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Study Examines Impact of Firm Traits On Performance

Research analyst additions and asset growth have the most standard impact on risk-adjusted returns for emerging asset management firms, according to a study released by **FIS Group** that focused on evaluating the impact of a firm's salient characteristics on performance. The study, which examined manager performance for the three years ending Dec. 31, 2006, assessed the impact of factors such as portfolio concentration, degree of trading activity and number of research analysts and portfolio managers.

"It is easy to look at top line returns and look at statistics," said **Tina Byles Williams**, founder of FIS. "Trying to get beyond that and look at actual characteristics. That is where the data collection becomes a little bit more challenging."

The study looked at large- and small-cap growth, core and value firms, with 830 total firms—492 large-cap and 338 small-cap—included. Large-cap core had the highest total number of funds at 209, with small-cap core having the lowest total at 77.

Byles Williams said prior studies by FIS, which it did not make public, looked at the emerging manager universe as a whole or only examined the large-cap or small-cap space, regardless of style.

"We wanted to look at it with a finer microscope if you will," she said of the new study.

Byles Williams also believes that understanding the relationship of various non-performance related factors to a firm's performance can answer additional questions during the due diligence process.

"If there is, and we believe there is, a performance impact of asset growth, what is driving that? It's not because people become less insightful, something is driving that. That is why we went a little deeper there," she said. "What we are trying to get at is general characteristics that lead to success or the lack thereof. So for example, if in fact the issue is turnover and that impacts performance, then for large-cap growth managers, that is something we would really focus on to look at trends in their turnover, or if it is a large-cap core manager … and we see dilution in their bets and or dilution in the input of insight into their portfolio decisions, then it gives rise to a series of questions. It doesn't mean we would change how we rate a manager, but it leads to an avenue of questions," she said.

Byles Williams said that small-cap value managers carry a strong correlation between additional research analysts and the degree of downside risk in the portfolio.

"We also found that value managers tend to have more concentrated portfolios than growth managers," she said. "And that also tended to positively correlate with measures of risk-adjusted returns."

"Portfolio concentration was a better thing in small cap value than small-cap growth," Byles Williams said, adding that there was a more rapid rate of dilution of risk adjusted returns with asset growth with small value than small growth.

"One thing that was interesting, not particularly new, but it really affirmed the notion that there really is a sweet spot, if you will, and the sweet spot appears to be growth up to $500 million but throwing lots of research resources that that $500 million," she said, adding that there appears to be a greater tolerance of asset growth for small-cap growth firms over value firms.

She said the firm also has other avenues it will look to explore in future studies, such as the differences between qualitative and quantitative firms.

"Because individual security selection appears to be less important than portfolio structure for value versus growth, the conclusion on growth could lend itself to more quantitative type products, something we want to look at" in the future, she said.

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