The eight Ps for evaluating managers and hedge funds (philosophy, plans, people, process, performance, product, progress, and price) provide a memorable way for advisors to begin manager and hedge fund evaluations. But I confess that I find it difficult to remember which P covers each of the questions that I want to ask in an evaluation.

So I created an efficient and easily replicable evaluation process that complements the eight Ps and that I can remember effortlessly. In addition to the eight Ps, I use the mnemonic 2xPROCESS when I evaluate a prospective manager or hedge fund and when I re-evaluate a manager or hedge fund in one of my portfolios.

2xPROCESS lists each letter in the word PROCESS twice. Each of those 14 letters stands for one major question. The 2xPROCESS manager and hedge fund evaluation process mnemonic is shown in table 1.

Using the 2xPROCESS checklist to begin my manager and hedge fund evaluation, additional and more-detailed questions flow more easily for me than by using the eight Ps approach alone. Each advisor using my 2xPROCESS will then develop their own personal follow on series of questions and weightings. Table 2 shows examples of how I drill down from the 14 beginning top-line questions in table 1.

Those are some of my manager/hedge fund evaluation questions. I hope they give you ideas about how you might use my 2xPROCESS as your own checklist to complement the eight Ps. Depending upon the circumstances and the specific manager or hedge fund, I will, of course, not ask some of the questions or I will ask other questions as well. My goal isn’t to create an evaluation template; it’s to create a checklist of initial questions that I can then build upon to complete the evaluation. Most of the answers to 2xPROCESS questions are available from the manager’s/hedge fund’s published and updated materials or easily researched by and available from the manager/hedge fund.

Conclusion

The sooner advisors develop their own memorable, encompassing, and durable manager and hedge fund evaluation processes, the more efficient they will be and the more frequently they can evaluate and re-evaluate their own managers and hedge funds. Perhaps the eight Ps analysis alone works perfectly for you, or perhaps my 2xPROCESS together with the eight Ps will work for you, or perhaps you have developed and refined your own evaluation process. Whatever the case, and however you choose to systematically evaluate your managers and hedge funds, your objective calculations seasoned with your experienced judgment will help you provide your best counsel to your clients. Our clients chose each of us because they trust us. Never take that trust for granted. Re-earn that trust every day in every way.

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| P | Performance?  
(Manager/hedge fund alone) | • Current month?  
• Current quarter?  
• Year-to-date?  
• Last 12 months? 3 years? 5 years? 7 years? 10 years?  
• Since inception?  
• Review outlier portfolios as well as model/composite portfolios?  
• How are the model/composite portfolios constructed (e.g., institutional, investors, separately managed accounts)? |
|---|---|---|
| P | Performance?  
(Compared to benchmark/index) (alpha) | • Agreed upon benchmark/index?  
• Performance for each of the above time periods measured against the benchmark/index (Jensen’s alpha)?  
• R² for each of the above time periods?  
• Absolute performance manager?  
• If no benchmark/index, then does the manager strive to consistently exceed a published return by a specific amount (e.g., 400 basis points above short-term Treasuries net of all fees)? |
| R | Risks?  
(“I LOVE BRIDGE.”) | I Interest rate risks?  
L Liquidity risks?  
O Operational risks?  
V Volatility risks?  
E Equity risks?  
B Business risks?  
R Reinvestment risks?  
I Inflation risks?  
D Distribution risks?  
G General market risks?  
E Exchange rate/currency risks? |
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<th>TABLE 2 (CONTINUED): MANAGER AND HEDGE FUND EVALUATION PROCESS QUESTIONS</th>
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| **R** Risk-adjusted returns? (Beta)  | • Total risk-related ($\sigma$)  
• Sharpe ratios?  
• M²?  
• Sortino ratios?  
• Systematic risk-related ($\beta$)  
• Jensen’s alpha?  
• Treynor ratios?  
• Tracking errors?  
• Information ratios?  
• What is the effect of adding this manager/hedge fund to the performance of the client’s portfolio as a whole?  
• Marston’s alpha-star? |
| **O** Ownership? (Manager/hedge fund) | • What exactly does this manager/hedge fund own?  
• Asset class?  
• Style category?  
• Who is the custodian of what?  
• Third-party objective ratings available?  
• Insurance (e.g., limitations, restrictions, caps)? |
| **O** Ownership? (Client) | • What exactly will the client own (e.g., stocks, bonds, unit investment trusts, mutual funds)?  
• How exactly will the client own it (e.g., shares, limited partnership interests, fund of funds)?  
• Are we only buying the manager’s intellectual capital?  
• Who does the trading?  
• Who takes custody?  
• Who does the reporting?  
• Multiple layers of paperwork?  
• Separate account necessary?  
• Limitations as to ownership (e.g., minimum investment required, accredited investor, qualified account)?  
• Consequences of such ownership (e.g., IRS extensions required and delayed tax filings, lack of transparency, availability as potential collateral, leveraged)?  
• Liabilities (e.g., any additional potential liabilities beyond the amount invested)?  
• Insurance (e.g., limitations, restrictions, caps)? |
| **C** Correlations and capture ratios? | • How does it correlate historically for the various time periods with the other managers and holdings already in the client’s portfolio or in the prospective portfolio?  
• What has been its upside performance compared to its benchmark/index, compared to the S&P 500, and compared to the Russell 3000, for the various time periods and through different economic and market cycles?  
• What has been its downside performance compared to its benchmark/index, compared to the S&P 500, and compared to the Russell 3000, for the various time periods and through different economic and market cycles? |
| **C** Costs and fees? | • “Normal” costs and fees (e.g., fee schedule)?  
• “Additional” costs and fees (e.g., 2-percent management fees and 20-percent performance fees)?  
• Claw backs?  
• Break points?  
• Volume discounts?  
• Can we bundle all our clients’ assets with this manager to receive reduced fees for each individual client?  
• Hidden costs (e.g., missed opportunity costs of illiquidity, time requirements for notice and selling the investment, thinly traded, penalties)?  
• Multiple layers of fees and costs (e.g., hedge fund of funds)? |
**TABLE 2 (CONTINUED): MANAGER AND HEDGE FUND EVALUATION PROCESS QUESTIONS**

| E | ETFs? | • Information ratios for the manager/hedge fund for the various time periods?  
• Why not just buy the comparable ETFs instead?  
• Core/satellite candidate? |
|---|---|---|
| E | Easy to understand and explain? | • Transparent?  
• Easy for me to understand what's happening with this investment and why?  
• Easy for me to explain it to my client?  
• Easy for my client to understand it?  
• Easy for my client to then accurately explain it to someone else? |
| S | Story? (Who, what, when, where, why, and how?) | • Who is the manager/hedge fund (e.g., biographies, experience together as this team, ADV Part I)?  
• Who makes the decisions (e.g., star system, team concept, other)?  
• What are they trying to do (e.g., top-down [timing], bottom-up [selection], sector, industry, country, ADV Part II)?  
• What are their research capabilities?  
• What is their buy discipline?  
• What is their sell discipline?  
• When did this strategy begin with verifiable historical performance data?  
• When did this star, or this team, begin its current run?  
• Where are they located (e.g., how often will I be able to visit with them in person)?  
• Why do they do what they do the way that they do (philosophy)?  
• Why should I believe that they are the best at what they do?  
• How do taxes affect this manager/hedge fund/investment/client? |
| S | Sense | • Does it all make sense?  
• Does the manager/hedge fund have a repeatable and durable process?  
• Are there any legal or registration issues?  
• Are there any yellow caution flags at all?  
• Are there any showstoppers?  
• Is more due diligence needed in any area? |
| S | Suitable? | • Would an investment with this manager/hedge fund at this time be suitable for this client?  
• Will this manager/hedge fund accept and consistently implement this client’s investment policy statement?  
• Will this manager/hedge fund’s investments consistently dovetail with this client’s asset allocation strategy? |
| S | Show time? (Decision time) | • Would an investment with this manager/hedge fund at this time be in the best interests of this client?  
• Will this manager/hedge fund consistently excel at meeting all of this client’s objectives? |

**Endnote**

1 This line comes from the Academy Award-winning movie *All That Jazz* (1979). The movie is loosely autobiographical about the life of choreographer and director Bob Fosse. Actor Roy Scheider plays the Fosse character, Joe Gideon, who says repeatedly throughout the movie, “It’s show time, folks.”

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