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# Top Performing Equity Teams:

## The Common Factors They Share

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By Jim Ware, CFA and Michael Falk, CFA, CRC

What factors are common to great equity investment teams? This question seems especially relevant in today's world. Active managers are under attack. Charles Ellis and Burton Malkiel have just written a book entitled, *The Index Revolution: Why Investors Should Join It Now*.[1] The Economist magazine wrote that "a recent study by Standard & Poor's, a credit-rating agency, showed that nearly 99% of active managers in American equities underperformed the S&P 500 index over ten years while in Europe, 86% lagged behind their benchmark over the same period."[2] Greenwich Associates published a report on the Future of Active Management which stated that "only 9.8% of active managers have outperformed the S&P Composite 1500 over the last 15 years, down from 52.3% in 2003."[3] And so it goes. The onslaught to discredit active management is in full bloom.

For the record, FCG believes there is a place for active managers in the investment landscape. But we would agree with the dissenting voices that very few equity teams have proven themselves to be valid and sustainable alpha generators. Our curiosity drove us to ask, "So what, if any, factors do the top performing teams share?" FCG has had the good fortune to work with equity teams that have established truly admirable records of alpha and risk-adjusted results, over long periods of time.[4] So, we addressed our curiosity by inviting excellent teams to participate in a study. Ten accepted. (Normally we would be very transparent about all the details – which teams, which strategies, track record, etc. – but in this case, many teams asked for anonymity.)

This paper will review the common factors and design an FCG "dream team" for equity analysis. And importantly, it will posit that a major problem for investors is self-deception.[5] I am continually amazed at people's ability to rationalize away problems, myself included. Many mediocre managers will read this paper and say, "Yeah, we know all that. Nothing new." However, they will continue to make the same mistakes which is why we separated each factor summary into the "conventional view" and "unconventional wisdom." Serious students of performance will pay close attention to the insights given in the latter discussion.

## The Process

We devised a list of factors that commonly relate to performance for funds, such as "do you use quantitative filters?" (to narrow the universe) and "do you invest in your team's strategies?"[6] We came up with 37 such factors.[7] Rather than have the teams decide collectively which factors contributed to performance, we asked each team member to respond to our survey separately. There were 96 individual responders in all.

The factors were derived from our experience with investment teams and from our basic team model – shown below – that divides team performance into two basic categories: the hard skills (process) and the soft skills (relationships). If these two sets of skills are executed well, then the tip of the triangle should be achieved: results.[8]

### Framework

Criteria:

- Benchmark plus nominal and risk-adjusted performance
- 10 years or longer
- Consistency, i.e. not one or two giant years

RESULTS

Purpose & Results:
Clarity about what we are trying to achieve and success in doing so.

LEADERSHIP

Impact of the leader on factors that are largely under his/her control.

RELATIONSHIPS

Relationships & Connection:
We respect and trust one another, we enjoy working together, we would choose to work with this team.

PROCESS

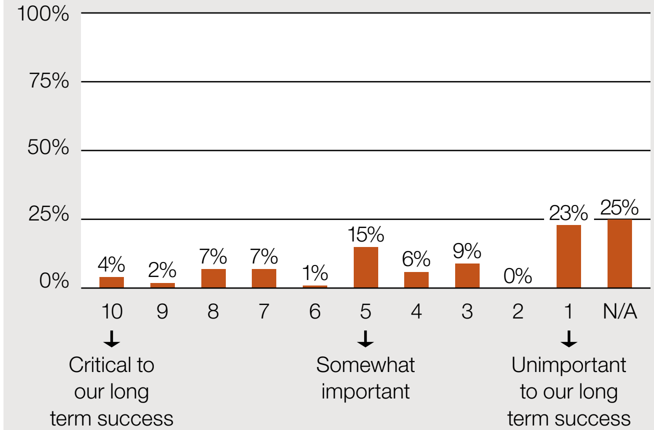
Process & Policies:
We have clear and repeatable ways that we work together, which include roles, responsibilities, rules and decision rights.

Obviously good leadership is required for overseeing the proper execution of hard and soft skills on the team.

The data that we received back from the ten teams came in the form of 96 individual team members and looked like this, in raw form:

### An example: the data

N = 96




We then took this raw data and organized it as follows:

### An example: How we organized the data

N = 96

Responses based on a scale of 1 – 10, with 10 being critical to long-term success and 1 being unimportant.

| Critical/Important | vs. | Unimportant |
|---|---|---|
| 21% | | 38% |

The percentage may be less than 100% as a result of not including "N/A" or "Somewhat Important"

We aggregated the "important" votes (those 10-6 votes) into one score, and the "unimportant votes" (those 4-1) to show the comparison. The participants were asked, "Is this factor important to your ability to outperform?" So, in the example above – which happens to be, "We have one or more stars that drive our success" – the data show that this factor is NOT considered important to outperformance.

In addition to a numerical score for each factor, the participants also were encouraged to write comments about the factor. The comments provided FCG with good "color" for each factor, answering the question, "WHY is this factor important or not?"

Armed with the responses from the ten teams, we crunched the data and analyzed the responses.

## The Findings

The results seemed to fit neatly into the two factors we identified above: hard and soft factors. The summary is given below:

### Findings: top ten factors

Hard: Process & Structure (% agree)

1 Disciplined process (95%)
2 Continuous improvement (94%)
3 Independence from outside (91%)
4 Diversity of thinking styles (86%)
5 Develop our teams members (85%)

Soft: Relationships (% agree)

1 Committed to one another's success (93%)
2 Passion for our work (90%)
3 Enjoy working together (89%)
4 Capacity for good debate (86%)
5 Emotional intelligence (85%)

As you can see from the "agree" percentages above, these factors were truly common to the top performing teams. The remainder of the report analyzes these separate factors by looking at the "conventional view" vs. what FCG considers to be the "unconventional wisdom." For example, the conventional view is that investment professionals should follow a disciplined process. No surprise there. But what exactly does that mean? And, importantly, are investment teams kidding themselves when they say, "Yes, we have a disciplined process."[9] Finally after looking at these factors, FCG puts forth its conclusions about what makes a "dream team": best practices for equity managers.

## The Hard Factors: Process and Structure

Starting with the "hard" skills, which FCG refers to as the "closed fist" factors (i.e. meaning the ones that are more clear-cut and directional)[10], we were not surprised that discipline was nearly unanimous to members of the ten teams.

Indeed, while all teams are expected to have a disciplined process, the unconventional wisdom is that these processes need to be examined over time and continually improved. The top teams indicated that they have buy/sell/hold processes. Additionally, there is clarity and acceptance of decision rights: who is making the final call and what are the ground rules for

### We are disciplined

Conventional view:
All teams are expected to have a disciplined investment process.

Unconventional view:
Processes need to be examined for continuous improvement over time.

Example: if you have a front-end filter, study the cut-aways to see what your process might be missing.

*"Very disciplined process that does not change with the markets or over time."*

decision making. Comments from participants, like the one in quotation marks above, showed a clear commitment to a disciplined process.

The second hard factor – continuous improvement – is related to discipline because the best firms are continually reviewing their disciplined process as markets and conditions change. Participant comments indicated that the best teams were comfortable with adhering to the basic philosophy and process while still examining it and updating it. In other words, they did not view upgrades as changing their core processes or execution techniques. Rather, the core remains intact but the way it is implemented could be fine-tuned.

### We have found ways to continually improve

Conventional view:
Teams should aspire to improve.

Example: teams should do post-mortems on stocks they've sold.

Unconventional view:
A good post-mortem process requires journal entries from when stocks are discussed, purchased and sold.

(The answer is typically "no!")

*"We go off every year on a three-day retreat. We review our process and past decisions in detail. We try to get better."*

The conventional view embraces the idea of continual improvement but, again, there is a bit of self-deception. Specifically, FCG knows of investment teams that do not engage in post-mortems on a regular basis to learn from past decisions (by our count, only about 10% of investment teams do). And even the ones that claim they do post-mortems don't keep careful journal entries when stocks are discussed, purchased and sold. Behavioral research tells us very clearly that our minds rewrite history, so careful records are necessary to learn from experience.

Now, here's the important piece on self-deception. Many investment teams pride themselves on the experience of their members: "Each of our professionals has more than 10 years' experience as an investor." Great. Except the research on continuous improvement shows clearly that 10 years is the point at which performance flattens out:

### Performance


Ericsson, *Development of Professional Expertise*

So, if a team is truly committed to continuous improvement, they have to be deliberate about their learning. Geoff Colvin, author of *Talent is Overrated*, writes:

"The factor that seems to explain the most about great performance is something the researchers call deliberate practice… Deliberate practice is hard. It hurts."[11] In FCG's experience, most teams are kidding themselves when they say, "Yes, we are committed to continuous improvement." Sorry to be a buzz-kill, but facts are facts. After 10 years, you've got to work "deliberately" to improve.

The third hard factor – independence--is well documented in various studies. Top performing teams only serve one master: the client. They are laser focused on process and execution and not influenced by shareholders or parent companies. Note, it IS possible to outperform if you have an outside influence. FCG has seen that in our experience. However, the participants are telling us in their responses that independence is important to their success. FCG has seen first-hand how outside influencers can creep in during periods of underperformance.

### We are independent of outside influencers

Conventional view:
Serving more than one master doesn't affect our decision making.

Unconventional view:
Incentives matter. Especially in difficult times, decision making is affected.

Example: closing a fund vs. keeping it open

*"Our business model serves our investment philosophy, and not vice versa."*

One of the biggest friction areas for active managers is the determination of when to close a fund. FCG's experience is that the top teams know when to close the fund and do it, before reaching capacity.

Another structural aspect of high performing teams involves the make-up of the team. And while the conventional view remains "we can win with smart, hardworking talent" the top teams are aware that cognitive diversity (i.e. different thinking styles) is a competitive advantage.

### We have different thinking styles on our team

Conventional view:
We can win with smart, hard working people.

Unconventional view:
Variant perception requires different thinking styles.

Example: Using personality assessments, like Enneagram or Myers-Briggs, measure the thinking styles to ensure difference styles

*"Cognitive diversity is a very important tool in finding a good decision, since it can correct for individual blindspots which might lead to bad judgment."*

There is a lot of solid research to support this position that cognitive diversity provides an edge.[12] FCG has experimented with various personality assessments to help investment teams find different thinking styles. For a while, we used the Myers-Briggs instrument. It is a solid, well-researched tool.

But there was a problem. We found that most investment teams, using this measure, were highly homogeneous: mostly NTJs. (NTJ means: big picture thinkers who like discipline and organization. No surprise.) We wondered, "Why are some teams that are mostly comprised of NTJ personalities able to win, while others are not?" When we switched to a different assessment – the Enneagram – we found that a team of NTJs can be very different Enneagram types. Indeed, we now advocate for cognitive diversity based on this tool. Of the nine basic Enneagram personalities, we recommend an investment team of, say, 6 professionals have at least 4 different Ennea-types. And, the research on gender diversification is also compelling!

The final hard factor is **development**. FCG partners with Jim Valentine, author of *Best Practices for Equity Research Analysts*, in our work with research teams. Jim has created wonderful training modules to improve the basic skills of analysts. Jim has seen countless examples of research teams that resist developing their analysts. The rationale: "We have investment professionals with CFA designations. We don't need development. We are fully-finished products." But when you go back to the opening paragraph of this paper, and look at the active manager results, you must wonder: how much denial are they in?! The same firms that are underperforming – and there are a LOT of them – resist development of their analysts(!) The results from our survey suggest that the best teams do NOT make this mistake. They do develop and train their smart, hardworking analysts.

### We develop our team members

Conventional view:

We hire fully developed, finished products. Or, the new hires learn by osmosis.

Unconventional view:

Investment staff needs to be trained to be fully skilled and aligned with your philosophy and process.

Example: mediocre firms hire smart, talented people who are not good fits with their philosophy, process and culture

*"It is important to provide training and mentorship to our team and we continue to increase both."*

To prove our point, one of the top teams hired Michael Falk to embed with them for several days. Note: this was a team that already HAD a solid track record. Their evaluation: "Michael's deep investment work with our team on our process, execution and even our pitch book during the days he 'lived' with us has proven to be highly beneficial. Our process became stronger, and our results have been terrific."[13] Valentine has gotten similar reviews from top teams. For the mediocre teams that resist outside help, someone should remind them of the definition of insanity: doing the same thing repeatedly and expecting different results. We know of funds that have underperformed for nearly a decade and NOT once asked for outside help. Really. No, I mean REALLY!

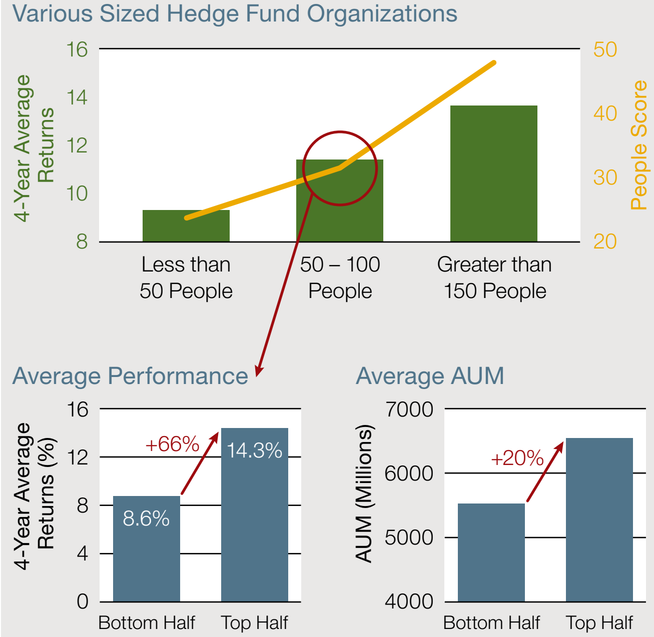
Additional support for developing team members comes from a study by Citi Prime Finance.[14] They studied the relationship between development of people and performance at hedge funds and found a significant relationship: firms that invested in development out-performed firms that did not.

### People Alpha and Returns

Funds that scored in the top half of our people alpha scoring grid out-performed funds in the bottom half.

- **50 – 150 employee firms** achieved an average 4-year return of 11.4%
- **Hedge funds 50 – 150 people that scored in the top half** had an average return of 14.3% percent – a figure that is nearly 600 basis points higher
- **Hedge funds with 50 – 150 people bottom half:** average 4-year return of 8.6%

Average Investment Returns & People Scores for Various Sized Hedge Fund Organizations




- **The average AUM of the firms:**
  – **Top half:** significantly higher at $6.5 billion
  – **Bottom half:** $5.4 billion average

## The Soft Factors: Relationships

Turning to the soft side of the formula, FCG was reassured to see that these factors matter deeply to the best performing teams. When I attended U. of Chicago Business School in the late 70's, there were NO classes on these skills. None. Nada. And there was no behavioral finance. Richard Thaler would never have been hired as a full professor back then. The thinking has changed greatly in the ensuing decades. Good! Now there is a greater appreciation for the leadership and team dynamics on an investment team. But the conventional view remains that investment pros are competitive and individualistic by nature, so getting them to work well together – to "see themselves as a team" – is an ambitious goal. FCG has been hired by many global investment firms to promote synergy among the different strategies: get the equity folks talking to the fixed income teams, and get the global people talking to the domestic ones. Indeed, in FCG's experience, this IS a tough challenge. One CIO told us flat out: "we've tried that several times, including throwing money at it, and never succeeded. So, we've given up. Let them work individually." So, perhaps one of the biggest advantages of top teams in their mindset of being one, unified team that has each other's back. That was the number one soft factor in our study:

In FCG's experience, we have seen many cases where the conventional view is accurate. So, our view is that hiring the right people – ones who naturally play team – is the most effective way to achieve this important factor.

### We are committed to one another's success

Conventional view:
Commitment to the team's success is important but hard to achieve for individualistic, competitive professionals.

Unconventional view:
Team needs to be "all in", working together as one unit.

*"Everyone is all in and genuinely shares in each others successes."*

*"Our process and our success is built upon the team and its commitment to each other. Without the commitment, I don't think we'd have the culture of trust which allows us to be creative, make mistakes, and still show up deeply excited to be there the next day."*

The second factor – passion – has some interesting nuances. We've never met a professional investor who didn't say, "Yes, I have passion for the work." And when we measure firm cultures, the factor "passion for the work" invariably comes out as the top motivational factor, ahead of clients, colleagues, and higher purpose. The nuance is this. Many of these professionals – either initially or after being "trained" by the industry – place money and winning ahead of passion for the work. These individuals become dis-spirited when performance is bad. (And bonuses are down.) They say they have passion for the work but actually have passion for the extrinsic motivators: things that are out of their control (i.e. money and performance). In contrast, the top teams truly love the markets and the work and their passion carries them through the inevitable down periods. Dan Pink, author of *Drive*, has studied this difference between intrinsic and extrinsic motivators. Pink asserts that knowledge workers can be properly motivated by three big factors: mastery (continuous improvement), autonomy (freedom to choose when, where and how to work), and purpose (finding deep meaning in the work itself.)

### We have passion for our work

Conventional view:
Of course, investment people love their work. It's very interesting. But many are actually motivated more by money and winning than the work itself. These people become dis-spirited when performance is bad. (And bonuses are down.)

Unconventional view:
Money is a dissatisfier. Top teams care about the intrinsic motivators: the work and the process. Autonomy, mastery, purpose are intrinsic motivators.

*"You won't be the best at something without passion – the effort required to be at the leading edge of a field is enormous, and only a deep, abiding passion will cause you to invest that irrational level of sustained effort necessary to become great at something."*

The third soft factor is enjoy working together. Again, the conventional view is that liking your team members is a "nice to have" but not a "need to have." We have heard PMs say, "I don't really care if my team members like each other; I care if they perform." But the top teams state emphatically that positive rapport is important to top performance. Many comments from responders mirrored the quote on the next page:

## We enjoy working together

Conventional view:

Enjoying your team members is nice. But it doesn't lead to good performance.

Unconventional view:

Top teams say that the enjoyment of their team mates leads to psychological safety, higher trust, better debates, and better decisions.

*"If we didn't like working with each other, or for the firm, we would be hard-pressed to contribute – over the course of years – the deep creativity necessary to our success."*

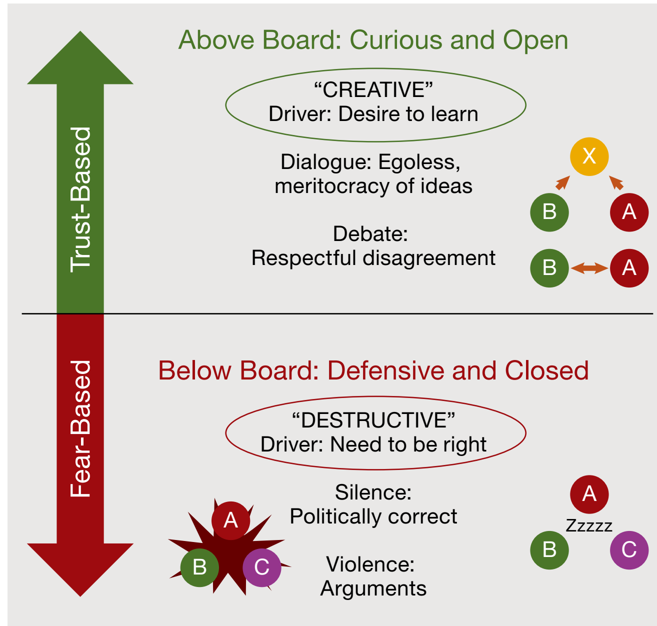
Trust, grit and resilience are important to long term success and are better developed in a team that has genuine regard for one another.

In FCG's view, the fourth factor – debate – follows naturally from the others. Teams that like and trust each other can develop much higher levels of good debate. The conventional view agrees that debate is important, but many mediocre investment teams don't achieve it. They either have silence, in which team members withhold their ideas and counter-points, or they have argument, in which team members become defensive and take it personally. Neither environment supports good decision making.

FCG draws a distinction between three types of exchanges:

1. Arguments. These take place "under the line" and are antagonistic in nature. They are typically not productive. They emphasize personality, "my idea is right; yours is wrong." Egos are prominent. Rarely do these exchanges produce great ideas.
2. Debates. These are encouraged as good exchanges in which both parties are respectfully seeking the truth. The parties listen to the counter-points and appreciate them when they are accurate. These conversations lead to insights and better ideas.
3. Dialogue. These exchanges are wonderful to watch, as they are largely egoless discussions in which all parties commit to learning and leveraging their knowledge. Participants are not interested in winning the debate but rather finding the best ideas. They are a true meritocracy of ideas, in which the participants are unconcerned about who brought which idea to the discussion.

Indeed, one survey participant commented: "We emphasize dialogue over debate." Only teams with high levels of trust and candor can hope to achieve true dialogue. FCG shows the relationship between these different exchanges in the following chart:




Top teams create a healthy environment for debate and dialogue by creating trust and safety. In the previous chart, the letters A, B, C represent ideas. In a fearful environment, those ideas will either be suppressed ("silence") or expressed as arguments ("violence"). As teams learn to operate "above board" the ideas come out in fruitful debate or dialogue. Imagine a post-mortem meeting in which two questions are easily addressed by the team: what could "we" have known but didn't, and what could "I" have contributed differently.

## The members of our team debate well

Conventional view:

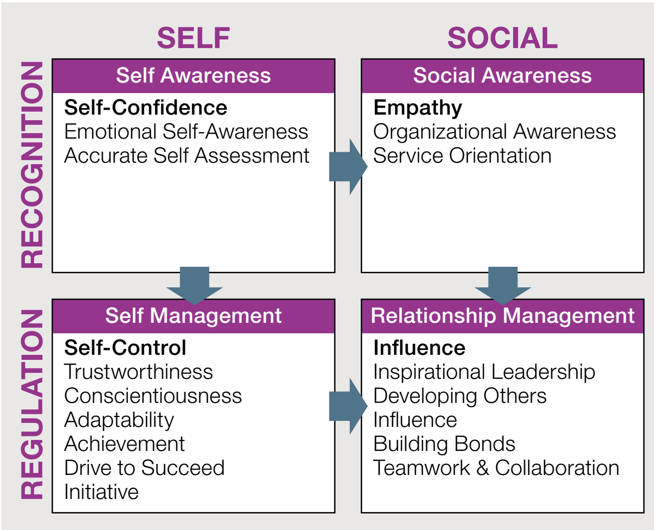
Most investment firms pay lip service to the importance of good debate but don't achieve it.

Unconventional view:

Top teams understand the difference between argument and debate. They assign devil's advocates to promote good debate.

*"We emphasize debate over argument. Our team understands which lines of debate are useful and how to skillfully use them. We are always working at getting better at this."*

Finally, top teams understand the importance of emotional intelligence. The term "emotional intelligence" (EQ) was coined by Daniel Goleman and consists of four skill sets, shown in the diagram below:




Emotionally intelligent teams are far more productive than teams on "auto-pilot." Research on EQ shows the following:


Comments from our elite teams were:

*"We recognize this is a very fickle business and that mistakes are made. Therefore, there is a level of ego and confidence that is mandatory, but it is also extremely important to be able to admit what you don't know, encourage others and learn from the inevitable mistakes."*

*"In a collaborative environment, we need people to feel safe evaluating each other's ideas. We could do a better job of speaking fairly and considerately, to spur honest feedback."*

*"We need to be able to rigorously challenge an idea and the work that went into it, and still walk away from the table as colleagues and friends. That is not easy, and it takes a lot of emotional intelligence in terms of how you conduct yourself in a debate, and how you manage your emotions before and after."*

*"Our team is highly emotionally intelligent and collaborative."*

*"I do think our culture and our team is a huge intangible asset to our success."*

*"Team culture and dynamics is a key consideration for every hire within the firm."*

*"I suspect compared with peers, we have more "emotional intelligence" than "discipline". Emotional intelligence is more difficult to develop as it needs a well-aligned, well-performing and stable team environment and it takes time."*

### As a team, we have "emotional intelligence"

Conventional view:

High IQ is sufficient. Leave your emotions at the door. This is a "non-emotional" business.

Unconventional view:

Top teams understand and respect the value of emotional intelligence to decision making.

*"We have no space or time for 'prima donnas' or outsized egos. We believe strongly that good teamwork with well-connected individuals in a constructive environment drives superior and more sustainable outcomes."*

The conventional view still seems to be that EQ is "nice to have" but the key is smart, hard-working people who can leave their emotions at the door. People with high EQ realize that we can't divorce ourselves from our emotions, so it is much better to become self-aware and skillful around emotions than to pretend that we don't have them.[15]

So, these are the top ten factors – hard and soft – identified by our top teams. FCG can appreciate the wisdom of each. And the danger of adopting the "conventional view." We are grateful to the teams that allowed us to survey and study their practices to learn more about their success. In what remains, FCG will construct an ideal equity research team, integrating these findings with our extensive work with equity teams. You might call this the equity research "dream team."

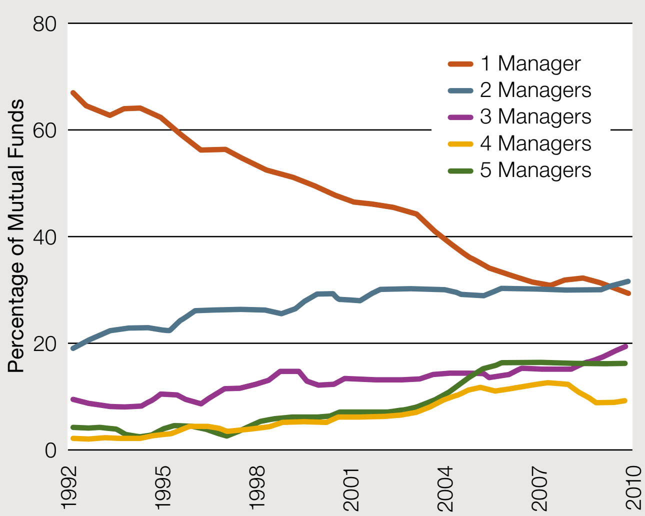
## FCG's Dream Team[16]

If FCG had the pleasure of putting together an equity research team from scratch – and it would be fun – we would construct one as follows.

### Right Team Members

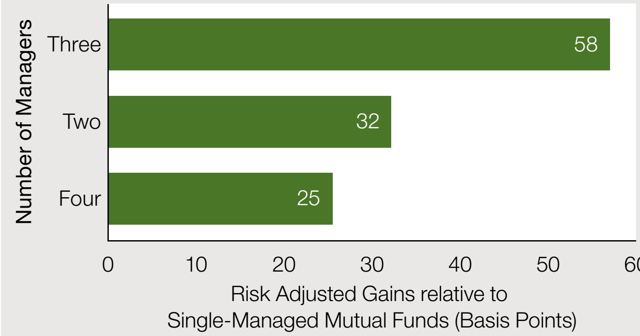
We would start with thorough interviews of talented, experienced investment professionals and look for evidence of prior success. Beyond that we would test for intrinsic motivation – the Pink stuff. *Do these individuals love the work itself? Or are they more interested in the money and the winning?* (Warren Buffett has a wonderful, one question interview: *Are they fanatics?*) We would not look for a star PM, as the data we collected – and various industry studies – indicate that teams are becoming more effective than any one star. The research below shows this trend:[17]

**Mutual Funds Shift from One to Multiple Managers**




Source: Saurin Patel and Sergei Sarkissian, "*To Group or Not to Group? Evidence from Mutual Fund Databases,*" Journal of Financial and Quantitative Analysis, Forthcoming, 2016.

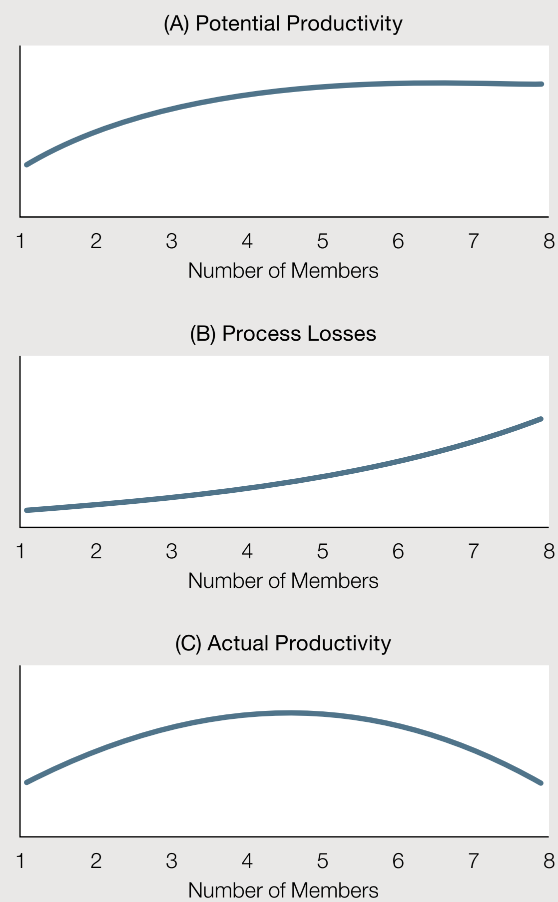
**Team-Managed Funds Relative to Single-Managed Funds (Annual)**




Source: Saurin Patel and Sergei Sarkissian, "*To Group or Not to Group? Evidence from Mutual Fund Databases,*" Journal of Financial and Quantitative Analysis, Forthcoming, 2016.

For most investment strategies, we would choose a team comprised of four to six talented individuals. Again, data from consulting studies – shown in the following graph – support this number:

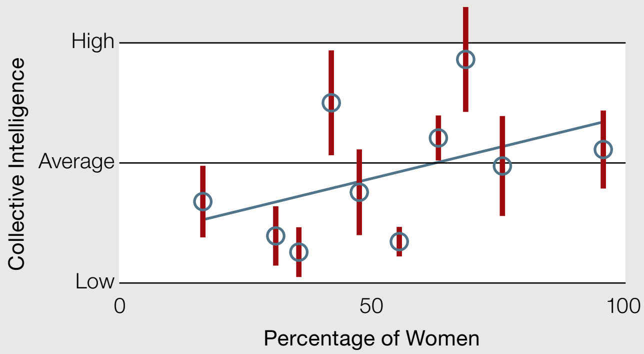
**Right Team Size: A - B = C**




Source: Adapted from J. Richard Hackman, *Leading Teams: Setting the Stage for Great Performance* (Boston, MA, Harvard Business School Press, 2002), 117.

We would look for diversity: cognitive, gender, experience, etc. The chart below shows a study involving decision making and indicating that mixed teams – men and women – are superior to homogeneous teams.

### Argument for Gender Diversification

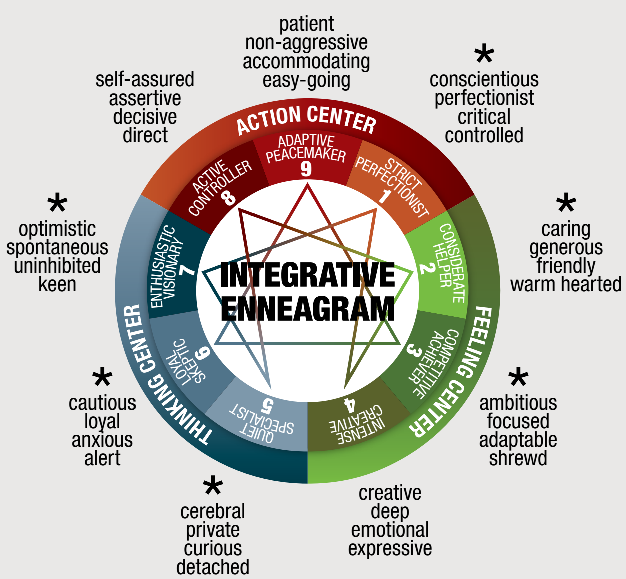



Collective intelligence – *c* – exists
- members contribute equally to discussion
- members score higher in a test of "Reading the Mind in the Eyes"
- teams with women outperform teams with men

Source: Anite Woodley and Thomas W. Malone. "*Defend Your Research: What Makes a Team Smarter? More Women*." Harvard Business Review, June 2011.

Another tool we would use is the Enneagram personality assessment, which helps to identify cognitive diversity; that is, different thinking styles. The chart below shows a well-diversified team of six individuals:

### Cognitive Diversity




* = investment team member

Our strategy in this regard would be to find pairs of cognitive styles that complement each other. For example, the "1" is the perfectionist, who is extremely good with details and finding what is wrong with a spreadsheet or analysis. While this skill is very valuable, it can be a bit harsh and demoralizing at times. (When perfectionists are confronted about their frequent, critical feedback, they invariably say, "I'm only trying to help!" Their motivation is positive, but the execution can be debilitating.) So, we would want to have a "2" on our team as well because they are typically positive, supportive and represent the "glue" on the team. (One of the CIOs of the top teams is a "2" and is great at being the glue which holds the team together.) Additionally, we would look for a "6" on our team because they are the best devil's advocates of all types. They can raise good counter-points for any thesis. And they are naturally wired to see the downside (i.e. the risks) in any investment thesis. To offset this mindset, we'd add a "7." They are wonderfully creative and positive. The 7 will find all the aspects of a situation that support the positive case. Assuming the team dynamics are well managed, the 6 and 7 can have a wonderful and productive debate on any idea. To round out the team, we could add any of the other types. In this case, we've chosen the "5" who is the deepest thinker of all types. So, they are very valuable when it comes to digging deep. (FCG's Michael Falk is a 5.) And we've chosen a "3" because threes are super productive and driven to win. They are natural achievers. But each of the types we've excluded also brings strengths to the table, i.e. the "9's" and the "8's". The only possible exception to the idea that all nine types are valuable is the "4." We rarely see 4's in the investment world because they tend to be artistic by nature – singers, poets, painters – and don't have much interest in the financial world. That said, the few 4's we have seen in finance, contributed by having a uniquely different take on many scenarios.

## Right Team Dynamics

Aside from diversity, we would look for core values and attitudes to make up a dream team. Of course, team members should embrace the basic DNA of the investment industry: client first, ethics/integrity, excellence through continuous improvement, and team player. With regard to this last characteristic – team player – Patrick Lencioni[18] has researched and written about the ideal team player. In FCG's experience, there is much wisdom in his insights, so we would use them in forming the dream team. The ideal team player has three core characteristics.

Humble

The first and most important virtue of an ideal team player is humility. A humble employee is someone who is more concerned with the success of the team than with getting credit for his or her contributions. People who lack humility in a significant way, the ones who demand a disproportionate amount of attention, are dangerous for a team. Having said that, humble team players are not afraid to honestly acknowledge the skills and talents that they bring to the team, though never in a proud or boastful way.

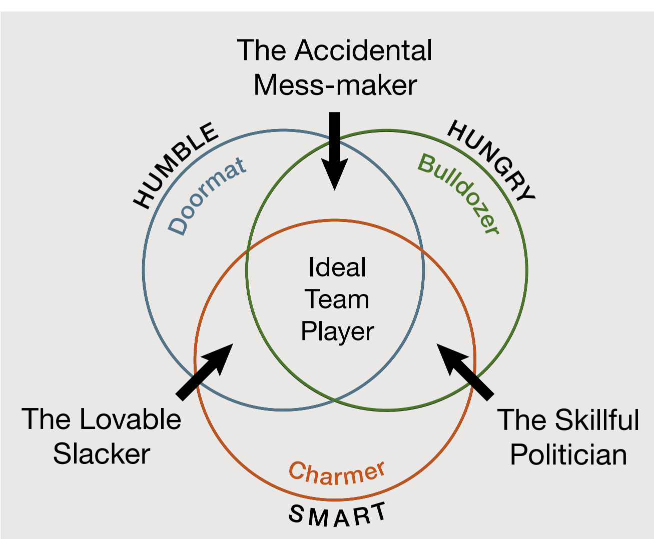
Hungry

The next virtue of an ideal team player is hunger, the desire to work hard and do whatever is necessary to help the team succeed. Hungry employees almost never have to be pushed by a manager to work harder because they are self-motivated and diligent. They volunteer to fill gaps, take on more responsibilities and are eagerly looking around corners for new ways to contribute to the team.

People Smart (EQ)

The final virtue of a team player is not about being intelligent, but rather about being wise in how to deal with people. Smart employees understand the nuances of team dynamics, and know how their words and actions impact others. Their good judgment and intuition help them deal with others in the most effective way.

Here's the key. Lencioni claims that you need all three to be a great team player. The chart below shows what happens if you only have one or two of the qualities:




If you are just humble, hungry or people smart, then you are a doormat, bulldozer or charmer respectively (as shown in the chart). If you have two of the three qualities, you are still not an ideal team player. These combinations are described as:

The Accidental Mess-maker

This person is humble and has plenty of drive but lacks people smarts. So, s/he's likely to create messes, as s/he acts with very little emotional intelligence and team savvy. This person may accomplish a great deal but leave behind a trail of interpersonal destruction.

The Lovable Slacker

This person may at first appear ideal because they are humble and people smart, and therefore very likable. But they lack the drive to go the extra mile. They do only what is required of them and soon frustrate all the truly conscientious members of the team.

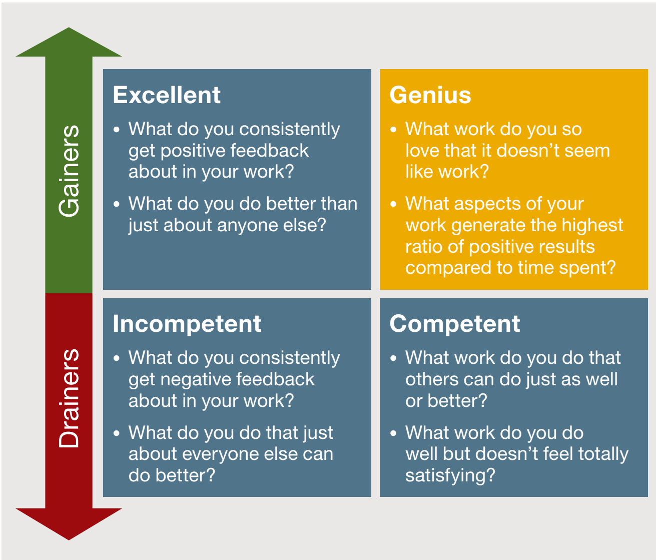
The Skillful Politician

Perhaps the most dangerous of the three "incomplete" players, the skillful politician knows how to present him/herself very skillfully and knows how to look well-intentioned and even humble. But all the while this person is egocentric and looking out only for his/her own interests. Team mates can end up feeling manipulated and scarred.

It's very ambitious to think that the ideal team could have each member be humble, hungry and people smart. But at least this model provides a guide and aspirational goal for reaching "ideal" status.

## Roles and Responsibilities

In addition to acquiring the right mix of team members and dynamics, FCG would be careful to employ them most productively. We call this the "genius" concept. Simply put, find out the highest and best use of each team member. Aligning them with their genius makes for happy and productive workers. Leaders should continually be looking for alignment of talents and roles. For example, which industries/sectors are most exciting to each analyst? And, where do they have the most success? Once decided, the leader's job is then to position analysts so that they spend 80% of their time in their genius area. The chart on the next page illustrates this concept:




The simple test for Genius – shown in the arrows above – is: which tasks increase your energy (gainers) and which ones deplete your energy (drainers). Putting team members in their genius area not only produces great results, but also limits the possibility of burn-out.

## Team Ground Rules

So far, so good. But have you spotted the challenge for the team leader? When you get a truly diversified team, it becomes a much harder job of managing them. Clarity and buy-in on the investment philosophy, process, execution, decision rights, roles/responsibilities are hugely important as diversity grows. These "hard" factors covered in the first part of the paper will need to be crystal clear if you hope to see excellent performance from your dream team. (When Michael Falk embeds with a team, they spend a lot of time getting this right and developing "learning loops" for continuous improvement.) FCG's experience with investment teams suggests that meetings are more productive when team members learn and practice these ground rules: (The key behaviors are in RED.)

- Mutual understanding. We'll "seek first to understand, then to be understood."[19] Show respect to your colleagues by being genuinely curious about their point of view.
- Full participation. We invite everyone to be fully engaged and respectfully candid. The best teams allow equal air-time for everyone.
- Shared responsibility. Think as one team. We are all in this effort together, so practice being accountable vs. blaming others.
- Assume positive intent. When listening to your colleagues, assume that they are trying their best. Give them the benefit of the doubt. Practice an appreciative mindset.

FCG has been teaching and employing these ground rules for a long time, so it was reassuring to see that Google found very similar characteristics for their top performing teams:

Google

### Google Study: Right Team Dynamics

- **Psychological safety**: team members feel safe to take risks and be vulnerable in front of one another
- **Dependability**: team members get things done on time and meet a high bar for excellence
- **Structure and clarity**: team members have clear roles, plans and goals
- **Meaning**: work is personally important to team members
- **Impact**: team members think their work matters and creates change

Source: Julia Rozovsky, "*The Five Keys to a Successful Google Team.*" November 17, 2016

As you read through the Google findings, you should be reassured that these factors were identified by our top teams. The language might be a bit different but the core points are the same. Interesting that the top factor was titled "psychological safety." FCG was delighted to see this result from Google. It matches our experience in the field with teams. Once a leader has assembled a dream team with all the right characteristics – hard and soft – then a key goal is to create safety and trust on the team. Magic occurs when team members are aligned with their genius in a safe environment.

## Motivation

The right team dynamics will do much to provide a lively and positive environment for investment professionals to do their work. Do they need additional motivation? What kind of compensation is needed? In FCG's experience the best teams are careful to use intrinsic motivators – meaningful work, a sense of purpose, autonomy, and opportunities for growth and development – to inspire their team members. We have seen shops try to solve the motivational issue by throwing money at it, with poor results. When it comes to compensation – more broadly "rewards" – investment professionals want three things: fairness, transparency, and simplicity. Our top equity teams do not pay top dollar. But their reward systems are fair, transparent and simple. Beyond that, motivation is all about the intrinsic drivers, as Pink pointed out in his book, *Drive.*

### Hard Factors for a Dream Team

So now you've assembled a dream team. It has 4-6 talented and diverse team members, good team dynamics, and proper incentives. What are some of the hard factors – process and structure – that they would use to win. Hard factors would include:

1. Clear and agreed upon processes to warranty buy/sell decisions for the team.
2. Clear decision rights for buy/sell/hold investment recommendations.
3. No less than quarterly reviews of all holdings.
4. No less than annual process and execution reviews based on data/input gathered through the year, to evaluate and continually improve the processes and execution techniques (identify where alpha was not captured).
5. Agreed upon meeting structure for the team, including clear agenda, purpose for the meetings and journal notes for all decisions, so that "hindsight bias" would be mitigated (and post-mortems could be done.)
6. Agreed upon format for presenting investment recommendations based on buy or sell checklists of the required inputs.
7. Separately schedule post-mortem meetings (i.e., monthly, quarterly) following the sales of securities.
8. Pre-work for all decision meetings: an agenda and pre-readings no less than 36 hours in advance.
9. A clear structure for debate. All team members – apart from a leader – would be assigned at the time of the meeting a PRO or CON position for the investment ideas. Team members should be prepared for both sides of the investment case.
10. A learning plan for each team member. They would report out to each other on a regular basis (say, six months) what they have learned, that is, how they've upped or broadened their game. The key concept here is "deliberate practice." Choosing a skill to develop and then deliberately working at it.

This list is not all-inclusive but gives the "feel" of the hard practices of a dream team. (For a complete agenda of Michael Falk's embedding work, see appendix.) The combination of great team members, solid team dynamics (i.e. relationships), and disciplined processes positions the dream team for success in today's challenging markets.

## Summary

No question that winning for active managers has become a tougher challenge. By some measures only a handful of teams are delivering on the promise of value-add returns. This paper has argued that active managers can and do win even in these tough markets, but only by building a great team with the right hard and soft factors. A good team leader must be adept at both the closed fist – giving clear directions for structural and process factors – and the open hand – creating team dynamics that include trust, safety, open debate, and continuous improvement. The "conventional views" presented in this paper represent the path to mediocrity. For teams to truly excel, they must remove their blinders and take a hard look at the reality of their processes and team. Both hard and soft factors matter. The good news is: teams made up of mortal humans are outperforming. So, it is possible. The bad news is: it is not easy. Teams must move beyond their self-deception and take a hard look at their team members and processes.

Our hope is that these insights will help teams remove their blinders and raise their game to the elite level. Our sincere appreciation goes out to teams that do.

## Appendix 1: the 37 factors, ranked by importance:

1. We are disciplined.
2. We have found ways to continually improve, never settling for “good enough”.
3. The team is committed to each other and successes.
4. We are independent of outside influencers, i.e. parent company, etc.
5. We have passion for the work, we love it.
6. We enjoy working with each other.
7. We have different thinking styles on our team.
8. The members of our investment team debate well.
9. We develop our team members.
10. As a team, we have “emotional intelligence”.
11. We make use of a sizing discipline.
12. We have good working relationships with client service.
13. We are creative.
14. We close strategies, that is, limit AUM growth.
15. Our team has clear decision rights which contribute to our success.
16. We have psychological safety on our team.
17. We have bench strength.
18. We keep journals of our decisions, so we can accurately review our thought processes.
19. We use quantitative tools.
20. We make better use of the information/research we have than our competitors.
21. We believe all team members are working in their “genius”, i.e. highest and best use.
22. We do deeper research than others.
23. For our investment decisions, we have an insight differentiated from consensus and validated beyond company management.
24. We make good use of our meeting time.
25. We use a filter to narrow our potential buy list.
26. We make use of a sell discipline.
27. We test and review our filter over time.
28. Our research focuses on a handful of critical factors (or investment controversies) for a given investment.
29. We conduct post-mortems on positions we exit to learn from our experience.
30. We understand the succession plan for our leaders.
31. We have a long-term perspective; a holding period goal of 5+ years.
32. All investment decisions are known by the team before being executed.
33. We have feedback loops to learn how our processes are doing.
34. We have “dedicated research teams” (vs. centralized research).
35. Most, if not all, of our team members have a meaningful amount of money invested in our fund(s).
36. We set price targets.
37. We have one or more stars that drive our success.

## Appendix 2: Typical Agenda for FCG Embedding Engagement

| | | |
|---|---|---|
| **PRE** | n/a | • MF to receive: IPS, process related documents and team org chart |
| **DAY 1** | Morning | • Firm product pitch to MF (preferably an investment person and a salesperson)<br>• Attend an investment committee meeting (as scheduled) |
| | Afternoon | • Begin team member interviews (30-45 minutes each)<br>• If possible, dinner with key members of the team this evening |
| **DAY 2** | Morning | • Complete interview sessions as need be; random conversations as desired<br>• Final preparations for afternoon diagnostic |
| | Afternoon | • An investment team session to check the team's alignment/understanding of the firm's philosophy, process and execution (diagnostic included) |
| **DAY 3** | Morning | • Meet with IC leadership to dialogue on the team, their processes, their execution and proposed improvements<br>• Prepare for afternoon team session |
| | Afternoon | • The 2nd investment team session to discuss what has been learned, to test alignment on recommendation thoughts |
| **POST** | n/a | • MF to send recommendations report and all embedding diagnostics |

## Endnotes

The authors wish to thank Chas Burkhart for his thoughtful contributions to our efforts.

[1] www.amazon – *The Index Revolution: Why Investors Should Join It Now*

[2] The Economist, October 8, 2016, pg. 68

[3] Competitive Challenges 2016, October 17, 2016

[4] Michael Falk, CFA is our deep investment expert. He used the following criteria to choose the teams in our study: benchmark plus nominal and risk-adjusted performance, for 10 years of longer. With consistency of results, i.e. not one or two extraordinary years that created superior performance.

[5] See Margaret Heffernan's book, *Willful Blindness: Why we Ignore the Obvious at our Peril* for a compelling look at our powers of denial.

[6] Vontobel advertises, "So confident in our approach that we invest in it." P&I October 17, 2016, pg. 6

[7] See the appendix for a list of all 37, ranked from "most important" to "least important" for success. Note: this list is in no way intended to be exhaustive, but does include many factors that are associated with success.

[8] Note: only the inputs are controllable; the output – results – are the residual.

[9] In FCG's experience, the answer is often "yes." Michael Falk embeds with investment teams for days at a time to help them improve their decision making (execution of hard/soft skills) and assures us that not all investment teams have clear processes and discipline.

[10] FCG's simplified view of leadership is the closed fist (i.e. directive, candid, clear, accountable) vs. the open hand (i.e. supportive, appreciative, listening, forgiving).

[11] Geoff Covin, *Talent is Overrated*, pg. 78.

[12] See Anita Woolley, Scott Page, and Michael Mauboussin for more on this topic

[13] Name of the firm withheld by request

[14] Exploring the Concept and Characteristics of "People Alpha," October 2013.

[15] "Neuroscience research shows that emotions are needed to decisions, and investing is all about decisions." Michael Falk

[16] Michael and I note that on THIS dream team players under 6 feet tall are eligible. ☺

[17] This chart and others are from Michael Mauboussin, who has done excellent work studying investment teams. Thanks Michael for your generous spirit and the way you share information selflessly.

[18] Patrick Lencioni has written a number of fine books on teaming: *Five Dysfunctions of a Team*

[19] Classic quote from Steven Covey's "7 Behaviors of Highly Effective People."