



Seeking Alpha? Find Innovation

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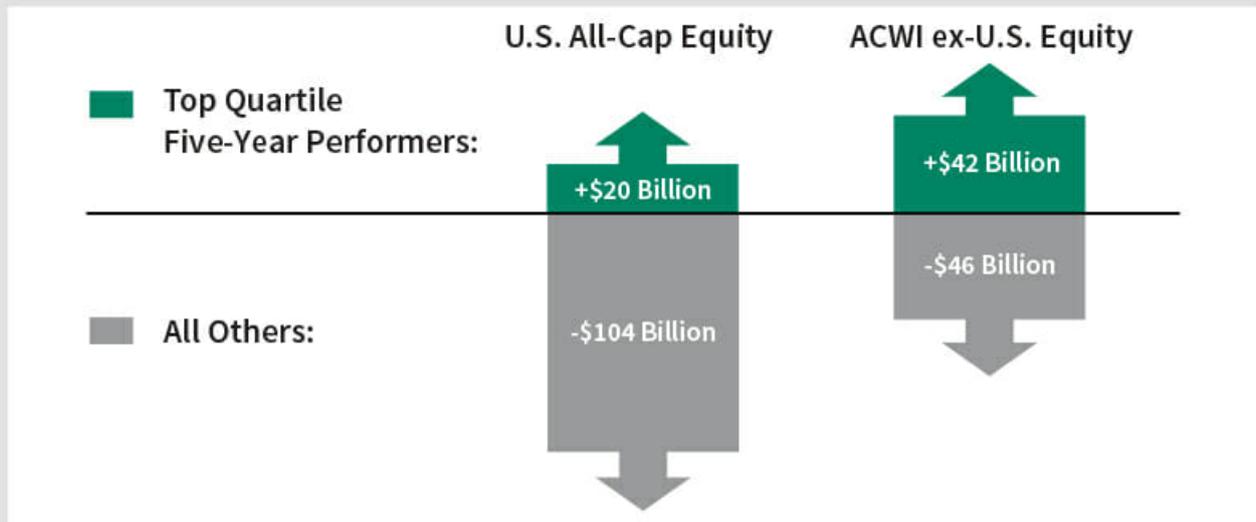
I've written previously about the forces of disruption in investing, but the question is, what can investors do to combat and capitalize on these forces?

Our job as investors is to analyze the impact of innovation on the companies we own and on industries as a whole, being ever mindful of evolving competitive dynamics. Investors look for growth created by radical innovations, but we must understand the nature of the growth and how long it will continue.

Having a framework to assess the changing nature of growth and its impact on corporate returns is important because value creation follows a cycle of innovation and changing returns. While many individuals get mired in the day-to-day news, as long-term investors, we know that the sources of growth and returns change, but the methodology of identifying them endures. This framework is applicable to companies, industries, and even countries.

Consistent alpha generation is paramount. According to eVestment Alliance, actively managed, U.S. all-cap equity strategies that performed in the top peer group quartile over a five-year period have seen \$20 billion in net inflows over the past three years, a significant contrast to the \$104 billion lost over the same period by the active strategies in the bottom three quartiles. International equity managers in the top quartile have enjoyed \$42 billion in net inflows, while those in the bottom three quartiles lost \$46 billion in assets.

Three-Year Net Flows of Actively Managed Equity Strategies



Source: eVestment Alliance, as of third-quarter 2015.

How do investment firms generate consistent alpha and garner these positive inflows? Alpha generation requires innovation at every level of the firm, from the investment process to the fundamental business model and distribution.

From an investment perspective, it is important to have a core philosophy. What do we believe are the key drivers of company and stock returns? Only if we have strong investment beliefs that are part of the very fabric of our teams can innovation occur. To paraphrase one of my former colleagues, “The key to long-term investment success is to combine a sound, unwavering philosophy within a dynamic, flexible approach. This requires continuous introspection that leads to innovation and process evolution. Not only is change good, it is required to remain relevant.”

Unlike in virtually any other industry, change is frowned upon in the investment world. Thirty years ago access to information was the competitive edge; now information is ubiquitous. The key differentiator today is how investors cut through the data and the noise and understand the short- and long-term drivers of both companies and stocks. Innovation in the process and in the tools is paramount. As investors, we look at disruption within industries; likewise, we need to disrupt our own processes and innovate.

It is important to innovate in terms of business models as well. Business models and distribution/delivery models are driven by the historical constructs of industry structure, but companies also adjust their business models given their competitive strengths and weaknesses. Investment firms need to reassess their business models and distribution/delivery models and ask questions. What are the core strengths of the firm and how should we capitalize on them? How do our teams interact with each other, and is there a better way? How do we deliver consistent alpha in strategies that clients need? How are client objectives compatible or in contrast with the firm’s strategies? Where are our target clients, and how do they make decisions? It is important to think about global shifts, shifts in wealth creation, and shifts in industry structure in deciding upon innovative solutions to address these needs.

Above all else, client focus is also important. How do clients communicate? How can we as investors partner with

them?

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