

A RENEWED PROFESSIONALISM

The six guiding principles for investment professionals to implement the Portfolio for the Future™





A Renewed Professionalism

THE SIX GUIDING PRINCIPLES FOR INVESTMENT PROFESSIONALS TO IMPLEMENT THE PORTFOLIO FOR THE FUTURE™

Earlier in 2022, we argued in our seminal piece, Portfolio for the Future™, that tectonic economic and capital market shifts globally were ushering in a new era that would require fiduciaries to work smarter and more creatively to deliver investment outcomes to clients. As we have dialogued on this declaration with practitioners worldwide, it has become increasingly clear that this narrative needed a “Chapter two,” or at least an addendum for two reasons.

- While the original piece outlined the five marks to future capital allocation, it was light on “how” the collective profession was to implement. We wanted to put human legs on the behavioral underpinnings necessary to achieve success in this new era.
- The need for professionalism has never been more critical. Generational headwinds in capital market expectations, inflation, and interest rates combined with a voracious appetite for exposure to less liquid, more complex, idiosyncratic asset classes and strategies are raising the bar for professionals in all corners of our industry. While we agree with this evolution in principle, a demonstrated level of competency and an unwavering commitment to a set of ethical standards is now table stakes to avoid a credibility reckoning of the fiduciary.

As such, we are pleased to present A Renewed Professionalism: six guiding principles for investment professionals to implement the Portfolio for the Future™.

1. Cultivate a Transparent and Client-Centered Ethos

The Portfolio for the Future™ must be rooted in a fiduciary mindset—the starting place for any conversation around professionalism. As a legal standard, fiduciary duty means putting the client’s interests front and center. As a professional, this standard should be core to your practice, business model, and culture; there should never be any doubt among your clients who you are serving.

Investment professionals can embody this philosophy and practice it on a regular basis by operating with a transparent, client-centered ethos and taking the following steps:

- **Invest for the client’s purpose.** At the onset, work with your clients to identify the overall purpose of their investment portfolios.
- **Align all parties to the goals and outcomes of the investment strategy.** This means ensuring that every investment decision is explicitly rooted in those client-driven goals and outcomes. Build alignment among fee structures and compensation. Your remuneration model should line up with, and indeed reinforce, client goals and outcomes.
- **Be transparent with your clients.** Explain why you are making your investment decisions and how those decisions serve to achieve their goals and outcomes. Capital markets are the means to a greater end. Make it clear why each investment tool you choose is appropriate for the goals of your clients.

PROFESSIONALISM IN PRACTICE

For defined benefit plans, the client's purpose is clear-cut. However, the demographic profile from one plan to the next can vary considerably, meaning the goals and outcomes may not be the same for every pension fund. A plan with younger pensioners (on average) will have different goals than a plan with older pensioners (on average) and therefore would likely have a different investment strategy and investment portfolio. Each plan should clearly connect (and articulate) their portfolio management decisions with the client's goals and outcomes.

2. Start with Purpose-Driven Portfolio Building Blocks

Creating a portfolio driven by goals and outcomes means investors must evaluate all investment options and should not be limited by generic portfolio models. A holistic, purpose-driven portfolio is one that is not defined or limited by asset class "buckets," but rather customized to the client's goals and outcomes.

Myriad factors and labels exist and are not all mutually exclusive; identify and measure the factors relevant to your client and construct a portfolio with these factors in mind:

- **Asset class targets should be the residual instead of the defining parameter.**
- **Invest, manage, think, and compensate beyond silos.** Drop the outdated "conventional" versus "alternatives" nomenclature and reset around "All-ternatives." Foster a dynamic environment where investment decisions at all levels of the organization are made with the client's overall portfolio in mind.

PROFESSIONALISM IN PRACTICE

Rather than creating "buckets" of asset classes, it may be more appropriate to think of a portfolio in terms of growth, yield, and inflation protection. Most institutional and individual investors carry multiple goals, and every strategy carries varying and multiple risk exposures within it. An allocation that focuses on the underlying spectrum of risks may more appropriately align the portfolio toward the objective of the client.

3. Diagnose Your Client's Values and Embed Tailored Sustainability Factors in Your Process

Investment professionals are in the business of understanding, managing, and optimizing risk and return. Among the components of risk and return, professionals must recognize the impact of sustainability factors:

- **Sustainability is not an overlay.** At a strategic level, it is far more substantive than ESG grades, investment exclusion lists, or hiring a disempowered ESG director.
- **Sustainability is a core component of the investment process.** Approaching ESG as one element ignores the impact, importance, and even conflicts of the underlying components. Truly separate out the environmental, social, and governance factors and embed the analysis into the investment process. Recognize that sustainability meaningfully impacts investment decisions and the risk/return profile of a portfolio.

PROFESSIONALISM IN PRACTICE

Since “ESG” is an aggregate of tens, if not hundreds of factors, it’s important to focus on what is most material to an organization. Taking a financial statement approach may be the best way to approach sustainability factors, asking oneself, “Is this material?” Some issues will be easier to tie back to financial statements, such as stranded asset write-downs, while others will require a longer-term view of the company’s strategy and decision-making, such as diversity, equity, and inclusion.

4. Treat Liquidity as a Feature Rather Than a Benefit

Liquidity is neither inherently bad nor good. Professionals must evaluate the true liquidity needs of clients and ensure that the liquidity of the assets match the liquidity of the liabilities. Traditionally, clients often have more liquidity than they truly need, and with most enterprise value creation now occurring in the private markets, a deeper understanding of the trade-offs is essential:

- **Liquidity is not a constant.** Therefore, you must understand how the liquidity adjusts across market cycles and dislocations and the moments when the client is most likely to need liquidity.
- **Private investments should not be viewed as levered public investments with an illiquidity premium.** Private investments are an extension of the investment universe. When paired with public investments, they can capture the complete global economy beta and/or provide uncorrelated streams of income.

PROFESSIONALISM IN PRACTICE

When investing in funds, evaluate the fund liquidity relative to the underlying investments (and liabilities if the fund manager utilizes leverage). Do not accept unnecessary illiquidity (e.g., long lock-up to invest in public securities) without requisite return or diversification compensation, and be aware of the risks of investing in liquid vehicles with illiquid assets (e.g., open-end real estate funds).

5. Identify and Capitalize on Your Firm's Edge

How do you add value in your investment decision making process? What allows your firm to consistently meet or exceed your clients' goals over the long-term? Know thyself:

- **Organizations and their underlying capital pools have unique structural or cultivated advantages.** Structural advantages may include time horizon, governance structure, or networks. Cultivated advantages may include diversity of talent, firm culture, proprietary innovation, and technology. These advantages should be harnessed to deliver long-term performance.
- **Leaders must diagnose and exploit these unique characteristics.** Levers include resource allocation, constant reinforcement, hiring practices, and compensation.
- **Articulate your edge to your clients.** Ensure your value-add is known to your clients and that employees understand and embrace this edge in their day-to-day process(es).

PROFESSIONALISM IN PRACTICE

In his work on Organizational Alpha, Stanford University researcher Ashby Monk describes the importance of knowledge sharing. When structuring an organization that encourages domain knowledge to flow through the organizational process, investors can meaningfully impact the risk-adjusted rate of return. Creating a structure and culture of knowledge sharing can be a real source of value-add. Grow your human capital to develop a deep understanding of the full spectrum of premia.

6. Invest with Integrity and Allocate to True Partners

Allocating capital to organizations that do not put client interests first is a risk not worth taking, regardless of past performance. Simply put, professionals should only invest with other professionals. To that end, practitioners should undertake the following:

- **Bring back the “partner” in partnerships.** If an investment firm (General Partner) is unwilling to treat clients as partners, then it is the responsibility of the allocator (Limited Partner) to take accountability and allocate elsewhere. Invest with partners first and keep an eye toward long-term relationships.

PROFESSIONALISM IN PRACTICE

It is a poorly kept secret that internal rate of return (IRR) can be manipulated in ways that don't increase value or cash return to the investor (i.e., multiple of capital). While measuring and evaluating performance has its challenges, professionals confront those challenges and focus on sustainable, long-term compounded growth. Professionals avoid playing games with producing and measuring performance and do not partner with firms that embrace such practices (i.e., small follow-on financings at large markups, selling between funds, and other zero value-add financial manipulations).

These six principles continue the conversation started with Portfolio for the Future™ by highlighting what we see as the key attributes needed for professionals in this increasingly complex world. What has not changed is the importance of continued growth. Whether it be through continuous education or recognized certifications, evolving and upskilling your competency tool set is critical to long-term success in this industry. Professionals must also recognize the benefits of collaborating with others exhibiting a diverse set of cultural experiences and skills. Just as diversification reduces risk in a portfolio, diversity enhances creativity, problem solving, and performance^[1].

Delivering a purpose-driven investment return for a client over the course of multiple cycles is wholly dependent on your commitment to being a true professional. Your training, ethical foundation, and behavioral principles are the necessary fuel for meeting the residual investment outcome expectations of your investors. At CAIA Association, we strive to create and model a blueprint for this professionalism framework within both the world-class curriculum of the CAIA program and shared thought leadership.

[1] <https://www.mckinsey.com/business-functions/people-and-organizational-performance/our-insights/is-there-a-payoff-from-top-team-diversity>



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The CAIA Association is a global professional body dedicated to creating greater alignment, transparency, and knowledge for all investors, with a specific emphasis on alternative investments. A Member-driven organization representing professionals in more than 100 countries, CAIA Association advocates for the highest ethical standards.

Our Vision

Global capital allocation is the engine for delivering pension benefits and individual retirement goals as well as preserving university, foundation and sovereign savings. Efficiently distributing both financial and human capital across the investment industry catalyzes innovation, cultivates societal wealth, and raises the integrity and quality of human flourishing. That virtuous purpose is incumbent on a properly functioning capital market system where training is robust, ethical conduct is consistent and enforced, and incentives of all parties are aligned. It is also dependent on a long-term, diversified approach to allocating that patient capital.

Since 2002, CAIA Association has sought to serve investors by educating industry stakeholders on the most current knowledge and best practices across the ever-changing landscape of alternative investments. Through credentialing of investment professionals, advocating with regulators and senior leaders, and developing world class thought leadership, CAIA aims to raise the standards of the industry. As a member organization, we are joined by CAIA Charterholders in 100 countries on a mission to collectively foster a true profession that serves the public good.

Our Mission

CAIA Association seeks to improve investment and societal outcomes of capital allocation through professional education, transparency, and thought leadership across all investor alternatives in our industry.



CAIA Association is headquartered in Amherst, Massachusetts, USA, and has regional office locations in Hong Kong and Geneva.

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