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Alternative data use going mainstream

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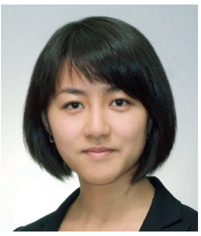
Executive Summary

Alternative data use, hitherto an increasingly sophisticated niche occupied by Western hedge funds, is now going mainstream by virtue of improvements in data accessibility and a growing array of alternative data services. Broadening beyond the hedge fund world, alternative data is now starting to be used routinely by nearly all types of financial institutions.



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Alternative data market continues to grow

In addition to traditional data such as company financials, share price charts and macroeconomic statistics, alternative data like retailer POS information is increasingly being used to make investment decisions. To date, alternative data has primarily been leveraged in the West by hedge funds aggressively pursuing excess returns.

According to AlternativeData.org[1], an alternative data aggregator, total buy-side spending on alternative data is projected to grow from $1bn in 2019 to $1.7bn in 2020. There are some 450 alternative data vendors today. Their ranks have been growing at a rate of about 50 per year. Against such a backdrop, leading-edge quant hedge funds continue to seek out novel, near-real-time data to gain an edge with which they can generate ongoing alpha. To dig up new data, major Western hedge funds' data sourcing staff frequently travel internationally, including to Japan, to meet with not only local data vendors but also companies that possess valuable data.

NOTE
1) https://alternativedata.org/

Alternative data use is thus an increasingly sophisticated niche for major hedge funds. Beyond the hedge fund space, it is showing signs of entering the mainstream.

The mainstreaming of alternative data

One such sign is increasing accessibility to alternative data. Incumbent alternative data providers, most notably Bloomberg and FactSet, are now being joined by major traditional data providers that are starting to offer alternative data to their customers through existing infrastructures. Examples of the latter include Nasdaq and Refinitiv, both of which have recently acquired or invested in an alternative data startup[2].

2) Nasdaq acquired Quandl in December 2018. Refinitiv acquired an equity stake in BattleFin in June 2019.

Another notable player is Thinknum, an alt-data startup founded in 2015. It has built more than 30 novel alternative datasets through daily data collection. They include data on job listings, store locations, car inventory, product pricing and social media follower counts. Thinknum offers relatively low-priced access to its datasets via an online research platform, which features analytics tools that enable comparative data analysis. It also frequently publishes analytics reports to help its subscribers glean insights from its alternative datasets more easily. Innovators like Thinknum have made alternative data more accessible even to smaller funds and asset managers without data sourcing/analytics staff or a lavish budget.

Various user-friendly solutions that incorporate alternative data have also been coming to market recently. A case in point is Yewno Edge, a service for fund managers that was launched in early 2019 by AI solutions provider Yewno. Yewno Edge uses both fundamental and alternative data to provide its subscribers with insights relevant not only to investment decisions but also to risk-managing of portfolio positions[3]. For example, it can identify non-obvious, company-specific implications of pre-specified events (e.g., trade conflict, weather event) by analyzing correlations based on past events, historical share price performance, news and other inputs. When pertinent events occur, it issues alerts customized to the subscriber's risk exposure.

3) Similar solutions are available from other vendors, including Kensho. Additionally, the value of using alternative data for not only investment decision-making but also defensive purposes has been discussed in academic literature, including by Ashby Monk in Rethinking Alternative Data in Institutional Investment (2018).

Growth beyond the buyside

Use of alternative data is beginning to extend beyond asset managers to other financial institutions as well. In December 2019, US federal financial regulators – including the CFPB, FDIC and OCC – jointly issued an Interagency Statement on the Use of Alternative Data in Credit Underwriting[4]. The statement warns that financial institutions' use of alternative data poses risks, mainly from a consumer protection standpoint, and recommends mitigating such risks with robust compliance management. At the same time, the statement acknowledges that utilization of alternative data in credit underwriting has benefits in terms of making credit more accessible to so-called credit invisibles – consumers with little or no conventional credit history. In light of such benefits, the statement recommends appropriate use of alternative data. As an example, it mentions that

4) https://www.fdic.gov/news/news/speeches/spdec0319.pdf

credit opportunities may be improved by alternative data use in “Second Look” programs (secondary credit screening of applicants rejected on the first pass).

In the US, credit screening that utilizes nontraditional data like information on credit applicants’ cash flows and social media content is already widely used by FinTech companies, particularly online lenders. Online lenders have been partnering with major financial institutions, including JPMorgan Chase, and non-financial companies that possess a wealth of personal information, like Google. The interagency statement may prompt other lenders in the US to start using alternative data for credit underwriting.

Alternative data on a path toward ubiquity

In sum, alternative data are not only used by Western hedge funds to pursue excess returns but also by financial institutions to upgrade their decision-making in various ways. As the alternative data ecosystem comprising analytics services and distribution infrastructure continues to mature, previously unavailable data should become more widely accessible. If so, use of some subset of alternative data may take root as standard practice within the financial sector.

Even in Japan, diverse services related to alternative data are starting to become available, lowering barriers to alternative data use[5]. For example, Japanese companies without any data scientists on staff are now able to outsource functions such as analytics and modeling.

5) NRI has been offering Japanese alternative data and analytics/support services since December 2019 (https://www.nri.com/en/news/newsrelease/lst/2019/cc/1114_1).

On the supply side, we are seeing a nascent trend toward inter-company data sharing through newly established consortia in the aim of promoting alternative data use. Data availability is expected to increase in response. As data vendors augment their service offerings, financial institutions of all types will likely turn their attention to actively utilizing external data services conducive to higher-quality decision-making.

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