The proliferation of databases may seem to streamline the process of selecting money managers, but investors should be aware of the shortcomings of using these databases as the primary means of finding and selecting managers. Open-access fund platforms come equipped with arrays of data on tens of thousands of investment solutions globally, but not without significant shortcomings. We live in a 'more is more' society; many institutions may equate more data with more information and better solutions.

There are a few key issues with relying on databases to select money managers. These include:

- Potential for failure to discern the nature and quality of data
- Potential for fixation on isolated data points and unrepresentative trends
- Inability to assess how different managers will fit together in a portfolio
- Inability to assess the ideology, energy, and experience of the team behind the fund

What's In (And Not In) The Data

Here are five issues with the data provided by open-access databases for investors to consider:

- Limitations of the universe represented by the database (including whether firms participate at all)
- Scope, depth and relevance of datapoints
- Input inconsistencies and quality control
- Timeliness of data
- Reversion to the mean

Limitations Of The Universe Represented By The Database

Databases provide a universe of funds, and many criteria by which to search and sort potential candidates. Firms and institutions seeking to make investment allocations and portfolio construction decisions doubtless benefit from this information. However, database universes are limited to unique subsets of a much larger population. As a firm that specializes in working with managers across the AUM, strategy, and diversity spectra, we know that not all managers elect to submit their data to databases, and not all databases accept data from all managers. Recently, the market has hatched specialized databases dedicated only to diversity-led firms, emerging managers, or other subgroups. The problem is that these databases are not exhaustive, and they seldom succeed in their objective to raise up managers by limiting their local peer universe. Indeed, the plethora of data bases and platforms today can be more of a curse than a cure.

Scope, Depth And Relevance Of Datapoints

Managers in our network often air grievances about the information which is, or is not, requested of them for database uploads. Frustration typically stems from the lack of applicability of generic database questionnaires, and managers are often eager to share the questions they wish they were asked. With a combined 60+ years of investment manager meetings, screenings, analysis, allocations, and postmortems, we know which information is most important, and that much of it cannot be pulled down from any database. Often, in order to keep their datasets consistent and streamlined, open-access database administrators request little information from funds in their universes. One example is a manager's style or strategy categorization -does it come from the managers (who often like to categorize themselves as the hot investment style of the moment), or the database operators (which tend to use the broadest of categories). Furthermore, questions are frequently geared towards the biggest funds, causing many smaller and [often] more exceptional managers to remain off the radar altogether.

Input Inconsistencies And Quality Control

True to any data exercise, the output is only as good as the input. Our experience has taught us that there are always significant input inconsistencies and quality control challenges facing generic databases. These issues arise because funds often neglect to invest in staffing data collection and entry teams, and because managers desire to minimize any data submissions which will not paint them in a fantastic light. This may result in incomplete searches, overlooked candidates, and a lack of breadth in manager shortlists.

Timeliness Of Data

Most databases request either monthly or quarterly data submissions. A lot can happen within a quarter. Even more relevant is the fact that many managers report to databases on a lag, again, a lot can happen. Firms and institutions building portfolios from databases are also less likely to have much in the way of connectivity with their managers. This *(continued)*

creates a problematic information void. In addition, quantitative screening uses historical data, which is by default a lagging indicator. As a firm that focuses on active portfolio construction––enhancing portfolios on a real-time basis––we find this reliance on datasets problematic at best.

Reversion To The Mean

Databases are designed to provide a simplified, efficient sorting and ranking tool. The objective is to serve up potential candidates, through a series of search criteria, at the click of a few buttons. As the same managers tend to populate databases in general, and the search criteria is relatively stagnant as it must be quantitative in nature, it is predictable that the same managers will rise to the top over certain periods of time creating a reversion to the mean. As a result, through our extensive history, we have seen entity after entity with the same allocations to the same managers, providing clients with the same portfolios time and again. In contrast, in our experience, we consistently find the best portfolios to be those which avoid the same handful of 'hot' managers, instead investing for the long term, allocating actively among managers and strategies, without regard for the 'top ranked' solution in any given database.

Manager Identification And Portfolio Construction

Here are five issues with the data provided by open-access databases for investors to consider:

- Lack of qualitative assessment integration
- Lack of correlation analytics and market stress test integration
- Insufficient tools for the construction of a diverse portfolio

Lack Of Qualitative Assessment Integration

Perhaps the most significant downside of a technology-driven database to guide manager selection and portfolio construction is the lack of qualitative assessment integration inherent in the solution. An effective qualitative assessment requires hands-on screening, review of extensive documentation, and dialogue with the management team. If a database is utilized as the sole or even primary resource for culling a universe, it ensures that quantitative assessment will always override qualitative analysis, despite the many factors that can impact a fund's quantitative profile, particularly in the short-term.

Lack Of Correlation Analytics And Market Stress Test Integration

While databases will generally provide fund statistics relevant to their index and perhaps a broad-based peer group (i.e., long/short equity managers), we believe this notably understates the importance of correlation and market stress-testing integration into the portfolio construction and ongoing management process.

Insufficient Tools For The Construction Of A Diverse Portfolio

True to any data exercise, the output is only as good as the input. Our experience has taught us that there are always significant input inconsistencies and quality control challenges facing generic databases. These issues arise because funds often neglect to invest in staffing data collection and entry teams, and because managers desire to minimize any data submissions which will not paint them in a fantastic light. This may result in incomplete searches, overlooked candidates, and a lack of breadth in manager shortlists.

Organizations reliant on databases for manager search and selection are by design limiting their diversification opportunities to the types of managers who self-select to populate the dataset. It is well known in the industry that core categories such as long/short equity will have lots of managers listed, but what about credit arbitrage? We see a lack of diversification as a common outcome of data-driven portfolio construction, both in strategy types and managers.

Effective fund screening must include the evaluation of distributions of returns for a subset of managers through a broad range of market conditions. However, what happens if current conditions are uncharacteristic of any past period? For example, 2020 was certainly something special. Additionally, what if one of those managers in your subset is brand new? Since databases offer point-in-time analysis, and most organizations utilize search and ranking criteria to prioritize their manager review, it is common for unrepresentative time periods to drive allocation and diversification decisions among managers more than they perhaps should. At Pluscios, we are strong proponents of manager evaluation independent of performance for this very reason. Returns are not everything; risk, and therefore diversification, is key. This applies to not only considering various time periods and track records, but also to the importance of diversifying among strategy types, not all of which will be in favor at the time of your database search and portfolio construction. Imagine, instead of *(continued)*

a portfolio, you are constructing an American football team. It may be tempting to fill your roster with receivers and running backs since they return more yards and touchdowns than your average lineman. In this setup, you may hit a big play every once in a while, but you are also at risk of a significant loss if the defense comes with a blitz. Tom Brady (love him or not) is arguably the greatest quarterback to ever play the game because he understands the importance of diversification and risk-adjusted returns. Surely, the quarterback would love to have more receivers on the field, but he also needs the lineman to prevent him from taking a sack. Brady is often criticized for his volume of short-range completions, as casual fans cannot always comprehend the importance of keeping your offense on the field. They want to see a big play, even if it means getting burned.

Making a determination as to fit for your 'team' is a qualitative endeavor. There has been a sizeable jump in the quantity, assets under management, and significance of alternatives and hedge funds over the past decade. Moreover, when you are building your team, it is not enough to have the best players in each position. It is paramount to understand how those players work together, which requires a serious assessment beyond the 'stats'.

Giving Diligence Its Due

At Pluscios, we invest with ten due diligence rules, which have helped us avoid many investment crises. Not a single one of these rules can be addressed by a database:

1. Do not invest in something you do not understand
2. Do not invest in a fund that will not let you speak face-to-face with the portfolio manager (including over video)
3. Do not invest in a fund if you have not been to the offices (or toured remotely) and interviewed key staff extensively
4. Insist on a well-known auditor, administrator, and broker (and they should be unrelated)
5. Look for institutional people, processes, and infrastructure
6. One size does not fit all – look for appropriate risk management systems and personnel
7. Question everything – initially and ongoing
8. Let fear, not greed, drive the due diligence process
9. When in doubt, sit it out
10. Diversify and right-size investment allocations (if the above items fail to protect you from losses, this will limit the impact)

In our experience, the ability to select a seemingly attractive fund from a dataset misses the hard work of digging deeper, asking questions, engaging management, and actively managing portfolios on behalf of clients on a day-to-day basis. Furthermore, the majority of these rules require expertise and an understanding of the quantitative and qualitative elements that make a good manager, along with the commitment and time allotment to engage well beyond the numbers.

Understanding the qualitative piece, not just the performance, is paramount to long-term success. If you watched the movie "Working Girl" with Melanie Griffith and Sigourney Weaver, you may recall a scene towards the end in which each character claimed a big merger idea. Ultimately, Melanie Griffith's character could give the exact details and moment when the idea came together, while Sigourney Weaver's character could not. If you dig deeper, you can find and invest with the former. A database can't distinguish between the two. This exact moment is exemplar of the edge with which we invest –– focusing neither just on the big picture nor a generic search and ranking system, but on the myriad of inputs, conversations, assessments, and construction considerations that make our portfolio 'teams' great.

While open-access databases can be a start in searching for managers, it is certainly not a portfolio solution and could actually hurt investor portfolios overtime. Finding the right combination of quantitative and qualitative assessment, hands on professionals to fully engage with the data and the managers and constructing well diversified and complementary portfolios makes all the difference.

ABOUT PLUSCIOS MANAGEMENT

Founded by Kelly Chesney (pictured left) and Constance Teska (pictured right), Pluscios seeks to combine the best qualities of a diversity-led, boutique, customer-focused organization with large institutional experience and processes. We work with our clients on a wide variety of mandates such as custom diversity solutions, manager due diligence, diversified hedge fund of funds allocations and advisory services. Many of our institutional clients are advisors themselves, seeking a private label partner to ensure efficiency and depth in their diversity allocations.

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