Why Does Holdings-Level Detail Matter?

Executive Summary

- Holdings transparency is essential to TIFF's equity investment process.
- Security-level holdings reveal portfolio factor exposures.
- They allow TIFF to isolate managers' idiosyncratic stock risk from factor risk, illuminating manager value-add.
- Granular holdings data enables precise portfolio construction and risk management.
- TIFF utilizes these elements in portfolio construction, risk management and manager selection.

Overview

For the marketable equity allocations, one of the most important portfolio analysis views is provided by security-level holdings. For most of our marketable equity managers, TIFF receives security-level detail, meaning what stock is held and at what size. This information is in addition to traditional exposure reports most managers provide. This level of detail allows TIFF to have a more robust and accurate view of our portfolio and to manage our exposures appropriately. The multi-dimensional, timely detail inherent in holdings is critical to TIFF's risk management and equity portfolio construction approach.

Why are holdings so important? There are three key reasons:

1. **Granularity & Specificity**: Holdings tell us the magnitude and sources of exposures at the most granular possible level.
2. **Idiosyncratic Risk Identification**: Active managers' specific stock views are the primary source of value in TIFF portfolios. The only way to identify and measure the individual risk and impact of these individual positions net of their generic factor exposures is to know the positions in detail.
3. **Actionable Risk Management**: Knowing detailed manager holdings enables TIFF to manage portfolio risk with passive exposures and hedges with more efficacy and precision, and with less chance of overlooking an important exposure or of inadvertently offsetting managers' specific stock views. Tracking the performance of individual stocks allows us to track these factor exposures in near-real time without

having to rely on manager updates.

1. Granularity & Specificity

Security-level holdings allow us to understand our exposures, both magnitude and sources, at the most granular level possible. TIFF works with its managers to get holdings level data beyond the traditional exposure returns, allowing TIFF a better understanding of those exposures. Granularity below the summary level matters, sometimes very much.

Active equity managers will generally provide summaries of portfolio exposures at the regional level (e.g., US, EAFE, EM) or sector level (e.g., healthcare, IT). They may bucket market capitalization in broad categories (e.g., mega, large, small cap). To the extent they track style factors, the information they share is generally qualitative (e.g., “overweight growth”). Style factors are security-specific characteristics, such as Value (price:book), Profitability (profit:revenue) or Momentum, that help explain risk and return of a stock.

Case Study: Sector Distinctions that Matter

These kinds of industry-level distinctions are significant more often than not.

- Healthcare comprises both large cap value-like pharmaceuticals (J&J, Pfizer), and small cap volatile biotech. It is one thing to have no net exposure to either industry and a very different thing to report no net healthcare exposure while being 5% overweight biotech and 5% underweight pharma.
- Both software and semiconductors are components of IT, recently displaying dramatically different behaviors.

Case Study: Style Factor Decomposition

For style factors, granularity illuminates how a given factor is arising. Style factors are defined on a spectrum comparing a given portfolio’s exposure to the average exposure of the full equity investing universe. A style such as a Profitability overweight can arise via larger holdings in stocks that are more profitable than average or, instead, via underweights to unprofitable stocks. These are very different portfolio constructions that look the same at the qualitative “overweight Profitability” level.

2. Idiosyncratic Risk Identification

TIFF primarily aims to add value by identifying and investing with active managers that take idiosyncratic risk, risk over and above the factor risk inherent in their portfolios. A number of such TIFF managers take a “fundamental” approach, characterized by concentrated portfolios of stocks with relatively long-term investment theses (i.e., not high-frequency trading

strategies), each of which is selected to deliver outperformance vs. similar stocks with similar factor profiles. The only way to understand the portfolio's sources of idiosyncratic risk and their performance is to analyze these at the individual stock level.

Even among very similar stocks the differences in ex-ante risk and ex-post performance can often be dramatic. Although Nvidia and Analog Devices are both larger cap semiconductor designers, there has been a massive difference between these stocks over the past few years. This year, there has been extreme dispersion between AI "winners" and "losers" within the software industry.

Absent holdings data, it is very difficult to tell how effectively fundamental managers are taking idiosyncratic risk. While they will generally manage to self-selected benchmarks such as the S&P 500 (SPX), or even much more specific ones such as the NASDAQ Biotechnology Index (NBI), they will generally take on factor risks with respect to these benchmarks. Without knowing their factor-driven performance we cannot identify their idiosyncratic performance. Even if a manager were to report total idiosyncratic performance, we are very interested in the details. Did a manager rely on a single Nvidia-like outperformer? Or did they generate idiosyncratic alpha across their portfolio?

Longer term, the factor postures and idiosyncratic risk efficacy of our managers are critical to understanding whether a manager is adding value and whether we maintain, upsize or redeem our positions.

3. Actionable Risk Management

The detail we get from holdings only really matters if it is actionable. We use this information to fine-tune our portfolio factor exposures through a few techniques including:

- passive ETF exposure
- custom baskets of individual stocks, designed to offset any unwanted factor exposures at an equally granular and timely level. Knowing our managers' intentional idiosyncratic risk-generating stock selections, we exclude any such overweighted stocks from our custom factor hedges to avoid inadvertently negating managers' views.

Where Holdings-Level Doesn't Matter

We are equally careful not to overuse holdings information. Alongside fundamental managers, we intentionally allocate to "systematic" managers (including multi-manager portfolios). These strategies are characterized by much more diversified portfolios with many more individual stocks and are also often characterized by higher-frequency trading

strategies. Many systematic managers are not seeking to generate idiosyncratic risk via fundamental stock analysis but rather via proprietary strategies that take advantage of factor-like characteristics that are different from the common factors that we concentrate on in our factor analysis.

Knowing the holdings of these strategies does not help us; but, critically, we know that these managers carefully manage their traditional factor exposures. That means that if they say they are managing to a benchmark such as SPX or NBI, we can count on them to match the factor exposures of that benchmark. We can then confidently use the benchmark's holdings as a proxy in our holdings-based factor analysis. We can also confidently ascribe all their performance vs. that benchmark to idiosyncratic risk. In this way, we appropriately combine holdings detail across different types of managers in our analyses and portfolio management.

Holdings-Level Detail Matters

Holdings detail is central to our equity portfolio management. Whether via fundamental manager individual stock holdings or very reliable proxies for systematic managers, we rely on it and would feel partially blind without it — to the extent that this information is a prerequisite for inclusion in our portfolios. We use it to efficiently and effectively construct portfolios with only the factor exposures we seek, minimizing unwanted, unproductive factor risk. In doing so, we allocate more of our risk budget to productive idiosyncratic risk, the area where our managers differentiate themselves and add value.

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TIFF Investment Management



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