Why is it that rankings in performance surveys are no indication of manager skill?

Imagine you are an investment manager and your top rated analyst has just recommended that gold shares are a "buy" at this moment. Now - you need to use this superior information to outperform other fund managers in the surveys.

How high a weighting in gold shares do you need to hold to outperform other fund managers?

Answer:

The question is impossible to answer because you have no idea of the other managers' weightings in gold shares.

How high a weighting in gold shares do you need to outperform the JSE All-Share Index?

Answer:

This question is answerable because you know that gold shares comprise approximately 6% of the index so the fund would have to hold in excess of 6% to outperform the JSE All-Share Index.[25]

Lesson 1 is that true manager skill can only be assessed against a benchmark that is investable and known in advance if managers are going to translate superior knowledge into outperformance.

Lesson 2: For performance rankings to be meaningful, like needs to be compared to like, in terms of asset mix, investment risk profile and manager style. Very few performance surveys ever reach that level of comparability.

What went wrong with the old paradigm of beating the other guy[26]:
For years, the UK pension investment business was dominated by what is known as a consensus type of philosophy. Pit each balanced fund manager against each other (or a consensus benchmark) and simply see who wins. "The consensus approach encourages all funds to have similar asset distributions, regardless of the fund's liability profile, risk profile, member composition, or performance expectations. The asset allocation decision was sidestepped. Trustees did not want to make asset allocation decisions so they passed them off to their fund managers….Although for a long time, that consensus philosophy seemed to serve quite a few people's interests, actually it did a lot of damage and the results are only just now beginning to show."

"…A final consequence of the old paradigm has been that the investment management community (and equally, the consulting industry) has often focused on what suited them rather than what necessarily suited the specific needs of the client. Of course, one might wonder whether the client really knew what he or she wanted, given the lack of focus on maturity profile (or, for that matter, risk profile and membership requirements.)"