



Information Overload

Can technology help asset managers improve research?

BY SHERREE DECOVNY

A couple decades ago, asset managers looked at demographic and quantitative metrics, such as ratios, earnings per share, and margins, to value a stock. Today, qualitative factors are often the main drivers behind valuations. Asset managers are bombarded with information, and many are struggling to gather it, track it, and make sense of it. Not having the right tools can put a firm at a great competitive disadvantage.

In 2000, the U.S. Securities and Exchange Commission implemented Regulation Fair Disclosure (FD), which mandated that all publicly traded companies must disclose material information to all investors at the same time. The purpose was to eliminate selective disclosure, whereby some large institutional investors received market moving information before retail investors. The intention of Regulation FD was to bring about better transparency and more frequent and timely communications between companies and investors. The litigation and regulation that came out of the dot-com crash and the collapse of Enron and WorldCom also has significantly affected the way in which asset managers conduct and procure research. [Editor's note: For more on the state of research, see our feature story "Settling Down" on p. 41 about the impact of the global research settlement.]

But the damage was done, and buy-side firms distrust sell-side research. Moreover, companies have clammed up. They have become less talkative and informative, one reason being that they are concerned that asset managers might short their stock. Not surprisingly, this situation has had an

impact on the quality of research.

"The quality of independent research is materially worse than it's ever been," says Charles Frumberg, chief investment officer at Emancipation Capital, a New York City-based hedge fund specializing in the technology sector. "There's been a brain drain from Wall Street, especially on the research side, that has created a need for information that is just not being filled."



Frumberg

Consequently, asset managers have had to hire more analysts and build out their networks so they can do research in-house. As the bear market takes its toll on the business, they are going to have to rely more heavily on productivity tools that make the research process more efficient and cost effective.

There are many models on the market to help with stock selection. If used appropriately, they can make the process of filtering data more efficient, according to Scott Johnston, chairman and chief investment officer of Sterling Johnston Capital Management.

The San Francisco-based firm manages about US\$1 billion for pensions and endowments. Its philosophy is to invest only in companies that have strong financials. To this end, the firm uses several quantitative-based tools, such as Lancer Analytics and Columbine Capital Services, to analyze balance sheets, income statements, and earnings predictions.

Yet a major challenge remains: sifting through massive amounts of other information, figuring out what is valuable, and tracking where it came from. Sterling Johnston does business with more than 130 brokerage firms,

KEY POINTS

- Regulatory changes supposedly increased transparency and leveled the playing field for information access, yet the quality of research is "materially worse," according to some investors.
- Asset managers are inundated with information at a time when they have to do more with less.
- Gaining competitive advantage is contingent on having the right tools for gathering qualitative information from various sources and tracking ideas.

and it is inundated with e-mails, conference calls and management meetings. In 2008, the firm had more than 600 analyst conference calls and 700 face-to-face meetings with the management of various companies.

To manage intangible information, the firm uses a system from First Coverage. Brokers input their best, high-conviction, and medium-conviction ideas into First Coverage. The system then tracks the performance of the stock and allows Sterling Johnston to score the broker input. "This system can pin down the value of the brokers that are giving you the good ideas," says Johnston. "We try the best we can to do business with the brokerage firm that gave us the idea."

A calendar system within First Coverage tracks the value of meetings. When the time comes to negotiate broker commissions, the firms that arranged the most valuable meetings are rewarded commensurately.

Sterling Johnston also uses StarMine's earnings-quality and balance-sheet models. The StarMine system tracks about 400 e-mails received daily and can be configured to automatically block e-mails from analysts that do not provide valuable information while still allowing the others to come through.

Without these systems, managing research would be extremely difficult.



Johnston

“You’ve got to have these kinds of tools to help you in this day and age,” says Johnston. “Otherwise, you’re way behind the eight ball.”

Emancipation Capital’s Frumberg notes that original data are more important than “getting the party line” from press releases or talking to a company’s management. Getting the right data involves a lot of detective work—calling companies, suppliers, and various constituents within a company’s “ecosystem.”

For the past year, the firm has been using a research system from FirstRain to help with that task. FirstRain crawls the web to find nuggets of information and discrete pieces of data that would not be found in a timely way or that might never be found at all. The system also tracks management changes that are not necessarily announced and can arrange information in an orderly, efficient, and customized way.

Technology is a data-rich sector—each company has its own story, supply chain, and customer set. “They have their own little universe of technology followers that write abundantly now in the blog world,” says Frumberg. “Getting our arms around that data to help inform our decisions is critical.”

FirstRain saves time and labor by cutting through the clutter. The information comes to Emancipation Capital through an e-mail or a portal, and the firm can determine how often and in what format it wants to receive it.

Most importantly, the system is a source of competitive advantage. “This is a business of having marginal information,” says Frumberg. “The sooner you have marginal information and can correctly assess it, the better you’ll be as compared with the next guy.”

HighStep Capital, a long-short equity hedge fund focused on the global technology sector, also uses the Internet as a giant investment research database. Jason Jones, president of the Mamaroneck, NY-based firm, gets a good grasp of the entire blogosphere by using the FeedDemon RSS reader. In doing so, he regularly taps into the expertise of CEOs, business sellers, consultants, and analysts.

“It’s all online, and it’s just a matter of using the tools and technologies that are out there to aggregate it, synthesize it, and make decisions on it,” he says. “The hardest thing is getting your arms around it.”



Jones

Jones uses a system from Connotate to take non-RSS information and enable it through an RSS feed. He creates his own datasets out of information that is freely available on the web.

For instance, he counts such things as the number of listings on eBay, homes listed for sale by various homebuilders, and cars available on an auto web site. He tracks pricing and creates indices for electronics products across retailers. He also tracks specific companies’ products. Recently, he has been looking at the price of Gillette products at a couple of drug store chains.

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CHARLES FRUMBERG

His advice to other firms is to leverage the consumer and retail tools available for free on the Internet before buying any other technology. Social network sites—such as Gerson Lehrman Group, Vista, LinkedIn, Facebook, and MySpace—can be valuable sources of intelligence.

“There are two ways of gaining an edge as far as I’m concerned: data extracted from the web and talking to the right person at the right time,” says Jones. “By leveraging those things that are out there, you can get to the right

person and you can find the right data.”

Several other research solutions are currently on the market. Code:Red’s Red Alerts RMS and IdeaNet portal stores all materials and interfaces with third-party providers to streamline information gathering. And JackBe’s Presto is a data access and visualization solution for syndicating mashup widgets (portable web applications that can integrate content from multiple sources) and operational dashboards (interactive displays for monitoring data flow) that deploy to any desktop environment. Presto integrates data from service-oriented architecture, legacy, database, business intelligence, and other in-house applications with any data source available on the web or from B2B partners in real time.

Highline Financial offers a web-based software environment for accessing, filtering, analyzing, and comparing data from U.S. banks, credit unions, savings and loans, and bank holding companies. It saves and organizes advanced searches, companies, and groups through a Web 2.0 interface. Asset managers can use it to evaluate potential investments in financial institutions as well as counterparty risk. The system not only provides credit ratings, but the data show when an institution is running into credit problems and what the problems are.

May the Best Tools Win

Asset managers are under pressure to reduce the cost of research while having to access, aggregate, and process more data. Given the explosion in the amount of information, technology will continue to play a key role in helping firms analyze multidimensional factors, track research, and integrate varied data into their workflow. In this environment, the winners likely will be those with the best tools. █

Sherree DeCovny is a journalist specializing in finance and technology.

RECOMMENDED RESOURCES

“From Overload to Overdrive”
CFA Magazine (Jan/Feb 2007)
(cfapubs.org)