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By Joachim Klement

Creativity is the X-factor that sets you apart as an investor

Creative people are more likely to end up in the C-suite and in well-remunerated technical positions

SOME time ago, I wrote about grit as a vital characteristic for investors. That triggered some email exchanges with younger readers who are at earlier career stages than financial analysts and money managers. In general, the discussions revolved around the skills a successful analyst and investor should have. And while a passion for markets and grit are key traits, I believe others are more fundamental.

First, there are cognitive skills – that is, the ability to think analytically and logically. Investing is a numbers game that requires analysts to make sense of mountains of data at every level – whether about the economy and markets as a whole or individual stocks and bonds. In my view, without good cognitive skills, an analyst doesn't have the foundation to become successful.

A study by David Gill and Victoria L Prowse examined the traits and abilities of people in childhood and how they influence success in different subjects in school, the type of jobs the students eventually end up in, and how much income they earn. It won't surprise you that children with high intelligence and strong cognitive skills were more likely to excel in mathematics, science, and English classes than in the arts and sports.

And this training in mathematics and science compounds their innate cognitive abilities and leads them to choose jobs that fit their talents. As young adults, people with these traits are more likely to ascend to managerial and technical positions and such professions as medicine, teaching, engineering, finance, and law. As a result, they also have higher lifetime earnings since managerial and technical careers – as well as the professions – tend to pay better.

So if you lack analytical and cognitive skills, you probably won't succeed as an investor. But most who work in finance as analysts or money managers do possess these traits. Which raises the question: What distinguishes good investors from the average? I believe it comes down to two traits.

People who focus on individual stocks and bonds tend to do better when they are diligent. Working your way through a financial statement with all its footnotes and asking probing questions on earnings calls are not easy tasks. And the more meticulous analysts are, the more likely they are to find the flaw in the story the management is trying to tell.

Let's face it, no CEO is ever going to tell investors that they think the company is about to go belly up or is otherwise floundering. The job of investors and analysts is to see if their knight in shining armour really is as shiny as they appear.

In the most extreme cases, diligent analysis, critical thinking, and challenging management can uncover frauds. Take the Enron case 20 years ago. Most analysts were hoodwinked by the firm into believing everything was great. Yet a few questioned the firm's accounting practices and use of special purpose vehicles (SPVs).

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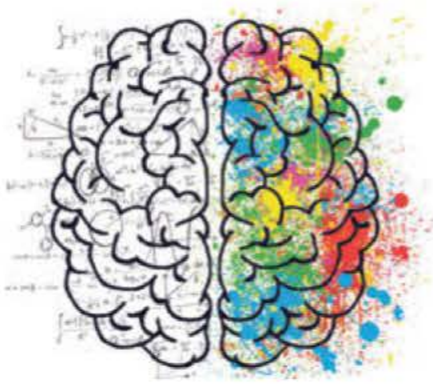
This probing led some to conclude that Enron was a fraud. These are the analysts you want to talk to because they add value and will help you perform better. The rest of the pack that just buys into the hype you can safely ignore. They won't make you money as an investor.

Beyond these analysts, you have the generalist fund managers, strategists, and asset allocators who don't dive deep into company financial statements. For these investors, diligence is less important and less of a differentiator. You can literally outsource that trait to research analysts who cover individual stocks.

But those in this cohort need another trait, one that makes all the difference between being average and staying ahead of the curve: creativity. And I don't mean creativity in the sense of painting or performing in an amateur acting troupe. Those are fun hobbies, but the sort of creativity that sets you apart as an investor is the capacity to see the data and markets differently than everybody else and put the individual pieces of information together to form novel insights. In particular, I mean being able to navigate a noisy, uncertain environment with the required flexibility and conviction.



Creativity's effect is about a fifth as strong as that of cognitive skills, but it is a compound effect. ILLUSTRATION: PIXABAY

Howard Marks, CFA, put it best when he said: "You can't do the same things as others do and expect to outperform."

Unfortunately, too many analysts, strategists, and fund managers do what everybody else does. The amount of true creativity in the investment world is very low, in my experience. Most people are just tinkering with existing investing approaches, adding a few additional parameters here and there. That is not the creativity that gets you additional performance.

Additional performance is created by doing what others aren't and truly differentiating yourself. What does that mean in practice? It is impossible to say.

But returning to the study, Gill and Prowse show the distinct advantages that being creative can have in life. Creative people are more likely to end up in the C-suite and in well-remunerated technical positions. Creativity's effect is about a fifth as strong as that of cognitive skills, but it is a compound effect. The message is clear: For success in investing, cognitive skills provide the foundation, but creativity gives you that something extra that sets you apart.

The writer is a trustee of the CFA Institute Research Foundation.