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Digging around your trading data makes your portfolio management oversight easier

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Every quarter for the last decade, **Jonathan Kaufman** has been "getting my fingers" dirty combing and assembling his firm's trading data to look for trends and exceptions.

"I'm doing a lot of [data] crunching," says the CCO at **Globalt Investments** ($1.2B in AUM) in Atlanta. Kaufman pulls reports from the firm's PM system, **AXYS**, and dumps them into Excel where he produces a "dashboard" view of what the firm's six portfolio managers have been up to.

His analysis probes averages and medians across accounts and how each PM compares against his benchmark and the composite, among other items. "You want to have a very tight standard deviation," Kaufman says after the numbers are all in. Anything outside of two standard deviations prompts him to take a closer look.

A question of fairness

"At the end of the day, you want your clients ... to be treated fairly ... that not one is being favored over another," he says, in stating the fiduciary duty basic that forms the nucleus of why other CCOs should be doing similar analyses.

Kaufman granted **IA Watch** permission to share one example of his analysis. The "equity income" graph below marks an outlier with "RVW," meaning it deserves a review by compliance. His "matrix" includes several pages of similar graphs, which he shares with the firm's compliance committee and its board.

The portfolio management review at **Perritt Capital** ($623M in AUM) in Chicago features CCO **Lynn Burmeister** sitting in on weekly PM meetings as well as the weekly investment committee gathering. Each quarter, she checks for the fairness of allocations among the accounts of the firm's mutual fund and high-net worth clients.

Be clear in your definition of what you consider to be fair allocation and make sure it's understood throughout your firm, Burmeister recommends.
"There should always be a continuing conversation" between compliance and portfolio management/trading, suggests **David Tang**, a former RIA CCO who is now counsel with **Seward & Kissel** in New York. "One of the jobs of the compliance officer is to ask the questions that no one else is asking," he adds.

Understand allocations

If you don't understand why certain trades are being allocated to certain accounts, ask, he continues. Have access to the trade blotter. Even better, have your firm's order management system on your desktop.

If you've seen trading problems at your firm, monthly tests may be called for. Otherwise, quarterly reviews will do. Tang gives examples of topics compliance officers may wish to make part of their trading reviews:

- ✓ Allocation of investment opportunities among clients.
- ✓ Allocating aggregated orders, and when they're aggregated.
- ✓ Trade order rotation.
- ✓ Consistency that your PM meets guidelines and restrictions.
- ✓ Reviewing performance of similarly managed accounts.
- ✓ Offering documents for private funds.

Review fund documents and client agreements against client setup in your system "to make sure every client guideline" has been coded in or you understand why it wasn't, recommends Tang. Develop procedures to track compliance with those that weren't coded in, he adds.

More trading tests

Four other PM compliance tests you may consider are:

1. Performance outlier test.
2. Trade activity (turnover test) outlier test.
3. Objective reviews.
4. Holdings outside the model.

The first test groups accounts by strategy and looks at the top 10 and lowest 10 performers, says **Michelle Kennedy**, president of **Compass Compliance Services** in Greenville, S.C. The second test examines the top 10 accounts by trading activity, as well as the 10 accounts with the least trades in a quarter.

Objective reviews refer to looking at client objectives versus how the account was actually managed. If a PM strays from objectives, insist on an explanation.

Holdings outside the model involves scanning your firm's list of approved investments for evidence that clients possess a security not on the list. Document why the holding appears in the account, says Kennedy. Perhaps it's a legacy holding, came in at a low price, is being held for sentimental reasons or some other explanation.

These tests can be performed monthly, quarterly or annually, she says. Share your reports with your investment committee for a full review, Kennedy recommends.

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