# INDUSTRY SURVEYS – THE GOOD, THE BAD, AND THE UGLY

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**WHEN ANY TOPIC HAS PROPONENTS ON EITHER SIDE, IT USUALLY, THOUGH NOT ALWAYS, IMPLIES THAT THESE VIEWS ARE INFORMED BY DIFFERENT PERSPECTIVES.** People will typically arrive at different conclusions by applying their own different value judgements.

Manager performance surveys (henceforth just surveys) are no different, and I'll touch on a couple of points to highlight these nuances.

## THE DIKW HIERARCHY

As a way of introduction, I would like to start with the concept of the hierarchy of: data, information, knowledge and wisdom (DIKW). This will be useful in the discussion below.

This hierarchy represents a process that at the most fundamental level involves the gathering of data. In surveys, this would involve the collection of the time-weighted returns for various manager composites, along with other data on the asset manager, e.g. the benchmark for each composite.

The next step in the hierarchy involves processing this data to create information. In surveys, this would include calculating risk (or proxies for risk, like volatility) and return measures (e.g. three-year annualised return).

The hierarchy then requires information to be analysed in order to gain knowledge. In surveys, this would be knowledge about the managers, and this is where surveys begin to fail because performance numbers almost always require context. The numbers themselves do not constitute knowledge, only information.

The final step in the hierarchy requires the synthesis of knowledge to gain wisdom. You should not expect to get any wisdom directly from surveys. However, investment decisions and actions should follow from knowledge and wisdom and not from data and information. This is important because it is the crux of the limitations of surveys.

## THE "GOOD"

To the extent that surveys merely represent a description of something (as opposed to the broader definition of survey that includes an examination or analysis), they can be really useful. They are a great reference for how managers have performed over various historical periods and how their performance compares to other managers doing similar or different things.

Using the concept of DIKW above, you could use surveys to examine or analyse the information being presented, from which a number of questions may arise - this is the "good" component of surveys. It is a good starting point for further analysis in the pursuit of knowledge and wisdom about the managers and how they perform; and of the broader industry. Even contentious information like the rank of the managers' returns needn't be contentious if the rank is used as a quick guide to the order of returns.

## AN ANALOGY

Think about the regular criticism by many industry participants of volatility being used as a measure of risk. If you understand volatility to be the same as risk, you have missed or misunderstood the context completely. Volatility is merely a proxy for risk, often used because it is fairly easy to calculate, communicate and understand. If all risks were easy to identify and measure, we wouldn't use proxies like volatility for it. It would be lazy, however, to stop the evaluation of risk at the volatility number.

Similarly, it would be lazy to stop the analysis of a manager's performance at survey level. The analysis should run much deeper.

If you use **surveys to decide which performance numbers**, and consequently which managers, are good or bad, you would **generally be making a big mistake** (this is the "bad" component of surveys).

IT IS A GOOD STARTING POINT FOR FURTHER ANALYSIS IN THE PURSUIT OF KNOWLEDGE AND WISDOM ABOUT THE MANAGERS AND HOW THEY PERFORM; AND OF THE BROADER INDUSTRY.

## CAUTION, SURVEY AHEAD!

It is important to recognise that surveys are often used in unintended ways. This is where the difficulty comes in deciding whether to produce this information or not - are you enabling the misuse? I tend to favour not throwing out the baby with the bath water and therefore support making this information available, although with appropriate caveats and hazard warnings.

If you use surveys to decide which performance numbers, and consequently which portfolio managers, are good or bad, you would generally be making a big mistake (this is the "bad" component of surveys). If instead you used them to raise further questions about why managers have performed so similarly or so differently, this would be a good use of surveys. Understanding how managers will perform over various time frames and in different market conditions begins providing the reader with knowledge of asset managers (including their philosophies and processes).

## WHAT IS "PERFORMANCE"?

Performance should never be understood to mean returns only. This definition is too limited and hence problematic. Performance should always be understood in the broader sense of risk and return.

Risk should also never be understood to mean a single thing, like market risk (for which volatility is typically a proxy). There are many other risks, like credit risk, interest rate risk, and liquidity risk, which will rarely appear in surveys. Risk can be understood in the context of benchmark risk, which is relevant in many situations, so don't be too quick to dismiss it. Risk can also be understood in the context of liability risk or the risk of not achieving your goals or objectives. This should be your most important way of viewing and evaluating risk.

## IMPORTANT TOOL, BUT WITH LIMITATIONS

Finally, if you use surveys to make "hire and fire" decisions, you have gone too far (this is the "ugly" component of surveys). Many people base termination decisions on poor past performance, and appointment decision on good past performance. I believe this is both naïve and dangerous. I can't think of any data or information in a survey that would be sufficient on its own to lead to a decision to appoint or terminate a manager.

For example, you could argue that massive under-performance on its own may be enough to decide to terminate a manager, but you should never do this without at least a superficial examination to validate the results. Some of the "best" asset managers globally have had some serious bouts of under-performance.

Similarly, the appointment of a manager with stunning out-performance, without further investigation, should be equally avoided, because a simple statistical examination of past performance rankings will show very limited predictive results.

**Put differently – past performance on its own is not a very reliable indication of future performance. Often, periods of extended out-performance can be followed by relative under-performance. Buying a manager on this criterion can lead an investor to buy an under-performer – exactly what they were trying to avoid.**

Surveys can extend their reach further up the hierarchy of DIKW, beginning to touch on forms of knowledge, but they will only manage to do this with limited success. They should therefore be relegated primarily as providers of data and information. Users of surveys should recognise this and use them appropriately. Surveys represent a starting point to acquire knowledge and wisdom of the industry and its participants and this requires extensive additional examination and analysis of the results.

## OTHER TOOLS TO GAIN WISDOM

We view holdings based analysis (where we examine asset managers' composite holdings in securities over time – reflecting purchases and sales) as another important component in understanding managers and the industry. We also view manager visits, due diligence questionnaires and meetings, and report backs, as critical components tying together what we call manager research. In 2014 alone, we dedicated in excess of seven hundred man-hours to these meetings, and this excludes all the additional hours spent pouring over questionnaires and analysing holdings and performance. This is our continuous journey from data to wisdom.