

August 20, 2019

LOL: Creativity (volume 1)

Readers: This blog is the first in a series of blogs on creativity in the investment world. We're doing this for three reasons:

1. Our upcoming Leadership Conference, October 17-18, will focus on creativity and innovation. We offer these "warm-ups" to our attendees in advance.
2. To wake up the industry. Despite the clear need for innovative solutions in the marketplace, investment firms are not creating innovative cultures.
3. To showcase Jason Voss, CFA, our new team member and expert on creativity. He has written and presented on creativity for investment audiences around the world. The timing is right to explore this important topic with him as our guide.

Creativity as the Investment Differentiator

Does the public view the investment industry as creative? Do you? One recent survey showed that only 24% of investment professionals viewed their firm as creative.¹ Consider this blog to be a red flag waver: *Warning. Investment firms that aren't creative will fail!* And we're not talking about only the active managers. All firms—active, passive, private wealth, and even (gasp) quant shops—will fall behind if they are unable to innovate.

Actively Creative

Valiant firms in the active space are trying their damndest to find bits of alpha. Alpha is defined as "[the excess return of an investment relative to the return of a benchmark index](#)"². (We know: Duh.) But what if we compare this definition to the definition of creativity? Creativity is defined as:

The ability to produce work that is novel (that is, original, unexpected), high in quality, and appropriate (that is, useful, meets task constraints).³

Note the similarity between the definitions of alpha and creativity. It's not a stretch to say that they are nearly identical. Active managers are now fishing in a lake with very few fish and where all the other fishermen/women are experts. But many are trying to catch those few remaining fish with the same tackle and techniques they've always used. Perhaps some of the "old timers" are getting up a bit earlier or trying a new spot. (Many even turning off their smart phones.) But are they exploring entirely new ways to catch fish? Seriously, are they revisiting their philosophy, process, and execution? Are they challenging long-held assumptions? Are they actively searching for new ideas? Are they taking advantage of new technologies? And what about looking for new fishing spots?

Example: Jason Voss, CFA while a PM at the Davis Funds established a Lipper Award winning record using creative approaches. He bypassed the academic debate about which valuation method (PE, DCF, EVA, ad nauseum) was the best and used them all. He valued businesses seven different ways to gain insight about what different classes of investors appreciated about the business. This approach also revealed possible errors in his modeling when

¹ Dammit, I can't remember where I saw this. I KNOW I read it somewhere! ☹️

² by Investopedia

³ Webster online definition

different methods suggested very different values. Some of you will say, “That approach is so obvious as to not even merit the status of creative.” But remember: “All truth passes through three stages. First, it is ridiculed. Second, it is violently opposed. Third, it is accepted as being self-evident.” (Arthur Schopenhauer)

[At this critical moment in the \\$74 trillion asset management industry](#), creativity may not be just *a thing you have to do*, it may be *the only thing you can do* in order to compete. If you are thinking, “Hah! I am not an active manager, so I can pass on creativity,” well, sorry. Contestant One, pick a different door...

Passively Creative

Passive investment managers are experiencing their own dog fight, with margins declining. They can benefit from creativity as well. Consider thinking up creative ways of wringing out additional expense savings. Or how about developing new approaches to your customers’ experience. When you are offering a commoditized product, a differentiated (read: more creative) customer experience may be what leads to the growth of your assets under management vis-à-vis the competition.

Example: Fidelity let loose a gigantic lightning bolt in 2018 by offering its passive products for a 0% management fee. Were they stark raving mad like the founder of FCG? No, they knew that this loss-leading offering would attract plenty of new AUM to which they could sell [higher margin financial advising and wealth management services](#). Fidelity may well be “mad like a fox.”⁴

Clients Need Creativity, Too

Private wealth managers can also benefit from a healthy dose of creativity. We know you advisors have never had trouble communicating with a client...(insert snarky comment)...but imagine if you did. Via creativity you could develop new ways of discussing overly abstract topics so that even politicians could understand. Clear communication creates a sense of safety and ease between the client and you. Or, consider the challenge of connecting your elegant financial plan to your client’s heartfelt goals. A creative, fresh presentation can help gain conviction and commitment. Again, it is creativity that is the handmaiden to better client outcomes.

Example: A wealth manager we know organized client meetings around presenting and discussing recent portfolio performance. This approach worked fine when performance was strong, but you can picture the discussion when performance tanked. Awkward. They got creative and realized that there is much more to their client relationships than performance. They reframed their approach to being in the service industry much more than in the product industry. Now they holistically review the client’s plan and progress towards their objectives. Clients now approach these review meetings with different expectations.

Creative Quants?

Purely quantitative investors pride themselves on taking emotion out of the investment decisions. They create sophisticated models that identify and bet on factors. But how do they think up their models? How do they dream up which factors to test and in what ways to test them? The design of the models and the creative use of mathematics and statistics is essential. How you construct your server array to wring out extra quant performance from your machines is also facilitated by creative insights on your part. Finally, you must distill the essence of your

⁴ While FCG team members dearly hope that their Founder will one day be “mad like a fox” so far, he remains mostly “mad as a hatter.”

genius into an easily communicated message so that you attract the critical AUM scale you need in order to open a new fund.

Example: A successful Quant fund was founded by a man who trusts his intuition to come up with creative new approaches. This CEO awoke in the middle of the night, having had a dream about a new fund strategy. When he presented it the next day to his team, he couldn't explain the logical steps that led to his idea. But he "knew" it would bear fruit. The team researched the idea, put "meat on the bones", and developed a winning strategy from this initial idea. To this day, the CEO continues to struggle with a team that questions his intuitive/creative ideas, but he has had many successes since the "dream idea" came to him. He trusts his intuition as a valuable partner with traditional logical approaches.

And still another example is quant fund legend Ray—"if-you-think-it, say-it"-- Dalio who years ago creatively realized that if you are a truly great investor you should outperform even if your "style" is out of favor. He therefore set out to identify the factors that would lead to outperformance and Bridgewater's famous All Weather fund was born.

The Creative Journey

In the blogs that follow, we will present creativity techniques that have proven useful to us and to clients. Creativity is not an innate quality that you either have or don't have. Anyone can improve their creativity by learning and practicing time-tested skills. So, tune in for more tips on helping yourself and your firm become a stark raving mad...no, wait a minute...an innovative and forward-thinking culture.

And remember, if you do what you have always done, you will get what you have always gotten. So, if you want to change and improve then get creative!

We look forward to an ongoing dialogue on this fun and fascinating topic.

Jim and Jason