HYPERION ASSET MANAGEMENT
a different horizon...

Hyperion's Alpha Framework - Leadership and Culture

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We believe an active asset management business needs an effective decision-making framework to be successful in the long term.

Hyperion Asset Management (Hyperion) has a structured framework that guides its decision-making processes and we believe this framework is an essential part of the sustainability of the business.

Hierarchy of decision-making frameworks

The hierarchy in the execution of the decision-making framework is as follows:

1) mission;
2) values and beliefs;
3) investment philosophy;
4) investment process; and
5) execution of theory.

In this white paper we focus on the decision-making framework used to help Hyperion produce portfolios that are valuable to clients.

The ability to generate excess returns after fees above a benchmark (alpha) requires an exceptional organisational and investment framework that is executed in a consistent, disciplined manner. Good decision-making requires two key elements:

1) a sound theoretical investment framework; and
2) good execution of that framework under strong, experienced leadership.

Sound theoretical investment framework

The theoretical investment framework of an asset management business comprises an ***investment philosophy*** and an ***investment process***. An asset manager's decision-making process is founded on an investment philosophy, which is supported by a system of core values and beliefs and guided by a mission. The investment process is a set of detailed procedures and rules that govern the behaviour of the asset manager to ensure decisions are controlled by the key tenets of the investment philosophy.

A sound theoretical framework for decision-making and the associated mission, values and beliefs are extremely important for the sustainability of any business. The mission and supporting values and beliefs of a business relate to what that organisation believes is important and the reason the business exists.

The mission, values and beliefs help frame the decision-making approach and procedures that are aimed at ultimately constructing portfolios for clients that produce attractive long-term returns in a sustainable manner.

In active asset management, an organisation's values and beliefs must include an awareness of the market inefficiencies the manager exploits and a disciplined framework to accrue these excess returns over time.

The reason an active asset management business exists is to generate returns after fees (net returns) to investors above the returns of passive asset management. In an active asset management business, the quality of investment decisions is determined by future events and outcomes, meaning investment decisions are made under ***conditions of uncertainty.*** An investment framework should provide guidance on the processes to follow, in the context of uncertainty, in making investment decisions that are consistent with the investment philosophy.

No organisation can serve two masters

We believe investment firms should be led by investment team members that believe and have conviction in the value of the investment decision making framework and the market inefficiencies that are being exploited. **Sustainable funds management firms are alpha driven and not marketing or product led firms.** Unfortunately, the active funds management industry is dominated by salesmanship, marketing and an asset gathering culture. We believe that sustainable active asset management businesses should have a predominant focus on the quality of the products produced and be investment led, research driven and alpha focused. Hyperion's belief is that focusing on producing a valuable product to clients that adds long-term alpha is the best way to create a sustainable business. We believe that active asset management businesses managed or heavily influenced by marketing and asset gathering approaches and cultures are doomed to failure in the long-term.

"As a group, we veered off-course almost 180 degrees from stewardship to salesmanship, in which our focus turned away from prudent management and toward product marketing." John Bogle

The ability of the asset manager to generate alpha and the expectation from clients that alpha can be generated in future periods, are critical to the perpetuity of a fund management business. If the asset manager's investment framework is unable to add value for the client over the long term, the business will eventually cease to exist. Marketing a poor product that is inferior to the benchmark is not a sustainable business strategy for an active asset management business.

Execution of the framework

If the theoretical decision-making framework is sound and when executed properly produces alpha, then the asset manager still needs to remain disciplined and execute its decision making under conditions of uncertainty. This requires internal conviction and a rejection of short-term pressures.

"In theory there is no difference between theory and practice, in practice there is." Yogi Berra

There is little benefit or value-add if the organisation cannot execute on the decision-making framework consistently. The asset management business needs to have an organisational culture and structure that facilitates and enables the process and philosophy to be executed effectively.

If the key decision makers in the organisation do not understand the investment philosophy and process or cannot or will not execute it, then the asset management business will ultimately fail.

Reasons for failure to execute include:

1) behavioural biases;
2) cultural problems including poor leadership and incentive structures;
3) lack of necessary knowledge, intelligence and experience;
4) insufficient client support and belief; and/or
5) business-related economic resource shortages or impediments.

In terms of cultural problems, a clear decision-making structure, appropriate incentives, and strong, experienced leadership is required to prevent business failure. Examples of where strong and experienced leadership and appropriate organisational structures are absent include:

1) new, relatively inexperienced members of the team attempt to set their own narrative rather than adopt the pre-existing mission, values, and beliefs of the organisation;
2) new but experienced members of the team use their seniority to adopt their own mission, values, and beliefs as leaders that differs from the firm's mission, values, and beliefs; and/or
3) the existing leadership do not follow and execute the framework.

If new, relatively inexperienced members of the team attempt to set their own narrative rather than adopt the existing mission, values and beliefs of the organisation they are in effect developing their own new framework rather than executing on the existing, successful framework. Existing frameworks must be written down and followed. We believe hiring junior investors from outside the organisation is risky if they are not successfully indoctrinated with the existing mission, values, and beliefs. This requires good communication and high expectations from established members of the team.

If new but experienced members of the team use their seniority as leaders to adopt their own mission, values, and beliefs they are in effect changing the existing, successful framework. We believe hiring senior investors from outside a successful organisation is extremely risky as they will inevitably attempt to introduce their own beliefs and methodologies (leading to a "cultural clash").

Since decision making is made under constant uncertainty, it is important that the key decision makers in the organisation have the conviction and belief to continue to follow the process in the face of external (and/or internal) parties questioning the process during periods of underperformance. Strong leadership and communication of the framework is also required internally as otherwise the broader team will set their own framework. If these key decision makers do not "buy into" and protect the investment framework or execution process (from both external and internal parties) then the asset management business will fail in the long term.

The conviction to continue despite external parties or newer members of the investment team questioning the process must be ***evidence based***. This means that the key decision makers must understand the pricing inefficiencies that the investment philosophy and process exploits, as well as the market and economic circumstances in which the process is likely to outperform and underperform.

Blind belief without knowledge and understanding of why the investment process and philosophy produces alpha will result in the business also ultimately failing. Of course, the process and execution should continue to evolve and improve as circumstances fundamentally change but the core of a successful framework should remain largely unchanged.

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