

# Why more people are joining an improved community

New ways of providing research, ideas and market information are providing a win-win situation for portfolio managers, sell-side firms, independent research providers, and investors, writes Steve Coomber

WE LIVE IN AN AGE of information overload. Advances in communication technology means that executives are bombarded on a daily basis with emails, voicemail messages, reports, news alerts, tweets, newsletters – the list seems endless. It is no different for money managers. On the buy-side, whether you are a mutual fund, hedge fund, or pension plan, sifting out valuable information is becoming increasingly difficult. And it is equally frustrating for securities research analysts who struggle to get visibility and recognition for their best ideas above the noise. Fortunately, says Randy Cass, founder and vice chairman of the board of First Coverage, the North American-based provider of financial information management solutions, technology provides a very effective way to help buy-side decision makers cut through the clutter.

“The amount of information that is available is growing exponentially daily,” says Cass. “It is not enough to keep doing things the way that you have always done. There is a better way to gather and evaluate information that buy-side firms are using to make their investment decisions.”

## A smarter way

Cass knows from experience. As a portfolio manager at the Ontario Teachers' Pension Plan, Cass, like many other managers on the buy-side, coped with the massive amounts of information he had to deal with by focusing on relationships with just a handful of people he thought were above average performers. But, as Cass began to realise, he was acting on gut feeling rather than any truly objective evaluation of one source of information against the others.

“If you just stick to what used to work, and the people that you trust because you have a history with them, inevitably you are going to miss out on really talented people, and very material information. I thought there had to be a better way of gathering and organising information and focusing on the smartest people. Our notion is that technology has put this industry in a place where you can now deal with the flood of information in a much more objective and systematic way.”

Alpha capture systems are software-based electronic systems with web access, which collate investment strategies and trading ideas, and provide an interface for the buy-side to view those

strategies and ideas in multiple facets. Having all the recommendations in one place allows their performance and quality to be monitored, compared and rewarded.

The idea originated in 2001 with Marshall Wace, the London-based hedge-fund, when it developed its Trade Optimised Portfolio System, which was rolled out in 2002. It was not long before other alpha capture systems were launched in London and then in North America. It is not surprising that buy-side firms were looking for better ways of assessing the value of the information that they were provided with. In 2002 Eliot Spitzer, the New York State Attorney General at the time, wrestled a billion-dollar settlement from a number of investment banks, having accused them of providing biased advice through associated broking firms.

More transparency was required – a key advantage that an alpha capture system can provide. “There is a demand for greater efficiency dealing with information, but also greater transparency; with what you receive, what you consume, what you pay for,” says Cass.

“Boards of all buy-side firms, as well as portfolio managers of buy-side firms, are demanding that if people want to be compensated for the information that they are providing, then it needs to be in a place where it can be tracked and the provider held accountable for it, and thus demonstrate to stakeholders that the provider of the information added value that was commensurate with the amount that they were paid.”

Daryle DiLascia is executive vice president and director of equity sales at Keefe, Bruyette & Woods (KBW). The firm specialises in the financial services sector. Alpha capture systems are an integral part of KBW's business, says DiLascia, and that includes the First Coverage platform. “It is all about how the client wants to receive information. We spend a lot of time on the phone with our clients every day. There is a large body of emails, and some clients have requested that we deliver all idea flow via an alpha capture mechanism, so that they can see that information and how it is received on their own desktop.”

“It provides the buy-side user with some ability to more easily measure the performance of the ideas that you put into the system. If you are just having a conversation with someone, it is not as easy to capture scientifically whether we are adding value or providing good idea flow. So some people on the buy-side like this as a supplement to phone conversations or emails while some use it exclusively.”

In fact First Coverage's solution provides more than

## TOP TEN FIRMS

- 1  
**KEEFE, BRUYETTE & WOODS, INC.**
- 2  
**CRAIG-HALLUM CAPITAL GROUP LLC**
- 3  
**FIRST ANALYSIS SECURITIES CORP.**
- 4  
**CLEVELAND RESEARCH COMPANY**
- 5  
**COWAN AND COMPANY, LLC**
- 6  
**MONNESS, CRESPI, HARDT AND CO., INC.**
- 7  
**STERNE, AGEE & LEACH, INC.**
- 8  
**DAHLMAN ROSE & COMPANY, LLC**
- 9  
**BREAN MURRAY CARRET & CO.**
- 10  
**WEDGE PARTNERS LLC**

just alpha capture, Version 3.0 of its “Community” web based platform, combines the features and functionality of an alpha capture system, a media sentiment engine and a meeting management tool. The Community aggregates, consolidates and analyses a range of traditionally unstructured data including trade ideas, news articles, industry blogs, research, and other communications. The result is a dynamic, holistic real-time view of market events, sentiment and opinion. Data is available in various formats and APIs, including SOAP, XML, tab delimited and Excel, making it easy to integrate with backend systems.

Research information and individuals can be sorted, organised and monitored according to a range of criteria, including conviction levels, average rate of returns, and best industries, for example. Performance against benchmarks is ranked. This allows portfolio managers not only to objectively assess the performance of idea providers and tailor coverage accordingly, but also to more closely link compensation with value. It also means only the best high-conviction ideas are likely to get input.

“We have automated the process of being able to find the smartest people,” says Cass. “For example, the rankings identify people in each industry, in each market type, that have done better than all their peers. So you might want to find people in Basic Materials who have outperformed the market by 300 basis points over the last year and entered at least 20 ideas with attached research. The Community lets you find those people.”

#### A range of benefits

Like all innovations, some analysts have found the transparency and objectiveness of alpha capture and information systems like The Community difficult to get used to. There is no question, however, that there are considerable benefits for consistent performers. A platform like The Community provides greater visibility for many high performing sell-side and independent research firms.

“When I was portfolio manager I had to react to an idea left on my voicemail, along with 27 other voicemails with four ideas per voicemail, on the day it was left. Either I reacted to it, and to do that you had to hit me on a day when I had capital to allocate, time to spend on it, and when I was even interested to listening to new ideas – that is a pretty high threshold – or I never heard of it again,” says Cass. Now, instead of using the sell-side and the independent research providers as an all you can eat buffet, where you go to the same four or five for absolutely everything, it becomes a kind of a la carte dining experience, where through the numbers and the rankings and the objective data, the portfolio manager goes to the best in any particular area.”

Behind the Numbers is a forensic accounting research firm that only provides earnings warnings and sell recommendations. Jeff Middleswart, president and director of research for Behind the Numbers, is a fan of The Community, and according to First Coverage’s Top Performer rankings was the number one institutional sales rep in the US in 2008.

“I think that these platforms allow for a more quantitative feedback generation on the actual ideas you are inputting versus the levels of service you are providing,” says Middleswart. “First Coverage benefits

## TOP TEN INDIVIDUAL PERFORMERS

1

**JEFF MIDDLESWART,**  
Behind the Numbers

2

**JEREMY HELLMAN,**  
Singular Research

3

**BRAD BISSELL,**  
William Blair & Company, LLC

4

**MATTHEW LANE,**  
Cowen and Company, LLC

5

**KEVIN TOWL,**  
Soleil Securities Group, Inc.

6

**MARK MURPHY,**  
Stifel, Nicolaus & Company, Inc.

7

**DEREK CLOTFELTER,**  
Pacific Crest Securities

8

**JOSH GRIM,**  
Dahlman Rose & Company, LLC

9

**BRAD WYNVEEN,**  
Citigroup

10

**STEVEN KROLL, JR.,**  
Monness, Crespi,  
Hardt and Co., Inc.

The First Coverage rankings are derived from more than 100,000 actionable sell-side trade ideas communicated by nearly 1,000 sales people at more than 250 firms that participated on the system in 2008 and represent the only completely objective evaluation of the sell-side.

us because we have so many warnings at any given time it can be tough for our clients to stay on top of them. We publish our research every month and update warnings as we go along. Clients would often forget that several months ago we wrote a story that we still really like. With this system if we like an idea from several months ago, that people may have forgotten we wrote, we can go back and highlight it.”

The Community also offers other benefits to sell-side and independent research providers. The platform protects the intellectual property – the buy side sees the performance not the detailed research. Sell-side and independent research firms can control their identity and idea, as well as the amount of information given to both existing and potential new buy-side clients.

The platform is also a useful tool for the research firm to evaluate and refine its own strengths, and the performance of its people.

“Personally I have found a lot of benefit in better understanding the amount of value that is being added by our sales professionals,” says KBW’s DiLascia (KBW was ranked number one in the US by First Coverage for its 2008 Top Performer Awards).

“As a salesperson, entering ideas into a system like this that provides you with feedback, helps you understand what you are good at and where you might lack in your idea generation. You can use that feedback loop to improve your own sales process, so that you can deliver a more concise and confident message to your investors over time.”

#### Capturing alpha

Alpha capture is here to stay. Buy-side firms value the ability to objectively assess performance and make more effective investment decisions as a result. It makes for a more transparent and efficient market in information and ideas. Add in the enhanced provision of real-time information, aggregated and analysed, and you get a must have product like The Community.

“With First Coverage, we can track stock performance, score broker input, and pin down the value of the brokers that are giving us their best, high-conviction ideas. Those are the brokers we do business with,” says Scott Johnston, Sterling Johnston Capital Management LP, which specialises in small cap growth equity management.

“Our process and performance shows that the sell-side represents a significant source of alpha provided their information can be efficiently captured, analysed, and risk managed. Our decision to use the First Coverage system as a feed into the GSA Alpha Capture fund was based on their ability to connect us to an interesting and diverse set of idea generators in North America that we might not otherwise have uncovered,” says Dan Squires of GSA Capital Partners, LLP.

“Portfolio managers like Scott Johnston and Dan Squires win because they start dealing with smarter people and better information,” says Cass. “The sell-side and independent research writers win because it becomes a meritocracy where value of information and content trumps whether you went to school with someone, or who gets along on the golf course, and the investors win because they get much more transparency around who is being paid, what they are being paid, and what the return is for that spend.” ■