Should Financial History Matter to Investors?

KEY INSIGHTS CAN HELP INVESTORS INTEGRATE KNOWLEDGE INTO DECISION MAKING

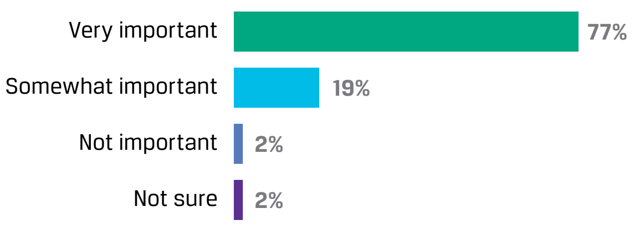
By Desi Allevato

What does it mean to learn from history, and can it make you a better investment professional?

Economic and financial history have been experiencing a revival in the aftermath of the Global Financial Crisis, and governments and central banks have been using claims and assumptions about past historical events to support and justify their policy decisions, for better or for worse. Knowledge about economic and financial history matters at a macro/systemic level and for individual investment professionals. But do we know what we're doing?

We asked CFA Institute Financial NewsBrief readers about the importance of economic and financial history to their success as investment professionals. Of the 844 responses, an overwhelming majority (96%) answered that it was either very or somewhat important. I suspect, however, that some may not know how to use this knowledge to make better investment decisions (or, at the very least, avoid poor ones).

How important is knowledge of financial/economic history to your success as an investment professional?



Over the past few years, CFA Institute has started exploring, through practice analysis and forthcoming research projects, how investment professionals can integrate an understanding of past events into their worldviews and investment decision-making toolkits. The following five insights from roundtable discussions convened by CFA Institute in London and Boston on the subject provide helpful guidance on how historical perspectives can be incorporated into investment decision-making processes:

1. **We are not really living in "new times" when it comes to financial markets.** Many of the situations, ideas, and techniques we think of as new or cutting edge actually aren't, even if the technology that supports them is (e.g., futures markets existed in ancient Egypt). Saker Nusseibeh, CEO at Hermes Fund Managers in London and a member of the Future of Finance Advisory Council, counsels us to be more skeptical and double-check our assumptions. "Do your own research, and then if you think something is new, assume that it is not."
2. **Historical information is not necessarily data that investment professionals are used to.** The further we go back in history, the less frequent and certain data become; when we do have reliable information, the time horizons are usually too short. Both Dan Fasciano, CFA, managing director at BNY Mellon Wealth Management, and Nusseibeh make the point that if you don't have enough data to do accurate modeling, don't do it. Incorporating historical information into decision making requires a mindset that doesn't rely on modeling for pattern recognition.
3. **Don't assume financial markets (past and present) are rules-based systems.** Russell Napier, ASIP, an independent strategist at and co-founder of Electronic Research Interchange (ERIC), recommends approaching financial history like biology instead of physics. Markets are like organisms that are impacted by many factors, including the human beings who operate them. Jeffrey Heisler, CFA, investment strategist at Twin Focus Capital, added, "[Finance] is not physics, and it is not math. We are a collection of people, and we do strange things."
4. **Behavioral finance and financial history have a lot to offer each other.** Dan diBartolomeo, president of Northfield Information Services, remarked that "people see what they want to see" at any given moment, and that is true throughout history. According to Napier, in order to understand why people made the mistakes they did in the past, we need to understand what misconceptions they held that led to those mistakes. We have our own misconceptions about present markets, and we need to learn to find and recognize them.
5. **If at first you don't succeed, try to be less surprised the second time around.** Foresight and anticipation are important to market stability and to individual analysts and portfolio managers. As Heisler put it, "Even if you tend to repeat your mistakes, it is nice to have at least seen them and to be a little bit forewarned."

If you use the guidance above to work your way through a thoughtful process, you just might stumble on an insight that helps you avoid a bad decision, take an opposite and advantageous position in the market (exploiting someone else's mistake), or prepare yourself and your clients for an impending development through better understanding and anticipation.

We are part of the history that future generations will study, and we owe it to ourselves and the clients we serve to thoughtfully consider lessons from the past when making decisions that will impact our future.

KEEP GOING

"Financial Market History Roundtable, London," *CFA Institute Conference Proceedings Quarterly* (First Quarter 2014) [www.cfapubs.org]

"Financial Market History Roundtable, Boston," *CFA Institute Conference Proceedings Quarterly* (First Quarter 2015) [www.cfapubs.org]

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