UC San Diego
RADY SCHOOL OF MANAGEMENT
The Brandes Center

PUBLIC EQUITY MARKET STRUCTURE

A PANEL DISCUSSION

2Q25

Executive Summary

During 1Q25, members of The Brandes Center's Advisory Board (BCAB) and guest experts in the investment industry met online for a candid conversation about managing public equity – structure and strategy. Watch the video here. Highlights of the diverse opinions:

PANELISTS

- **Rachel Carroll, CFA**
  Managing Director, Consulting at Russell Investments
- **Dr. Aswath Damodaran**
  Brandes Center Advisory Board (BCAB) member and Professor of Finance at New York University's Stern School of Business
- **Trevor Graham**
  Deputy CIO at TIFF Investment Mgmt.
- Moderator: **Barclay Douglas**
  BCAB Advisory Board member and Founder, Criterium Advisors

The discussion took place in mid-January 2025. Among the topics:

- Active and passive investing
- Allocations by geography, sector and style
- Manager selection criteria
- Cyclical vs. structural market changes

On Recent Market History

Graham: "The last 15 years have been one of the best 15-year periods for US equities in history, but if you look at the long-term history, geographic diversification really pays off. It's amazing, but people tend to forget that."

Carroll: "Getting into that fixed mindset that markets are always going to present in the way that they are currently presenting—and it's always going to be those 7 to 10 big tech companies that are the drivers and small cap is never going to work again, and value is never going to work again," she paused, then added, "seems like that's when the shift happens, and we all get humbled a little bit."

On Value Investing

Damodaran: "For 40 years, we've treated low price-to-book stocks as value stocks. That comes from an academic. And academics are lazy.

"We need to open the door to value being something that reflects price versus what the cash flows in this business will generate. That's a much richer definition of value."

Damodaran: "The more uncertainty there is, the greater the chance that you might find something that is truly mis-valued. But," he warned, "you'll have to live with that feeling in your gut after you've taken that position. And I'm not sure very many investment committees want to live with that."

Carroll: "You have to be very patient. For a lot of corporate investors that are facing investment committees, they don't have the timeline or appetite that might be necessary to wait for a value tilt to pay off."

On Manager Selection and Evaluation

Graham: "When performance is terrible, that often gets our attention because if the process isn't broken and it just turns out that the holdings are very out of favor, sometimes that's a great time to start investing."

Carroll: "Performance is cyclical. We don't expect every manager to outperform all the time, so the caution I would have is an investment manager changing their process, hoping to chase what's going to work next. That's a manager we don't want."

On the Use of Indexes and Passive Investing

Graham: "People are going to compare how we do relative to that index—and I think they should. That's a healthy part of the process. And the index we most commonly use is the MSCI All-Country World."

Carroll: Investment committees are measured against a benchmark and "…taking big bets against that benchmark can make you look like a rock star, or it can make you look quite foolish, depending on how the market moves. For a lot of the organizations that we're working with, because they are large and well known, there's headline risk."

Damodaran: He called the average active investor "crappy." "I hate to use that word, but it's crappy," he reiterated. "You charge me 100 basis points for delivering 2% less than an index fund? It's going to catch up with you."

Damodaran also said markets are inefficient.

"They make all kinds of mistakes. But can people exploit these mistakes to make money? That's a much tougher test. The ability to exploit mistakes has become less [evident] over time, partly because the investment world has become flatter."

On AI and the Industry

Carroll: Russell is using AI to leverage the time and expertise of its teams. "[AI] is not impacting the number of people that we have doing research, but it's allowing us to get a broader set of products to look at to evaluate."

Graham: "Our view is that AI very likely benefits the systematic managers first. It's actually a real threat to the fundamental folks because it's more possible than ever before that elements of what they do can be automated.

"And as a result, we've actually shifted capital over the last roughly 12 months away from fundamental to systematic. We still use both. But we want to be on the right side of this trend over the long run."

Public Equity Market Structure: The Discussion

Moderator Barclay Douglas noted that many investors today have shifted their analytic time away from public equities to alternatives (private equity and credit, hedge funds, commodities, etc.).

Given this shift in visible investor interest, is it a good time to be focusing on public equity? Douglas believes it is for two reasons:

1. public equities remain a significant allocation in fund portfolios—especially for US public pensions and not-for-profit funds.

2. Douglas said for the past decade or a bit more, several traditional strategic beliefs have backfired. There were a handful of key tenets that we learned back in the '90s, which we embraced with a level of pride. These include the notion of a value premium, non-US diversification, and the small-cap premium. Point being, each of these have been extremely penal for quite a while.

"It's not a problem when your key investment beliefs are out of sync for a couple years, but 16 years?" Douglas asked.

For a broad perspective on equity differentials, while the S&P 500 Index delivered an annualized gain of 12.5% over the past 15 years ending 2024, the Russell 1000 Growth Index was +16.5%, the Russell 2000 Value Index was +9.5%, the MSCI EAFE Index was +5.2% and the MSCI Emerging Markets Equity Index was +3.0%. That likely is not what the typical asset allocator would have projected going into 2010.

In fact, the actual results may reflect the *inverse* of what many investors may have predicted.

Douglas opened the discussion by asking Trevor Graham how the portfolio at TIFF is structured today.

"We use a mix of active and passive, but it's typically 85% to 90% active," Graham said. "We are very aware of the challenges with active investing, so we use a couple of techniques to try to improve our odds."

He explained that TIFF uses a combination of highly concentrated managers (who may own just five to 10 stocks) and country and sector specialists who they believe have expertise that provides a "distinctive competitive advantage."

A couple other key aspects may distinguish TIFF from other institutional investors, including widespread use of performance-based fees. "The management fees on most of our relationships are very low; in some cases, they're actually zero. We are trying to motivate people to outperform—not gather assets."

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--Trevor Graham

He added TIFF is also open to investing with emerging managers--firms that haven't been in business very long. "Twenty to 25% of our current portfolio is in the hands of partners where TIFF was either the first institutional investor or the first investor ever." The last differentiator? TIFF does "a fair amount of risk management in house" by aggregating manager holdings and evaluating the resulting exposures. "If we find we are overweight a certain sector or country in an unintended way," Graham said, "we will manage that risk with a combination of futures and/or ETFs."

Rachel Carroll, CFA noted that many of the firm's well-funded pension plans have de-risked their portfolios and reduced public equity holdings. But, generally, she noted that Russell still believes in the "old tenets" Douglas outlined at the start of the call.

"There is a very long tail to some of the cyclical things that we have seen happening," she said. "You have to be very patient. For a lot of corporate investors that are facing investment committees, they don't have the timeline or appetite that might be necessary to wait for a value tilt to pay off. So, we are flexible in how we approach the clients that we work with. Each client is unique."

Dr. Damodaran said he teaches corporate finance and an investment philosophies class. But, he said, "I pretty much break every rule of what I tell other people to do in that class. At the start of 2025, the world looks very US-centric. US equities account for over half of global market cap. And in terms of global sectors, technology is 21%. If you have a portfolio that deviates from this composition, it's not bad.

"But you better have a really good reason for what you're doing. Unless you can show me what your competitive edge is for having a skew, I'm going to be skeptical."

As an internationally recognized expert in valuation, Damodaran noted, "Eugene Fama and Ken French specifically state that they did *not* find a premium for value stocks. They found that risk and return models didn't *explain* what they found in the data. So, they argued something is wrong with our models—not that you can beat the market. Of course, people took what they wanted out of their work."

His comments triggered a discussion of portfolio positioning relative to a benchmark.

Graham admitted he gets questions about the benefits of diversification from clients and prospects. "It's easy to forget that no geography carries the day forever," he said. "The last 15 years have been one of the best 15-year periods for US equities in history, but if you look at the long-term history, geographic diversification really pays off. It's amazing, but people tend to forget that."

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Carroll reiterated her point about clients who are de-risking their portfolio, noting that the "return-seeking portfolio has become smaller and smaller." In these cases, investors may use passive investing to have MSCI ACWI-like exposure. "It's really coming from a mindset of trying to simplify the portfolio more so than a call on US vs. non-US." She added she agreed with Graham's assertion that investors "forget" about diversification benefits. "The minute you start to think, 'This time is different' is the minute you are shown that is not so."

She added that investment committees are measured against a benchmark and "…taking big bets against that benchmark can make you look like a rock star, or it can make you look quite foolish, depending on how the market moves. For a lot of the organizations that we're working with, because they are large and well known, there's headline risk."

Douglas asked Damodaran for his thoughts on geographic allocations.

"The cost of not being globally diversified has decreased," Damodaran said. "And US equities, as we call them, have become more global. With the S&P 500, you are buying 500 large US companies. But at the same time, the technology sector gets about 60% of its revenues *outside* the US. You are getting global exposure."

Damodaran shared one other wish regarding indexing: "For too long, we've thought about companies in terms of incorporation. I'd love to see an index that is based on operations. I know it's going to be messier to create, but I'd love to see an index that says, 'Let's look at the returns from looking at companies that have operations in the US, operations in India and operations in China, etc."

Given the conversation on benchmarking, Douglas segued into the active/passive debate. "I encounter it on a daily basis," he said. "Clients are wondering, 'What's our divergence factor? What's our tracking error? Should we be more passively oriented?'" He turned to Damodaran to trigger the discussion.

Damodaran said markets are inefficient. "They make all kinds of mistakes. But can people *exploit* these mistakes to make money? That's a much tougher test. The ability to exploit mistakes has become less [evident] over time, partly because the investment world has become flatter." He added that has been partly due to greater access to information.

"Even though we believe in active and we utilize it quite a bit, we still have a healthy passive allocation," Graham said. He noted that TIFF's passive allocation is heavily tilted toward large-cap US stocks, the "hardest place within public equities to consistently outperform."

But he noted, "We tend to find there's a lot of alpha to be had in niche parts of the market like biotech or certain other sectors—or certain non-US markets. The challenge is there's a limit to how much we can deploy in those areas without causing the tracking error to go through the roof and the portfolio construction to basically have a big bet on a different set of exposures than what the benchmark looks like."

Carroll said, “Fully passive approaches are driven by two different factors. One would be that simplification that I talked about earlier. That return-seeking portion is a much smaller component—maybe somewhere between 10% and 20% of the overall total plan assets. And so having a bunch of complexity in a very small portion of the portfolio doesn't feel worth it.”

The other? “We have some clients with investment committees who are very adamantly *non*-believers in active management.” She added that Russell “believes in a multi-manager structure. You can blend together pretty elegantly, both passive and active, in a way that allows for some potential excess returns, but doesn't swamp risk or fee budgets at the same time.”

Damodaran said active managers should “go where the uncertainty is greatest because that’s where you’re going to find market mistakes.” He said people tend to move in herds, whether it’s a region, a sector or a group of companies.

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“The more uncertainty there is, the greater the chance that you might find something that is truly mis-valued. But,” he warned, “you’ll have to live with that feeling in your gut after you’ve taken that position. And I’m not sure very many investment committees want to live with that.”

Douglas then asked about “tactical allocation between active and passive” approaches.

“That's a market timing judgment,” Damodaran said. “I'm not a good market timer. So, if you ask me, ‘Would I do it?’ I would not.”

Carroll agreed. She cited both philosophical and practical reasons. Success with tactical allocation demands speed—and most investment committees cannot move quickly. “Committees typically meet four times a year, so it’s really hard to jump in and say, ‘My goodness, with this current market dislocation we can move right now and shift that allocation more or less toward passive.’ And just from a philosophical standpoint, we tend to like an asset allocation that you stick with for the long term.”

“Even though it's not what we've done at TIFF,” Graham said, “I might be open to shifting the active versus passive weight over time. But my reason for doing it actually has nothing to do with capital markets. It has to do with the current assessment of the quality of the active manager options. For us to take active risk, [the manager] has got to be someone really special.”

Damodaran added that “the existential threat that active investing faces is that long-term trend is *against* active investing.”

> *"If you go into active investing, I'd have two rules: find investors who have a philosophy that is consistent and look for humility."*
>
> *--Dr. Aswath Damodaran*

He said the trend reflects a loss of faith in active investing, but "not among academics, not among efficient marketers, but among those people who started as true believers in active investing. And that's a trend that's not going away."

He also called the average active investor "crappy." "I hate to use that word, but it's crappy," he reiterated. "You charge me 100 basis points for delivering 2% *less* than an index fund? It's going to catch up with you. I'm not tarring the entire group. But collectively, that group is going to get smaller, and maybe only the best, I think will survive."

Douglas countered that valuations are high and the indexes are "incredibly concentrated." Should these insights play a role in how investors modify their allocation between passive and active strategies?

Damodaran agreed, noting that the same companies have carried the index for the last two decades. "If you go into active investing, I'd have two rules: find investors who have a philosophy that is consistent and look for humility."

His comment triggered a discussion on manager selection. Carroll said Russell uses holdings-based analysis as one tool to evaluate managers. "We want people who stick to their knitting," she said. "When we are building a diversified portfolio, we are looking for managers to play specific roles in that portfolio."

Graham shared "two other points that are relevant to these comments." First, he said TIFF searches for "specialists" in an industry or country—especially when that specialist is out of favor. "But that only works if the people that we hire are consistent—especially as someone who has an off-benchmark, high-tracking error strategy. They need an almost religious belief in what they're doing. It's funny," he added. "When performance is terrible, that often gets our attention because if the process isn't broken and it just turns out that the holdings are very out of favor, sometimes that's a great time to *start* investing."

Carroll agreed. "It can be a hard sell to an investment committee, but if you've got a committee with the right mindset, it's the basic tenet of 'buy low.'"

"But in my experience," Graham noted, "the better the investment is, the *less* likely it is that a third-party investment committee will approve it." As some of the panelists chuckled, Graham added, "Seriously. That's one of the great things about TIFF; we have full discretion."

Given all the talk about active and passive management, Douglas took a step back and asked panelists, "How do you think about benchmarks? Why do they matter?"

"They matter because clients care about them," Graham said. "And I don't mean that to sound dismissive. People are going to compare how we do relative to that index—and I think they *should*. That's a healthy part of the process. And the index we most commonly use is the MSCI All-Country World (ACWI)."

Graham added that TIFF's mission is to "enhance the long-term returns of US nonprofit organizations." And "enhancing" reflects some deviation from that index along with consistent application.

He shared a story about his former CEO who said, "If we discover the cure for cancer, but nobody takes the medicine, we haven't cured cancer."

He added, "If we have the best investment engine in the world—and I'm not saying we do—but if people don't stick with us through the rough periods, then we're not doing anybody any good. And that's why the benchmark matters.

"We need courage to deviate, but we need to do it in a thoughtful way—and we need to be aware of just how much risk we're taking and how much we should assume is realistic for our clients to tolerate."

Douglas then shifted the discussion to the validity today of the old school "9-box" style investing for equities. See Exhibit 1.

Exhibit 1 | A 9-Box Style Investing Approach to Public Equities

	VALUE	CORE	GROWTH
LARGE CAP			
MID CAP			
SMALL CAP			

The question Douglas asked: Is this approach useful or is it just a simplified retail construct that is too antiquated for effective institutional use?

“Our client base is not style box focused,” Carroll said. “There's no way they have the appetite, or the interest, in having nine separate service providers with nine contracts and nine portfolios to oversee. It's administratively too burdensome.

“But,” she added, “we want managers that are going to adequately cover whatever space they're in. I understand why individual investors can find [the 9-box approach] intuitively comforting, but I don't think, in practice, that's how many institutions approach the question.”

“So, I'll say something a little bit controversial,” Graham added. “For an organization that is genuinely trying to add some value in public equities, the style box approach may be backwards. It may actually be wrong. The scarce resource is a sustainable competitive advantage in the investment process that generates alpha.

“The notion of trying to force active managers to fit all 9 boxes? It's almost inevitable that it will result in the average quality of the active manager being lower.

“One other way to think about it: It would be purely coincidental to me if we found someone fantastic in all 9 boxes.”

“I've always believed it's artificial,” Damodaran said. “Every time somebody does it, they should be paying a royalty to Fama and French.

“I do believe sector constraints might make more sense than the traditional style constraints. If 60% of your money is in technology, I might need to know that.”

“Can I make one additional point?” Carrol asked. “We work with large, defined contribution [DC] plans as well—and this is one place where I think investor psychology can play a big role. Oftentimes, we see the DC plans offer style box options. You can see really perverse, return-seeking participant behavior that can result in them having allocations that again, with that long-term lens, are probably not optimal.”

Douglas then circled back to selecting active managers. “Trevor, you've gone into some detail, but I’m going to ask that you go into a little bit more. Is there a menu of criteria that you follow? And Rachel, I'll ask you the same question: if you can put it in a nutshell, what is your selection criteria?”

Graham offered a few high-level points and examples. “There are three characteristics that are very important to us. One is the notion of a sustainable, competitive advantage in the investments process. That's number one—and probably the hardest to find.

“Oftentimes, we see the DC plans offer style box options. You can see perverse, return-seeking participant behavior that can result in allocations that, with that long-term lens, are probably not optimal.”

--Rachel Carroll, CFA

“The second is a proper alignment of interests. And there's an internal and external element to that. The internal element deals with characteristics like how the organization handles compensation: are people who work there motivated to outperform? Are they likely to be able to attract and retain great people over time?

“We also tend to like firms that are 100% employee owned. There's no outside interference. There's no pressure, for example, from a publicly traded parent for the investment team to take on capital when they don't want to. Things like that.

“The external piece deals mostly with the terms on offer to us. We prefer low management fees and we favor performance fees. We tend to like firms that have a singular focus. We think it's hard to be world class at anything. It's really hard to be world class at five or six or 10 things at the same time.

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>
> *--Trevor Graham*

“The last piece is actually more about us and less about the manager, but it's very important. There has to be strategic value to the rest of the portfolio. There are a limited number of positions that we can monitor well and really know in great detail.

“It's funny, having a very diversified portfolio makes some people feel better. I actually worry about it quite a bit because the probability that we're going to miss something starts to go up. So, what I mean by strategic value to the portfolio is the notion of keeping the position count manageable.

“Everything that we add has to add a diversifying exposure that we want—and that will lead to good returns and/or reduce tracking error or reduce volatility. And if it's not a diversifying exposure, it's got to be an upgrade over something we already have.”

“I know your portfolio has some specialist managers,” Douglas said, “be they in China or healthcare or biotech. When you allocate and size those positions, what's the trade-off between thinking about alpha potential and the projected beta?”

“We think about it in a couple of different ways,” Graham said. “Number one, there's this trade-off between expected incremental excess return and incremental tracking error.

“Most of our clients can tolerate a tracking error in their public equity allocation that's something like 3%. That's our guideline. And it's what we've delivered over time.

“The second way that we look at it: we place a big emphasis on understanding the positions in the portfolio. Let's say it’s healthcare—and we're contemplating adding a healthcare specialist. We either need to have it be a replacement for something else we already have, or, if we really feel confident about it, we have to have a way to cost effectively hedge back the beta.”

Then he offered an example. “It's different now, but we were overweight China from roughly 2016 through 2021. We would have been even more overweight based on the alpha opportunity. But hedging the market exposure was cost prohibitive and a position larger than our then-current max would have blown up our risk budget.”

Carroll referred to Russell’s approach as “the four P’s:” philosophy, people, process and performance. “Is it a star portfolio manager approach? Is it a co-portfolio manager approach? We are fine with either. We just really want to understand who's driving decisions and how they're accountable for those decisions.

“We are trying to look for somebody who has a unique investment philosophy and a repeatable process that we think will work long term.”

She added that a fifth P could be the portfolio. “We are verifying all of that by looking at the portfolio. Are they doing what they say they are going to do? And does that pan out through the performance? Really, we are looking for what we would call skillful risk takers.”

Carroll described how Russell’s Manager Research Group uses a variety of techniques to rank managers on a scale from one to four—with a four being the firm’s highest rating. She noted, “If there is a downgrade and a client is considering a change, you want to make sure that change is worth the *cost* of the change.

“We can also use these great tech tools to model different portfolios. We can see at a holdings level if we swapped out Manager A for Manager B, what would that resulting portfolio have looked like historically? And what would we expect it to look like in the future? Is it giving us the exposures we want? Tracking error is always an issue, as well. We don't have a hard and fast rule. Tracking error appetites vary by client. But, certainly, you don't want a super high tracking error product with a sensitive investment committee. It's going to be really hard [for them] to stay the course.”

Douglas turned to Damodaran. “You're an active manager skeptic, but you also said you would look at managers or investors who embrace areas of uncertainty. Would there be any other criteria that would be at the top of your list?”

“Luckily for me, I don't spend as much time with money managers as Trevor and Rachel,” he said. “I probably speak more to my Starbucks barista than I do managers, but I'll go back to basics.

“My first question is: what is the market mistake you think you can exploit?” He said this is the essence of active investing. “Second, why do you think you're better positioned than others to take advantage of that mistake?”

He offered an example of a biotech specialist manager who believes the market doesn't do a good job of gauging success of drugs moving through the pipeline. But the manager has hired doctors and scientists who can better evaluate these drugs vs. most other investors. If that's the case, "I'm willing to listen," he said.

"When you talk about exploiting market mistakes, do you prefer to hear an answer from a manager that it's something systematic, something that persists?" Douglas asked.

"Then I'll have a follow-up question," Damodaran said. "*Why* does it persist? It's the nature of mistakes. People find them and they disappear. That's how markets become efficient in the first place." He added he's been skeptical of the "small-cap premium" as it hasn't existed since 1979. He added its demise has been due to fundamental changes. "The things that gave rise to the small-cap premium have weakened or dissipated—or even disappeared. So, when people hold on to the small-cap premium and say it's coming back, I'm not sure they have thought through what causes small-cap companies to earn a higher return than large-cap companies."

Douglas then asked about the value premium—and tied it to managers. "Aswath, there's something you call 'lazy value.' Can you explain that to our audience?"

Damodaran said, "For 40 years, we've treated low price-to-book (PB) stocks as value stocks. That comes from an academic. And academics are lazy. They have to classify thousands of companies.

"They want to use a metric they can easily get—and price to book was the metric. That was the original value premium in Fama and French. It's a price-to-book premium. It's not a value premium, but we've called it a value premium."

Damodaran asked if managers simply buy low PB stocks, "Why do I need an active investor? An ETF can buy low PB stocks just as well—and probably not screw it up along the way because it doesn't make math errors.

"If we want to talk about value versus growth, we've got to talk about the full essence of value to me," he said before sharing an example.

"Nvidia was undervalued in 2018. It wasn't a low PB stock. It was undervalued because, given its growth and cash flow potential, it was trading at a low price. I think we need to open the door to value being something that reflects price versus what the cash flows in this business will generate. That's a much richer definition of value."

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--Dr. Aswath Damodaran

Douglas said, “I have a particular affinity to the argument you just made. And I’ve got two more questions on this—for Rachel and Trevor. Is it possible to tell when a manager that’s had a winning strategy is about to sour? Are there any indicators?”

Carroll said, “I would argue that if they have a repeatable investment process, it’s not that their process is going to sour. It's that the market will not be rewarding what they're doing—through no fault of their own. Performance is cyclical. We don't expect every manager to outperform all the time, so the caution I would have is an investment manager changing their process, hoping to chase what's going to work next. That's a manager we don't want.”

She added that Russell advises all of its clients to have patience with investment philosophies that are out of style. “If there is a true information advantage, or a true anomaly that is being exploited in the market, then over time that should be rewarded. You don't want to walk away from a manager at exactly the wrong time.”

Douglas asked, “So, can you generalize the reasons that Russell would take a top-rated manager down to a lower-rated manager? Or terminate a manager?”

“The one big one that we see often: there is one portfolio manager [PM]. They are the final decision maker. They are constructing that portfolio—and they leave. Then the question is: was there a succession plan in place? And do we have as much confidence in whomever the successor is as we had in that star PM?”

She added that Russell also looks for managers that offer sufficient resources for their products in terms of technology or analyst support. She reiterated the importance of sticking with a stated investment approach. “If not, that would drive a downgrade,” she said.

Graham said his answer would reflect two parts. “There is one answer for when it’s time to rebalance—to take some risk off and redeploy capital somewhere else,” he said. “And there’s a different set of answers for when it’s time to terminate a relationship.”

In terms of rebalancing, he said he looks at trailing excess return “…that’s more than a standard deviation and a half ahead of our expectations. Valuations in that area are very high and there’s what I would loosely categorize as ‘hot money’ coming into either the manager or that part of the market.”

Then, he shared three reasons why TIFF would end a relationship: material, adverse changes; TIFF made an error; and/or TIFF finds an upgrade.

Examples of material, adverse changes include “…launching too many strategies, too many assets are coming in or someone important departs—and we just don’t think it’s easy to replace that person.”

He said sometimes TIFF believes it has found a competitive advantage with a manager, but that conclusion proves faulty.

Douglas closed the session with a question about artificial intelligence [AI] and its potential impact on the industry and decision-making.

> *"If your investment philosophy is mechanical and rule driven, AI will beat you to it. The machine is better at mechanical stuff than you and I will ever be."*
>
> *--Dr. Aswath Damodaran*

"I'll jump in," Damodaran said. "I wrote a piece called 'Beat your Bot.' If your investment philosophy is mechanical and rule driven, AI will beat you to it. The machine is better at mechanical stuff than you and I will ever be."

He reiterated his view that active investing will continue to shrink and cited AI as a contributing factor. "It goes back to what makes successful managers successful. You are bringing something to the table that's not mechanical. It's consistent—but it's not mechanical."

"I have a slightly different take on it," Carroll said. "The institutional, quantitative managers that we work with have been ones who have harnessed AI from the beginning. These managers try to find some unique element that they are going to exploit. A lot of them are very secretive about what those elements are. They will only tell you retrospectively. You know what these different factors or key things that they were looking for are in portfolios. So, could they, in the future, need less people? Yes. But I don't think they go away."

She added Russell is using AI more as a research tool. "We have individual people pulling all the data [for products] and looking at all the characteristics. That takes a long time. AI can do it super fast. So, it's not impacting the number of people that we have doing research, but it's allowing us to get a broader set of products to look at to evaluate."

"Our view is that AI very likely benefits the systematic managers," Graham said. "It's actually a real threat to the fundamental folks because it's more possible than ever before that elements of what they do can be automated.

"We think [AI] benefits the systematic community because they are naturally better positioned to make use of it. They are used to rules-based processes. That's the core of their main business. We think this is going to help sophisticated, systematic firms. And as a result, we've actually shifted capital over the last roughly 12 months away from fundamental to systematic. We still use both. But we want to be on the right side of this trend over the long run."

"As Trevor pointed out, AI is going to make the strong even stronger," Damodaran agreed. "So, it's going to make the biggest players even bigger in pretty much every dimension. That is going to show up, not just in the economy and what we think about in terms of antitrust, but in markets, in terms of where the money is going to be made.

"Passive investing is part of the mechanistic drive; it's increasing the power of momentum in both directions," Damodaran said. "Right now, we notice the upside, but we're feeling that we will see the downside, as well. Momentum has become an even stronger force than it used to be."

"The pace of technological innovation is accelerating," Graham added. "And tech is impacting every single industry in some way. AI is a very obvious version of that. But there are others.

"Larger businesses are better equipped to take advantage of technological innovations because some of these things require hefty fixed costs and big businesses can absorb them more easily.

"People talk about the Magnificent 7 and how amazing their stock performance has been over the last 3 to 5 years. A big part of the reason for it is because this is not like 1999. These businesses are actually generating outstanding fundamental performance.

"And part of the reason for it is these big tech companies can really make use of technological innovation in a cost-effective way."

"I agree with both sets of comments there," Carroll said. "The only thing that always is in the back of my mind is something I said at the beginning. Every time people decide that things are fundamentally different is when we seem to have a shift in another direction. "Getting into that fixed mindset that markets are always going to present in the way that they are currently presenting—and it's always going to be those 7 to 10 big tech companies that are the drivers and small cap is never going to work again, and value is never going to work again," she paused, before adding, "Seems like that's when the shift happens, and we all get humbled a little bit."

Graham said, "I want to be clear. I don't think value is dead. It's just been dormant for a very long time, and part of this is also an opinion. I think people care about valuations a lot more in a tough market." He pointed to the Great Financial Crisis in 2008 and Covid in 2020 as painful corrections—but very short vs. other crises in history. He added, "I don't think we've been through a really tough equity environment for a very long time."

"It appears that our clock has run out for the day," Douglas said, then thanked each panelist and closed by stating, "You have heard some common and differing views. That is what makes a market. My hope is that members of our audience have been able to embrace select concepts from this discussion, which will help you in your individual decision-making."

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>
> *--Trevor Graham*

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