

# Excess Returns

Monthly insights for investment marketing and sales professionals



October 2014

Volume 4 | Number 9

It is potentially the most powerful page in any presentation book. It can articulate a firm's identity in distinctive, memorable terms. It inspires calm fortitude during market upheavals, and it often provides points of intellectual alignment with clients and consultants. This issue of *Excess Returns* takes a fresh look at one of the most undervalued, misunderstood elements in the investment marketing tool kit: the investment philosophy statement.

With best wishes,

Liz Hecht

Founder, Principal and Director of Research

## In This Issue

Investment Beliefs and Marketing

Beyond Short-Termism

Investment Beliefs, The Book

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*Alpha Partners is an investment marketing firm specializing in research and presentation strategy. Our goal is to create alpha (excess returns) by helping investment firms win, keep and diversify assets under management.*

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## Investment Beliefs and Marketing

The investment philosophy statement defines the beliefs that guide investment decisions. It is the first and possibly the most important of “the four Ps” that we’ve all been taught are critical in any institutional-quality presentation: philosophy, process, people and performance. Yet many investment firms still either do not seem to have a philosophy statement or offer up as a “philosophy” a list of truisms lacking in character, substance or distinction. In 2007 I wrote an article, [Philosophy for Investment Managers](#), about the role of the philosophy statement — what it is and is not — for the Art & Science section of our firm’s website. Since that time, much has changed.

### The Evolving Role of the Philosophy Statement

I see three new trends that investment company professionals should consider when articulating their beliefs about investing:

- 1. Your target audience has beliefs, too.** In a review of 2004 marketing literature for investment consulting firms, I found relatively few references to “investment beliefs” or “investment philosophy” — and virtually all of these references related to evaluating an investment manager’s philosophy as opposed to communicating the consulting firm’s own philosophy. Today, prominent investment consulting firms clearly articulate their beliefs about how to invest successfully, and asset owners such as CalPERS and the Ontario Teachers’ Pension Plan also have published carefully considered beliefs about investing.

Familiarity with the beliefs of your audience may confer an advantage during meetings and formal presentations. At the very least, such knowledge may save time. (Thinking about a visit to Timbuktu to flog that active US large-cap equity strategy? A quick check of Timbuktu's Investment Policy Statement might save you a trip, as Timbuktu does not believe in active management for the most efficient areas of the market.) *This new emphasis on beliefs among consultants and asset owners gives investment firms another important way to get to know their audience.*

- 2. The investment time horizon is increasingly important.** Time is the context in which every investment philosophy plays out. According to a dataset of 40 pension funds and asset managers with publicly reported investment beliefs, however, only 6.4% of pension funds and 5% of asset managers address the time horizon when describing their philosophy of investing.<sup>1</sup> In my experience, virtually all investment managers across asset classes claim “a long-term view” as a competitive advantage. But what does this really mean (and how big an advantage can it be if everyone else lays claim to the very same advantage)? While the market is filled with practitioners claiming to maintain a long-term discipline, one measure shows the average holding period for stocks declining steadily from 33 months in 1980 to 26 months in 1990 to 14 months in 2000 to just six months in 2010.<sup>2</sup>

This focus on short-term results might mean that long-term holders have become a bunch of complacent suckers, mere prey marching into the maw of high-frequency traders. Or it might mean that a long-term view has become a more significant competitive advantage, particularly in the current market (as I write this, the Dow is down over 300 points today after being up almost 300 points yesterday). *Thoughtful, clearly articulated beliefs about the investment time horizon have become more important in crafting the investment philosophy statement, especially now when markets are so volatile and concern is rising over the [tyranny of short-termism](#).*

- 3. Asset owner and consultant belief systems often explicitly address Environmental, Social and Governance (ESG) principles.** My 2007 article cited the following as an example of a strong philosophy statement: “We believe that sustainable development will be a primary driver of industrial and economic change over the next 25 years ... Shareholders will best be served by companies that maximize their financial return by strategically managing their performance in this new economic, social, environmental and ethical context.” More recently, in 2012, Towers Watson stated its belief that “environmental, social and governance factors have material influences on risks and returns, which investors may find difficult to price fairly. This creates an information advantage for those investors who are skilled at pricing these risks accurately.”<sup>3</sup> As of this writing, there are 1,300 signatories to the United Nations Principles for Responsible Investment, including asset owners, investment managers and professional service partners. Even if you are meeting with an institutional investor or consultant that is not a signatory as an organization, certain influential individuals within that organization may well be ardent supporters. One of these individuals might ask how an investment firm considers ESG factors in its decision process. *Given rising support for Environmental, Social and Governance investment principles, investment firms can increasingly expect questions about their beliefs with respect to ESG investing.*

Despite these new developments, much has remained the same. Investment managers still tend to give their beliefs short shrift, stating the obvious (an active equity manager who believes the market is inefficient) while failing to note potentially strong sources of differentiation. When belief statements are robust, they tend to be too long or larded with the uninspiring, often confusing language of academia. Actions, strategies and investment styles still are put forward as beliefs (“We are a value investment manager” is not a belief). Proof linking beliefs to results remains rare. And client review meetings, while long on portfolio characteristics and performance, rarely tie this information back to the belief system clients bought when they hired the manager. All of which adds up to a rich field of marketing opportunity for investment firms that can clearly articulate a differentiated investment philosophy and tie their beliefs back to performance.

## Beyond Short-Termism

CALPERS has stated the belief that “a long investment horizon is a responsibility and an advantage.” And in their 2014 *Harvard Business Review* article, “[Focusing Capital on the Long Term](#),” Dominic Barton and Mark Wiseman propose emphasis on “metrics like 10-year economic value added, R&D efficiency, patent pipelines, multiyear return on capital investments and energy intensity of production ... in assessing a company’s performance over the long haul.” Many of my public equity clients, however, who believe their performance should be evaluated over at least a three- to five-year time horizon, have told me that in reality three years is a luxury. A 2013 *McKinsey Quarterly* survey of 1,000 board members and C-suite executives indicates that while a majority believed that a longer time horizon would positively affect corporate performance, they nonetheless felt pressured to demonstrate strong financial results in two years or less.

Mr. Barton, the global managing director of McKinsey & Company, and Mr. Wiseman, the president and CEO of the Canada Pension Plan Investment Board (CPPIB), note that “one reason why private equity firms buy publicly traded companies and take them private” is to avoid short-term performance pressure. In “Focusing Capital on the Long Term,” they write: “Research, including an analysis by CPPIB, indicates that over the long term (and after adjustment for leverage and other factors), investing in private equity rather than comparable public securities yields annual aggregate returns that are 1.5% to 2.0% higher, even after substantial fees and carried interest are paid to private equity firms.”

Proposed remedies abound for what Mr. Barton has called “the tyranny of short-termism”: superior voting rights for longer-term holders, compensation plans for company executives tied to long-term performance with penalties for underperformance and boards structured to diminish cronyism, to mention only a few.

Messrs. Barton and Wiseman zero in on the source of the problem and the solution: *asset owners need to start acting like owners*. At present, they write, “many asset owners will tell you they have a long-term perspective. Yet rarely does this philosophy permeate all the way down to individual investment decisions.” In other words, institutional investors need to start putting their beliefs into action. Or, put more bluntly, it’s time to walk the talk, especially when fiduciary responsibilities of the world’s largest asset owners stretch over generations.

## Investment Beliefs, The Book

*“I’d be a bum on the street with a tin cup if the markets were always efficient.”*

— Warren Buffett

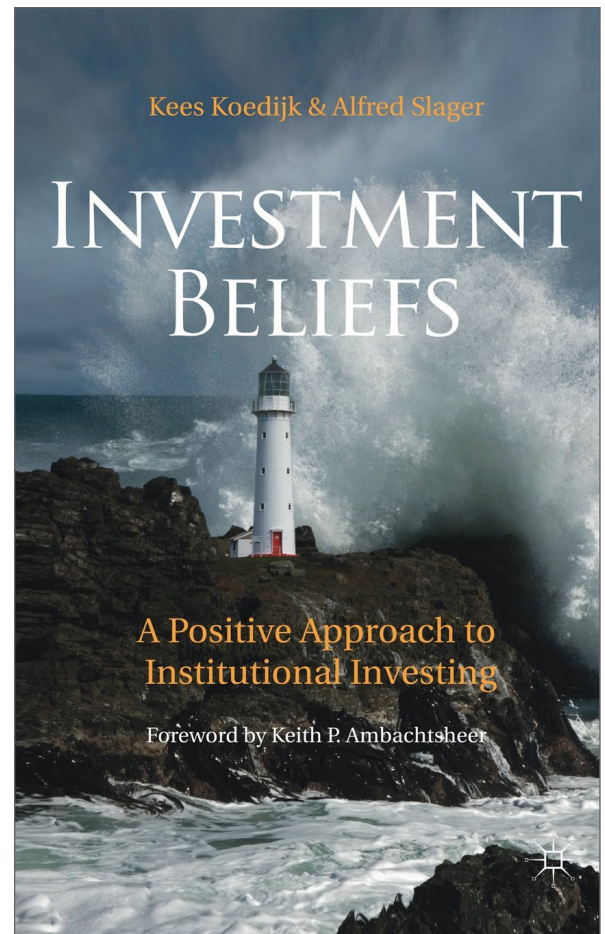
*“I’d compare stock pickers to astrologers, but I don’t want to bad-mouth the astrologers.”*

— Burton Malkiel

*“We’re passive, but we’re not stupid.”*

— Dimensional Fund Advisors’ co-founder David Booth

In 2011, Kees Koedijk and Alfred Slager wrote the book [\*Investment Beliefs: A Positive Approach to Institutional Investing\*](#), which I believe will become required reading in our industry. Mr. Koedijk is Professor of Financial Management and Dean of the Tilburg School of Economics and Management, The Netherlands, and Mr. Slager, the former Chief Investment Officer at Stork Pension Fund, is director of CentER Applied Research, Tilburg University. The authors point to beliefs as key to achieving clarity of purpose in a world where volatility is the norm. In such a world, a clear set of investment beliefs — a lighthouse in a stormy sea, to borrow the book’s cover image — becomes critical.



One can read this book page by page or jump around in search of specific information. There are useful summaries and case studies spanning organizations from different countries and industries. I particularly liked the chapters that demonstrate the dispersion of beliefs around topics such as inefficiencies, risk premiums, investment horizon and sustainability. Each of these chapters includes a case study, the theory behind different beliefs and debates to be aware of; the quotes above in the chapter on inefficiencies, for example, dramatize the range of beliefs around active versus passive investing.

1. Table 4.1 in the book, *Investment Beliefs*.
2. The NYSE Factbook. For another view on the symptoms and proposed cures for short-termism, see Robert C. Pozen’s May 2014 article published by The Brookings Institution, [“Curbing Short-Termism in Corporate America: Focus on Executive Compensation.”](#)
3. Towers Watson Investment Beliefs, under “Alpha-related” beliefs.