INVESTOR EDUCATION

It's Getting Better All the Time: 40 Years of Lessons

Henderson Rowe is disrupting the UK market by delivering institutional-quality investment solutions directly to private clients. **Patrick Donovan**, a Senior Investment Manager at Henderson Rowe, has experienced the industry's advances since rotary telephones, telex machines and the 'Belgian dentist'. In this investor education article, he explains how his early revelation-turned-conviction in low-cost ETFs and evidence-based investing helped shape Henderson Rowe today.

There are advantages to longevity, not least of which is having seen it all before. After all, if one is willing to learn from history, they are not condemned to repeat it! Accordingly, I'd like to take my colleagues, friends and clients (often one and the same) down memory lane. Let's see if perhaps we've all learned a few things along the way.

Over the past forty years, I've witnessed the rise and fall of financial products, practices, themes strategies and regulatory regimes. I've experienced booms and busts. I've seen the astonishing ascension and meteoric collapse of trendy funds and managers, and the paradigmatic shift in developed markets as they've become dominated by institutional investors. I've seen the remarkable growth of emerging markets as savvy investors seek global portfolio diversification. And, as an early advocate of index tracking strategies, I've witnessed the rise of low-cost passive and smart beta investments in both traditional and exchange-traded fund format. (Henderson Rowe's reputable FTSE-RAFI fund was among the first passive EM products available in the UK, and we were among the earliest UK retail managers to leverage low-cost ETFs as part of our strategies.)

To put it colloquially: I've been around the block.

My tenure grants me more perspective than most investment managers. As a result, I often receive questions about the historical basis for my current beliefs. In particular, clients ask (1) why I'm an outspoken advocate for low-cost products like ETFs?; (2) why I talk so much about evidence-based investing?; and (3) what role should high-conviction stock selection play in modern portfolios? My thoughts on these topics have all been shaped by watching the industry evolve and grow over the past four decades.

The 70s

When I started in the investment business in 1974, I possessed nothing more than a 3rd class degree in law from Oxford and a few languages. Still, it was enough to earn a desk at a private bank in Brussels, and I soon became a Eurobond dealer. My tools consisted of a rotary telephone, a clunky bond yield calculator, and a reliable telex machine (kudos to those who can remember these trusted tools of the trade).

I was also introduced to the concept of the 'Belgian Dentist', a metaphor for every European private client who liked to put his savings into liquid, Bearer bonds issued by household names or AAA Institutions offering high coupons in myriad currencies. These bonds (not unlike share certificates

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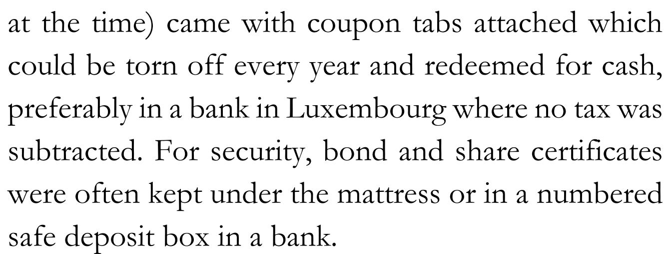

at the time) came with coupon tabs attached which could be torn off every year and redeemed for cash, preferably in a bank in Luxembourg where no tax was subtracted. For security, bond and share certificates were often kept under the mattress or in a numbered safe deposit box in a bank.

The 80s and 90s

But things were changing.

The privatisation of British businesses in the 70's introduced a whole new class of private investors to securities markets. At the same time, accelerating globalisation in the early 80's created a new generation of international stockbrokers. These brokers were happy to tap newly-minted retail investors looking for investments outside traditional domestic markets, and the resulting demand triggered new issues and IPOs that carried into the dotcom boom of the 90s. During this period, it became more profitable to 'stag' new tech shares for a quick turn than to keep them – hence the inevitable bust at the end of the 20th century. From this experience I learned first-hand about the conflict-of-interest inherent in our industry, and about the costs and limitations of active stock selection.

But there was another important finance development underway at the same time. The first index fund launched in 1976, and soon thereafter quantitative and technological improvements allowed the development of exchange-traded funds ("ETFs") that could mimic market and sector indices. These products, which were only possible because of electronic shareholding, allowed investors to buy diversified exposure to global growth while reducing concentration risk. They had the added benefit of being cheaper to manage, thus improving performance by reducing costs.

Having already spent nearly two decades in finance, these developments were a revelation to me. I quickly came to understand the role that quantitative methods and technology could play in improving my clients' investment outcomes, from diversification and asset allocation, to stock screening and selection. Experiencing this transformation gave me a deep appreciation for the value of evidence-based solutions. I was an early and true believe.

Post-2000

At the turn of the 21st century, improved technology and increasing institutional market participation compressed bid-offer spreads and trading costs, particularly in developed markets. This put a squeeze on brokerage firm profits, and the only way to cling to historical margins was to increase trading volume. This led to a barrage of free "research" and "stock tips" from large brokers designed to encourage turnover. For many of these brokers and funds, investment advice was secondary – trading became the most profitable aspect of their business model.

And yet, during this same period, evidence about investment costs and net-of-fee returns also became more plentiful and easier to access. So, too, did evidence-based and low-cost investment products. This era saw the popularization of non-cap weighted indexing, multi-factor strategies and other innovations. Unfortunately, most of these were offered primarily to institutional and professional investors. For retail investors, this era saw a proliferation of the opposite: expensive and complex fee structures, increasing investment product costs and high turnover active strategies.

Henderson Rowe was established in response to the times. From the outset, my co-founders and I were committed to becoming a progressive, bespoke alternative to the corporate behemoths. While we were never the cheapest advisors on the market – and there are practices I wish we'd adopted earlier – we

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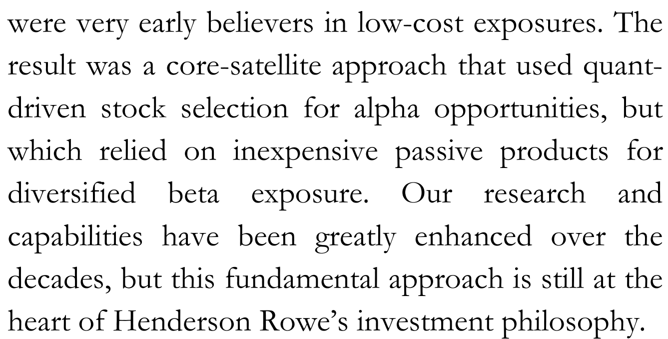

were very early believers in low-cost exposures. The result was a core-satellite approach that used quant-driven stock selection for alpha opportunities, but which relied on inexpensive passive products for diversified beta exposure. Our research and capabilities have been greatly enhanced over the decades, but this fundamental approach is still at the heart of Henderson Rowe's investment philosophy.

Modern Day

One need look no further than Financial Times and The Times to see how our industry has changed over the past decade. Corporate powerhouses like St. James Place are being called out for poor performance, excessive fees, and misleading sales tactics; superstar managers like Neil Woodford are imploding; and the value of traditional active managers is being continually called into question. Meanwhile, the industry is being disrupted by innovative researchers like (and the CIO of Henderson Rowe's parent company) Jason Hsu, PhD, whose work on index weighting, factor investing, dollar-weight returns, firm culture and ESG have blown apart old models and approaches.

I'm proud that Henderson Rowe has been at the leading edge of this transformation. By 2003, we were already using low-cost passive ETFs to provide efficient market and sector exposures. By 2007, our publications were challenging the value of active managers and exploring fundamental indexes (an early precursor to the category of investing now known as "smart beta"). And in 2012, we launched our own award-winning FTSE-RAFI EM index fund. Henderson Rowe's progressive approach continues to this day, including through its recent collaborations with Rayliant Global Advisors and Premia Partners, as well as through our new and transparent pricing structure.

I've travelled a long and winding road from my old bond desk in Brussels – and I may even have grown somewhat wiser. I like to believe that wisdom has led to me to evolve along with the industry. In fact, even after forty years, I still find myself at the forefront of the industry's continued evolution towards heightened transparency, low-cost products, evidence-based strategies, and ESG-and culture-based investing. After all, if there's one thing I've learned it's this: if you can't beat them, join them!

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His experience in financial services for over 40 years has seen him active in bond trading, fixed income sales, FX trading and HNW private client portfolio management. Before joining Henderson Rowe as an investment manager in 2003, he was with Merrill Lynch International Bank London.

Patrick earned his BA (Hons) and MA in Jurisprudence both from Oxford University. He speaks French and Italian fluently. His career has taken him to Paris, New York and Hong Kong before settling in London, providing a diverse cultural immersion that contributes to his job of managing client relationships and global investor portfolios.

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