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BOOK REVIEW

The Future of Investment Management

BY RONALD N. KAHN

Reviewed by Judy Benson

INVESTMENTS & WEALTH INSTITUTE®

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Ronald Kahn, PhD, is a managing director and global head of systematic equity research at BlackRock, where he has overall responsibility for the research that underpins the firm's systematic active equity products. Previously, he was director of research at Barra, where he focused on the equity and fixed income markets.[1] Kahn has written extensively about investing; he has received industry accolades including several prestigious awards, and is a recognized expert on portfolio management, risk modeling, and quantitative investing. With apologies for the cliché, he knows from whence he speaks.

His most recent book, *The Future of Investment Management*, was released almost two years ago—some may argue that is a lifetime in the investment management world. Yet the views expressed are rightfully described as prescient.

The Future of Investment Management espouses a number of key tenets about investment management, and here is a sample (paraphrased):

- Investment management innovations typically are launched in the institutional arena and over time wend their way to the retail investor. As the pace of change is accelerating, the complexion of retail investing is evolving. This cohort is increasingly cost conscious, more accepting of passive investment structures, and "gets" the merits of diversified exchange-traded funds.
- Although Kahn focuses on quantitative approaches to investing, he is emphatic that quant investing is a particular form of systematic investing. He is emphatic that investing (and therefore investment management) is becoming increasingly systematic—systems, analysis, structure, and understanding—built on increasingly available data—which is replacing "gut feelings and whim."

The book portrays the evolution of investment management from its earliest roots all the way to an assessment of the future. Each chapter provides historical context and a powerful explanation of investment management for an era—whether past, present, or future. Kahn begins by taking us back to the Dutch East India Company and its trading on the Amsterdam Stock Exchange, the South Sea Company and the so-called Bubble Act of 1720, and the commencement of stock price lists in 1691 in the "Collection for Improvement of Husbandry and Trade." He addresses the first broadly available trust—Eendragt Maakt Magt ("Unity Creates Strength")—as a response to a financial crisis.

Kahn's treatment of more recent investment management history includes the first efforts at systematic investing and the birth of the ideas that eventually would form the underpinnings of investment funds. He addresses the ultimate outcomes of the 1929 stock market crash, including requirements for independent audits and disclosures of financial statements, as well as a plethora of other rules and regulations. He presents a timeline of crucial investment management events and details their roles in progressing investment management "thinking," such as Benjamin Graham and David Dodd's *Security Analysis* (1934), John Burr Williams and *The Theory of Investment Value,* Harry Markowitz and the birth of modern portfolio theory, William Sharpe and the capital asset pricing model (1963), and Eugene Fama and the efficient market hypothesis. Kahn also describes the birth and maturation of the index fund, the industry adoption of factor models, and the impact of behavioral finance.

Kahn presents a cogent defense of active management—its goals, the constituent parts of the information ratio, and the job of the active manager—which he defines as forecasting residual returns (i.e., alpha) rather than the calculation of portfolio return minus benchmark return. He delves into various elements of active management,

The Future of Investment Management
by Ronald N. Kahn
CFA Institute Research Foundation, 2018
136 pages, $17.99

such as the importance of understanding how portfolio constraints affect the efficiency of implementing investment ideas. One timely insight explores data mining and the importance of perspective. To quote, "one should judge any new investment idea on the basis of whether it is sensible, predictive, consistent, and additive."

Kahn also addresses the shift from active to passive and the implications of increased competition. He recognizes that big data is a positive trend for active management, as long as there are appropriate filters to identify which data is meaningful. Interestingly, he makes the case for several newer sources of data—social media, images, and video. Smart beta/factor investing comes to the fore and is clearly distinguished from active investing. Kahn even makes the case that incentive fees may become more prevalent.[2]

The discussion culminates by addressing the future of investment management. This reviewer offers no sneak previews or spoiler alerts. Suffice it to say that this thought-provoking, 100+ page work is a must-read for practitioners and investors. Kahn's work provides invaluable context on the evolution and near-term[3] future of the investment management industry.

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ENDNOTES

1. Ronald Kahn's background was sourced from the book and the institutional website of BlackRock.
2. Several recent *Investments & Wealth Monitor* articles address trends in incentive compensation, their relatively low adoption in mutual funds to date, and the testing of new incentive structures in those vehicles, the goal of which is to align investor and investment manager goals.
3. Next five to 10 years.

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