Inside the Investment Process of Stamford Associates

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This interview is partner content from Sovereign Wealth Ltd.

Stamford Associates is a leading London-based global investment advisory firm, that creates a unique edge by (among other things) integrating behavioral psychologists into the investment analyst teams. The consistent application of Stamford's evidence-based investment approach has achieved superior outcomes for clients over time, with 85% of managers beating their benchmarks over 10-year periods.

Adrian Furnham is by training a personality and social psychologist, having been a professor of psychology for over 35 years. He has adjunct professor roles at both the University of Exeter Business School and the University of Oslo business school, and also works as a consultant to Stamford Associates. Steven Braudo is Stamford's Managing Director. An actuary by training, Steven has in excess of 25 years of experience working in financial services covering investment management, insurance, and wealth management.

In this interview with Rachel Pether, CEO & Co-Founder of Sovereign Wealth Ltd, Adrian and Steven discuss Stamford Associates' differentiated approach, behavioral psychology, and how it's been such a success for the business.

RACHEL PETHER: Behavioral economics is based on cognitive and social psychology. What initially generated your interest in behavioral psychology?

ADRIAN FURNHAM: The Nobel Prize for Psychology has been won three times by behavioral psychologists, and I met Daniel Kahneman (a behavioral psychologist who later went on to win the Nobel Prize in Economics in 2002) years ago. I wrote a book in the 1980s on the link between psychology and economics called *The Economic Mind: The Social Psychology of Economic Behavior*. At this time, behavioral economics in the Kahneman sense was only just beginning, but I became extremely interested in one or two of the academic biases. I've now published 92 books on the topic, as well academic papers focusing on the anchoring effect – this occurs when a person is affected by an initial piece of information that strongly influences their subsequent decision making.

RACHEL PETHER: Can you tell me more about the origins of behavioral finance?

ADRIAN FURNHAM: We talk about behavioral finance and behavioral economics and neuroeconomics – a lot of people use these terms interchangeably. The overarching idea is that *homo economicus* – this extremely rare, very rational person that made extremely careful logical decisions – was proved to be non-existent. We've known for years that psychological factors play an important part in decision making. What the behavioral economists do is try to systematically understand the biases people have when they make decisions. In Kahneman terms it's System 1 and System 2 thinking – thinking fast and thinking slow. Most managers are prone to these psychological biases – in fact, all of us are prone to these psychological

biases. What we're interested in is the extent to which people fall prey to them – indeed, one of the most common biases in investment managers is overconfidence. We look at how and when and why people make fast decisions and therefore become prone to making sub optimal decisions.

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RACHEL PETHER: Lets delve into Stamford Associates and what your focus areas are – and why this is important for the business?

ADRIAN FURNHAM: About 20 years ago, Nathan Gelber – the founder of Stamford Associates – employed a psychologist in the organization to help make better judgments, both in regard to the assessment and the monitoring of investment managers. Her contribution was a very important one. We found we selected portfolio managers who performed better over time because she had insight into how they performed in bull and bear markets, their self-awareness and how they related to their team. We now have a higher ratio of psychologists to analysts than any other investment advisory business, and the psychologists are completely integrated into the investment analyst teams.

STEVEN BRAUDO: Stamford asked, "How do we get an edge? What can we do in this people business?"
Behavioral psychology was becoming more mainstream, and after a psychologist was employed we noticed that the ratio of managers who were beating their benchmarks started to increase, initially to over 60%, whereas traditionally it is only 50% in the active manager space. When you're looking to hire an active manager, it's all about how the mind works, their behaviors, their decision making – is their behavior repeatable? Can good behaviors be repeated for the benefit of clients? One of the firm's core beliefs is understanding people, hence the behavioral psychology approach.

RACHEL PETHER: How successful has your approach been?

STEVEN BRAUDO: It we look over the last 20 years and consider every manager to whom our clients have allocated capital irrespective of the time that they managed this capital, 62% of our recommended managers have beaten their benchmarks by around 1.2% per annum. If we look at the same figures but restrict the analysis to those managers who managed capital allocated for at least 10 years, then 85% of our recommended managers have beaten their benchmark on average by 2.1% per annum. Managers who have been with our clients for longer have performed better partly because our philosophy is that we don't want to advise on firing a manager when they are underperforming – as a matter of fact, this could be the time to give a manager more capital, provided the manager is keeping to the mandate, has the detailed understanding of the shares that they invest in, and of course, the psychological strength and conviction to stick with their beliefs.

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RACHEL PETHER: Since the longevity of a manager is an important factor for you, how do you monitor managers on an ongoing basis, both from a quantitative and qualitative perspective?

STEVEN BRAUDO: First, we research managers and we look at qualitative aspects, quantitative aspects, and behavioral aspects for the particular mandate. All of these aspects are imbedded into our research process. We seek to understand their portfolio footprint. We analyze their portfolio in detail, ideally using at least 10 years of data including trade data, so that all of our research is evidence based. Then we'll go through case studies – why they bought a stock, why they sold a stock – you have to make sure the managers have deep conviction and a deep understanding of the stocks that they hold. We assess the repeatability of their actions, and we also look at the wider organizational culture – Has the organization culture changed in the firm? Is it moving towards being dictatorial rather than collaborative?

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Importantly we meet all parties – we meet the CEO, CIO, COO, investment team, the technology head – so that we get a total picture of the firm, understand the factors influencing decision making and understand the culture.

ADRIAN FURNHAM: We see the managers at least twice a year, for 3-4 hours per session. We put a huge amount of work into preparing for these sessions and try to gather as much information as we can on any issues we identify. How you manage your team is very important. We get upward information from the analysts about the portfolio managers as well as from the top down.

STEVEN BRAUDO: A lot of managers are excellent marketers – but processes, oversight, and dynamics change over time and can lead to unexpected outcomes. Proximity to the manager and to his or her portfolio footprint is crucial for us. Such in-depth knowledge of the managers gives Stamford conviction in the managers we're recommending, and that's a big differentiator for us.

RACHEL PETHER: What are you looking for when interviewing portfolio managers? What are some of the key differentiating factors?

ADRIAN FURNHAM: The first thing that struck me is that, even though all managers are individuals, one key differentiator is how they manage their team. Although we think of portfolio managers as people making individual decisions, it's not like that – they work with each other, they work with teams. When you see how they get their information, how they judge it, and how they bounce it off their colleagues – that for me is quite an important differentiator.

RACHEL PETHER: You have been working in this area for over 20 years. How have you seen attitudes towards behavioral analysis changing over time and the acceptance of the space?

ADRIAN FURNHAM: It's been very dramatic – even the economists are giving in now! What interests me is that many people will talk about these biases, but a knowledge of the biases doesn't necessarily make you less likely to fall to them. You need to put in processes to actually reduce the biases – like sleeping on the decision overnight, having someone in the team playing devil's advocate – then the chances are that the biases will be reduced.

RACHEL PETHER: With the fact that it's becoming more mainstream, does that put you at risk of losing your edge?

STEVEN BRAUDO: We have a number of key differentiators – firstly, full integration of behavioral psychologists and understanding the power of the mind and the investment process. Other organizations use psychologists as a sounding board, rather than as part of the internal decision-making process; secondly, granularity – hundreds of man hours goes into the selection of every manager, and this evidence-based detail gives all stakeholders, particularly investors and the regulators, comfort; and thirdly, we are a small firm in terms of total number of people, both in terms of employees and clients – we like it this way, as it allows us to give a personalized service.

We look for repeatable processes in our managers, but we also have our own repeatable processes.

The result of all of this is that we end up recommending managers to our clients that are often very different to what any of our competitors may have – we end up with high conviction managers that believe in active management, and it's often names that others haven't heard of because our own process is so unique and differentiated.