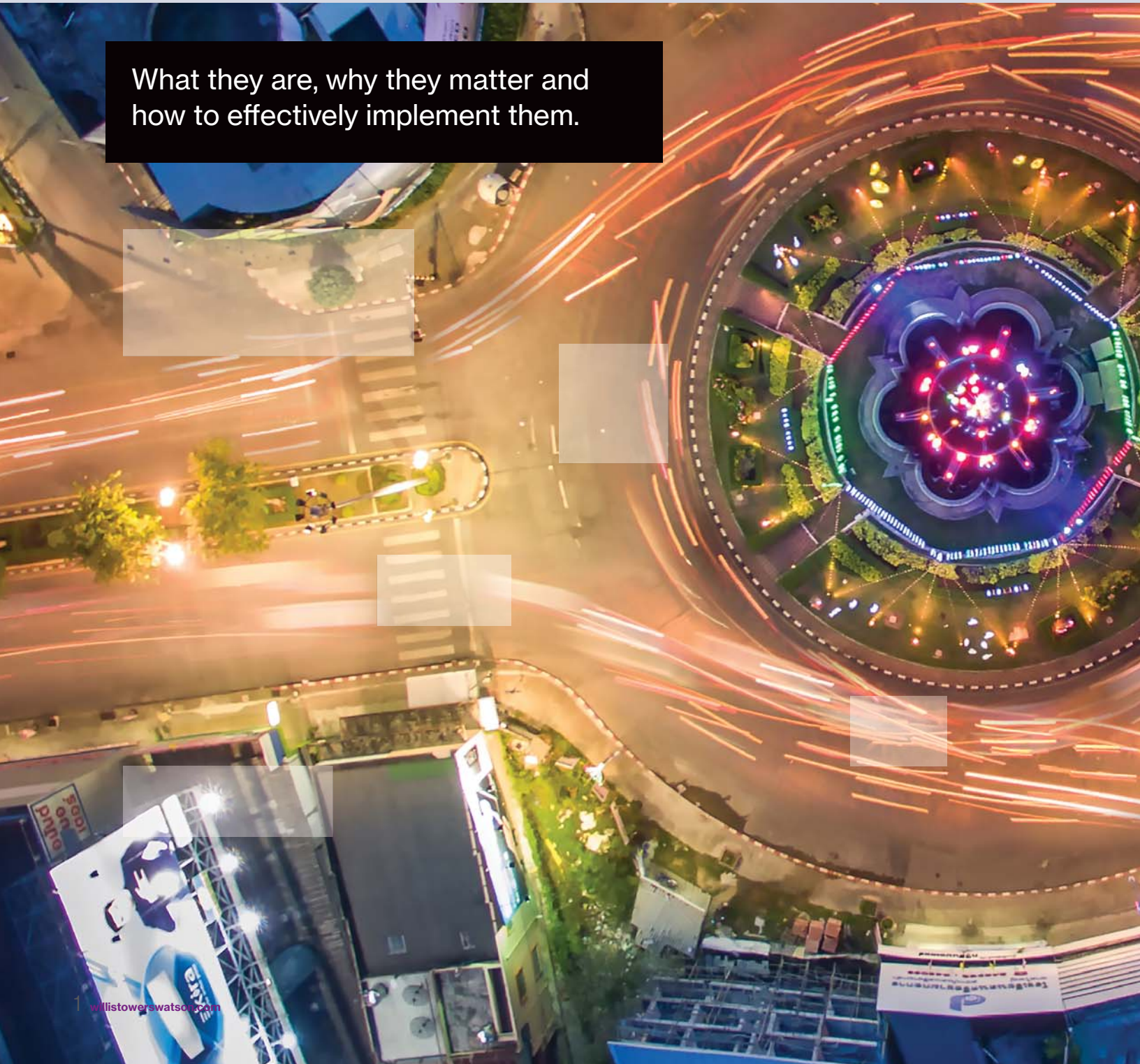
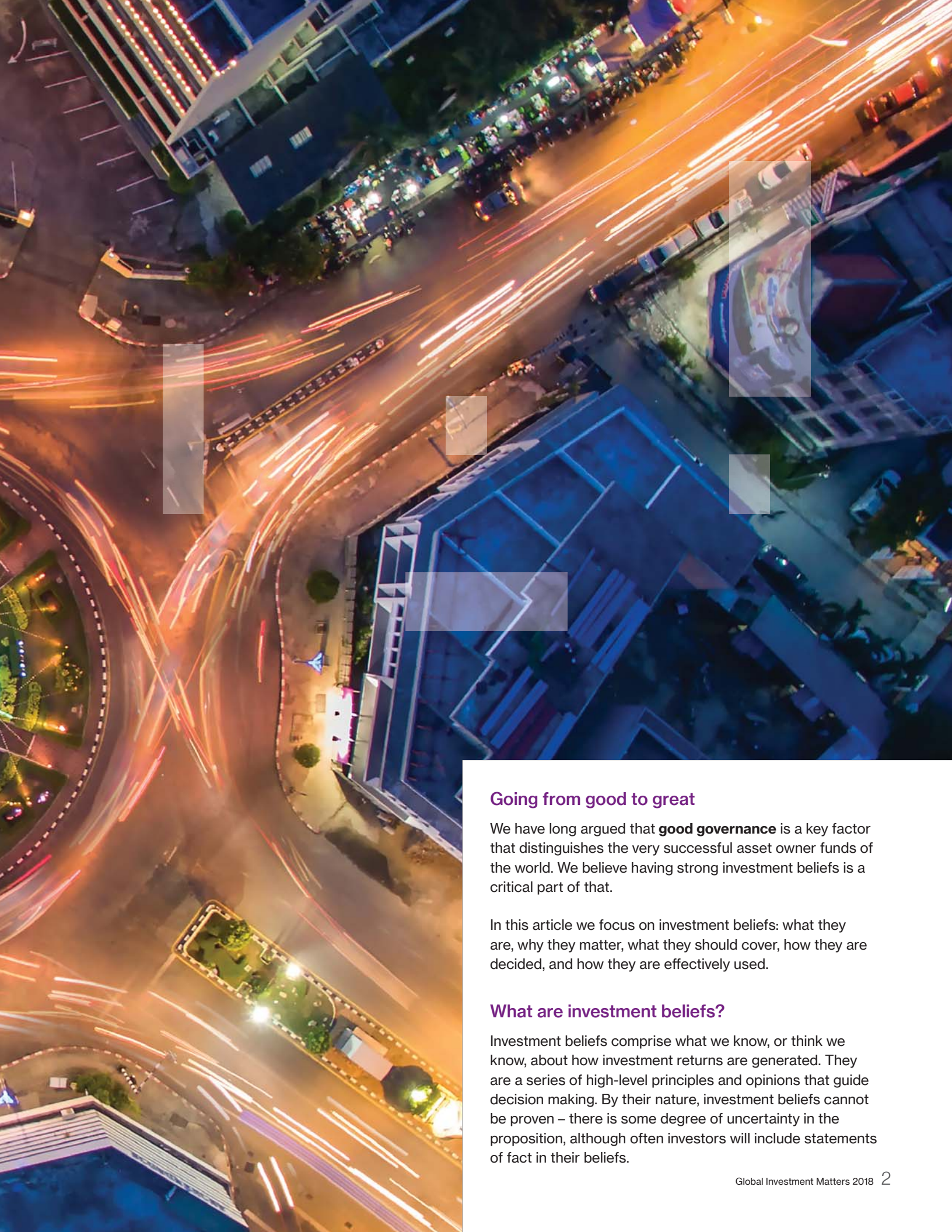
Investment beliefs

By Tim Mitchell



What they are, why they matter and how to effectively implement them.



Going from good to great

We have long argued that **good governance** is a key factor that distinguishes the very successful asset owner funds of the world. We believe having strong investment beliefs is a critical part of that.

In this article we focus on investment beliefs: what they are, why they matter, what they should cover, how they are decided, and how they are effectively used.

What are investment beliefs?

Investment beliefs comprise what we know, or think we know, about how investment returns are generated. They are a series of high-level principles and opinions that guide decision making. By their nature, investment beliefs cannot be proven – there is some degree of uncertainty in the proposition, although often investors will include statements of fact in their beliefs.

The challenge for an organization is how to bring the various implicit or explicit beliefs of its key decision makers to the surface and work through differences to arrive at statement of beliefs that everyone involved can agree on.

Why do beliefs matter?

We think there are six key reasons to have a well thought out set of explicit beliefs:

Figure 1. **Beliefs matter**

To save time	Beliefs can act as shortcuts in our decision making, saving large amount of time.
To enhance discipline and consistency	Human behavior and psychology can be detrimental to investment success. Investment beliefs provide a strong foundation to make good decisions, especially in times of stress.
To help fill gaps	Our knowledge of the world is incomplete and uncertain. We need beliefs to help us make decisions and avoid being "paralyzed" to inaction.
To help settle differences	A good beliefs process will surface sensitive issues, encourage constructive thinking, socialize the issues and settle the differences.
To improve transparency	Beliefs help decisions to be subject to greater transparency and greater institutional memory for the benefit of beneficiaries and stakeholders.
To promote insightful action	The best investors have beliefs that are smart, incorporate deep insights and are thoroughly socialized (i.e., widely understood and acted upon).

What should beliefs cover?

Beliefs should cover all the elements that impact on investment decision making. This will vary between investors given their respective purposes and context, but a reasonable set of beliefs might cover the following topics: governance and decision making; comparative advantages (i.e., what is the organization particularly good at); risk management (what matters and how it's measured); how markets work (what factors are most important, whether markets are efficient) and how portfolios are best constructed (e.g., concentrated or diversified); stewardship and sustainability; and cost management.

How are beliefs decided?

The challenge for an organization is how to bring the various implicit or explicit beliefs of its key decision makers to the surface and work through differences to arrive at a statement of beliefs that everyone involved can agree on.

Usually we start by putting a series of statements in front of the key decision makers and asking them to respond to those statements using a scale running from "I completely agree with this" to "I completely disagree with this." We highlight those areas where members of the group are in complete or substantial agreement.

We focus discussion on those statements where there is not agreement, and we look to draw out the reasons for the disagreement. Sometimes this is to do with experiences. Sometimes it's how members of a group interpret the same words. By surfacing these issues we find that often members close the gaps between them. Where differences remain we focus on a process we call "settling." Here we aim to see if we can arrive at a statement that allows all parties to say, "I wouldn't quite have expressed it like that, but I can agree with the sentiment." This process often involves a lot of wordsmithing to arrive at statements that all involved can agree to.

Having reached a degree of agreement on the various statements we then distill these down into a shorter set of distinct statements that the whole organization can sign up to. Generally speaking, we think that organizations should have no more than 10, high-level, investment beliefs.

How are beliefs used effectively?

To be effective, beliefs should have three core characteristics:

Figure 2. **Effective beliefs**

Aligned	**They should be signed up to by all decision makers and key stakeholders** Beliefs don't work if key decision makers can opt out of them easily. That said, people's beliefs might change as they process new information, so there needs to be a mechanism where new ideas are carefully worked through. The most successful users of beliefs have an ongoing process to deepen them through internal debate and reference to new external thinking.
Actioned	**Portfolio decisions should correspond to them** Beliefs have little value if decisions are taken that are inconsistent with the beliefs. A critical question that decision makers should ask is, "how is this planned action consistent with our beliefs?" If the answer is that it isn't, then that action should be avoided. Taking a different angle, decision makers should ask, "what are we doing to leverage the beliefs we have?"
Accurate	**Over time, outcomes should follow from them** This is a tougher challenge, but over time investors should look back and ask how well adherence to a particular belief has played out in practice. The challenge here is that investment markets are inherently "noisy" – it is very hard to draw meaningful conclusions from outcomes in the absence of a lot of data.

For a more detailed look at our approach to investment beliefs see "Building strong foundations – Investment beliefs."[5]

[5] www.willistowerswatson.com/en/insights/2017/05/Building-strong-foundations-Investment-beliefs