

2018 Idea Lab Highlights

This year's Idea Lab brought together investment professionals, political leaders, and academics to consider a broad range of issues central to managing portfolios in the challenging environment of compressed risk premiums, high levels of policy uncertainty, mounting global debt, and late cycle market dynamics. While it is impossible to do justice to the depth of the discussions during the two-day forum, four areas were particularly noteworthy. These include the centrality of sound portfolio construction and robust risk management for investment success, the turbulent political environment in the U.S. and the E.U., the forces besieging liberalism, and words of wisdom on investment governance by Charles D. Ellis, a long-time Chair of the Yale Investment Committee.

Portfolio Construction & Risk Management

The Strategic team set the stage with a focus on the analytics and disciplined approach needed to construct well-diversified portfolios capable of generating sustained value added. The key to success is to focus active risk on a large number of judiciously calibrated, well-diversified positions, rather than concentrating on a small number of large decisions. This approach increases the likelihood of adding significant value within well-defined risk parameters. Applying this philosophy, Strategic emphasizes manager selection, which captures all of the security selection and other decisions taken by active managers across the various asset classes, as the main way to seek value added. Because of the vast breadth of independent decisions it encompasses, manager selection provides the richest and most consistent source of potential value added. Active asset allocation decisions to respond to significant valuation anomalies across and within asset classes also provide opportunities to seek value added. However, the size of these tactical positions should be calibrated by the degree of misvaluation. The Strategic team highlighted the qualitative analysis and proprietary quantitative tools used to identify skilled managers and optimally combine them to construct portfolios designed to seek sustained strong performance.

Political Ructions in the U.S. and the E.U.

A forum held in a stately room overlooking the White House would not be complete without a discussion of politics, especially in these febrile times. Congressman John Delaney, the first announced Democratic candidate for President in 2020, was our opening speaker on the second day of the Idea Lab. He shared his views on restoring a bipartisan spirit to governance, emphasizing civility, respect, tolerance, a common purpose, and global engagement. Later in the day, we had a reprise political discussion, this time focusing on the rise of populist forces in Europe. According to our panelists, voters attracted to populist candidates shared two traits: a belief that traditional parties are ineffective, out of touch, and

unresponsive to genuine needs, and concern over immigration. Our panelists identified a potential silver lining of populism. Its rise might help overturn elements of a myopic austerity that has deferred overdue investments needed for long-term prosperity.

Liberalism Under Siege

Our dinner keynote speaker, Zanny Minton Beddoes, Editor in Chief of *The Economist*, discussed the history of liberalism, a philosophy of free trade, free markets, limited government, a distrust of centralized economic and political power, and a firm belief that progress requires an open competition of ideas. These tenets have animated the Economist from its inception over 175 years ago. Recognizing that the current discontent with liberalism reflects its failure to address the ill effects of free trade on certain industries and regions, the loss of social cohesion because of immigration, and the unhealthy concentration of wealth, political power, and production in key industries, she argued for a reinvention of liberalism. That liberalism is under siege represents an opportunity to test and refine its principles against others in a competition of ideas. Quoting James Wilson, the first editor of *The Economist*, she concluded that nothing serves liberalism better than "a severe contest between intelligence, which presses forward, and an unworthy ignorance obstructing our progress."

Words of Wisdom on Investment Governance

A highlight of the 2018 Idea Lab was the reflections of Charles D. Ellis on the critical importance of nurturing a culture of sound investment governance. Institutional investment committees typically focus on transactions, or "repair work" rather than promoting sound governance. The role of the committee chair is not to be nice, or to have the best ideas, but to assemble the most effective team possible, with the chair acting as a "servant leader." The chair must set clear expectations for each committee member and ensure that these expectations are met. Each committee member must know what makes the institution unique and be fully committed to furthering its mission. Successful investment committees must review past decisions and learn from their successes and failures. Charley concluded that, to test whether your governance process is sound, ask yourself whether you would be willing to freeze the portfolio for the next 10 years.

We hope that this overview of highlights from Strategic's 2018 Idea Lab encourages you to join us at the Idea Lab planned for 2019. It promises to be every bit as insightful and entertaining as this year's forum.

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