

<https://blog.en.erste-am.com/quarterly-capitalism-attack/>

“Quarterly Capitalism” under attack

Peter Szopo



© © iStock.com

If you thought “quarterly” was a simple adverb characterizing a regularly recurring activity, you may need to reconsider. A new term is making the rounds: “quarterly capitalism” – and in this context, “quarterly” stands for “*short-term, myopic, greedy and dysfunctional*”. In fact, the term was already invented four years ago by [Dominic Barton of McKinsey](#) and was swiftly embraced by, among others, Al Gore and Prince Charles to call for a major overhaul of current business practices of listed companies and fund managers. Recently the term has reached a new level of prominence after presidential candidate Hillary Clinton, in a series of appearances, complained that the “*tyranny of the next earnings report*” resulted in companies’ paying “*too little attention on the sources of long-term growth: research and development, physical capital and talent*”. Unsurprisingly, Mrs. Clinton’s proposed remedy consists of a mixture of higher taxes and more regulation.

While a proper discussion of the strengths and weaknesses of the capitalistic economic regime prevailing in the Western world is clearly beyond the scope of this blog, the ongoing debate asks for some qualifications.

Good long-term, evil short-term?

First: The attack on what has been dubbed “quarterly capitalism” rests on the unproven premise that long-termism is necessarily good, while short-termism is evil. This view is confused: whether decisions are right or wrong is not necessarily related to the frequency of making and revising them. Obviously, erratic hyper-activity and changing the business model every other week will unlikely result in a sustainable and profitable business. However, neither will following a long-term strategy that is all wrong.

Second: The empirical evidence regarding short- vs. long-termism is mixed. Of course, everybody can tell anecdotes about hugely successful long-term strategies, but it is equally easy to name many failed long-term strategies. [Larry Summers](#), although generally sympathizing with the critics of quarterly capitalism, points to General Motors, for example, which was a poster-child of long-term strategic thinking – before it had to be bailed out by the US government.

That said, [there is evidence](#) that newly listed companies are less innovative than their unlisted peers. But these differences may be telling us more about when companies, in their development, choose to go public, rather than about the negative impact of stock markets. There is also [some evidence](#) that privately owned companies invest more and pursue longer-term strategies than public companies, but a convincing explanation why – despite the long-term focus of private firms – practically all main industries are dominated by public players is rarely provided.

Third: The negative effects of investor pressure on management tend to be overrated, while the negative effects from a lack of shareholder pressure are neglected. Again, Larry Summers provides an example in pointing to the [unconvincing performance of the Japanese system of cross-shareholding](#) that was designed to protect management from shareholder pressure. Closer to home, every Austrian citizen remembers the country’s state-owned industries, which – free from any serious shareholder pressure – burned billions of state support before their privatization in the 90s.

Fourth: The short-term focus of investors and their assumed greed for dividends and other forms of payouts is generally exaggerated. Take the biotech sector for example, which has been trading on a dividend yield of under 0.5% and an earnings yield of 2% – and still has been among the best performing sectors in recent years. Or take Amazon, which has been described as “*a charitable organization being run by elements of the investment community for the benefit of consumers*”. The company, so far, has never returned any money to shareholders due to the lack of profits, but its market capitalisation is US\$245bn. In fact, investors are prepared to go a long way in supporting long-term growth stories despite the lack of immediate cash returns. Often, those commentators who are bragging about investors’ short-termism are the very same people who warn about the next emerging bubble whenever investors buy into stocks lacking any near-term cash flows or dividends.

Fifth: As far as the negative correlation between corporate investments and payouts to shareholders is concerned, it is far from clear in which direction causation works. Some argue that “*a dearth of profitable uses for capital is driving payouts to shareholders*.” There is an ongoing-debate mostly among US economists about the threat of secular stagnation and a slowdown in productivity growth. Management – it seems – is facing a lack of investment opportunities in an over-regulated, mature domestic economy, and at the same time is being confronted with a slowdown in emerging markets, which have been driving global growth in the first decade of the century. Thus, nobody should be surprised when money is returned to shareholders instead

of being wasted in investment projects with mediocre return perspectives.

Sixth: The [attack on quarterly reporting](#), which is often a by-product – and sometimes the core – of the usual laments about short-termism are not convincing. Typically, they misunderstand the purpose of regular financial reports; they fail to explain why less frequent reporting will limit the noise around earnings releases; and they ignore the risk of rising insider trading if data about operations and financials are released less frequently. Most importantly, the critics of quarterly reporting fail to provide a reason why, from a principal-agent perspective, with an ever-growing amount of short-term information available to and used by management, the information of shareholders should be less frequent.

Finally, the attack on short-term trading, which often – like in Hillary Clinton's [recent speech](#) – comes in tandem with the critique of short-termism, are – well – short-sighted. As [Sebastian Mallaby recently pointed out](#), short-term traders “*make money by pushing prices to their reasonable level after a disturbance: for example, a large sale by a sovereign wealth fund. This stabilising function helps other market participants, including long-term investors: it ensures that they will get a fair price for their shares whenever they sell them.*” Moreover, it is worth mentioning that a significant share of a typical fund manager's trading takes place in response to regulation, i.e. to avoid violations of legal and fund-specific investment restrictions.

Right balance between short-term and long-term investors needed

Bottom-line: It goes without saying that aspiring to do the right thing over a long period is a desirable attitude – both in private life and in business. However, as a recent research piece from Credit Suisse (“A Long Look on Short-Termism”) pointed out “*there are some legitimate reasons for the shortening of time horizons*”, including shorter asset lives, on average, in the corporate sector.

At Erste Asset Management it is one of our key goals to identify companies that follow a sound and successful longer-term strategy, and we make every effort to look “through” short-term market volatility and the noise that sometimes surrounds quarterly earnings releases. We understand Warren Buffet, who famously quipped that his “*favorite holding period is forever*”. However, we are also aware that a) fundamentals of companies often change; b) investors in our funds decide, for a good reason, to give us more or to withdraw money; or c) our assessment of a company's future – yes, it can happen – was less than perfect. Therefore, also for long-term investors there are many good reasons to trade. Then, the presence of short-term traders and investors helps, while new taxes and regulations don't.

Legal disclaimer

This document is an advertisement. Unless indicated otherwise, source: Erste Asset Management GmbH. The language of communication of the sales offices is German and the languages of communication of the Management Company also include English.

The prospectus for UCITS funds (including any amendments) is prepared and published in accordance with the provisions of the InvFG 2011 as amended. Information for Investors pursuant to § 21 AIFMG is prepared for the alternative investment funds (AIF) administered by Erste Asset Management GmbH pursuant to the provisions of the AIFMG in conjunction with the InvFG 2011.

The currently valid versions of the prospectus, the Information for Investors pursuant to § 21 AIFMG, and the key information document can be found on the website www.erste-am.com under “Mandatory publications” and can be obtained free of charge by interested investors at the offices of the Management Company and at the offices of the depositary bank. The exact date of the most recent publication of the prospectus, the languages in which the key information document is available, and any other locations where the documents can be obtained are indicated on the website www.erste-am.com. A summary of the investor rights is available in German and English on the website www.erste-am.com/investor-rights and can also be obtained from the Management Company.

The Management Company can decide to suspend the provisions it has taken for the sale of unit certificates in other countries in accordance with the regulatory requirements.

Note: You are about to purchase a product that may be difficult to understand. We recommend that you read the indicated fund documents before making an investment decision. In addition to the locations listed above, you can obtain these documents free of charge at the offices of the referring Sparkassen bank and the offices of Erste Bank der oesterreichischen Sparkassen AG. You can also access these documents electronically at www.erste-am.com.

N.B.: The performance scenarios listed in the key information document are based on a calculation method that is specified in an EU regulation. The future market development cannot be accurately predicted. The depicted performance scenarios merely present potential earnings, but are based on the earnings in the recent past. The actual earnings may be lower than indicated. Our analyses and conclusions are general in nature and do not take into account the individual characteristics of our investors in terms of earnings, taxation, experience and knowledge, investment objective, financial position, capacity for loss, and risk tolerance.

Please note: Past performance is not a reliable indicator of the future performance of a fund. Investments in securities entail risks in addition to the opportunities presented here. The value of units and their earnings can rise and fall. Changes in exchange rates can also have a positive or negative effect on the value of an investment. For this reason, you may receive less than your originally invested amount when you redeem your units. Persons who are interested in purchasing units in investment funds are advised to read the current fund prospectus(es) and the Information for Investors pursuant to § 21 AIFMG, especially the risk notices they contain, before making an investment decision. If the fund currency is different than the investor's home currency, changes in the relevant exchange rate can positively or negatively influence the value of the investment and the amount of the costs associated with the fund in the home currency.

We are not permitted to directly or indirectly offer, sell, transfer, or deliver this financial product to natural or legal persons whose place of residence or domicile is located in a country where this is legally prohibited. In this case, we may not provide any product information, either.

Please consult the corresponding information in the fund prospectus and the Information for Investors pursuant to § 21 AIFMG for restrictions on the sale of the fund to American or Russian citizens.

It is expressly noted that this communication does not provide any investment recommendations, but only expresses our current market assessment. Thus, this communication is not a substitute for investment advice, does not take into account the legal regulations aimed at promoting the independence of financial analyses, and is not subject to a prohibition on trading following the distribution of financial analyses.

This document does not represent a sales activity of the Management Company and therefore may not be construed as an offer for the purchase or sale of financial or investment instruments.

Erste Asset Management GmbH is affiliated with the referring Sparkassen banks and Erste Bank.

Please also read the “Information about us and our securities services” published by your bank.

Subject to misprints and errors.



Peter Szopo

Peter Szopo has worked as chief equity strategist at the Erste Asset Management since March 2015. Before he already worked as a consultant for equity fund management at Erste Asset Management for Central and Eastern European equity markets. From November 2009 to April 2013, he was head of the research department at Alfa Bank in Moscow.

After his research work at WIFO (Austrian Institute of Economic Research) from 1978 to 1990, he worked as a securities specialist in various management functions at internationally renowned investment banks. During this time he held the position of Head of Research at such institutions as Creditanstalt Investmentbank, UniCredit Bank Austria, Robert Fleming Securities, and at Bank Sal. Oppenheim.

Along with his analysis activities, he worked from 1997 to 2000 at Eastfund Management as the fund manager for Central and Eastern European equity.