Size Matters

An initial question many allocators ask is: "How much does the manager have in Assets Under Management (AUM)?" We feel that what is more important than absolute size is whether size acts as a headwind or a tailwind for the strategy being reviewed.

Sometimes it is better to be small:
Managers with a unique niche – opportunistically buying out-of-favor mispriced mortgages, for example, or finding privately held technology companies aimed at leading the adoption of renewables – find it advantageous to be small. When money managers have too much AUM locked into constrained strategies, the manager will often be tempted to drift into territories outside her area of expertise. This is known as strategy drift, and it often results in poor performance. Furthermore, with greater AUM comes greater challenges that managers must overcome to be successful. Simply put, sometimes smaller is better.

Sometimes it is better to be big:
There are activist managers who buy up shares in publicly held companies with the goal of creating value by electing innovators to board positions and by advancing strategies for revitalizing management. In order to accomplish this, they need AUM so that they can control more votes and carry out their objectives. More shares bring more votes, which in turn increases one's ability to drive change, increase profitability, and attempt to deliver greater value to shareholders.

Sometimes size doesn't matter:
In the context of certain investment approaches, such as quantitative strategies in the deep futures and forwards markets, size is somewhat irrelevant.

We suggest that allocators need not be concerned about a specific benchmark to determine how much managers should have in AUM. Instead, we suggest that allocators consider the more pertinent question: "Is the size of AUM in this strategy a headwind or tailwind?" Remember Mark Twain once remarked:

"It's not the size of the dog in the fight, but the fight in the dog."