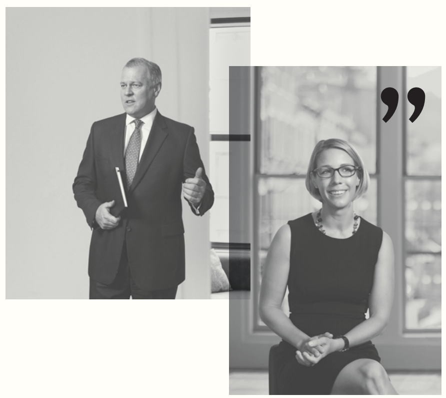
“Is now the time to write the future?”



John Green
John is global head of client group at Investec Asset Management. He is responsible for all of the firm’s client related activity including sales, client management and marketing.

Katherine Tweedie
Katherine is executive director at the Investment Institute. She is responsible for providing research and insight to financial institutions on geopolitical, economic and investment trends shaping portfolio strategy and asset allocation decisions.

Introduction: Capitalising on the long term

SUMMARY: There is ever more compelling evidence in support of taking a long-term approach to investing. But is this easier said than done? How can key stakeholders move from talking about the importance of long-termism to taking action? Is long horizon investing only for private markets or can it be pursued in mainstream equity and fixed income strategies? Are there emerging thematic areas that will lead to value creation as part of a long horizon investment philosophy? What role does sustainability and ESG play? These questions and more underpin the work of the Investment Institute and our fifth edition of *The Journal*.

An unusual consensus

It is rare to find areas of strong consensus in the world of investing and capital markets. However, it is increasingly apparent that a broad array of stakeholders do share the view that short-termism in all of its guises is bad for investors, bad for companies and bad for economies and growth.

As an industry which demands curiosity, analysis, insight and rigour, we tend to seek evidence before we take action and then, when we have the proof, we demand more. The evidence in favour of the benefits of increased long-termism is building. We believe now is the time for all capital market participants to consider how to take action to improve long-termism.

In the report, *Measuring the Economic Impact of Short-Termism*, The McKinsey Global Institute (MGI) shows that firms with a long-term orientation (defined as more than seven years) generate better returns for both shareholders and society, enhancing the economy.

According to MGI, for such firms, average revenue and earnings growth were 47% and 36%[1] higher respectively than those of their competitors. They also showed less volatility and their market capitalisation grew faster than their more short-termist counterparts. Companies that focused on the long term also created 12,000 more jobs, on average, than their peers in the period between 2001 and 2015.

In a 2016 study, Hsu et al[2] considered the effect on long-term performance of retail investors taking short-term views. The study looked at US mutual fund flows over a period of 20 years and analysed trends of investors trying to time the market – invariably buying high and selling low. The study concluded that this behaviour resulted in value destruction of 2% in returns per annum. It may not sound like much, but when considering the compounding effect over 20 years, 2% per annum increases a portfolio value by almost 40%.

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[1] McKinsey Global Institute (MGI), February 2017. 'Measuring the Economic Impact of Short-Termism': http://www.fcltglobal.org/insights/publications/measuring-the-economic-impact-of-short-termism

[2] Hsu et al. 2016. 'Timing poorly: A guide to generating poor returns while investing in successful strategies'. Journal of Portfolio Management, 2016, Vol. 42, No. 2

Finally, recent findings by the Willis Towers Watson (WTW) Thinking Ahead Institute show that investors, with a longer horizon approach, benefit from a net premium that could range between 0.5% and 1.5%, depending on an investor's size and governance arrangements. The WTW working group argue that over time this investment philosophy also manifests in lower costs and losses and avoids the pitfalls of buying high and selling low.

Moving actively and deliberately to improve long-termism

With growing consensus on the value of long horizon investing, the real question is - what should we do about it? How do we, as key actors in a connected ecosystem that drives economic growth, provides capital to companies and generates returns for individual savers take tangible steps to re-orient our focus towards the long term?

In this Journal and for the rest of the year, our Institute will be focused intently on exploring these questions. We will explore it from several perspectives and we trust our readers will not only be provided with food for thought, but some specific ideas on how we all might act to effect change.

Later in this chapter of *The Journal*, we will learn from Mark Walker, CIO of Univest, that long-termism is a state of mind that requires constant reflection on whether decisions are taken or advice is provided based on an outcome that is ten-plus years in the future, rather than the next two or three years. This means, as Dominic Barton, Managing Partner at McKinsey argues, the conversation is not about either shareholder maximisation or stakeholder maximisation, but rather about how all those engaged with capital should shift to sustainable value creation through long-term thinking.

To make a difference we will be exploring how each of the key decision makers in the capital markets chain can consciously consider what steps they can take to improve long-termism.

For asset owners, we ask them simply to start by determining if they agree with the long-term consensus. If so, do they commit consistently to seeking to improve long-termism in all of the allocation decisions that they make in their statement of investment strategy? Most pension funds and individuals would shy away from this question, concluding that to improve long-termism you need to invest in illiquid strategies that constrain cashflow and commit you to investment lockups well beyond your comfort horizon. We hope to demonstrate in the work that we are doing within the Institute that this is not the case. Any investor can take steps to improve the long-term orientation of their portfolio by simply asking whether the managers who manage their money are taking a genuinely long-term view in the way they invest and the way they engage with the companies they own on investors' behalf.

For investment consultants, we argue that more needs to be done to help asset owners consider how they can improve the long-term orientation of their portfolios. Developing specific views on which liquid strategies support improved long-termism, engaging actively with managers to understand not only how they will deliver market-beating returns but also in what way they do this will be key. We challenge the consultant community to step away from the consensus that long-term equals illiquid and to find ways to help investors in liquid strategies make meaningful progress in their desire to improve long-termism. Probably the most important step in this effort will be to clarify how investors in these strategies should think about assessing and measuring their managers. We know that one of the most effective destroyers of long-term thinking in the investment ecosystem is the obsession with benchmarks and short-term performance relative to benchmarks. Consultants will play a crucial role in developing approaches that are relevant, give asset owners confidence and hold managers accountable.

For investment managers, the action is to be much clearer about how they are committed to long-termism. At the highest level this is about the firm and whether its approach to its business, its investment processes and its clients is genuinely long term. At a lower level the question for every investment manager is how they are taking steps within their investment strategies and their new capability-building to advance the focus on long-termism.

Through this journal we set out some very specific strategies that we at Investec Asset Management believe take a genuine long-term view on investing. These include our Quality investment process, our Africa infrastructure capability and our view that one of the key long-term themes for investors is a commitment to supporting the growth of renewables companies in the listed capital markets.

In conclusion

Trying to predict the future will always remain a challenge. However, one trend that appears set in stone is that exponential technological innovation and increasing access to real-time information will only increase our connectivity and pressure to act in 'the here and now'. As such, it is going to take even more discipline and the combined efforts of stakeholders across the corporate and investment landscape to work together to shift our priorities. With a long-term focus we can create the world we want to live in 10, 20, 50 years from now. We must, however, move beyond talk and analysis and into action. We hope that in the months to come, the Institute, its journal and the opportunities we provide for dialogue, will help action happen.