

Honing Your Information Edge

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Conventional wisdom suggests that of the four sources of edge in investing – informational, analytical, behavioural and structural – the possibility of gaining an informational edge has been eroded, with the information revolution over the last two decades helping blunt this edge. Information about companies and industries has become easy to access, but even as the volume of information increased exponentially, signal value has deteriorated.

The notion that the informational edge has been blunted also has its roots in a triumph of the efficient market hypothesis (EMH) and the rise of passive investing. The inherent contradiction at the heart of EMH is that if it becomes universally accepted, the agents who need to ensure that markets price in all information may stop acting to ensure that the efficiency persists, thus creating inefficiency. While there is negativity about the durability – even viability – of the information edge, it is a mistake to write it off.

The information advantage is real and legitimate, especially when investing in private markets. Moreover, informational edge and analytical edge are inextricably connected – information is critical to set the correct baseline that precedes any analysis. Investors who are able to consume and process information in an organized fashion and on an industrial scale will be at a more precise starting point for deeper diligence.

Moreover, in investment analysis one data point alone is not the determinant of an investment thesis. Data points have to be linked to construct a mosaic, and building a thesis requires weaving together disparate pieces of information to develop a differentiated perspective from the crowd. The art of investing is to anticipate which mosaic represents the most accurate picture of the future among all the possibilities. This can be challenging given the range of the possibilities on how a given business will evolve, and the way to improve one's odds of selecting the right mosaic is to weight analytic possibilities with the knowledge of history.

But just as the information revolution has taken away the easy pickings, it has enabled intrepid investors to be innovative with information sourcing and analytic work. Creative investors can use computing technology to harness new sources of data and integrate them in ways that were not possible. To adapt a famous Mark Twain quip, capital allocators who don't read and assimilate information from a wide number of sources have no advantage over capital allocators who can't read and assimilate information widely.

When a new technology or business model is deployed in an industry in another country, investors now have the ability to observe the transformation unfolding there, and draw conclusions on whether the same transformation may take place in their own focus country. This enables a new kind of arbitrage, where anticipating change and translating the novel into one's own context creates new investment opportunities.

The globalized nature of most industries means that information assimilation simply cannot be restricted to sources from the national or regional economy in which the business

principally operates. Regulations and competitive forces that originate far away from the home country of a business shape industries in all globalized economies. Commodity players in particular are affected by global developments, with the supply-demand balance that drives pricing subject to an array of international and subnational forces. To use an analogy from physics, globalization and the explosion in information have together transformed investing from a determinate, Newtonian discipline to a probabilistic, quantum mechanical one.

In a world cluttered with me-too ideas and self-similarity, the best investors draw information from disparate sources and ideas from diverse fields into thesis construction, and it is this capability in sourcing and synthesis that enables differentiated investment ideas to emerge.