asia Property Securities	USD	-1.4%	3.5%	-8.4%	-9.0%
Global Property Securities	USD	-0.5%	4.9%	2.4%	6.4%
Currencies					
Euro	USD	-0.2%	1.4%	-1.8%	-1.9%
UK Pound Sterling	USD	-0.3%	1.8%	0.9%	-0.3%
Japanese Yen	USD	2.4%	4.6%	-8.4%	-8.6%
Australian Dollar	USD	-1.8%	-1.6%	-4.0%	-2.8%
South African Rand	USD	0.0%	-0.3%	-0.1%	-3.4%
Swiss Franc	USD	0.6%	1.7%	-5.0%	-2.3%
Chinese Yuan	USD	0.3%	0.2%	-2.1%	-1.4%
Commodities & Alternatives					
Commodities	USD	-1.7%	-4.7%	2.6%	-2.4%
Agricultural Commodities	USD	-0.9%	-2.3%	-2.1%	-9.3%
Oil	USD	-1.8%	-6.1%	5.3%	-2.2%
Gold	USD	-0.6%	2.6%	15.7%	21.2%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

*Data as at 15 July 2024 due to Bank Holidays in India

For more information, please contact:

Distribution Services

E: distributionservices@momentum.co.uk

T: +44 (0)207 618 1806

Important notes - This document is only intended for use by the original recipient, either a Momentum Global Investment Management Limited (MGIM) client or prospective client, and does not constitute investment advice or an offer or solicitation to buy or sell. This document is not intended for use or distribution by any person in any jurisdiction in which it is not authorised or permitted, or to anyone who would be an unlawful recipient. The original recipient is solely responsible for any actions in further distributing this document, and in doing so should be satisfied that there is no breach of local legislation or regulation. This document should not be reproduced or distributed except via original recipients acting as professional intermediaries. This document is not for distribution in the United States.

Prospective investors should take appropriate advice regarding applicable legal, taxation and exchange control regulations in countries of their citizenship, residence or domicile which may be relevant to the acquisition, holding, transfer, redemption or disposal of any investments herein solicited.

Any opinions expressed herein are those at the date this document is issued. Data, models and other statistics are sourced from our own records, unless otherwise stated. We believe that the information contained is from reliable sources, but we do not guarantee the relevance, accuracy or completeness thereof. Unless otherwise provided under UK law, MGIM does not accept liability for irrelevant, inaccurate or incomplete information contained, or for the correctness of opinions expressed.

The value of investments in discretionary accounts, and the income derived, may fluctuate and it is possible that an investor may incur losses, including a loss of the principal invested. Past performance is not generally indicative of future performance. Investors whose reference currency differs from that in which the underlying assets are invested may be subject to exchange rate movements that alter the value of their investments.

Under our multi-management arrangements, we selectively appoint underlying sub-investment managers and funds to actively manage underlying asset holdings in the pursuit of achieving mandated performance objectives. Annual investment management fees are payable both to the multimanager and the manager of the underlying assets at rates contained in the offering documents of the relevant portfolios (and may involve performance fees where expressly indicated therein).

MGIM (Company Registration No. 3733094) has its registered office at The Rex Building, 62 Queen Street, London EC4R 1EB. MGIM is authorised and regulated by the Financial Conduct Authority in the United Kingdom (registration no.232357), and is exempt from the requirements of section 7(1) of the Financial Advisory and Intermediary Services Act 37 of 2002 (FAIS) in South Africa, in terms of the FSCA FAIS Notice 141 of 2021 (published 15 December 2021). For complaints relating to MGIM's financial services, please contact distributionservices@momentum.co.uk ©MGIM 2024.