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Does Past Performance Matter in Investment Manager Selection?

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Abstract

The authors empirically investigate the investment impact of commonly used manager selection heuristics that involve redeploying assets from underperforming to outperforming managers. Studying portfolios constructed using the typical three-year evaluation periods employed by most pension funds, the authors find that investors who chose managers with poor recent performance earned higher benchmark-adjusted returns than those who chose managers with superior recent performance. Their findings pose a challenge for asset owners: If past performance is used at all in selecting managers, it is the best-performing managers who should be replaced, not the underperforming ones. Realistically, however, a policy of replacing successful managers with poor performers is unlikely to gain widespread acceptance. Instead, the practical implication of this article is that asset owners should focus on factors other than past performance. The authors offer alternate criteria for selecting managers.

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