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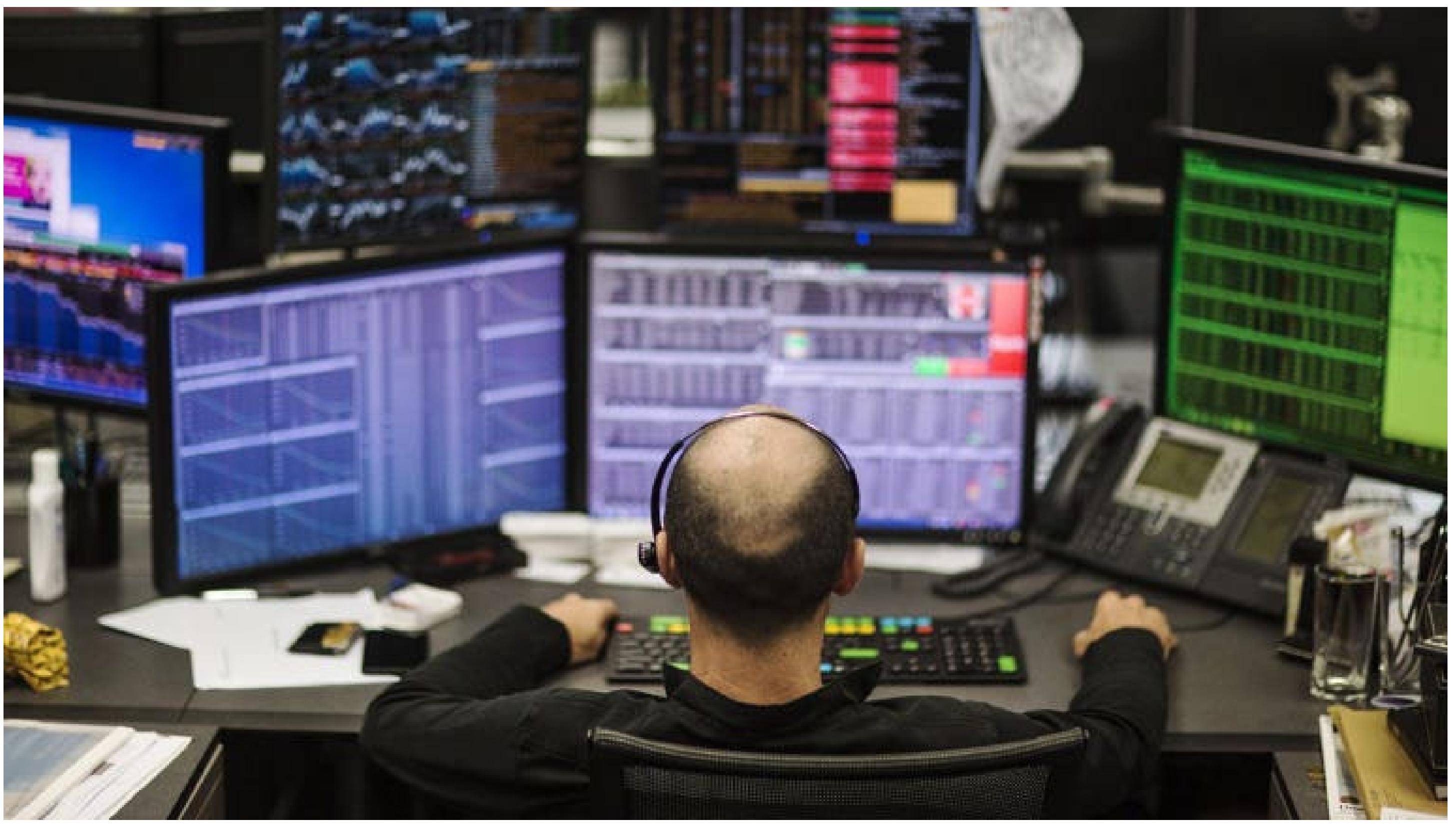
6 popular investment strategies of fund managers

Dan Weil – June 29, 2022

Mutual fund managers use a variety of investment strategies and criteria when they select their assets. Managers have many different investment strategies to choose from, so when choosing an investment fund, you should look closely at the manager's investment style to make sure it fits your risk-reward profile.



© Bloomberg/Getty ImagesA stock trader sits in front of multiple trading screens

"Investment style is incredibly important because of the way that investing works," says Chris Geczy, professor of finance, The Wharton School of the University of Pennsylvania. "Both risk and return are connected to style. According to current practice portfolio theory, you can optimize a blend of styles for diversification, balancing reward and risk."

Here's a look at six popular investment strategies among fund managers, including:

- Top-down investing
- Bottom-up investing
- Fundamental analysis
- Technical analysis
- Contrarian investing
- Dividend investing

Top-down investing

Top-down investing strategies involve choosing assets based on a big theme.

For example, if a fund manager anticipates that the economy will grow sharply, they might buy stocks across the board, or the manager might just purchase stocks in particular economic sectors they believe will do well.

If the manager expects the economy to slump, it may spur them to sell stocks or purchase shares in defensive industries such as health care and consumer staples.

“The great advantage of top-down is that you’re looking at the forest rather than the trees,” says Mick Heyman, an independent financial advisor at Heyman Investment Counseling in San Diego. That makes screening for stocks or other investments easier.

Of course, managers might be wrong on their big idea. And even if they’re right, that doesn’t guarantee they’ll choose the right investments.

“A good example is gold,” says James Holtzman, president and CEO at Legend Financial Advisors in Pittsburgh. “That would make sense for a top-down investor. But what if you’re looking at a gold-mining stock and the company is being run into the ground? The particular stock could be ready to collapse, even though investing in gold makes sense.”

Bottom-up investing

Bottom-up managers choose stocks based on the strength of an individual company, regardless of what's happening in the economy as a whole or the sector in which that company lies.

A bottom-up manager benefits from thorough research on an individual company, and a good manager can sometimes find attractive investments even in out-of-favor industries. Often, the best investments are found where "the baby has been thrown out with the bathwater."

While bottom-up investing can help managers identify good investments with upside potential, it may carry more risk than top-down investing. A market plunge often pulls even the strongest investments down, but over time an individual company's strong fundamentals can lead to attractive returns.

Fundamental analysis

Fundamental analysis involves evaluating all the business factors that affect an investment's performance. For a stock, it would mean looking at all of the company's financial information, and it may also entail meeting with company executives, employees, suppliers, customers and competitors.

"You want to analyze management, really understand what's driving the company and where growth is coming from," Heyman says.

Most managers emphasize fundamental analysis, because they want to understand what will drive growth. Investors expect the stock to rise if a company is growing profits, for example, so understanding if a company is well-poised to grow is important to predicting the stock's future direction. Managers will also look closely at valuation to understand if they're paying an attractive price for the company.

But fundamentals don't always carry the day.

"You can have a period of time where the market moves on technicals," Holtzman says.

Technical analysis

Technical analysis involves choosing assets based on prior trading patterns. Technical analysts look at the trends of an investment's price rather than the fundamentals of the business.

Heyman sees power in technical analysis, because he believes an asset's price at any single moment reflects all the information available about it.

However, technical analysis does not provide a holistic picture of what is going on "under the hood." Technical analysis does not include the underlying driving forces behind what is influencing the price of the asset, for example, economic forces or business developments within a particular sector.

The best managers use both fundamentals and technicals, says Holtzman. "If a stock has good fundamentals, it should be stable to rising. If it's not rising, the market is telling you you're wrong or you should be focusing on something else."

Contrarian investing

Contrarian managers choose assets that are out of favor. They determine the market's consensus about a company or sector and then bet against it, if the investment case indicates they should do so.

The contrarian style is generally aligned with a value-investing strategy, a strategy that means buying assets that are undervalued by some statistical measure, says Wharton's Geczy.

"In the long run, value has beaten growth in assets around the world, though during certain periods that's not true," he says. "The contrarian style generally rewards investors, but you have to choose the right assets at the right time."

The risk, of course, is that the consensus is right, which results in wrong bets and losses for a contrarian manager.

Dividend investing

As the name suggests, dividend funds buy stocks with a strong record of earnings and dividends. Because of the stock market volatility of recent years, many investors like the idea of a fund that offers them a regular payout.

“Even if the price goes down, at least you’re getting some income,” says Russ Kinnel, director of mutual fund research at Morningstar. “It’s a nice way to supplement income if you’re retired.”

However, the popularity of dividend stocks causes some market pundits to wonder if they’re currently overvalued. Also, beware of funds with extremely high yields. That could be a sign that companies are taking outsized risk and are headed for declines.

Things to consider when building an investment strategy

- **Diversification:** As the experts outlined above, it’s a good idea to not keep all your eggs in one basket. Investing in different sectors and different asset types is an important first step when strategizing your investments.
- **Active vs. passive investing:** You will need to decide if you want to be an active day-to-day participant in your investments or if you prefer to invest passively, taking a buy-and-hold approach. Here are other key differences between passive and active investing.
- **Asset allocation:** Your asset allocation – how much you have invested in various asset classes such as stocks, bonds and even cash – makes a big difference in your performance. For example, an investor fully invested in bonds will have different returns from an investor fully invested in stocks. Fund managers allocate assets for their clients based on their goals, and it’s important to know how they do so.
- **Time horizon:** Another important aspect of any investment strategy is time horizon. Asset managers and individual investors can allocate investments based on how quickly they will need to access their money. Money that will be needed soon should be invested in safer assets such as CDs or bonds, while investors with a

longer time horizon can hold out for the higher but more volatile returns on stock investments.

Most experts advise diversifying among investment styles.

“In the end, a balanced way of looking at things tends to create fewer errors,” Heyman says.

Bottom line

There are several investment strategies fund managers use to allocate your money, and it’s important to choose a fund or manager that falls in line with your personal investment goals. Whether your fund manager focuses on technical analysis versus fundamental, or is focused on investing for the short-term only, getting a handle on a fund’s investment strategy can help you make better investment decisions for yourself.

Note: Bankrate’s Georgina Tzanetos contributed to a recent update of this story.