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Ham and Eggs: Due Diligence Data Scavenging and the Requisite Knowledge

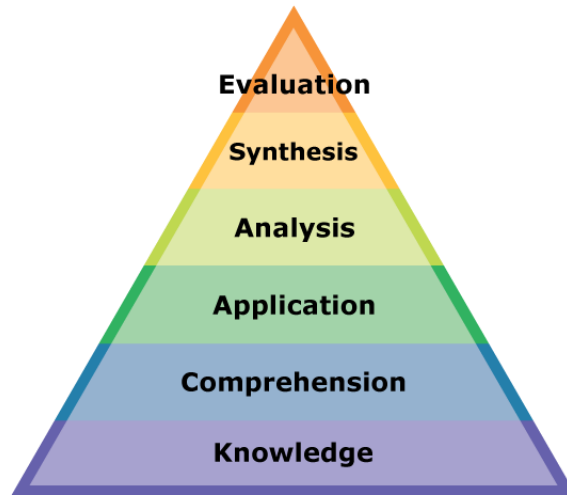
By Alan Snyder

Huh? There he goes again (or that's what I hear you saying). If we are thinking about investing in a new strategy or manager, all of us want to dig deep – getting as much data, information, facts and figures as possible. Our goal is to resolve uncertainty. Similarly, as a tennis player, reading about techniques for killer backhands, devastating overhead smashes and wicked topspin forehands will help, with tennis pros weighing in along the way. The goal of our tennis player and investor is the same (be great practitioners) but an incomplete solution from data alone at this point. These data points are only ingredients and are missing the skills on how to combine them. It's like one hand clapping.

The tennis analogy best shows this incompleteness. No matter how much data I learn about playing tennis, even if I become the world's leading expert, I must put this data into practice as a player to become the next Roger Federer. Ditto for picking strategies and managers. As investors or tennis players, we must leverage the data and synthesize it with understanding, knowledge and practice to become successful.

Several luminaries spell out the challenge:

- Albert Einstein pithily commented, "Information is not knowledge."
- Somewhat earlier, Plato noted in his "Laches or Courage" (380 B.C.): "A good decision is based on knowledge and not on numbers."
- More recently, Benjamin Bloom, a famous American educational psychologist, put the power of information together with the culmination of understanding in his "Taxonomy of Learning":



Bloom got it! The real ham and eggs analogy is the requirement to combine data *and* implementable knowledge or understanding. For success, you must have both complements like ham and eggs.

Attached to this note is a table detailing several items that might be included in a data request, particularly from a money manager. These are the ingredients for our omelet and it is our understanding and the expertise of how to combine them that will make a great culinary treat or investment.

1. Offering/Subscription Materials

These are the basic building blocks even if a separately managed account (“SMA”) is under consideration. Recently, an investor who limits his portfolio to SMAs told me he never looks at partnership or limited liability company documents since they didn’t apply to him. Totally goofy! These docs contain a wealth of information that has been scrubbed by legal counsel, a helpful prophylactic.

2. Marketing Materials

Bring it on because more is merrier, although the profusion kills more brain cells. For insights, specifically examine pressure points of exceptional performance, either up or down, in manager commentaries or attribution analysis.

3. Strategy/Portfolio Information

Past readers of our notes will know that “valuation policy” documents are essential to evaluate.

4. Audits and Performance

Carefully peruse all audit notes, which contain a wealth of critical information. Often, it is in these nooks that risk is uncovered. Assets under management (“AUM”) growth

rates when compared to performance tables can be enlightening: cash drag, excessive growth outstripping idea generation and/or market limits, etc.

5. Regulatory/legal

How forthcoming are our new “best friend” managers? Comparing volunteered information against third party due diligence reports establishes a transparency standard.

6. General Review

Verification of references from each service provider can unearth new information. Many prior cases of fraud could have been prevented and much heartache avoided with this step, e.g., does Ernst & Young acknowledge that, yes, XYZ manager is truly a client?

7. Operations and Compliance

The compliance manual, which sometimes includes a code of ethics section, provides a sense of the duty of care to which the manager subscribes, a useful “tell” indeed.

Our note is a relatively short trairpe through the data thicket. After our due diligence questions and diligence data, the next installment in this series will be onsite visits.

As usual, all comments, criticisms and questions are truly welcome. Happy diligencing and good luck with your ham and eggs investment omelets!

Due Diligence Data Requests

Offering/ Subscription Materials	Marketing Materials	Strategy/Portfolio Information	Audits and Performance	Regulatory/Legal	General Review	Operations and Compliance
PPM/Disclosure document	Summary sheet	Attribution analytics	Audits (past three years)	Form ADV (if applicable)	Sample K-1	Compliance Manual/Code of Ethics
Limited Partnership Agreement/ LLC Agreement	Presentation	Risk allocation by asset class, sector, trade length, model, etc. (if available)	Additional performance info (including performance record adjustments, if applicable)	SEC/NFA Exit Letters	Monthly brokerage statements (managed accounts only)	Disaster recovery plan
Subscription documents	Due Diligence Questionnaire ("DDQ")	Contact info for platforms (if applicable)	AUM (strategy/firm) by month since inception	Criminal/civil/litigation/tax/regulatory or other disclosures	Standard reporting package to investors (e.g., sample account statement/ letters)	
Paperwork/ funding deadlines	Frequently Asked Questions ("FAQ")	Valuation policy			Investor references	
	Recent commentary (as many as available)	Third-party valuation agent			Service provider references	
	Miscellaneous marketing material				Third-party due diligence reports	