

Is there skill? What does it look like?

Decision Attribution for performance reporting

NOTE FOR RECIPIENTS of PDF:

This are the annotated slides of a talk given by Dr Kate Land, Lead Data Scientist of Inalytics, on Feb 29th 2024 in New York, at the FTF Performance Measurement and Client Reporting conference.

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SEE SKILL

Skill Does Exist

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MORNINGSTAR

Active Funds Continue to Fall Short of Their Passive Peers

Investors should focus on long-term signals and costs when picking their spots, based on the latest Active/Passive Barometer.

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Active funds fall behind passives in 2023 rally

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Is active management doomed?

Asset managers are under pressure as never before as the 'golden decade' for the industry recedes from memory. Zero interest rates and quantitative easing pushed equity markets to record highs and bond yields to record lows. In the current environment of higher inflation and higher interest rates, however, investors are increasingly focused on cost and are migrating to low-cost passive options. The failure of active strategies to outperform amid the favourable conditions of 2022 is placing further pressure on the

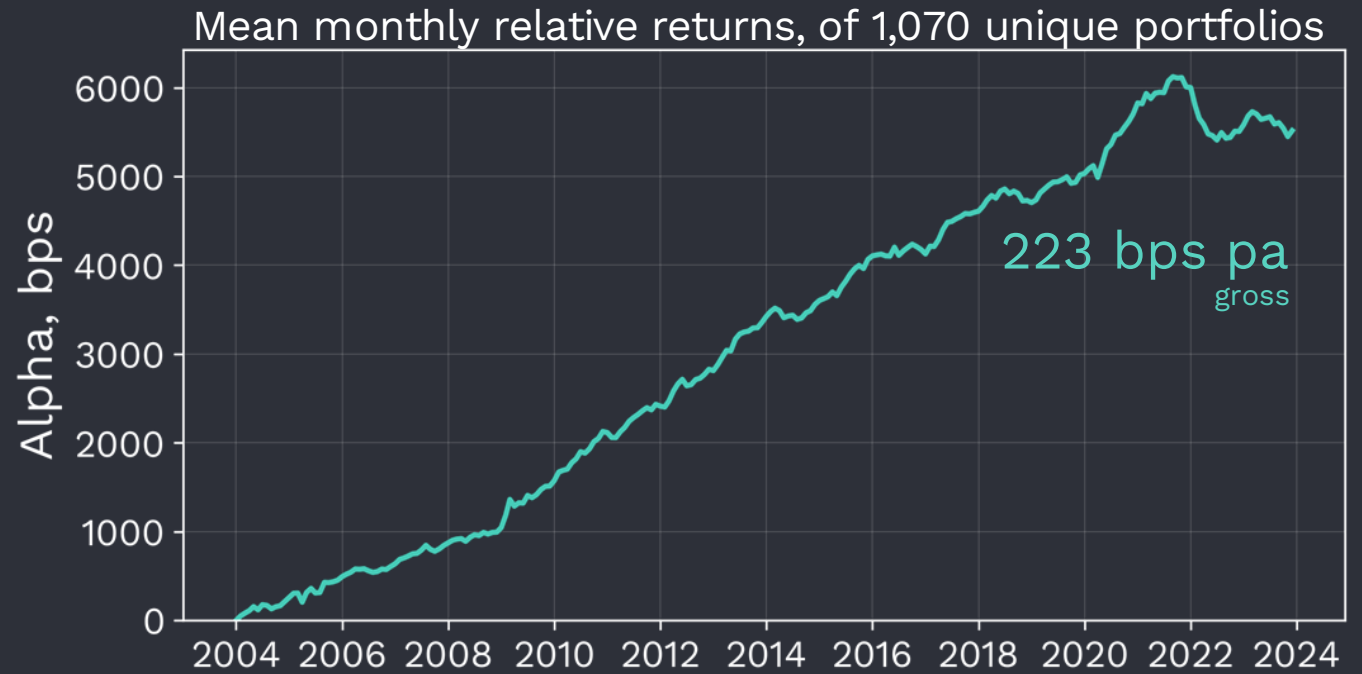
Despite the headlines, it is our experience that skilled managers do exist.

What is happening on average in the industry, or on aggregate, is not that relevant. We need to know why someone has experienced the outcome they have.

Skill Does Exist

At Inalytics, we are in the unique position of having a lot of historical data, we can use for research. We have a database of over 1,000 unique portfolios.

When working with skilled managers, going through tough patches, it is important our analytics are relevant, constructive, concise, and easy to understand. We turn data into information.



Decision Attribution

DECSIS™ is our proprietary Decision Attribution framework.

It tracks the impact of a manager's decisions, allowing us to attribution performance to different parts of the investment management process.

This provides insights that are constructive, and resonate with how the manager thinks and operates.

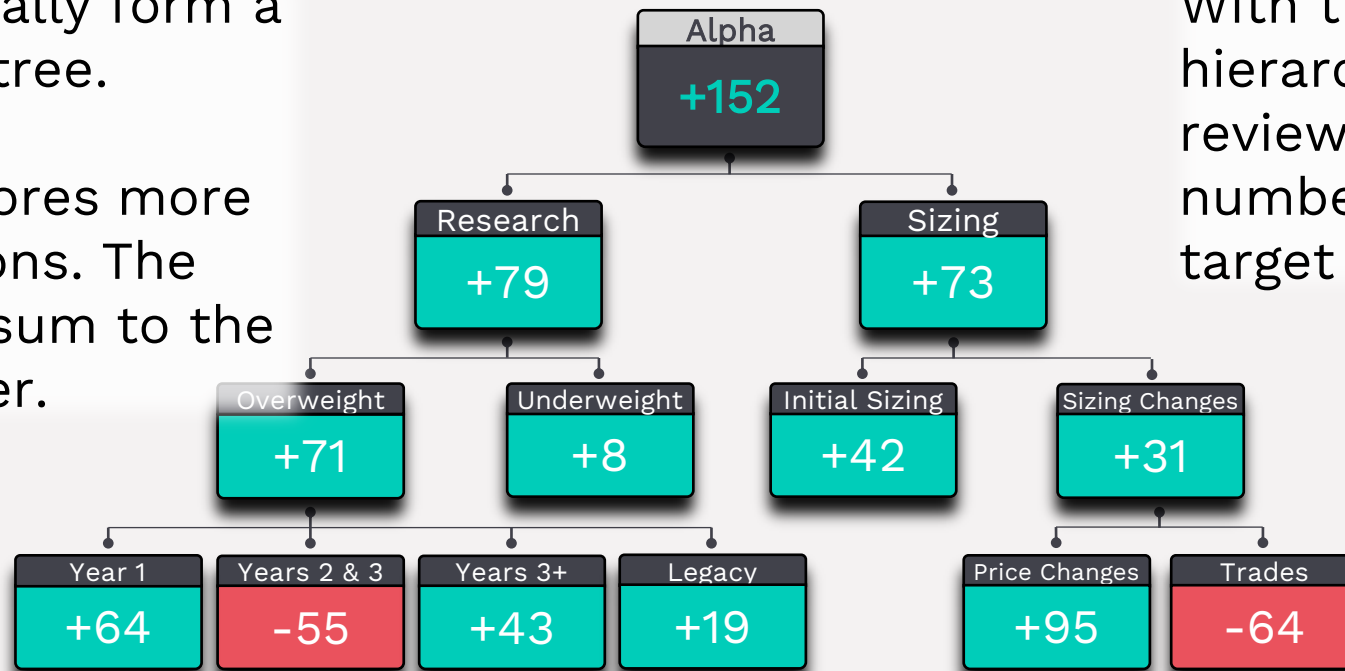


A Hierarchy of Decisions

Decisions naturally form a hierarchy, or a tree.

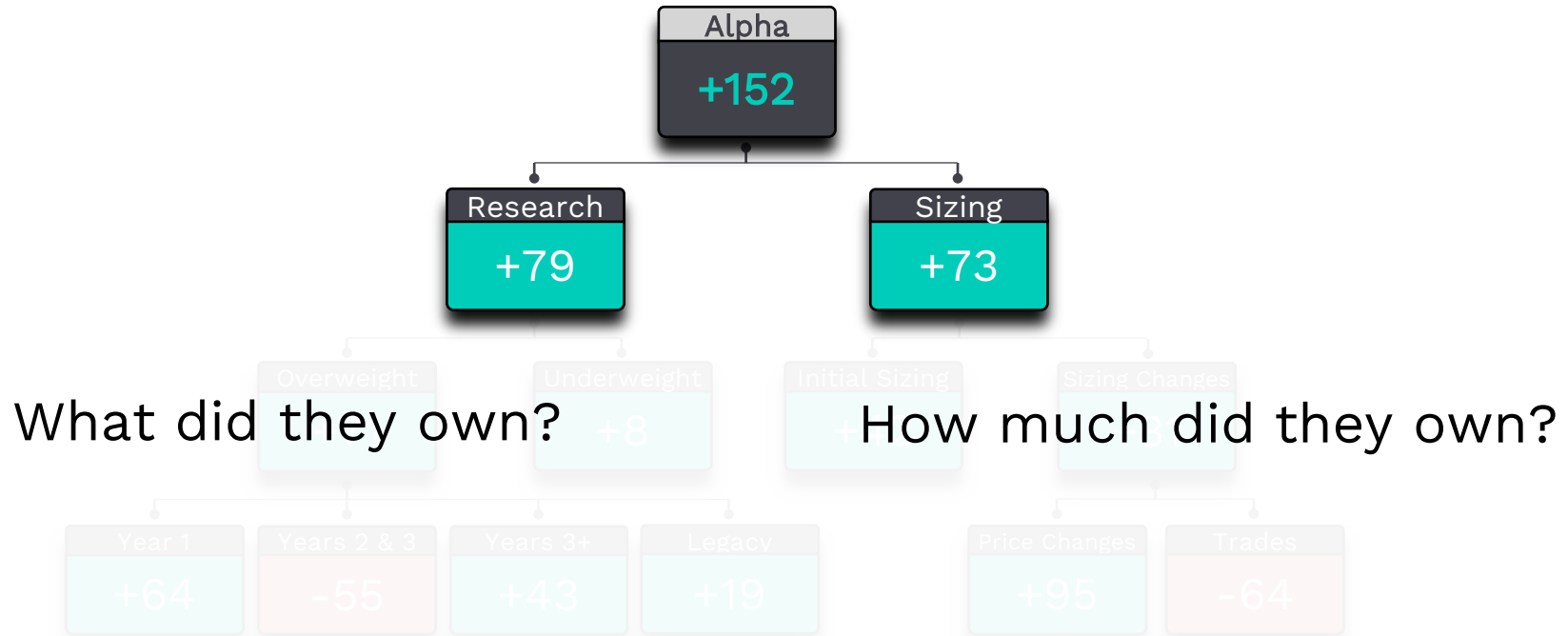
Each level explores more granular decisions. The results always sum to the previous number.

With the DECSIS™ summary hierarchy, we can quickly review a portfolio against a number of key issues. And target further investigations.



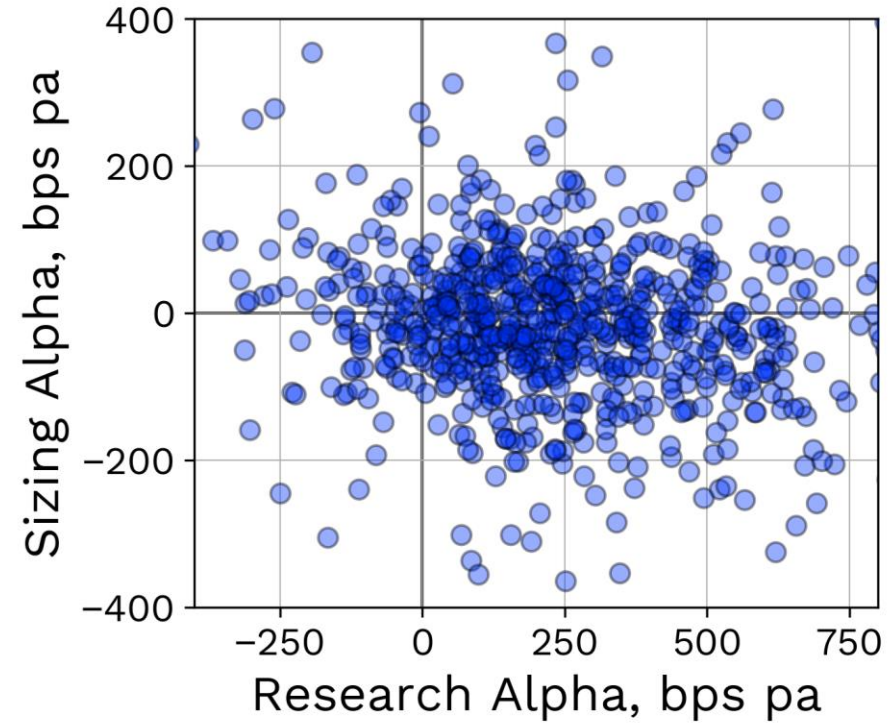
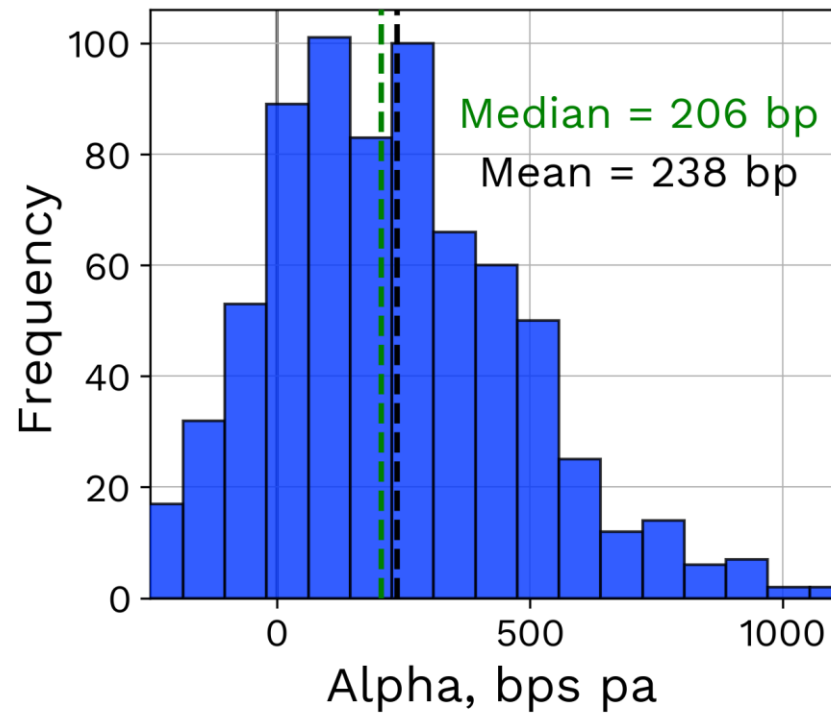
Annualised alpha since inception, bps

Two Types of Decision

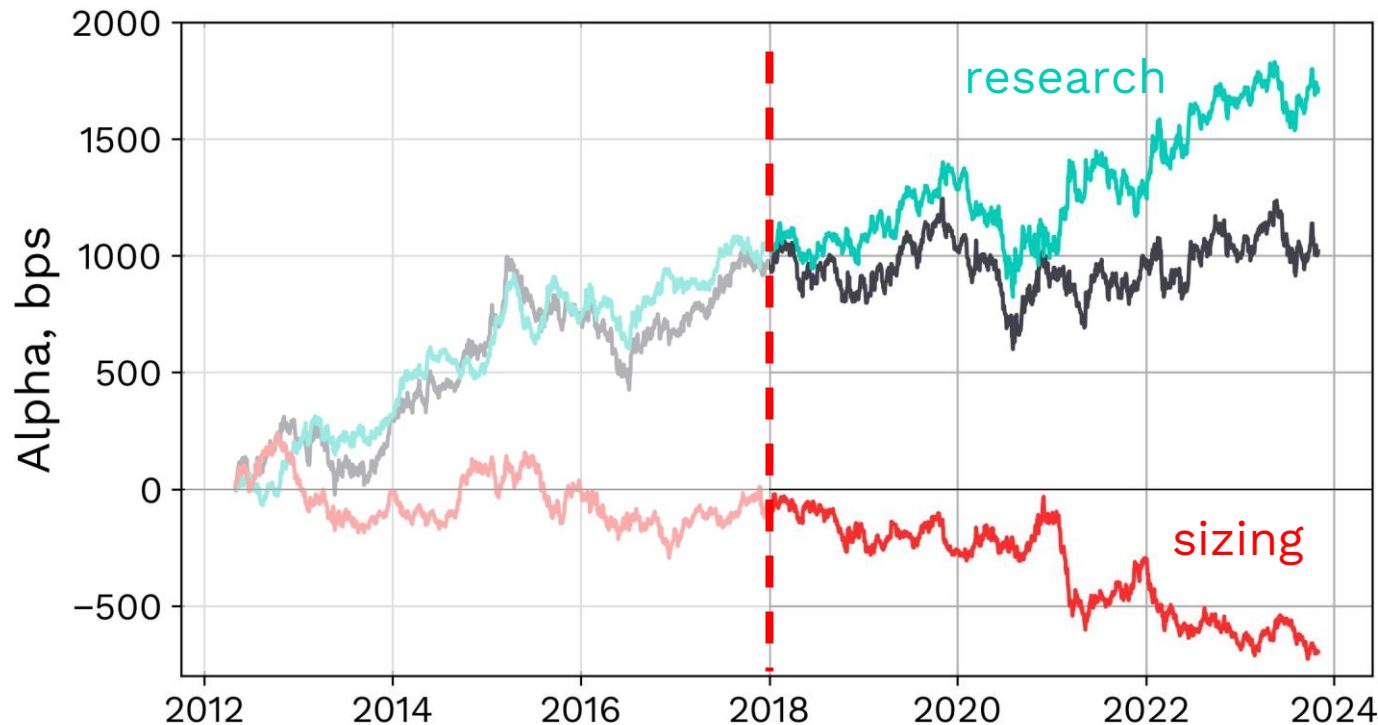


Industry Findings

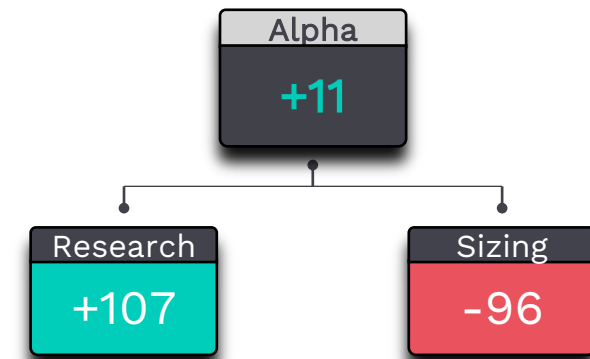
On average, Portfolio Alpha is driven by Research. But there is a wide range of results.



Alpha Left on the Table



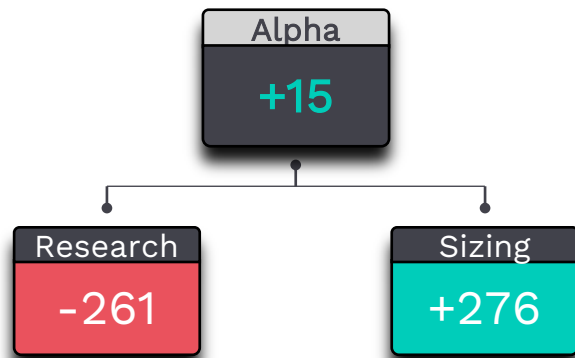
In this case study, the manager has experienced flat performance for the last ~6 years, but that is not due to a decline in their research skill.



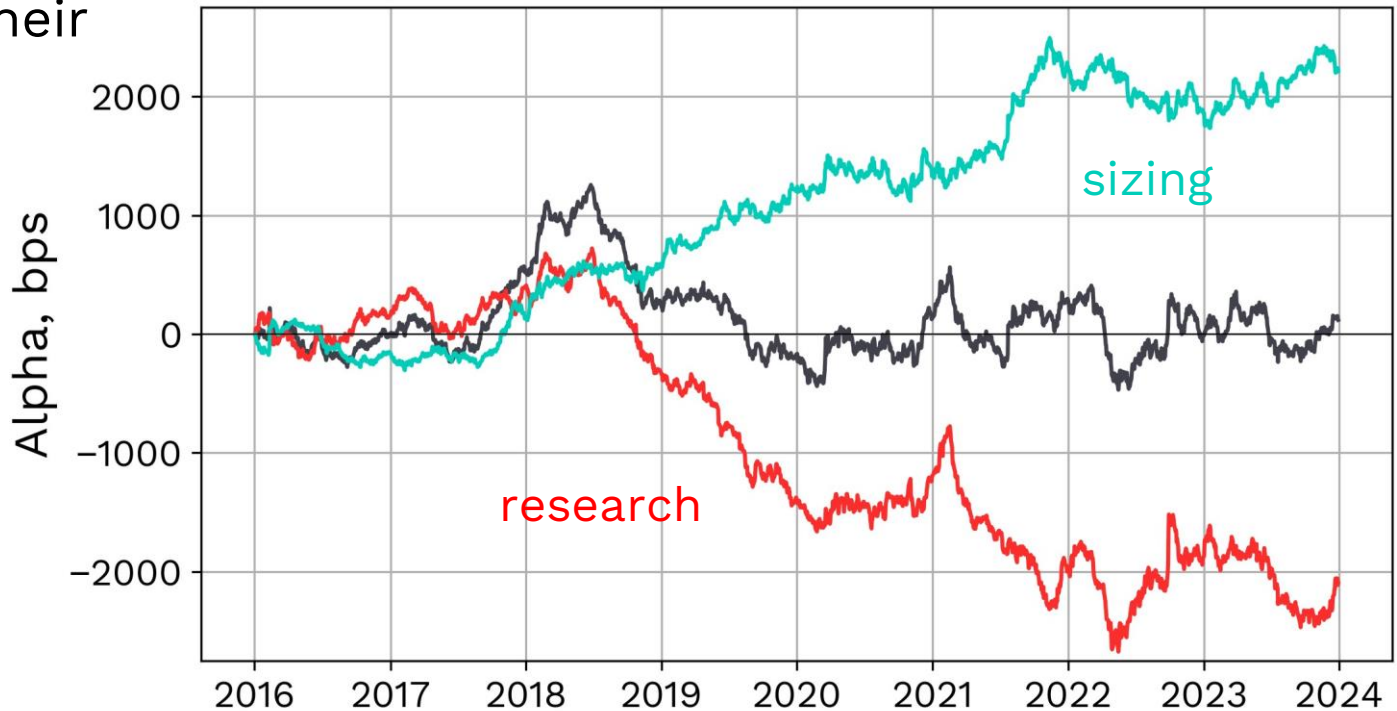
Annualised alpha, since Jan 2018

Sizing Saves the Day

In this case study, the manager appears to know which their best ideas are. But the majority of their instruments haven't performed well.

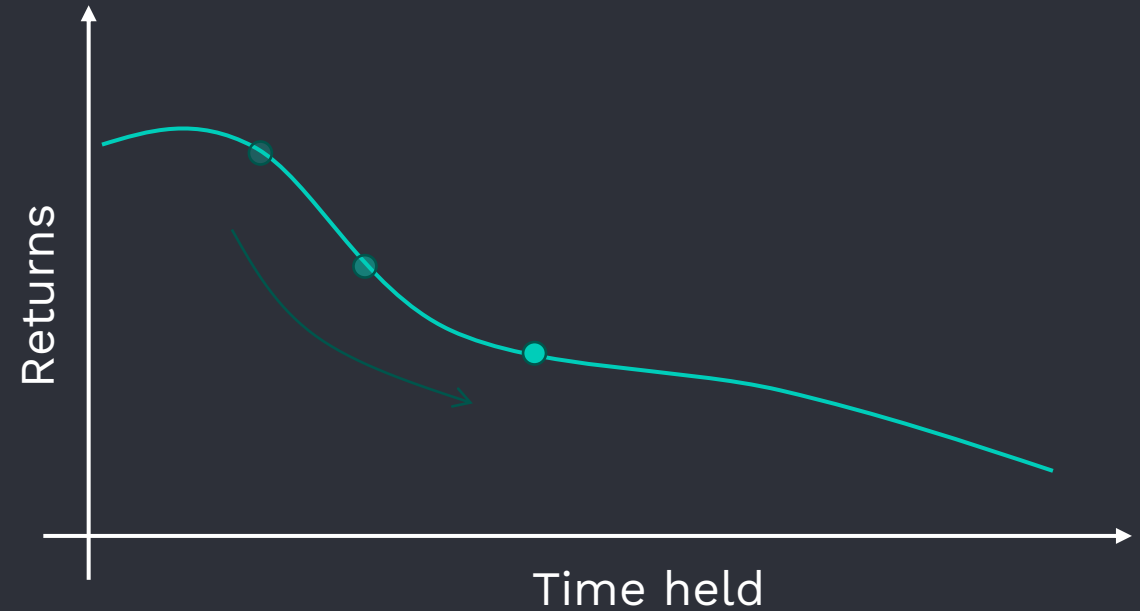


Annualised alpha, since Jan 2016



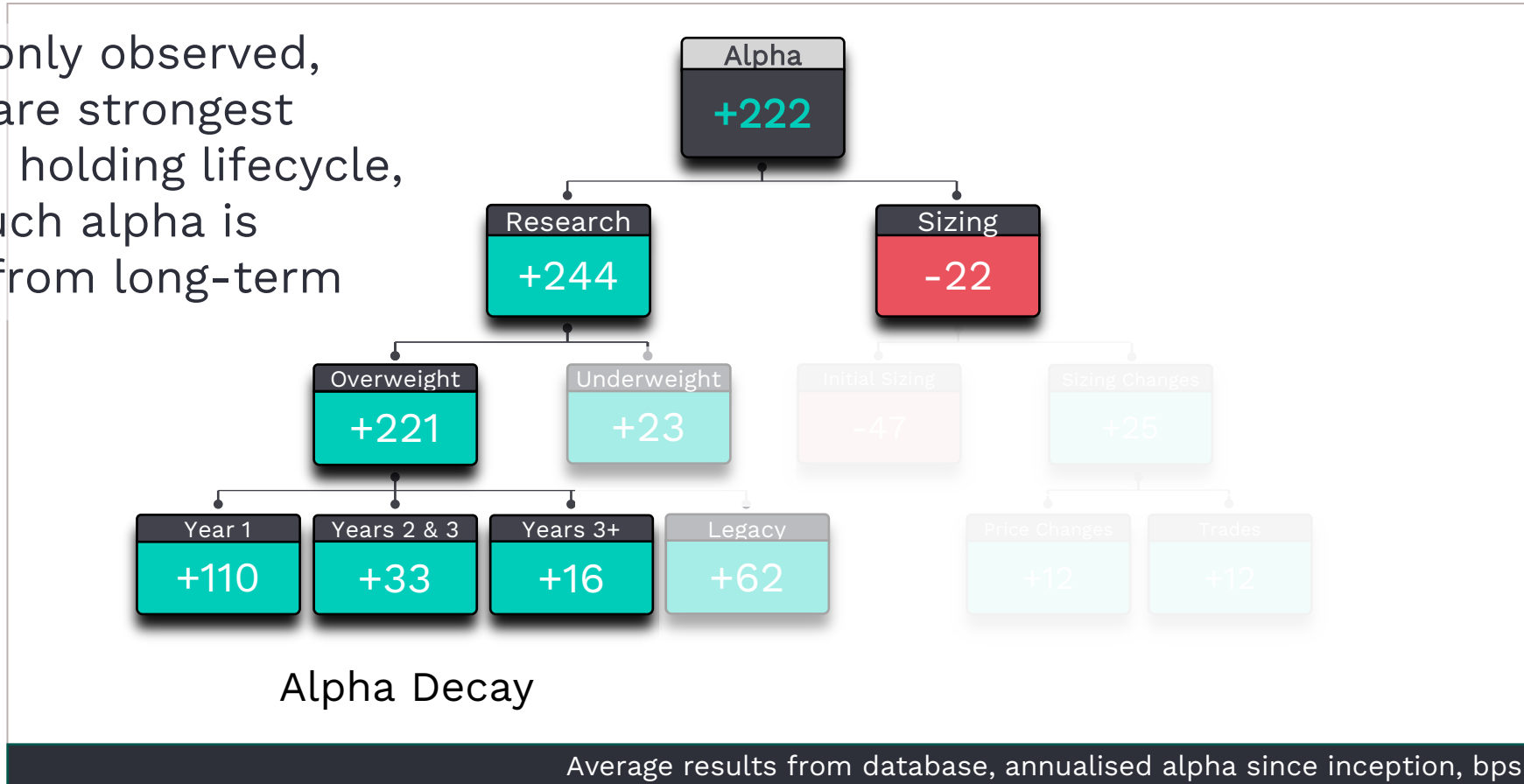
The Research Process & Alpha Decay

How we use DECSIS™ to explore the research process, and the issue of alpha decay.



Examining the Research Process

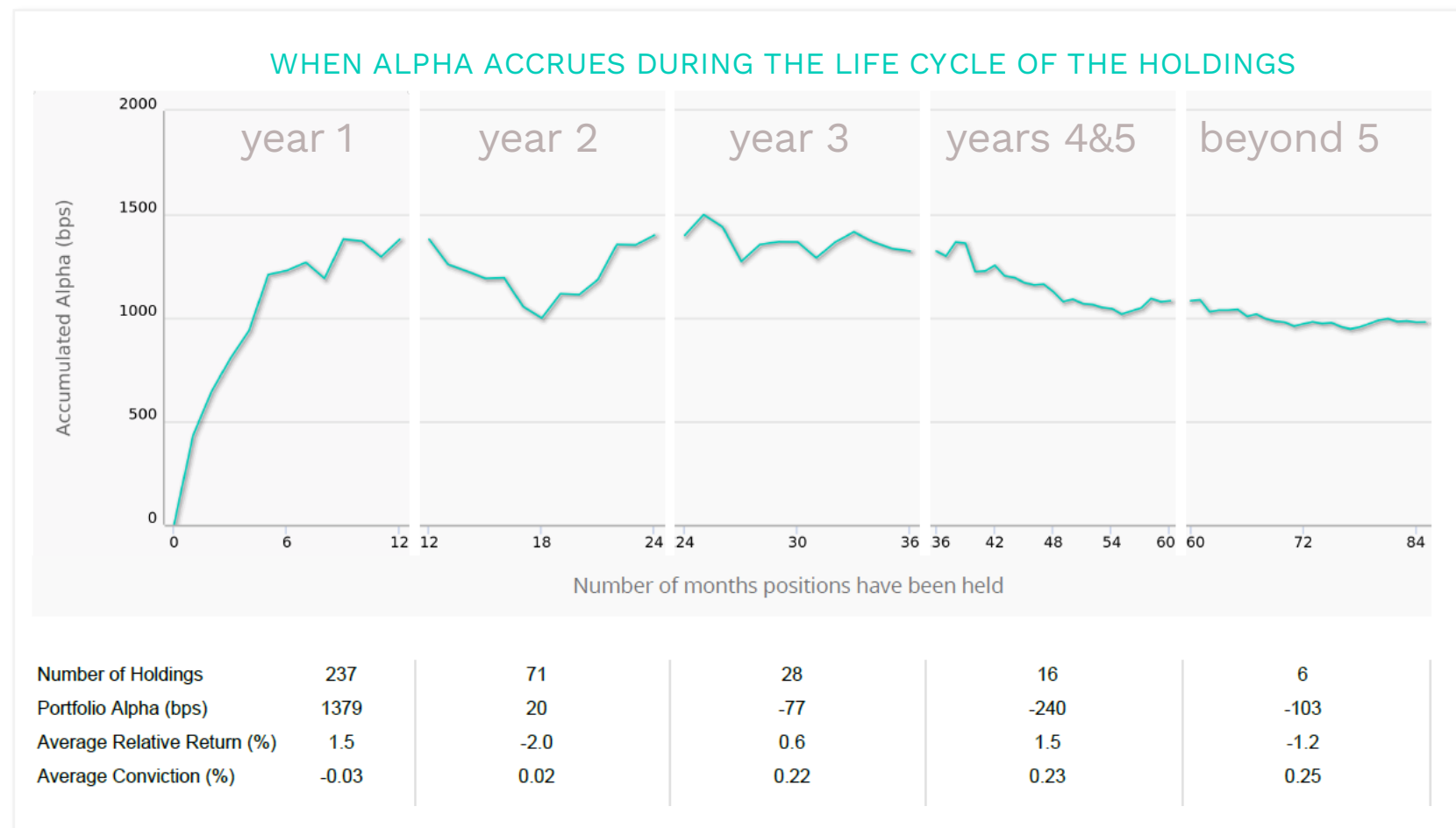
It is commonly observed, that ideas are strongest early in the holding lifecycle, and not much alpha is generated from long-term holdings.



Alpha Decay – case study

Holding Lifecycle analysis shows when alpha is generated, aggregated over all holdings.

In this example, there is evidence of poor continue-to-hold decisions.



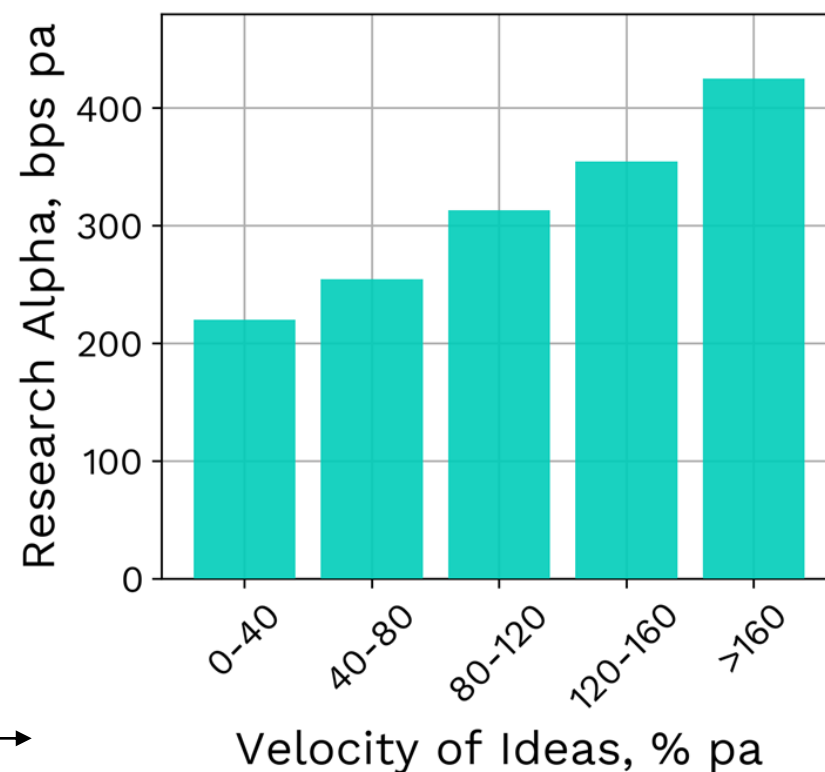
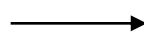
Alpha Decay – industry findings

Our large systematic studies show that, on average, ideas perform best early during the holding.

As a result, we observe that managers benefit from introducing new ideas to the portfolio.

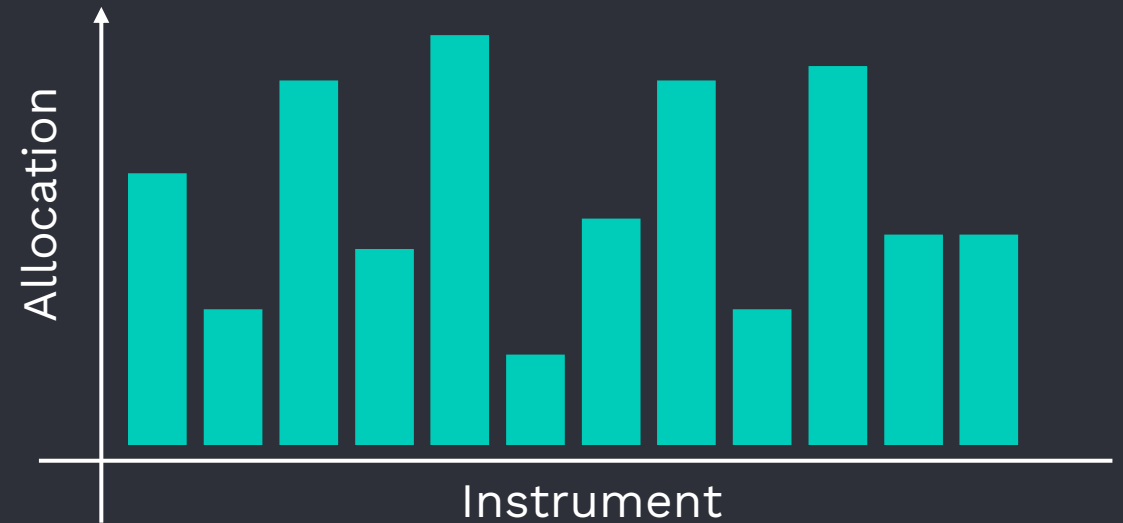
“Velocity of Ideas” is similar to Turnover. We find higher turnover portfolios perform better, on average.

“Velocity of Ideas” is the number of new ideas added to the portfolio, as a % of the average number held at any time.

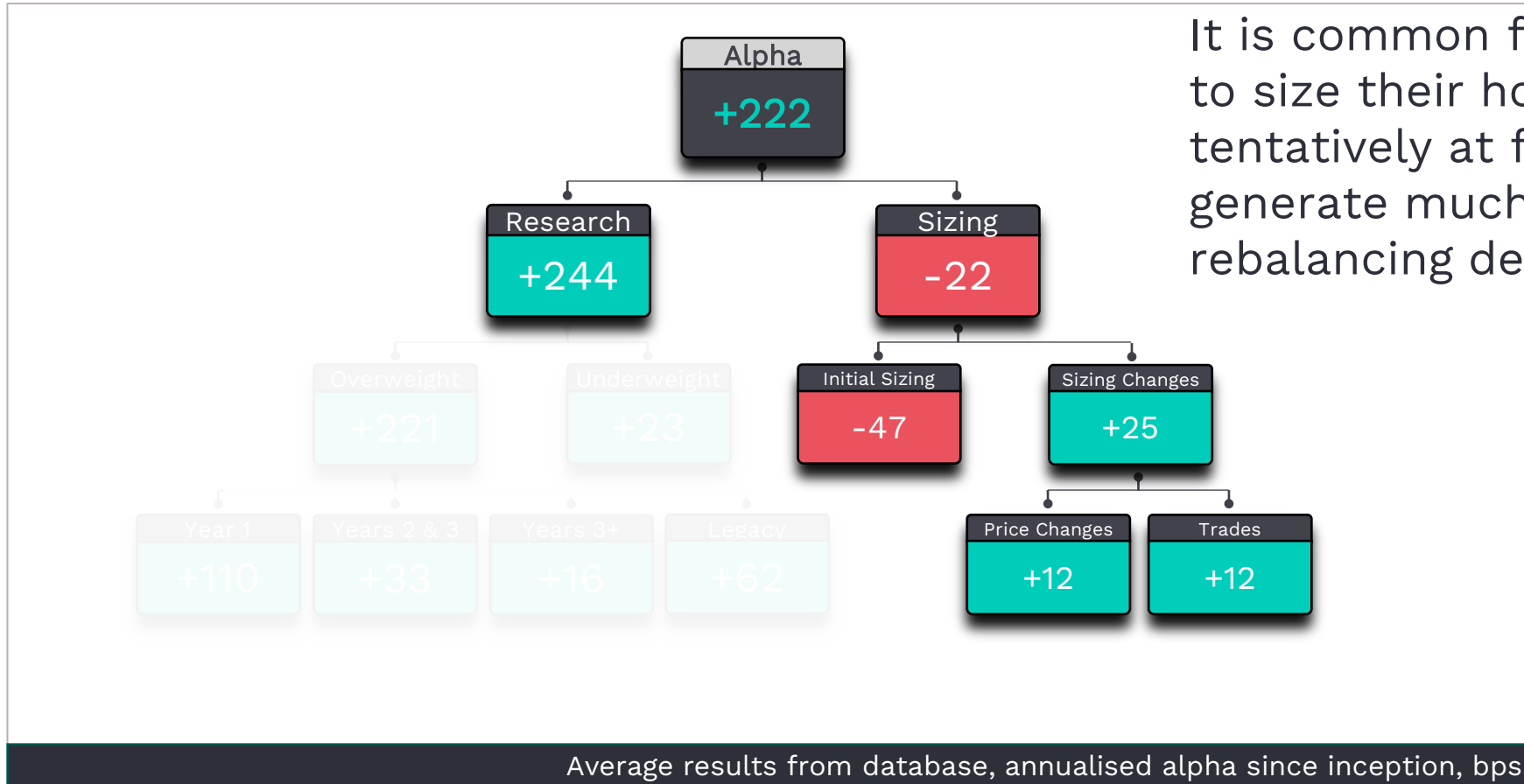


The Sizing Process

How we use DECSIS™ to explore the sizing process.



Understanding the Sizing Process



It is common for managers to size their holdings tentatively at first. And not generate much alpha from rebalancing decisions.

Summary

- Skill does exist
- DECSIS™ is a novel and powerful framework:
 - Connects outcomes to investment process
 - Shows the big picture, and enables targeted follow up
- Our research reveals that, *on average*, managers:
 - Benefit from Research
 - Accrue most alpha early in the holding lifecycle
 - Size new holdings too tentatively

Find out more about our research findings at inalytics.com/insights/

Thank you



Angus Duncan



Kate Land