

## What is a Behavioral Investment Manager?

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**What is a behavioral manager?** In the recent edition of the CFA Institute Magazine there was an article about a manager who had written a book on behavioral finance. This manager stated that there were “emotional investors” and “behavioral investors.” This manager also correctly stated that behavioral investors try to avoid the emotional and behavioral biases and build portfolios based on the behavioral inefficiencies. At Hillcrest, we’ve always believed that behavioral deviations from fair value stem from investment teams making decisions during the portfolio management process. Therefore, we would agree that emotions and emotional investors are part of the behavioral reason that prices are not efficient.

This manager then went on to say that, by his definition, a behavioral manager does not pay attention to anything about the stocks in which he/she invests. He states that a behavioral manager, again his definition, should never know the names of the companies in which they invest. He advocates investing based on several pre-set criteria for each stock. At Hillcrest, we strongly believe that taking such an extreme view is NOT behavioral investing; rather, it is simply a version of quantitative investing.

This example illustrates one of the great misunderstandings concerning behavioral portfolio management. Indeed, it can utilize quantitative techniques to help remove emotion but behavioral investing does not, and should not, mean that you are 100% quantitative in your methodology. It does NOT mean you cannot know the companies in which you invest. In fact, we believe just the opposite. A manager (or investor) SHOULD know the companies in which he/she invests and know them well. Not knowing the individual companies well prevents you from complementing the quantitative process. At Hillcrest, half of our value added since inception comes from our fundamental work. Understanding a company’s products, clients and management are critical to investing in a good company that will, in turn, be a good investment. The bottom line is, we believe behavioral investing includes all of the following:

1. Understanding the behavioral market cycle of stocks
2. Utilizing a good screening process using non-emotional data that can be compared directly company to company
3. Conducting a thorough fundamental analysis focusing on a common set of information to include growth, management, financing and risk
4. Avoiding the framing bias when constructing portfolios

Only by combining behaviorally aware quantitative screening with comprehensive fundamental analysis can you have a superior behavioral investment process.

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### **Brian R. Bruce, CEO and Chief Investment Officer**

Brian is the CEO and Chief Investment Officer of Hillcrest and oversees all business and investment activities at the firm. Before founding Hillcrest, Brian was Chief Investment Officer in charge of equity management and research at PanAgora Asset Management. Previously, Brian was President and Chief Investment Officer of InterCoast Capital and worked at State Street Global Advisors, the Northern Trust Company and Stein Roe & Farnham. Brian received his MBA from the University of Chicago, an MS in Computer Science from DePaul University and a BS in Business Administration from Illinois State University. He is a member of the Illinois State University College Business Hall of Fame and is a recipient of the University of Chicago's Graduate School of Business CEO Award. Brian has published numerous scholarly articles and books including *Analysts, Lies, and Statistics*, which he co-authored with Harvard Business School professor Mark Bradshaw. He is also the Editor of the *Journal of Investing* and the *Journal of Behavioral Finance*.

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### **About Hillcrest Asset Management**

The Hillcrest Portfolio Team utilizes their combined behavioral finance expertise to create all client portfolios. Hillcrest remains guided by a fundamental belief that stocks deviate from their fair value due to behavioral biases and stocks follow the behavioral cycle of stock movements. We combine model-driven behavioral analysis with traditional fundamental research to build on the strengths of both approaches. Our goal is to add value equally through both behavioral models and fundamental stock research. Results reflect Hillcrest's expertise in successfully utilizing these concepts in the portfolio management process.

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