



*Reprint of FundFire article written
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CFA SOCIETY OF SACRAMENTO

MoneyVoices: Manager Research Must Improve

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Many pension plans are hiring managers-of-managers to run their external manager programs. These plans seek to diversify internally managed strategies, as well as to add alternate sources of alpha to address funding-liability mismatches. Manager-of-manager programs require a breadth of knowledge spanning several asset classes, as well as the ability to integrate individual manager return-risk characteristics within an overall portfolio's objectives. As more institutions use this type of program, we need to remember that manager research and evaluation is as much of an art as it is a science.

The CFA Society of Sacramento, whose membership comprises several individuals who run or administer external manager programs, has encouraged several discussions regarding how to conduct such evaluations. CFASS members question whether it is possible to quantify the qualitative. If so, then there may be a need for standardization of the measures employed to rank qualitative events, such as the departure of a key investment professional, negative changes in asset flow, or some subtle and potentially deleterious change to a firm's culture.

CFASS members agree: it is difficult to assign hard values to such events. These events are idiosyncratic and are subject to interpretation on a firm-by-firm, or

even strategy-by-strategy, basis. Even if it were possible to establish a point or quartile system for certain commonly occurring events, there isn't a method for deriving a standardized Z-score across all the various, qualitative issues. [A Z-score is a common statistical way of standardizing data on one scale for comparison, like a common yard stick for all types of data.] Some feel such standardization is not even necessary.

As CFASS members grapple with the question of whether — and how — to standardize and/or quantify the qualitative, managers-of-managers continue to reconcile the oftentimes conflicting demands of their roles. As investment anthropologists, they study lagging indicators such as performance and modern portfolio theory statistics, building a profile based on historical tendencies and batting averages. Then, as cultural psychologists, they deconstruct that effort. Neither activity alone, nor together for that matter, can be used to forecast with certainty a manager's performance.

We need more discussion on whether there ought to be a standardized way to account for "life events" within a manager-of-managers' firm or strategy. With that, it might be possible to extract one overall "hire" or "terminate/de-fund" signal, which could then be used to evaluate with more certainty the manager or strategy in question. •