2019 Idea Lab Highlights

This year's Idea Lab combined keynote addresses, in-depth workshops, interactive panels presented by Strategic's investment team, and preeminent guest speakers from the academic, policy, and investment worlds. Our keynote dinner speaker was Dan Ariely, Professor of Psychology and Behavioral Economics at Duke University. Over lunch the next day, Adam Tooze, Professor of History and Director of the European Institute at Columbia University, gave the keynote address. While it is impossible to do justice to the depth of the discussions during the two-day forum, four areas were particularly noteworthy. We consider these below.

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 is to focus on fundamental valuations, the riskiness of each active position, and the interaction of all positions in the portfolio when determining top-down positioning and manager selection. In the current environment of unsustainably low bond yields, we maintain a significant underweight to duration. We also judge U.S. equities, which have strongly outperformed other international markets since the Great Financial Crisis, to be significantly overvalued, warranting an underweight. Within U.S. equities, we have initiated a tilt toward value stocks as the long string of outsized returns for growth at the expense of value stocks has made value quite attractive. Real estate valuations, flattered by low yields and ample liquidity, have also risen to unattractive levels and we have reduced their allocation accordingly. While top down insights into fundamental misvaluations like these have added material value historically, we find manager selection to be a more robust, consistent, and sustainable source of value added. This is because manager selection encompasses a vast breadth of independent decisions, as well as greater opportunity to gain an information advantage. Ultimately, sound investment governance requires a stable foundation of analysis, a disciplined process, and keen judgment born of experience, a foundation that Strategic has continuously strengthened for over 30 years.

Behavioral Finance and Life

Dan Ariely's keynote address ranged from humorous insights into the dynamics between a mother and her son's soon-to-be wife, the best way to encourage the poor to save, and the most effective motivator of workers – no, it is not money. Professor Ariely reminded us that, like a rocket ship, the best way to direct behavior in desired directions is to reduce friction and increase fuel. Through a series of case studies drawn from field research, Professor Ariely shared insights, some practical, others tongue-in-cheek, on influencing behavior. How did the mother know which of her son's girlfriends was destined to be his wife? Simple, the future wife was the only one she hated. An effort to promote savings in poor villages in Kenya discovered that higher interest rates, gifts, and prizes were far less effective than a public record shared with the family of whether savings targets had been met. A study of worker motivation found that while salary and benefits were important, nothing was a stronger motivator and boost to morale than respect, encouragement, and recognition of a job well done.

Persistent Tremors of Great Financial Crisis

The lunch keynote address given by Adam Tooze highlighted the continuing reverberations of the Great Financial Crisis (GFC) and their impact on current global political, economic, and market fault lines. In Tooze's view, the GFC shattered a long-enduring consensus that economic policy need only focus on promoting open markets, free trade, prudent fiscal policies, and price stability. With markets seen to be largely self-correcting toward a stable equilibrium, this "Washington Consensus," as it was known, enjoyed wide support in advanced economies across parties of all stripes, rendering politics largely irrelevant to economic policy. This consensus collapsed with the market crash and prolonged economic slump that followed the GFC. Populism, protectionism, and fiscal profligacy have risen in its place, precipitating policy uncertainty, market volatility, and steep declines in global trade and industrial output. Whether a new consensus can be forged around enduring principles remains an open question. In the meantime, we can expect the trade war between China and the U.S. to continue and global economic policy making to remain fractious.

Politics, Policies, and Financial Stability

Syndicated columnist Jonah Goldberg also attributed the current caustic tone of political discourse to a post-GFC feeling of betrayal at the hands of elites managing a rigged system. Without strong political parties to channel and temper the disillusionment, social media amplifies the most extreme impulses of the crowd. Even the normally placid realm of monetary policy is in flux. A panel on monetary policy and the late stage of the credit cycle highlighted the conflicting pressures faced by global central banks. With policy rates low, central bank balance sheets bloated, bonds totaling $15 trillion bearing negative nominal interest rates, and the late stage credit cycle exhibiting signs of excess, the ability of global central banks to address an eventual economic slump is limited. Meanwhile, policy uncertainty in the form of trade tensions and Brexit are increasing the risks of recession and financial instability and central banks appear ill equipped to respond to renewed challenges.

We hope that this overview of highlights from Strategic's 2019 Idea Lab encourages you to join us at the Idea Lab planned for 2020. It promises to be every bit as insightful and entertaining as this year's forum.

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