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Seven Habits of Highly Successful Portfolio Managers

By Faryan Amir-Ghassemi

In today's hyper-competitive business world, there's a never-ending deluge of self-help lists, management consultants, and executive mentorship training. You can read Medium or HBR, you can watch TED talks, and you can attend a Coursera webinar. While most management observers point to improved baselines across corporations, the zeitgeist of media attention gravitated toward the Silicon Valley startup space and their novel adaptations toward scaling. Meanwhile, asset management has seemingly lagged behind the cutting edge, as today's young talent opts for Mountain View instead of Wall Street. Whether or not you see this as a secular change or simply a cyclical trend, little has been written about asset management needing to evolve in the face of a drastically different regulatory and competitive landscape.

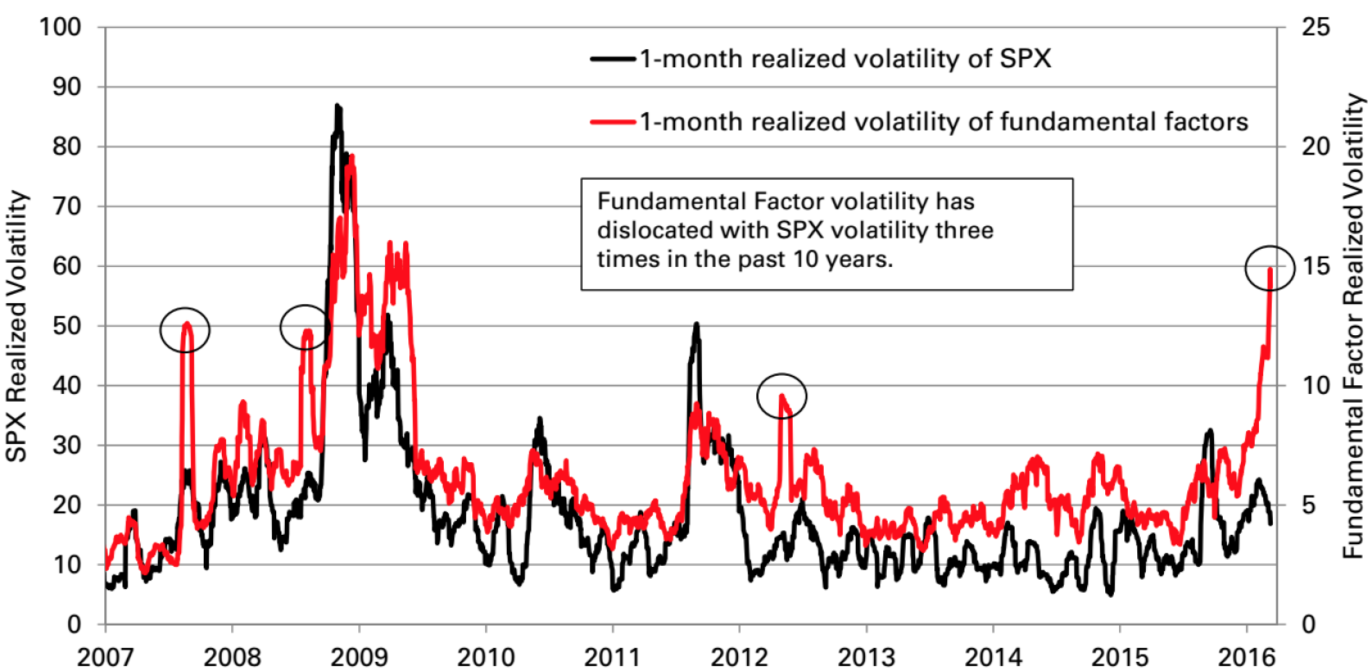
In the active management space, specifically, the image of hedge funds run by eccentric geniuses barking out buy orders like soothsayers is a dying trope. In today's world, top management techniques will be a requisite for fund managers to survive the washout of organizations hit by redemptions, closures, and fee compression. The later point, in particular, has forced noticeable belt-tightening amidst a historically profligate niche industry. The silver lining here is that tightening can be healthy if it leads to more prudent evaluation of expenditures and emphasis on cultivating human capital.

In this piece, I'll use personal experience interacting with dozens of hedge fund PMs—from small 50mm startups to multi-billion-dollar world-beaters—to explore successful techniques in running great businesses instead of simply making great investments. Borrowing a theme from our friends over at Sentieo, these techniques will be framed around (you guessed it) Stephen Covey's Seven Habits of Highly Successful People.

1. Be Proactive

No one knows where the market will be in three, six, or twelve months. Ask anyone who's burned premium on downside protection for the last seven years. The current abnormal macroeconomic conditions make this type of prognostication near impossible beyond assigning probabilities to outcomes. Thus it's difficult for portfolio managers to focus on long-term investment perspective or adapt to violent sub-trends that ripple underneath the calm veneer of the market's upward drift. A thought-provoking chart by Goldman Sachs Investment Research displays the recent dislocation between market volatility and that of "fundamental factors." See below.

Beyond doom and gloom, this "new normal" makes the proactive positioning of one's portfolio more important than ever. Understanding how the portfolio, sleeves, or individual securities will behave under exogenous circumstances is crucial to maintain balance during turbulence. Take, for example, High Yield's return trip in the



Source: Goldman Sachs Global Investment Research last twelve months, or that of media companies in the first quarter. Biotech may be another example, as are the currently en vogue "low-volatility" ETFs. In the last year, many funds scrambled to identify how these sub-trends blindsided their portfolios. A proactive orientation about investigating beyond the fundamentals allows for better decision making when volatility picks up.

2. Begin with the End in Mind

One of the best adages I've heard from portfolio management is from a former hedge fund PM talking about his objective for each year. It wasn't tied to a specific performance metric (e.g., 20% annualized), which is almost impossible to project if you have market sensitivity (he ran l/s equity). Instead, he aims to produce the following:

$$\textit{Fund's Expected Gross Return} = .4 \cdot \beta + .1 \cdot \alpha$$

He started by focusing on capturing 40% of the market's beta (which can be controlled by adjusting net and monitoring the beta of longs, shorts, sectors, geographies, and cross-asset class correlations). He then focused his primary research effort on generating 10 percentage points of alpha. Obviously this is easier said than done! But starting with that end in mind, the investor has a framework for evaluating the inclusion criteria for every security prior to entry into the portfolio: How does this name affect our beta? What's the upside/downside potential? How much incremental risk am I assuming to achieve a portion of our annual alpha objective? How attractive is the merger/arbitrage opportunity given our risk/reward parameters? Can I leverage Bayesian frameworks for making opportunity cost assessments? Can I track my efficacy in achieving the end goal? Beginning with the end helps clarify thinking in the now.

3. Put First Things First

In Seven Habits, Covey speaks of an instrumental prioritization grid. It looks something like this:

	URGENT	Not Urgent
IMPORTANT	Urgent and important	Important but not urgent
Not Important	Urgent but not important	Not urgent and not important

As seemingly basic/obvious as this is, it's a superb mental model for long-term prioritization that combats our tendency to focus on urgent tasks. Most highly functional thinkers (whether HF PMs, med school students, or summa cum laude law graduates) start their career path by successfully executing urgent tasks (deliver a project, cram for a final, memorize a brief). In the investment management industry, career progression often starts with quick turnarounds surrounding timely events. As you transition to leader and business owner, these highly honed skills—while important—need to be complimented, and often fully replaced, by less urgent but perhaps more important tasks such as running a business, portfolio construction, cultivating and mentoring talent, and providing leadership to drive alignment/common purpose. Portfolio Managers need to live in the important/not urgent box, while figuring out the organizational structure to satisfy the rest. Crossing that Rubicon is crucial for successful PMs and for organizations that want to scale from performative to institutional businesses.

4. Think Win-Win

This isn't an immutable law, but a common trait across the institutional asset managers we interact with isn't necessarily the genius of the PM in feeling the market or understanding trends in sectors or interest rates; it has been the focus of the principal to cultivate talent in their organization. They understand the multiplier effect of passionate employees. There is a Silicon Valley saying about employee effort:

$$1.02^{5} > .98^{10}$$

This simple equation basically says that if your base ingredient (human capital) delivers above and beyond (102% output) with only five of those ingredients (employees), it will outperform twice the investment (ten employees) operating only 2% below peak. While the math here is drastic, it's rooted in the reality that scaling organizations leads to exponential increase in complexity. What worked with one PM and two analysts at $250mm of capital doesn't scale linearly when capital is tripled. You can't simply add bodies and expect the same cohesiveness, focus, and quality. PMs may have to wear several hats to ensure that their startup's lights are on and their bills are paid, but they need to make effective transitions to building institutional businesses rather than struggling to maintain status quo. The easy answer is always to hire more bodies, but that approach can be dilutive if quality and alignment are compromised. This is an extremely challenging balancing act that we'll address more thoroughly in point 6.

5. Seek First to Understand then to be Understood

Novus offers high-touch consulting services to investment managers who want our proprietary expertise to review their portfolios. Having per-

formed many of these reviews, I've been kicked out of a corner office or two for presenting unflattering analyses to PMs. I now empathize with outsiders/consultants offering advice (for a fee) about someone's business. One of the most pointed criticisms about consultants is that they rarely understand the intricacies, nuance, and difficulties of their practice, choosing one-size-fits-all aphorisms and Band-Aid solutions. This can especially be the case when taking a generalized approach (in a field such as data analysis).

Some of the most effective PMs I have encountered, however, are those willing to hear an outsider perspective—even against immutable truths they know—and then debate why they disagree with the conclusion. This readiness to converse permeates analyst meetings where ideas are discussed as well as interactions with portfolio management companies. It demonstrates patience, a willingness to step away from confirmation biases, and the process orientation to synthesize information through open-minded rigor. Those that seek to understand first are often those that develop the most impressive businesses by being open and vulnerable to self-improvement.

6. Synergize

Creating cohesive workflows is crucial for successful PMs. As we discussed earlier, PMs must graduate from primary research/vision to executive skills like optimizing staff strengths and workflow. Balancing getting 102% from one's analysts (Point 4) against overstretching/burning them out is a critical challenge.

Understanding that Jane is excellent at EMEA, while Jacob has a bias toward Industrials cycles isn't only imperative in positioning their output and portfolio impact (remember 102% vs. 98%); it's essential in fostering motivation and development that help analysts grow to become accretive contributors to the fund's success.

Having the risk team spend less time on model implementation and more time on analysis and actionable insight is another relevant analog.

Providing operational leverage to one's human capital is critical to winning the balancing act that pits self-driven alignment against constant task mastering. At a recent panel discussion on private equity, Michael Milken outlined his personal framework for engendering this prosperity:

$$P=\Sigma Ft_i*(\Sigma HC_i+\Sigma SC_i+\Sigma RA_i)$$

P = Prosperity
Ft = Financial Technology
HC = Human Capital
SC = Social Capital
RA = Real Assets

The prescription is quite clear: To drive prosperity (in the form of organizational excellence and ultimate shareholder or partnership returns), investment firms must achieve operational leverage through financial technology to get the most out of human capital, social capital, and their real assets. PMs need to carefully consider which tools allow these forms of capital to be leveraged to their fullest extent.

Over the last ten years, we've seen a change in how office work is done at asset management firms. Some firms remain deeply rooted in Excel for their DCF models, their data gathering/analysis, and their risk/attribution modeling. Others have moved to database infrastructures with querying languages like SQL that allow them to store, access, and manipulate data at a greater scale. Cutting edge organizations are using vendor software services for repetitive tasks, allowing human capital to focus on synthesizing information into actionable insight.

The build vs. buy vs. body approach must be done judiciously: Know when an employee should wear two hats versus outsourcing a function; understand when to graduate that function to unlock the employee's extra core-competency contribution while reducing low ROI time-allocation. Providing employees adequate training in new technology is also crucial to ensuring growth. The end result isn't just increased productivity—it means attracting and retaining talent not only with compensation (which breeds mercantilism) but also through meaningful work and personal growth. This is how to engender Matthews Effects in highly competitive markets.

7. Sharpen the Saw

Brian Chesky may have understood this best: when a business leader is entirely consumed by her passion, she may lose perspective of how the functional reality around her has evolved. Physical renewal is definitely one aspect of it (healthy mind and body), as is mental balance (as Ray Dalio has espoused through his championing of meditation).

Focusing on renewal will not only sharpen your execution but will also ensure that your perspective doesn't fall out of balance. Evaluating companies as anonymous widgets on a 10-K may divorce one from the intangible realities of the business and its end-consumers. While that might seem like a stylistic choice (e.g., the investor who prefers meeting with management versus those who separate from potential bias), it's really about retaining the ability to make quality judgments over time. Ultimately, the ability to really understand the business requires a centered, healthy lifestyle—as opposed to living in Excel and Bloomberg for eighty hours a week.

These prescriptives won't work for every organization and should be tailored to the idiosyncrasies of each situation. Nonetheless, the rapidly shifting environment necessitates a positive evolution in asset management business practices, and I'm willing to wager that highly effective organizations that understand how to leverage their resources while navigating the difficulty of scaling will win out in the long run.

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