Understanding what it means to have confidence and trust in someone or something

Although confidence and trust are very similar concepts, there is a difference. Whereas confidence is a meaningful step on the way to building trust, trust is more resolute. The Oxford Dictionary defines these two concepts as follows:

- **Confidence**: The feeling or belief that one can have faith in or rely on someone or something.
- **Trust**: Firm belief in the reliability, truth, or ability of someone or something.

When outsourcing the responsibility for investing capital to a fund manager or adviser, it would seem obvious for an investor to ask themselves whether they have confidence in this person or fund manager and whether they trust them. Your gut feel would usually lead you to answer these questions subconsciously to some degree, but it is important to also consider these questions consciously, clearly articulating the sources for your thoughts or beliefs.

**What questions should you ask when deciding on a fund manager?**

Investing with a fund manager for the first time takes a leap of faith. It requires doing research, attending presentations and reading marketing collateral to form a view. However, all of this is based on past behaviour and on the claims of the fund manager themselves. Feelings and beliefs are not the same as facts. That is why investors must focus on the few pieces of information that are most reliable.

When deciding on whether to place your confidence and trust in a fund manager, we believe there are two main questions that you need to ask:

1. **Why do I believe the manager is capable of achieving a good investment outcome?** This is a question about whether the manager has a rational and sustainable investment philosophy, and the skill to apply it.

2. **What evidence is there that these people are motivated to look after my interests ahead of their business interests?** This is a question of integrity and alignment of interests.

**Determining the sustainability of long-term performance**

Regarding the first question, as investors we are particularly reliant on our thoughts or beliefs. We know that short-term past performance is no guarantee of future outcomes. Even though evidence of long-term outperformance tells us that something that has been repeated over time has a high likelihood of being repeated, it still has its limits. You can assess whether there is a good reason that the manager’s approach should continue to work long into the future. Can you see the logic in why it should work, and can the manager explain this simply to themselves, and others? Who are the people involved, and what reasons do they give you to place your confidence in them?

The difficulty with answering these questions is that aside from looking at past performance, the investor must develop their own thoughts and beliefs, based on the manager’s performance. What makes this even harder is fund managers tend to not readily offer their investment ideas unless there is a good story on the merits of the approach.

**Finding evidence of alignment of interests**

In dealing with the second question, it is possible to find firm evidence of alignment of interests. This can narrow down the field dramatically, considering that business structures that align interests with clients are more fact based – they either exist, or they don’t. To determine alignment of interests, you can consider these questions:

- **Do the people responsible for managing your money have a meaningful part of their own wealth invested alongside you?**
- **Are they committed to providing a long-term service, for example is their capital locked into the business for an extended period of time?**
- **Do they demonstrate transparency in their interactions with clients, both in general communications, and when asked for specific information?**
- **Do they demonstrate consistency in their behaviour by sticking to their philosophy through challenging times, and resisting the temptation to launch products to capture short-term demand for the latest fad?**

**Trust is much easier to destroy than create**

It is therefore possible to narrow down the decision by applying some thought to these questions. Ultimately though, confidence and trust are primarily instilled through behaviour over time – providing evidence of both skill and integrity. It must be earned.

However, that is only the start of the journey. Creating trust is a combination of many actions, where destroying trust only needs one action. Poortinga and Pidgeon (2004) summarise it very clearly when they say: ‘Within the risk literature there is an ongoing debate on whether trust is vulnerable or enduring. Previous research on nuclear energy by Slovic in 1993 has shown that negative events have a much greater impact on self-reported trust than do positive events. Slovic attributes this to the asymmetry principle: specifically, that trust is much easier to destroy than to create.’

For our part, our journey in Australia is only in its infancy. It is up to us to show and reinforce to our clients that we have a disciplined investment process that is both consistent and repeatable and that we have aligned our interests with them.

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Commentary by JD de Lange, Chief Operating Officer at Allan Gray Australia

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1 Risk Anal 24 (6), ‘Trust, the asymmetry principle, and the role of prior beliefs’, December 2004