



# THE IMPACT OF ARTIFICIAL INTELLIGENCE ON INVESTMENT MANAGEMENT



**This is the fourth in a series of notes that I have written about the impact of artificial intelligence on investment management. The first in August 2017 posed a series of questions and so, quite naturally, the follow up in October of the same year dealt with answers, either full or partial. A year later came an attempt to set out the cornerstones for growth; a definition of what an AI fund is, early examples of implementation and measurement of results.**

Now ahead of the 5th NextGen Alpha Artificial Intelligence Investor Event in Frankfurt on 8th November, I had a question and answer session with Fred Sage, Chairman of NextGen Alpha about recent developments. Fred explained their AI journey commencing 2016 when they started to track the early days of an AI-based fund universe and their mission, alongside the entrepreneurs who are the AI innovators of the fund management industry, to play a leadership role in the application of AI to the investment management industry. He is firmly of the view that AI will have a positive impact on the investment management industry as we know it today.

**DM: You have recently published a definition of an AI-based fund: what is the background leading to this decision, why now and what is the purpose?**

**FS:** Over the past two and a half years NextGen Alpha has been conducting ongoing research in relation to developments, trends and growth of the AI-based fund universe. In our opinion the growth of the universe is becoming meaningful and by introducing a definition we have reached a timely milestone for establishing a standalone fund category for AI-based funds. The definition of an AI-based fund also impacts the standard and consistency of our research and the manner in which we qualify an AI-based fund and the universe as a whole.

**DM: In your opinion what should investors and other market participants use to compare the funds in the standalone AI-fund category with?**

**FS:** This standalone category will offer guidance for investors and other market participants for benchmarking purposes and for comparing the AI-based fund to its non-AI fund peers (for example, either a fund that the investor is currently invested with or to an index that accurately reflects the strategy of the AI fund).

I would like to highlight that an AI fund index whose constituents are AI-based funds across a range of strategies and asset classes is not an accurate measure of how AI funds are performing nor an accurate measure/benchmark for a particular AI-based fund. AI is the underlying tech and not a strategy or asset class. Therefore an AI fund index has no relevance.

**DM: In terms of NextGen Alpha's activities and plans how will you apply the AI fund definition?**

**FS:** Internally, we use the definition as the framework for our AI fund research and tracking the universe of AI-based fund products which started in 2016. Therefore, since we leverage our AI fund research across our AI activities in effect the AI fund definition serves as the basis for our AI products and services which offer investor access to this universe.

For example, regarding our AI event series (5th in Frankfurt Nov 8), presentations by managers who offer AI-based funds that qualify under the definition. Regarding our soon to be launched AI fund database the definition is the basis for the database universe. Regarding the plan to offer AI investment advisory solutions the definition is applied to services related to AI fund due diligence, AI fund selection and customized AI portfolios.

**DM: You mentioned NextGen Alpha's portfolio advisory service, what are the criteria for selecting funds from the AI fund universe?**

**FS:** In no specific order both qualitative and quantitative criteria include:

- Qualification under the AI fund definition
- Trust/transparency/openly communicated
- AI dedicated team, serious, passionate, smart



- History/background of AI R&D
- Team experience
- Deliver what is promised in terms of targets and or addressing via ongoing R&D, what is not working

**DM: Amongst the names in the universe is there a common manager attribute or type who offer these funds?**

**FS:** When it comes to innovation it is my opinion that the passionate, dedicated, risk taking entrepreneurs are the change agents and this includes the application of AI to the investment management industry.

**DM: What about large established asset managers and AI?**

**FS:** Large managers have their priorities in terms core business and fund product offerings and when it comes to applying AI technology some are using AI as a tool to support their existing range of products with the aim of generating alpha. In my opinion this is a clever approach.

**DM: Can you breakdown the universe of AI funds that qualify for the definition?**

- FS:**
- Approximately 20 managers offer AI-based products and a few offer multiple AI products
  - On average most are long biased equity focused on a specific or multiple markets. However, the universe is diversifying in terms of strategies and asset classes
  - Vehicles being offered include on-shore (i.e. UCITS) and off-shore funds, ETF's and managed accounts
  - On average live track records range from two months to one year
  - In terms of funds under management in aggregate, this is sub USD1 billion and highly concentrated in a handful of funds

**DM: In general how are AI-based fund funds doing?—delivering what is promised? Have any failed (liquidations)?**

**FS:** Some are delivering or exceeding their targets, but it is important to note that as with any innovation mistakes are being made, lessons are being learned and via ongoing R&D improvements are being implemented and again as with all innovations some have crashed and burned. There are no failures only valuable learning experiences. It is important that clients expectations are managed which requires clear and transparent communication.

**DM: What do you feel are key success factors for the AI fund winners?**

**FS:** Smart, experienced, passionate team dedicated to ongoing research and development and focused on delivering what is promised.

Before ending, a story from a research trip that took Fred from Munich to New York to meet an AI manager based in Colorado. Uncertain about where to meet they searched the internet and selected a top ten venue, only to find on arrival that it was a one counter diner. Quality most certainly, but capacity limited. To be continued, but a temporary conclusion and drawing on Tom Wolfe's book, The Right Stuff, developing AI investment strategies is about pushing the envelope, success is far from guaranteed, but what is important is to learn from the failures as well as celebrating the successes.

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David Miller is a Quilter Cheviot Executive Director and active investment manager. He makes regular appearances on TV and radio and is the author of the prizewinning weekly, Diary of a Fund Manager, which now has a global circulation list of over 20,000. In a career spanning four decades, he has worked as a stockbroker and then fund manager, advising private individuals throughout, for the last ten years at Quilter Cheviot which is part of Quilter plc. He read Natural Sciences at Cambridge University and is a committed empiricist, suspicious of economists with theories.

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