“Show your work.” All math students hear this command from their teachers — and for good reason. Without seeing the process that a student followed, a teacher has no way of knowing whether the final answer was a result of luck or skill. The same principle applies when you evaluate mutual fund managers.

Many investors choose mutual funds based on data screens — numbers that illustrate a fund’s historical performance and rankings. But without seeing the work behind those results — the manager’s adherence to a sound investment process — you don’t know whether the manager’s skill or simply favorable market conditions produced those results.

This distinction is important because — while no one can predict the future with perfect accuracy — an investment philosophy and process that is clearly expressed can serve as a window into the mind of a manager, helping you see how he may perform under various market conditions.

Many investors choose mutual funds based on data screens — but having a window into the fund manager’s process can be just as important.

For example, standard deviation is a number that illustrates the historical volatility of an investment, such as a mutual fund. Many investors use this to gauge the future level of risk. But standard deviation doesn't reflect the whole story. To estimate how risky a fund may be, investors need to understand the managers' philosophy and process. You should know, for example:

- The sectors the fund invests in.
- Traits managers look for in an investment.
- The number of companies the fund invests in.
- Events that would trigger sale of an investment.
- The quality of the management team.
Sorting it out
Data screens lump past performance into two boxes – good and bad. They don’t identify whether those results came from market conditions or manager skill. When evaluating managers, a qualitative window like the one below is a necessary complement to backward-looking screens.

<table>
<thead>
<tr>
<th>Skill, with favorable conditions</th>
<th>Skill, with unfavorable conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Good performance based on consistent and skillful application of a sound investment process</td>
<td>Consistent application of sound investment process not in favor with the market environment</td>
</tr>
<tr>
<td>No skill, with favorable conditions</td>
<td>No skill, with unfavorable conditions</td>
</tr>
<tr>
<td>The outcome of a market environment that favors the portfolio but likely not repeatable nor the product of skill</td>
<td>Poor results due to low skill, unsound process or inconsistent application</td>
</tr>
</tbody>
</table>

Sticking with skilled managers
No single investment process will outperform in all market environments. Therefore, the most challenging aspect of manager evaluation is to identify skilled managers whose processes aren’t in sync with current market conditions.

A backward-looking data screen would lump an underperforming manager into the “bad” category. But if you find a window into the mind of the manager – by examining his philosophy and process – you may discover that the manager could be in good shape to take advantage of the next market shift.

Effective manager evaluation analyzes results over a full market cycle and attributes them to skill and market forces. This requires a forward-looking framework that considers historical data points but isn’t limited by them.

Next steps
Meaningful manager assessment requires an understanding of what drives performance and tries to determine whether past results are repeatable.

- When you evaluate fund managers, it’s important to talk with your financial advisor, who can help you assess the factors involved in picking skilled managers who may add value to your portfolio.
- When reading your fund materials, look at the fund manager commentaries as well as the performance tables. These can offer insights into the management team’s philosophy and process.

Intentional Investing Challenge

Your challenge as an investor is to create a financial plan that’s built to meet your needs no matter what the markets are doing. Meeting that challenge requires thoughtful planning, deliberate action and a financial partner who’s dedicated to your success – that’s what Intentional InvestingSM is all about.