Watch The Gap

Every serious investment research analyst knows about the "leap". The leap is what gives you the confidence to embrace the unknown. The willingness to leap is what fortifies your resolve to go against or be with the crowd. Regardless of how many questions you have asked, memos you have read, models you have dissected, or scenarios you have run, the leap still awaits. The thoroughness of completed due diligence work can immensely help with the left brain's (logic, analysis, linear, sequential, factual, etc.) leap coordination, but the right brain (creativity, intuition, artistic, emotion, etc.) is equally, if not more, essential when making the jump. I want to talk about some important aspects of investment decision-making that do not kowtow to accessible heuristics. These are things that most analysts know are essential for increasing investment comfort levels but have no universal scale to confirm the integrity of ascribed grades. Simplistically, these are sometimes labeled as qualitative factors, but the truth of the matter is that these go deeper than just a feeling about a GP or an investment manager answering a weird question with resonating sound bites. Describing these factors almost becomes a circular exercise because most of the elements are unforgivingly intangible and subject to wide arrays of interpretations. These attributes cannot be faked or rehearsed – they just are – and when you see or experience them, you know.

- **Passion**: How do you quantify the passion of a GP? That is a tough question – it is like asking someone to give you a specific measurement of a particular emotion. It is almost impossible. You can talk around it, and give unique or quintessential anecdotes, but you still cannot perfectly describe it. A GP's passion for their strategy is infectious – it surpasses finance or investing and flirts with the spiritual. I know this is getting a little too cosmic, but I also know this is true. A passionate GP can go on and on into extreme depth about its strategy to anyone (regardless of status, investment decision-making authority, and whether or not there is capital available to invest). With a passionate person, no question feels inappropriate, and no answer is put forth with defensiveness. It is a real vibe, and the presence of that vibe cannot be repudiated. Of course, passion can sometimes drown out the practicality or viability of the strategy, so the analyst has to be cognizant of this risk, but without the existence of passion, you are likely being sent on a fool's errand.

- **Transparency**: How does one determine transparency when you don't know the full composition of what lies on the other side? You can compare GPs with peers to determine who was more forthcoming, but without a clear picture of what is being left out, you could very well be comparing "below average" to "average" – both are unacceptable. The willingness of a GP to go above and beyond with information sharing gives confidence to the analyst that the manager wants to facilitate a smooth due diligence process. Also, information shared to one LP, and made available to all other LPs improves overall alignment. Additionally, a GP's inclination to freely discuss past mistakes, lessons learned from those missteps, and the subsequent adjustments to the strategy, goes a long way in creating GP/LP bonds forged in trust.

- **Motivation**: Determining what motivates a GP is like trying to catch an eel while wearing latex gloves that were soaked in olive oil. Good luck! Forgive the melodramatic illustration, but you know what I mean – it is extremely slippery. "Wealth creation" is an easy go-to motivation but the worthwhile GPs have more spurring them on than just that. Whether it is the will to win, the compulsion to prove naysayers wrong, redemption for high school awkwardness, or an urge to fix perceived societal injustices, motivation is extremely polymorphic. Although it is difficult to pinpoint motivational factors, an analyst must have a sense of what drives a GP. Intrusive questions combined with the critical dissection of past actions/statements can point one in the right direction, but the full truth will always remain safely locked in an impenetrable box guarded by a "human state" forcefield. Motivation determines longevity and trustworthiness, so getting a handle on it is critical in determining whether the partnership with the GP could be short-lived and precarious, or long-term and drama-less.

- **Essence/Integrity**: Now we are getting into an enhanced level of ambiguity. I paired "essence" with "integrity" because, in some abstract way, I see a clear connection. "Essence" tackles the aura of a GP – do you get from the GP a sense of authenticity, truthfulness, genuineness, and shared values? On the other hand, "integrity" affirms whether your read on all the "essence" factors was correct. There is a time element needed for "essence" to connect with "integrity" but when the connection is established, a long-term partnership with genuine connectivity is born. Essence tends to be effortless because it is the organic ambiance that comes from being yourself. The presence of a calming, trustful, and worthy-of-following essence (although comprehensibly draped in intangible garments), is quite discernable – LPs talk about this amongst themselves as a way of confirming its realness, but also as candid observations when due diligence sharing goes past the superficial.

- **Diversity**: I am unsure how to seamlessly and eloquently fit this in, but I know it deservedly belongs among the rest. It baffles me that the finance world has wholeheartedly bought into diversification as a portfolio-enhancing feature, but certain factions still drag their feet when it comes to including people's diversity into the fray. With guidance from the diversification gospel, concepts including equity/debt, value/growth, large-cap/mid-cap/small-cap, US/international, developed/emerging, active/passive, etc. have all been embraced as critical ways to improve portfolio sturdiness, so why does diversity of people cause so much consternation? Is it so farfetched to believe that adding different forms of education, backgrounds, races, genders, etc. to a portfolio can potentially improve investment outcomes, as opposed to sticking with historical homogeneity? There will always be debate about the amount of value diversity brings to a portfolio, but from a logical standpoint, would it not be prudent to have diversity as a portfolio improvement tool? Putting aside all the chatter about "wokeness", "double bottom lines" and even "impact", choosing not to take the diversity component seriously, despite upside potential, will always be a head-scratcher for me.

- **X-factor**: "X-factor" is another nebulous term that is difficult to valorize. X-factor comprises a combination of the above-mentioned points along with an assortment of other attributes that make a GP extraordinary. The x-factor tends to kick in when there is a close race between two, or a few, GPs for a limited allocation of capital. If the assessment of quantitative data points and other traditional pain points generate satisfactory results, the GP's x-factor is explicitly or implicitly used to pick a winner. Examples of x-factors I have witnessed include "a GP's way with people", "a GP's commendable treatment of its personnel", "a GP's training in a field other than finance – say theology, philosophy, or beekeeping", "some personal unthinkable hardship that a GP faced in childhood or life in general", "next level EQ", "clear and well-thought-out views of where the world is going", etc. These examples cannot be graded or translated into a foolproof formula for investment success, but they give an encouraging sense to the LP that he/she has picked a GP with distinct superpowers. GPs who accept their uniqueness/awkwardness and deftly apply it (if it can be applied) to their strategy greatly facilitate LPs' discovery of their x-factor.

I think this is my most philosophical writing to date, but I am unwaveringly convinced that the core of what I am trying to convey exists within all investment decisions. The aforementioned attributes can manifest in many different ways so keen senses must be peeled at all stages of due diligence.

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