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## How Marketing A Portfolio Mistake Can Help Your Asset Raising



In portfolio manager and investment process due diligence analysis by financially astute, sophisticated institutional investors, there is something that they want to get detail about that can strike fear into the hearts of portfolio managers being vetted: mistakes they've made in managing their portfolios.

While it's more likely that a sophisticated investor will query portfolio managers under consideration about mistakes they have made, even an investing novice can spot what might be signs of portfolio management errors within their live performance record.

Over our decades of communications and sales marketing consulting work with a wide variety of money manager types and strategies we have seen a pattern repeated by investment firms of all sizes. If there was something that the portfolio manager or the manager and his or her investment team missed or got wrong in the past, they were loath to bring it up. This left the family offices, the institutional plan sponsors and their gatekeepers to bring it up and ask. In such scenarios any response, even if a good one, comes off as being defensive.

I'll give you two real life examples of what investment process related portfolio management mistakes can look like and how building this into fund marketing can help the asset raising effort.

## What an interest rate change-up laid bare

A US small cap growth stock money manager had a good but not stellar five year track record. It was 1995. They reached out to us for help to make it through the investment due diligence gauntlet of corporate pension plan investment committees. The problem was their significant underperformance in 1990. That one-year drawdown, seen in the down-spike in their since inception returns performance line chart, was making those institutional investors question whether the manager's investment process was going to be reliable enough to achieve long-term success without suffering major setbacks. Additionally, the portfolio manager was lacking a clear and detailed enough investment process explanation as to company screening and analysis and asset weighting decision making.

Working with the portfolio manager we uncovered that while he had detailed steps in his investment process for carrying out company-specific risk analysis in selecting stocks, he had not paid equal attention to non-company specific risks. This resulted in an unintentional clustering of businesses that at that time had shared a commonality. It turned out that 35% of company holdings that were meeting his key desired fundamental-based stock picking characteristics had leveraged balance sheets. Such an exposure to interest rate risk caused the problem. Interest rates went up, banks stopped making loans and the stock prices of these companies got hit significantly.

So, he said, he learned from that unintended exposure and had put in place a risk management step at the final stage of making asset allocation weighting decisions in selecting which stocks to add to the portfolio. Ceilings were set as to what percentage of the book could hold companies that could be sensitive to different non-company specific risk factors such as interest rates, inflation, energy prices, liquidity risk and regulatory risk. If a non-company specific risk 'bucket' was already full, either a new stock addition would have to take the place of another in that 'bucket' or else be kept on the sidelines as a possible future addition.

Very good. A clear demonstration of a portfolio management mistake, a lesson learned and those insights applied to reduce the potential of that recurring. There was just one problem: this change in strategy implementation was not in *any* company communication or in its marketing materials. The only people who had heard this were investment committee members who were grilling the manager at a due diligence meeting when he gave a verbal response to "But what about this significant drawdown?"

The first thing we did was counsel our client that he would no longer wait to be asked about the drawdown. Instead, he was going to bring it up himself when meeting with prospective institutional investors. We drafted an explanation of why it happened, what he learned from the experience and what additions he made to his investment process to reduce the odds of such a drawdown occurring in the future. This was applied to marketing collateral.

Next, we turned to the financial trade press, targeting a specific industry publication and telling the behind-the-scenes story. This resulted in the cover feature article, *Road to Damascus - How the correction of 1990 turned a stock picker into a portfolio manager*. When presented to a second targeted publication, it wrote a *When The Masters Stumble* article, where it interviewed two other portfolio managers as well who also had made investing mistakes. While the other two communicated what they did wrong only our portfolio manager spelled out what he was doing now to seek to prevent such drawdowns in the future. It was clear to any reader: choosing among the three, the sensible decision would be to allocate to our client's fund.

And then an interesting thing happened. Institutional investor prospects stopped challenging the investment firm at due diligence vetting meetings about the issue. And its asset raising efforts started to take off.

### **“We were hoping you wouldn't ask!”**

This was a quote from a second-time client. The first product they hired us to work on was their core US equity strategy offering for institutional plan sponsors. The investment firm was meeting resistance to their value oriented strategy by plan sponsor gatekeepers and investment committee members who were complaining that the portfolio manager and his team were being too opaque, too generic and not detailed enough in their communications about their investment process. We solved that problem and the firm started winning more mandates.

They returned to us with their international equity investing product for similar help to win more institutional investor mandates and overcome the too opaque, too generic and not detailed enough complaints. But there was one additional factor this other investment team hadn't initially mentioned to us. Upon reviewing what was their current marketing materials we found in the returns since inception performance line chart three separate down-spikes of drawdowns.

We arrived at their offices to meet with their group: the portfolio manager, two analysts on his team, the firm's salesperson and their president. The manager and two analysts comprised their investment committee. *You've taken a look at our marketing materials*, the portfolio manager said. *Where would you like to start?* he asked. We asked them to tell us what happened at these three down-spike periods in their performance.

*We were hoping you wouldn't ask!* was their response. Yes, really. They went on to say that they kept being asked the same question at every in-person meeting they'd gotten with plan sponsor prospects and they were uncertain how to respond.

Truth be told, the portfolio manager said, pointing at the analysts, it was due to those two. We were then introduced to them. One was the top-down quant-based analyst and the other the bottom-up fundamentals-based analyst. It turned out that for deciding upon tactical implementation methodology for the risk management-related step three in their investment process, the investment committee first voted to go with the bottom-up analyst's idea. After some marketplace twitching the first performance down-spike occurred. Next, they went with the top-down analyst's idea for their step three. Related but not duplicate marketplace twitching brought about down-spike number two. They then swapped that out for a variation on that theme, then came down-spike number three.

The portfolio manager went on to say that there was presently figurative arm wrestling going on between the two analysts sitting opposite us at their boardroom table about how to tweak their risk management step once again. OK, we responded. Finish arm wrestling and decide what you'll be changing step three to in your investment process because you can't create a detailed enough explanation as to how you assemble and manage a basket of holdings until you can lock in the whole linear process. Then we can help craft a more cogent, compelling and transparent explanation as to how you run your strategy's investment process.

Importantly, we added, in future sales meetings we want you to start making a point out of bringing up — and not wait to be asked — what you learned from your previous three tries at having a good enough risk management step three in your methodology, how you've taken that into consideration in establishing your new step three, and what you are now doing to mitigate the cause of the previous three drawdown periods.

Four months later they decided on their new step three. So, with an updated investment methodology, and a new, detailed, verbal and in print leave-behind explanation for it, a lessons learned segment became part of their sales meeting presentation. And some of their prospects then converted to investors.

### **Marketing mistakes can help your asset raising, too**

Sophisticated investors recognize that all portfolio managers can make investment mistakes; but not all learn from their mistakes. So, the investors ask themselves, are the money managers we are currently considering awarding an investment mandate to able to demonstrate that they are still learning and not just coasting?

If you made an investment mistake at some point, and adjusted your investment process to seek to prevent experiencing another drawdown for the same reason, then communicating about this may help your asset raising efforts, too.

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### **About the author**

Bruce Frummerman is CEO of Frummerman & Nemeth Inc., a 38-year-old financial communications and sales marketing consultancy that helps financial services firms create brand identities for their organizations and develop and implement effective new marketing strategies and programs. Frummerman & Nemeth's work has helped money management firm clients attract over \$7 billion in new assets, yet they are *not* third-party marketers.

Frummerman & Nemeth is internationally recognized for its work in crafting for clients the beyond-the-numbers story of how they invest — content that investment committees actually discuss, debate and vote on behind closed doors when considering firms on a short list for potential investment. Importantly, this is required due diligence content that cannot be communicated in pitchbook format.

Frummerman & Nemeth's work also includes providing strategic consulting on product and strategy-specific branding, crafting the required strategy-specific content detail and designing and producing the marketing tools needed to make it through the two-month to two-year institutional selling cycle. Clients also employ Frummerman & Nemeth to help promote the intellectual acumen of management — helping them get speaking opportunities, write and give speeches as panelists or stand-alone speakers at industry conferences, and through media relations marketing services.

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