

Investment Belief Systems

Northfield Information Services

Summer Seminar

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Outline

- Intellectual precursors
 - Schein view of culture (2004)
 - The clinical perspective in fieldwork (Schein 1987)
 - Philosophy of religion (James (1896), Dennett (2006))
 - Investment philosophy (Minahan (2006))
 - Fifteen years consulting experience
- Beliefs and Belief Systems
- Culture as a Determinant of Investment Beliefs
 - Liability-Driven Investing
 - Equity Style Analysis
- Managing Belief Systems
- Evaluating Belief Systems

Schein View of Culture

- Culture is a shared set of basic assumptions that
 - Shape the behavior, attitudes and beliefs of a group of people
 - Are taken for granted by members of the group
 - “Group” includes societies, ethnic groups, families, organizations, professions
- Culture forms in two ways
 - Successful interaction between people
 - Leadership
- How culture survives and grows
 - Task success
 - Social validation of beliefs and assumptions
 - Indoctrination
- Mechanisms of culture change
 - Natural evolution
 - Leadership

The Clinical Perspective in Fieldwork

- Traditional ethnographic research avoids disturbing the subject of the research
 - If you change the subject you get contaminated data
- The clinical perspective:
 - You can't study a human system without inadvertently changing it
 - You can't learn how a system works without trying to change it
 - You get access to better data if you are helpful
- Real-world fieldwork always involves a mix
 - A clinician's interventions must be strategic
 - Often this means holding back like an ethnographer
 - An ethnographer has to get people to cooperate
 - Often this means intervening like a clinician
- Real-world work and consulting experience are a good source of clinical data

Other Strands of the Yarn

- **Philosophy of Religion**
 - How do people come to believe what they do?
 - How are group beliefs passed on to new members of a group?
- **Fifteen years consulting experience**
 - Assessing beliefs of managers
 - Dealing with beliefs of clients
- **Investment Philosophy**
 - A set of beliefs about where opportunities come from and how they can be exploited
 - How should investment philosophy change over time?

Beliefs and Belief Systems

- What is a belief?
 - A hypothesis we hold to be true
 - Can be conscious or unconscious
 - Can be deliberate or passive
 - Can be consistent with data, not, or indeterminate
 - Can be validated experientially or socially
 - May or may not have consequences
- What is a belief system?
 - An accumulated set of beliefs and the process by which this set changes over time
 - Can be fixed, adaptive, or proactive
- Beliefs and belief systems are cognitive phenomena
 - But also have a cultural aspect

Liability-Driven Investing

- Economists trained to focus on first principles
 - Efficacy of LDI does not hinge on its accounting treatment
 - Fact that public and Taft-Hartley funds don't mark to market (or that corporations do) is a second- or third-order consideration
- Different perspective from plan sponsors
 - “Don't they know we are a public fund?”
 - “Don't they know public funds don't mark liabilities to market?”
- Differences hinge on beliefs about what is important
 - Not always conscious, examined, or deliberate
 - Anchored in professional training or occupational perspective
 - Socially validated

Style Analysis

- Analysis of a thesis-based value manager
 - Holdings-based style analysis shows “style drift”
 - Closer look shows consistent process
- My superior tells me
 - Style analysis objective; manager comments spin
 - I will learn not to trust managers as I get more experience
- Frustrating from manager’s perspective
 - Can lead to perverse product development incentives
- Lessons
 - Consultants and managers have different beliefs
 - Socialization and sorting is a mechanism for preserving culture
 - Social validation of beliefs does not imply economic competitiveness
 - Style analysis useful but can be a crutch
 - Money manager cultures can be influenced by consultants

Managing Belief Systems

- Enhancing self-awareness
 - Write beliefs down
 - Become introspective when surprised
 - Different cultures
- Using theory
 - Two types of theory:
 - Bedrock – more or less true
 - Conceptual framework – helps us think
 - Many conceptual frameworks are inverted irrelevance propositions
 - $A \Rightarrow B \Leftrightarrow \text{not}(B) \Rightarrow \text{not}(A)$
 - Efficient Market Theory
- Role of evidence
 - Learning from experience
 - Learning from proactive data gathering

Evaluating Investment Belief Systems

- Evaluating belief content
 - Violations of bedrock theory
 - More substantive questions
 - How view opportunity set?
 - What positions the manager to exploit opportunity set?
 - How does opportunity set change over time?
 - Helpfulness of inverted efficient market theory
- Evaluating belief management
 - How does the manager self evaluate?
 - Get the benchmark right
 - Supplement performance data with non-performance indicators of process success
 - Does firm culture support or retard greater awareness of beliefs?
 - Using subcultures to enhance awareness
 - Hiring practices and culture

Conclusions

- Beliefs permeate the investment business
 - But are often unconscious
- Beliefs matter
 - Decisions hinge on them
- Culture is an important determinant of beliefs
 - Cultural analysis can shed light on beliefs
- Belief systems resist change
 - But sometimes must change
- Beliefs can be actively managed
 - Indeed, this is a central aspect of leadership
- Evaluating belief systems is a central part of evaluating an investment manager

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