

Investment Management

*Meeting the Noble Challenges
of Funding Pensions, Deficits,
and Growth*

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and
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Editors



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A Sea of Changes and Waves of Opportunity	1
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Jacqueline Charnley and Christine Røstvold

The 2008–2009 credit crisis roiled the already-turbulent environment in which asset managers confronted their stewardship challenges. The authors cite seven major elements of the “pre-crisis” turbulence, and remind readers of Darwin’s dictum of survival. Proactive relationships with all the players are the key.

PART ONE:

The Challenges of Changes and Crises

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Wayne H. Wagner

The twists and tangles of the 2008–2009 credit crunch will long be remembered. This chapter does not address that specific discontinuity, but discusses discontinuities in general. From a longer time perspective, we see that these discontinuities occur frequently, suggesting that in addition to applying our experience and running our models in “normal” times, we need to prepare to face the inevitable

discontinuity environments. This is the first chapter of several in which we reflect on Taleb's Black Swan.

CHAPTER 2

The Sub-Prime Crisis as a "Predictable Surprise": Strategic Lessons to Be Learned

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Keith Ambachtsheer

The fallout from the events of 2008–2009 has engendered several million words of criticism, constructive and otherwise. Yet, very little relevant appraisal has come from the investment management industry. An enduring champion of pension reform describes the collective actions that can be effectively marshaled when confronted with another threat of asset erosion. Why, in this case, Bazerman and Watkins are more relevant than Taleb.

CHAPTER 3

The Solidarity Challenge

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David G. Tittsworth, Esq.

Compared to many other laws, the statutory framework of the Investment Advisors Act of 1940 is relatively simple and straightforward. The fiduciary culture it has fostered distinguishes the advisory profession from other financial services. Now, the basic legal and regulatory structure that has governed investment advisors for decades is being debated. Well-organized and well-financed groups seek to change the laws based on the 1940 Act, charging that they are "outdated" and "losing relevance." The author suggests three actions to ensure that investment advisers work together to preserve what is good about how the advisory profession is governed.

PART TWO:

Keeping the Challenges in Perspective

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The Failure of Invariance

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Peter L. Bernstein

When published in 1996, Against the Gods: The Remarkable Story of Risk took its place as one of the seminal history books.

written in the twentieth century. Here is Chapter 16 from that remarkable work. Many readers encountered for the first time Kahneman's and Tversky's "Prospect Theory." Investment managers who have not read Against the Gods are at a competitive disadvantage—big time.

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G.C. Seldon

Not for the first time, we anthologize this excerpt from Psychology of the Stock Market, first published in 1912. Sage observations from which the author observes, "Historical parallels are likely to be misleading."

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An experienced and innovative investment manager reflects on "the triumph of temptation over reason," and offers a "list of ten causes of irrational, and occasionally bizarre, behavior" by professional investors.

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Richard Bookstaber, PhD

An elegant analogy illustrating how innovation, endogenous risks, and regulation should be contemplated so as to assure a market "that is more robust and survivable." Excerpted from the best-selling A Demon of Our Own Design (Hoboken: Wiley, 2007).

CHAPTER 8**Managing Outside the Box****111**

Robert A. Jaeger, PhD

This reflection on fads and fashion in the investment business provides an appropriate departure for studying Part Three of this book: The Challenges Under Transformation.

PART THREE

The Challenges Under Transformation**CHAPTER 9****The Evolving Challenges of Quantitative Investing****119**

Robert L. Hagin, PhD and Kathleen T. DeRose

The authors suggest that the rapid pace of technological change affects both fundamental and quantitative investors. Despite their similarities, quantitative investors, particularly those who acknowledge the limits of technology, are better equipped to deliver on their clients' performance expectations. As investment approaches begin to incorporate insights from beyond computer science, drawing from biology and other disciplines, the debate becomes a philosophical one about the frontier between the computer and the intellect.

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Wayne H. Wagner and Ralph A. Rieves

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Ron Surz

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Harry Liem

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Robert A. Jaeger, PhD

The author of this chapter turns from commenting on fads and fashions to reflecting on investment skill. Skill is elusive, but it is not illusionary. He argues that skill is real precisely because it is elusive. “The barriers to entry in the hedge fund business are seductively low; the barriers to success are formidably high.”

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Fiduciary 360

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Edward Siedle, Esq.

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outperformance. Clients who can't distinguish between myth and reality are more likely to be subject to chicanery. The burden is on clients to make that distinction, not on SROs or regulators. This theme is reiterated in several chapters of this book.

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“Dove Green”

The term socially responsible investing (SRI) has morphed into environmental, social, and governance investing (ESGI), and is sometime referred to as sustainable investing. Each of these terms has been used by the cadres of activists to describe their persuasive campaigns—the targets for which are now trustees, investment managers, and corporations. Here is a discussion about the concerns of shareholder activists and social activists. Are ESG policies and procedures the new intangibles? Whatever the cause, fiduciary duty still trumps all.

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Ron Gold

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Amit Goyal, PhD and Sunil Wahal, PhD, et al.

We would have liked to have changed the title to “Suspicious Confirmed.” This chapter appeared in the August 2008 issue of the Journal of Finance and is reprinted in its entirety, including references and citations.

A complete familiarity with this work is recommended for managers, consultants, and trustees throughout the world.

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Steve Wunsch

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Wayne H. Wagner

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Steve Webb and Simon Bennett

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John R. Minahan, PhD, CFA

Beliefs permeate the investment business. They shape our decisions and our institutions. Beliefs themselves are shaped by culture, by professional training, by experience, and by deliberate attempts to clarify ambiguity and reduce uncertainty. In rapidly changing times, it is valuable to examine one’s beliefs in light of theory, evidence, and alternative points of view.

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Jim Ware, CFA and Jim Dethmer, ThM

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