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Move over robo-advisers, here come the robo-selectors

By Siobhan Riding

Technology firms are increasingly making a play for the fund selection market, developing sophisticated automated tools they claim could replace human fund selectors.

The role of technology in fund selection has traditionally been confined to the initial quantitative screening that selectors carry out to whittle down the fund universe.

But startups such as Switzerland's iFund Services believe there is potential for the qualitative part of fund selection, which has traditionally been carried out by humans, to also be automated.

IFund offers an automated fund selection service based on both quantitative data it collects, as well as more qualitative aspects input by its researchers.

The service, which is aimed at banks and wealth managers, uses algorithms to generate fund recommendations based on a user's profile and takes into account any of their specific requirements.

This mirrors the way so-called robo-advisers, which generally cater to end investors, create portfolios using algorithms. However, robo-advisers tend to focus on passive funds, which do not require as meticulous due diligence as active funds.

Matthias Weber, partner at iFund, acknowledges that automated fund recommendations cannot hope to measure up to recommendations made by human fund selectors.

However, he says the system developed by iFund is "qualitative due diligence as far as you can get".

Mr Weber says such services have the potential to revolutionise fund selection and make the process more efficient.

"[Automated fund selection tools] are really changing the game," he says.

"[They allow for] a more industrial approach – you can scale everything."

According to Mr Weber, robo-selectors can generate fund recommendations responding to multiple client needs "in an instant", whereas a human fund selector would require significantly more time to do this.

"Of course you cannot go as deep as a human being [in analysing funds]," says Mr Weber.

"But you have much greater coverage and [can work] much faster."

He adds that automated fund selection tools "could certainly replace" human fund selectors – allowing banks to make significant cost savings.

Many large banks in Europe employ sizeable fund research departments. When open-architecture fund offerings were popular in the early 2000s, banks rushed to build out fund selection units in order to offer added value to their clients.

However, running such units is “very, very expensive” for banks, which are facing ongoing cost pressure, says Mr Weber.

HSBC Private Bank, for example, laid off some members of its fund selection unit earlier this year after an overhaul saw it move its product team to London. The firm is understood to have considered outsourcing its fund selection arm.

Amin Rajan, chief executive officer of asset management consultancy Create-Research, agrees that as automated fund selection tools become more sophisticated fund research departments will shrink.

“The emerging digital tools are demystifying the craft of investing across a large part of the investment value chain,” says Mr Rajan.

In addition to their efficiency, the objectivity of these tools compared with human fund analysts will help them to gain traction, he adds.

“Human selectors are subject to a host of unconscious biases that work against client interests,” notes Mr Rajan.

Oren Kaplan, founder of SharingAlpha, a startup fund rating website, describes the fund selection services currently on offer to investors as “very poor”.

Investors can either use fund recommendations based on quantitative analysis – principally past performance, which “has been proven to add no predictive value”, says Mr Kaplan.

Alternatively they can use human fund analysts who “due to the current market structure can only a cover a very limited number of funds”.

According to Mr Kaplan, “technological advancements are probably the only way to overcome these challenges and offer investors better solutions”.

Jon Beckett, UK research lead at the Association of Professional Fund Investors, adds that the use of automation in fund selection could help simplify the process and make it more transparent – just as robo-advisers are doing in the advice market.

If fund selection were to evolve in this way investors would “need far less middle men making fund decisions in future”, he says.

Mr Beckett points to another technology startup, Pure Group, which carries out factor analysis on funds to provide a forward-looking assessment of how they will behave in future.

“This is not a million miles away from qualitative fund analysis,” notes Mr Beckett.

Patrick Murphy, founder of Pure Group, says that although the startup does not currently sell its services to fund buyers, it could imagine doing so in future.

He believes that interpretative models, like the one pioneered by Pure, could represent “the next generation of manager selection”.

Mr Murphy shares the view that fund selection teams will shrink but does not think humans will be entirely replaced.

Hervé Croset, former head of fund selection at HSBC Private Bank and founder of new fund research service Wealth Solutions Partners, acknowledges that the ousting of human fund selectors by computers “will certainly happen in certain circumstances”.

However, he doubts this could happen across the fund selector industry.

“Think about how a financial market would behave if all and every investing agent in that market used the same robot, with the same algorithm, taking the same decision at the same time, assuming no human involvement at all,” he says.

Etienne de Merlis, chief investment officer of Signia Wealth, agrees: “Given how complex fund selection is, both human and technological involvement is essential.”

Mr de Merlis notes that “when selecting systematic, model-based strategies, quantitative analysis may be able to provide a reasonable guide”.

However, it is a different question for highly active and flexible funds, he says.

“[With these funds] understanding how the managers think and then tracking how the managers adjust their portfolio over a significant period is the key to a successful selection process and relies heavily on human judgment,” he says.

But Roland Meerdter, a former Deutsche Bank fund selector and managing partner at asset management consultancy Propinquity, says the argument between humans and robo-fund selectors is less binary than this.

“There is a third way,” he says.

According to Mr Meerdter, fund selectors “spend too much time collecting and organising due diligence information such as the responses to questionnaires”.

He argues that by standardising and digitalising this process using technology, analysts will be able “to do more of what they are best at – analysis”.