June 6, 2016

LOL Journal - No, Gordon: Greed is NOT Good

Raise your hand if you think the investment industry's reputation is in need of an extreme makeover. Okay, except for the guy sleeping in the back row, everyone's hand is up. Clearly Robert Jones, CIO of Systems Two Advisors, raised his as well and was bold enough to state it in his JPM piece, *Defending the Wall*.[1]

I will leave it to my colleague Michael Falk in his blog to debate Jones' various points on capital markets, crowd wisdom, and economic development.[2]

My interest in Jones' piece is this passage:

> *"No one needs to promote greed; it's deeply ingrained in all of us. Wanting more than you need (aka greed) is, for better or worse, human nature. The simple fact is this: People who wanted more were more likely to survive and reproduce than people who were satisfied with what they had. Greed is in our genes. From an evolutionary perspective, we are all descendants of greedy ancestors."*[3]

Robert, Robert, Robert. If your goal is to improve our industry's reputation, you're not helping. Defending greed doesn't put us in a favorable light! It just makes it easier to rationalize overcharging clients: *Phew. We can't help ourselves: we're just greedy. Rats, I wish we were more fair-minded, but we're not. Too bad*. How else can you explain the profit margins in our industry? And please, please don't tell me it's because of all the value we deliver. I don't want to hurt myself laughing. Jack Bogle has shown us repeatedly that the average investor is better off with low cost index funds, especially after fees. But, no, the long-only active level of profit wasn't enough so then the really greedy folks got together and figured out an even better fee arrangement: 2 and 20. *Now we're talking! I can underperform and get even richer*. *The Economist* magazine ran a piece this month: *Hedge funds haven't delivered on their promise.*[4] And quoted Warren Buffett, "There's been far, far, far more money made by people on Wall Street through salesmanship abilities than through investment abilities."[5] CALPERS eventually got smart and said, "Enough already, no more hedge funds."[6]

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[1] Robert Jones, Invited Guest Editorial, The Journal of Portfolio Management, Spring 2016
[2] Michael Falk, CFA is FCG's expert on investments, markets and strategy. His first installment of "WTF" ("What the Falk?") will discuss the merits of Jones' JPM editorial.
[3] Ibid, pg. 4
[4] The Economist, Buttonwood, May 7, page 66.
[5] Ibid. pg. 66.
[6] To be clear, hedge funds are not the villain, but their fees ARE! The key is providing value: performance at the right fee level.

Alas, if an extreme makeover is doable, it will be because we've shifted our thinking. The JPM passage above is "old" thinking. It's not even accurate old thinking. As to the "evolutionary perspective," we can go right to the source—Darwin—who wrote:

> "*In the long history of humankind (and animal kind, too), those who learned to collaborate and improvise most effectively have prevailed."*[7]

It's not greed but collaboration that explains much of our survival. And let's go to another old master—Adam Smith—to get his take on greed. The publisher of Smith's economic classic writes,

> *Without Smith's essential prequel, The Theory of Moral Sentiments, the more famous The Wealth of Nations can easily be misunderstood, twisted, or dismissed…Smith's capitalism is far from a callous, insensitive, greed-motivated, love-of-profits-at-any-cost approach to the marketplace, when seen in the context of his Moral Sentiments.*[8]

So, if we are to undo some of the damage done by Madoff, Boesky and those nasty Wall Streeters, let's show the world that we understand the new thinking. We've moved beyond the naiveté of MBA classes preaching about maximizing shareholder value and Milton Friedman's nails-on-blackboard quote, "The only purpose of a business is to make a profit."[9] James Montier wrote, "It is quite staggering just how many bad ideas in economics appear to stem from Milton Friedman." Montier calls the profit/shareholder maximizing idea the "world's dumbest."[10]

And while we're on the topic of greed, we are all clear that Gordon Gekko—"Greed is good"-- was not the HERO of the movie *Wall Street*. Right? (In one study of MBA students, over half the class thought he WAS: *I want to grow up to be like that*.)[11] The movie *Wall Street* and the books, Liar's Poker and Bonfire of the Vanities wonderfully captured the ego and greed that ran through our industry in the 80's.

But it doesn't have to be that way. We have a choice. The investment industry can be a noble calling. But we have to shift from old to new thinking. Let's start by defining each. The old thinking is nicely described in the JPM passage above. So, what's the new thinking?[12]

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[7] See this website: http://www.theleadermaker.com/the-origin-of-species-charles-darwin/
[8] Fred Kiel, Return on Character, pg. 18
[9] See this article on Montier: http://www.businessinsider.com/gmos-montier-maximizing-shareholder-value-is-the-worlds-worst-idea-2014-12
[10] ibid
[11] "Greed is good:" Despite the notoriety of this encomium to enlightened self-interest, few people know that these words are based on an actual commencement speech, at what is now the Haas School of Business of the University of California at Berkeley, delivered by convicted insider trader Ivan Boesky in 1986, only eighteen months before his conviction. From the article by Andrew Lo, *The Gordon Gekko Effect*. See this article for the reference about students thinking Gekko was the hero.
[12] It's actually not so new. It dates back to Buddha and even before that in the oldest spiritual traditions.

The new thinking shows up in the works of scholars like Adam Grant and Fred Kiel. In simple terms it highlights the success of "generous/abundant" mindset over the old "greedy/scarcity" mindset that we learned about in the dismal science. (Small wonder economics earned that title.) To be sure, many people still choose the greed/scarcity mindset but it **is** a choice. And we are all free to examine the evidence and then decide how we want to show up in the world.

So, what's the evidence?

Adam Grant's book, **Give and Take**, is a well-researched look at a new paradigm; it argues for the benefits of generosity. Grant's goal is "to persuade you that we underestimate the success of givers…[and show] why givers dominate the top of the success ladder."[13] Many thought leaders, including Dan Pink, Dan Ariely, and Robert Sutton enthusiastically endorse Grant's research. And Lenny Mendonca, director, McKinsey & Co. writes:

> *Give and Take will fundamentally change the way you think about success. Unfortunately in America, we have too often succumbed to the worldview that if everyone behaved in their own narrow self-interest, all would be fine. Adam Grant shows us with compelling research and fascinating stories there is a better way.*[14]

For an industry struggling with rebuilding trust,[15] investment leaders would be wise to think carefully about this new paradigm. One financial adviser credits his success to this strategy of generosity:

> *There's no doubt that I've succeeded in business because I give to other people. When I'm head-to-head with another adviser to try and win business, people tell me this is why I win.*[16]

And regarding the "old" notion above that people are largely greedy, a study by Shalom Schwartz looked at values globally and found:

> *In all twelve countries, most people rate giving as their single most important value. They report caring more about giving than about power, achievement, excitement, freedom, tradition, conformity, security, and pleasure. In fact, this was true in more than seventy different countries around the world. Giver values are the number-one guiding principle in life to most people in most countries.*[17]

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[13] Adam Grant, Give and Take, pg. 9
[14] Endorsements in Give and Take
[15] See the Edelman Trust Barometer at their website. The financial services industry ranks near the bottom.
[16] Grant, Give and Take, pg. 20
[17] Ibid, pg. 21

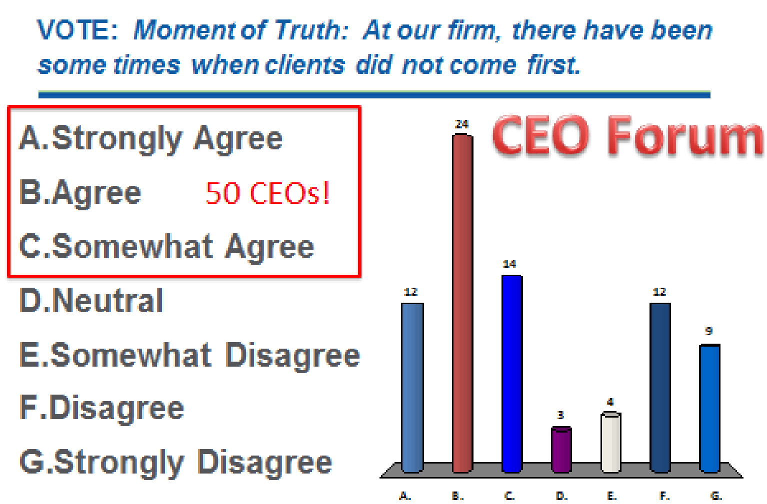
Another good resource for "new" thinking is Fred Kiel's book, **Return on Character**. Kiel applies many of the same principles as Grant, dividing leaders into self-focused (greedy) vs. character-driven (positive/compassionate). Kiel's research shows that

> *There is an observable and consistent relationship between character-driven leaders and better business results. Leaders that rank high on the ROC scale achieve nearly five times the return on assets that leaders who fall at the bottom of the curve achieve.*[18]

Kiel contrasts the old vs. new paradigms in this way:

> *The old Economic Human view of human nature is incomplete. Classic economic theory's view that human beings are totally rational and completely self-focused is an inadequate model for understanding effective leadership.*
>
> *New research enables us to form a new and complete view of human nature, the Integrated Human. This model of human nature views people as capable of becoming mature, complete, integrated humans, not just self-focused rationalists.*[19]

As long as Joe and Joan Public view us as the former—coldly rational, self-focused and greedy—the industry will continue to rank at the bottom of the Edelman Trust Barometer.[20] And for Joe and Joan to see us differently, we must begin to behave differently. For example, in FCG's work in the industry, we often poll CEO's to collect data. The vote below examines one of the most fundamental trust issues in the industry: do you put your client interests first? Look at the results![21]



[18] Fred Kiel, Return on Character, pg. 3
[19] Ibid. pg. 49
[20] See the report on their website: https://www.scribd.com/doc/295815519/2016-Edelman-Trust-Barometer-Executive-Summary
[21] Polling results from an investment conference in Canada with just under 100 CEO's in attendance.

Of the investment CEO's present, over two-thirds of them answered that they do NOT always put client interests first! Yikes. (Robert Jones must be thinking, "See, I TOLD you they were greedy!") Indeed, and it's no wonder that Joe and Joan don't trust the investment industry. It's gotten to the point now where investment clients value "putting my interests first" twice as much as "investment performance."[22] Joe and Joan have lost so much confidence in the industry that they will settle for an honest advisor, forget about superior performance. Just don't rip me off!

So, my hope is that our industry will begin to explore this new mindset—abundant/generous—and come to see it as much more effective than the scarcity/greedy one. And accept that there is choice; we don't have to be greedy. We can take a page from Maslow and move up the needs-hierarchy—past security and survival—to self-actualization: *The self only finds its actualization in giving itself to some higher goal outside oneself, in altruism and spirituality*.[23] Surely, given the intelligence and financial well-being of investment professionals, they are perfect candidates for pursuing self-actualization. But collectively we must raise our sights above the lowest levels of the needs-hierarchy! It was refreshing to see Charles Ellis, one of the most respected names in our industry, agree with this view:

> *The best long-term benefit of active investing—and all its many benefits—is not just economic but also spiritual.*[24]

Ellis went on to echo FCG's view that investments can and should be a noble calling:

> *To the extent investment experts continue to do the important work of advising clients on investment policies to achieve their true objectives and values and sustain their commitments through various markets, our profession will be appropriately admired and well rewarded.*[25]

Old Thinkers: Meet the Millennials!

Finally, on the topic of greed, I'll add one more puzzle piece: the Millennials. FCG has researched this new generation—born between 1980 and 2000—and found that they are much closer to the abundant/generous mindset than the scarcity/greedy mindset.[26] Consider these facts about the Millennials:

1. Very attuned to social causes
2. Over 85% said that money is not a good measure of success

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[22] See the CFA/Edelman report "From Trust to Loyalty" in the Investment Industry: https://www.cfainstitute.org/learning/future/getinvolved/Pages/investor_trust_study.aspx
[23] Maslow, from **The Hierarchy of Needs**
[24] FAJ, July/august, 2015, pg. 6
[25] ibid
[26] Kudos to Keith Robinson on our team for deep research into this generation. Principle resource, Managing the Millennials, by Espinoza, Ukleja & Ursch

3. Over 60% expect their employer to contribute to their social causes

4. Over 60% would rather make $40K in job they love, than $100K in one they think is boring

For investment professionals clinging to the old view, watch out. Millennials are coming at us like a bullet train. In less than 10 years, they will be over 75% of the workforce. And their values are much more in line with the new view. They have donated more time to charitable causes than Xers and Boomers combined. They are very big on purpose, with many choosing to work with ESG and SRI funds. The Gallup organization characterizes them in this way:

Boomers: My Paycheck **Millennials: My Purpose**[27]

Millennials don't see money as the top value. So, if you don't familiarize yourself with the new thinking of Grant, Kiel and others, you may be increasingly out of sync in the future.

The Yin and Yang of it

In summary, let's acknowledge the yin and yang of greed. Yes, we can all be greedy, especially when we're fearful: *There won't be enough, I'd better grab all I can get*. But we can also be generous, when we feel confident and secure. Grant argues that some of us are inclined—either by nature or nurture—to be more greedy (takers), while others are more generous (givers). Again, the key is: we have a choice. Anyone reading this piece is bright enough and wealthy enough to choose "generous" as a mindset. Maslow and others see this choice as the natural evolution of human development. And certainly investment professionals who have a fiduciary responsibility to steward OTHER people's wealth should be deeply committed to this mindset. Doctors are asked to live by the Hippocratic Oath, which ends with the statement, "may I long experience the joy of healing those who seek my help."[28] Similarly, for the investment industry to rebuild its reputation, we must encourage our colleagues to embrace the mindset of service: experience the joy of helping our clients. So, let's all have a good chuckle at the Gordon Gekko part of ourselves—yes, it's there—and then commit to the noble calling of fiduciary service.

No, Gordon, greed is NOT good. Now, please give me back my wallet.

Curiously and generously yours,

JW

P.S. If you really liked this piece, send a generous donation to the "FCG New Thinkers Fund." You'll feel SO good doing it! ☺

[27] See the Gallup Report on Millennials, "How Millennials want to Work and Live" available on their website. http://www.gallup.com/reports/189830/millennials-work-live.aspx
[28] See the final line: https://en.wikipedia.org/wiki/Hippocratic_Oath#Modern_version