

# Long/Short Equity

## Manager Due Diligence Checklist

Long/Short Equity strategies may help improve the overall risk/return profile of client portfolios by dampening volatility, while still capturing potential up-market returns. However, as there is wide dispersion among managers in the category, performing proper due diligence is key to success. Below is a checklist to help you find the right manager for your Long/Short Equity allocations.



### Investigate the Manager's Investment Philosophy

- What inefficiencies does the manager believe exist?
- Why do they exist?
- Why should they reasonably persist?
- What is the manager's definable edge in exploiting those inefficiencies?

"Exploiting an inefficiency, such as the low volatility anomaly, enhances the stock selection process on both long and short holdings..."

28%

of Long/Short Equity funds invest Globally which may influence the risk characteristics vs. Domestic only.

### Identify the Portfolio's Source of Risk

Use Returns-based and Holdings-based analyses and review:

- Exposure to the equity risk premium
- Exposure to other risk premia; size, value or momentum
- Exposure to sector and/or geographic concentrations



### Measure the Manager's Ability to Deliver Alpha

Through attribution analysis, ensure the manager delivers on both the short and long book.

"If a manager cannot generate alpha on the short book, there is no question that an investor should look elsewhere."

189

funds were in the Morningstar Long/Short Equity Category.

### Conduct a Peer Group Analysis

Due to wide performance dispersion within the category, reviewing a manager's decision making against other like managers is critical in ensuring proper selection.



### Consider the Alignment of Interest

Review the alignment of interests between the manager and shareholders, this could include understanding current AUM and future growth goals which could impact performance.

50%

of portfolio managers have no investment in their own funds.\*

All data as of 6/30/2018.

\*Source: "Portfolio managers shun investing in own funds", Financial Times, September 18, 2016.

^The average net expense ratio based on prospectuses.

Alpha measures the difference between a fund's actual and expected returns, based on beta, and is generally used as a measure of a manager's added value over a passive strategy.

Morningstar Long/Short Equity Category is defined as long-short portfolios that hold sizable stakes in both long and short positions in equities and related derivatives. At least 75% of the assets are in equity securities or derivatives.