

## The Sorting Box: A Framework for Manager Evaluation

“Show your work.” All math students hear this command from their professors – and for good reason. Without seeing the process that a student followed, a professor has no way of knowing whether the final answer was a result of luck or skill.

The same principle applies to portfolio management teams.

### Windows vs. screens

Many investors choose mutual funds based on data screens of performance, standard deviation and industry rankings. But without seeing the work behind those results – the manager’s adherence to a sound investment process – investors don’t know whether the manager is skilled, or if he simply benefited from favorable market conditions.

This distinction is important because – while no one can predict the future with perfect accuracy – a well-articulated investment philosophy and process can serve as a window into the mind of a manager, helping you see how he may perform under various market conditions. For example, data screens that measure risk through standard deviation don’t reflect the whole story. True risk is revealed in asset sizes, sector exposures, style bias, market caps, holding concentrations, the management team, sell disciplines, etc.

### 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 is a necessary complement to backward-looking screens.

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

No single investment process will outperform in all market environments. Therefore, the most challenging aspect of the sorting box is to identify and hold skilled managers whose processes aren't in sync with current market conditions. A screen would lump an underperforming manager into the "bad" category, but a qualitative window may reveal that manager's underlying skill. Such a manager may be in good shape to take advantage of the next market shift.

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### Intentional Investing<sup>SM</sup>

Intentional Investing is the science and art of investing with purpose, prudence and diligence. It's about thinking carefully, planning thoughtfully and acting deliberately. We believe an intentional approach and a forward-looking view are important when evaluating investment managers.

The experts don't evaluate managers solely by good or bad results. Meaningful assessment requires an understanding of the root drivers of performance, and tries to determine whether past results are repeatable. 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 quantitative factors, but emphasizes qualitative ones.

Consult your financial advisor during the manager evaluation process. Your advisor can help you assess the qualitative factors necessary to pick skilled managers who may add value to your portfolio.

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Standard deviation measures a fund's range of total returns and identifies the spread of a fund's short-term fluctuations.

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