

August 30, 2017

LOL: Transactional vs. Relational

Our latest book “Money, Meaning, and Mindsets”¹ focuses on a key mindset distinction, defined as ORANGE and GREEN. There is a lot of research behind these two mindsets, which the book covers in detail. For our purposes, I want to focus on the transactional orientation of ORANGE vs. the relational aspect of GREEN. Typically, investment managers and traders personify the transactional approach, whereas financial advisors and client service are more relational. In our book, we make the case that the investment firm cultures have historically been largely ORANGE. Our position is that successful firms in the future will begin to appreciate and leverage both ORANGE and GREEN.

Investment ORANGE (IQ)	Investment GREEN (EQ)
Purpose is to win by offering superior investment returns and excellent client service.	Purpose is to genuinely add value for the client and improve people’s lives. Often extend the purpose to all stakeholders.
Competitive stars: Peter Lynch, Bill Miller, Bill Gross, and their like.	Collaborative teams, with multiple portfolio managers.
Zero-sum (win/lose): we win for our clients, while other firms lose. Some firms will beat the benchmark, while others won’t.	Abundance (win/win): markets rise over time, lifting all “boats.” Outcomes for clients are customized, not judged against a benchmark.
Investment alpha: industry’s resources go to creating alpha in portfolios.	Household alpha: financial literacy, tax and estate strategies, financial planning and advice.
Value investing: finding mispriced stocks, buying winners.	“Values” investing: aligning investments with client’s personal values: ESG , Impact investing, or highest return possible.
Short term: quarterly earnings, yearly performance results	Long term: investing across cycles with long-term goals
Process: the philosophy, discipline, and process are paramount	People: the relationships of trust and respect are paramount
Growth and expansion: grow the client base and assets under management (AUM)	Value add: provide a truly valuable service that makes clients happy, secure, peaceful
Profit driven: our job is to make money in the markets in any legal fashion we can	Societal driven: our job is to help make the world a better place through responsible investing

This week I had a conversation with Fred Martin, the founder of a very successful long-only active manager firm (Disciplined Growth Investors, DGI). Fred is a perfect case in point for the transformation we describe in our book. By his own admission, Fred started DGI with a very ORANGE perspective: compete and win in the equity markets. Over time, though, Fred has transitioned his approach--and the firm’s-- into a blend of ORANGE and GREEN. Fred explains part of the change as a natural consequence of aging. He’s 70. (Maslow would predict this evolution, as one ages.) In fact, Fred has organized and funded a conference which focuses on the relation between the advisor and the client. He is now passionate about making that relationship into a true partnership, which means scrupulously following

¹ [Click here](#) for a free download of our book

the fiduciary standard. At the conference (October 5, 2017 [click for details](#)), Fred will open the day with a presentation focused on the difference between transactional and relational investment firms. Here is the gist of his message:

Transactional	Area of Interest	Relational
Stocks	Investing	Companies
Vendor	Client	Strategic partner
A job. Work orders	Employees	Career. Purpose.
\$	Success	Win-Win

Given my familiarity with Fred and DGI, I can vouch for his practicing the principles on the right. Over the years, he has moved from a dogged determination to create alpha to a firm that produces alpha (DGI has an outstanding performance record) but also prioritizes relationships. Fred also plans to view four guaranteed life events from both a relational and transactional perspective.

Transactional	Guaranteed Life Events	Relational
Sell stocks, cut expenses	Financial crisis	Learn from the event
Start well	Mortality	Finish well
Hubris	Bull market	Humility
Zero-sum, situational	Habits	Durable, build trust

On this last point, the CFA Institute recently conducted a study of the main trends impacting the investment management practice in the future. The findings showed that investment professionals recognize the importance of developing relational skills. The trend called “importance of investment managers possessing soft skills” received 93% of respondents saying that it will have impact in the future. With two-thirds of them saying the impact will be greater than “slight.” Fred’s firm is already there, and thriving.

DGI is not alone in this trend. Two other “Focus Elite” firms² are practicing this same blend of ORANGE and GREEN. Bridgeway, a quant shop in Houston, and Polen, a long-only manager in Boca Raton, each have established enviable track records and AUM growth by employing the relational approach (GREEN) as well as sharp analytical skills (ORANGE). For more on these companies, read the chapter in our book that highlights all three companies and their approaches.

With debate raging over passive vs. active, FCG believes there will always be a place for active managers. However, the surviving managers will need to up their game and produce real value for clients. In our most recent white paper entitled “Teaming Effectively: 3 Key Factors”³ we show the results from 29 teams we studied in the investment world. The results were conclusive at the 99% confidence level. The three factors that are most important:

² For more on this distinction of “Focus Elite,” read the criteria for and successful results of these firms in our paper at this link: [Focus Elite](#)

³ [Click here](#) to download “Teaming Effectively”

1. Clear Direction and Purpose
2. Right Team Members
3. High Trust levels

The third factor—trust levels—is all about relational skills. If you develop high trust on a team, you get the following benefits:

- **Respect**: for differing opinions and viewpoints
- **Candor**: willingness to speak up and share ideas
- **Debate**: respectful, rich exchange of differing viewpoints in decision making
- **Conflict resolution**: willingness to address and resolve tough issues

The three firms mentioned in this piece enjoy these benefits and leverage them for competitive advantage. All three have worked on these skillsets, they don't expect them to simply "happen" on their own. A key factor in achieving all these skills is what Google calls "Psychological Safety."⁴ A transactional firm often breeds fear (think: hedge fund), whereas the relational firms discussed here have achieved a high level of safety, thus reducing fear and increasing trust.

Importantly, FCG is not suggesting that we "kill off" the ORANGE mindset. It is hugely useful in successful investing. But any strength that is overdone becomes a weakness. Think: Milken, Madoff, and Cohen as poster children for excessive ORANGE. The successful firms of the future will create a balance between ORANGE and GREEN that creates the truly powerful formula for success. It's already happening.

Curiously yours,

JW

⁴ Google study on most effective factors on top teams: [Google Study](#)