The AMBACHTSHEER Letter
Sustainable Pension Design • Effective Pension Management

March 2025

MAKING INVESTMENT THEORIES MORE PRAGMATIC:

HOW *CONTEXT CLARITY* HELPS

"It is not a case of choosing stocks that, to the best of one's judgement, are really the most attractive, nor even those that average opinion really think the most attractive. We have now reached a third degree where we devote our intelligence to anticipating what average opinion expects average opinion to be."

John Maynard Keynes, 1936

"In the short run, the Market is a voting machine, but in the long run it is a weighing machine."

Warren Buffett, 1993

"Context is what appears when you hold your attention long enough. The longer you hold it, the more context appears."

Jenny Odell, artist and writer, 2022

'Context' for a More Integrated Investment Theory

When thinking about investment theory and its relevance to investing retirement savings, we would do well to take Jenny Odell's advice seriously: do some clear thinking first about what you want to achieve. What is the context for your quest? For example:

- Is it about understanding how the Capital Asset Pricing Model and Arbitrage Pricing Theory can help you set realistic investment return targets?
- Is it about understanding how the Efficient Markets Hypothesis impacts the potential value of corporate security analysis?
- Is it about setting time-frames for investment decision-making and for results evaluation? For example, what are the implications of the clear 'long-termism' views set out above by wise investors like John Maynard Keynes and Warren Buffett?

Why pose these context questions about investment theory in this *Letter*? Because prior recent *Letter*s have been addressing components of investment theory without explicitly setting out the full context why we were doing so. The purpose of this *Letter* is to explicitly raise the 'context' question to ensure that the investment theories we have been calling on are pragmatically useful.

Towards More Pragmatic Investment Theories

The six specific *Letter*s we refer to were written between January 2024 and January 2025. Their titles begin to tell the story:

1. "**Improving Investment Models For Pension Funds: How Are We Doing?**"
2. "**Traveling The Road To 'Pension Fund Capitalism': A Progress Report**"

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3. "**A Pragmatic Theory of 'Pension Fund Capitalism': Implications For Pension Organizations**"
4. "**Pension Fund Capitalism' And 'Ownership Investing': Are These Lofty Ideas Useful In Practice?**"
5. "**The New *CFA Institute* Treatise On Net Zero Investing: The Missing Part Of The Story**"
6. "**Understanding Corporate Longevity: What Secret Sauce Do Over 100 Year Old Firms Have In Common?**"

Taken together, these six *Letter*s cover a lot of investment theory ground. But do they coalesce into a practically useful framework for managing large pools of retirement savings?

From 'Macro' to 'Micro'

Rereading these *Letter*s now, the first 'context' issue that surfaces is 'macro vs. micro', where 'macro' means addressing broad investment policy issues and 'micro' means addressing investment decision processes at the individual investment level. So for example, the first *Letter* on the list above ("Improving Investment Models") is very 'macro':

- **Improving Investment Models** contrasted Andrew Lo's 'Adaptive Markets Hypothesis' (AMH) with the Kay-King 'Radical Uncertainty' Hypothesis. In the K-K model, the future is wholly unpredictable, while in the Lo AMH case, some predictability is plausible. Long-time readers of this publication know we have long sided with Lo by broad-brush painting post-WWII socio-economic environments, and then using the simple Gordon Model to judge whether the SP500 Index was priced favorably or unfavorably relative to the long inflation-linked Treasury Bond yield. This approach correctly warned of unfavorable S&P500 pricing in the late 1990s…..and favorable pricing post the Global Financial Crisis of the late 2000s.

The second listed *Letter* begins the investment theory transition from a 'macro' to a 'micro' perspective:

- **Traveling the Road to Pension Fund Capitalism** recounts Peter Drucker's 1976 book "The Unseen Revolution" and its message that workers are becoming owners of the means of production, not through violent revolution, but peacefully through their pension funds. The birth of the Canadian Pension Model in the 1990s introduces an ideal organizational structure for managing pension funds as owners of the means of production.

The concept of pension fund capitalism logically leads to a requirement to identify the key features of corporate value-creation. That is the goal of the third-listed *Letter*:

- **A Pragmatic Theory of Pension Fund Capitalism** introduces Bartley Madden, creator of the micro-focused Pragmatic Theory of the Firm. The Theory has four components: 1. A corporate vision that inspires, 2. An R&D culture that keeps the firm at a leading innovation edge, 3. Win-win relationships both inside the firm with employees and outside the firm with customers and suppliers, and 4. An eye to the future by assessing the impact of its products and services on future generations. The *Letter* notes that these four value generators not only work well in a corporate context, but also in the context of pension organizations themselves.

Following this three-*Letter* transition from macro to micro investment theory, Letters #4, #5, and #6 dig deeper into the practical implications of 'ownership investing'.

Ownership Investing

Letter #4 is appropriately titled "Pension Fund Capitalism and Ownership Investing: Are These Lofty Ideas Useful In Practice?" It answers the question through a 'real world' case study:

- **The asset base of the *CPP Investment Board*** is currently about C$700B, and is projected to cross C$1T by the end of this decade. Its 40 person-strong *Portfolio Value Creation* (*PVC*) *Group* has a mandate to create value in *CPPIB*'s investment portfolio companies, working across all sectors, geographies, and deal phases. Case studies on the ownership investing activities of *PVC Group* document the creation of carve outs, new profit pools, divestments, governance adjustments, as well as changes in strategic and operational planning. Benchmarking metrics confirm these activities are actually creating value.

Letter #5 notes that the *CFA Institute* sponsored a major 55-page study focusing solely on the theory and practices of Net Zero Investing. All well and good, but as Sir John Kay notes in his new book "The Corporation in the 21st Century", current micro investment theory espoused by academia throws little light on the nature of value-creating decision-making processes in the real world:

- **Should the *CFA Institute* be concerned about this micro investment theory deficit?** Should the *Institute* not play an active role in addressing this problem? For that matter, should all of us not be concerned about this problem? To further make the point, the *Letter* cites a Danish study which found that active pension fund capital provision led to corporate increases in profitability, patent approvals, and planning time horizons. How did this happen? It appears to be a good case study for testing the prediction potential of the Pragmatic Theory of the Firm.

Letter #6 was inspired by Vicki TenHaken's book "Lessons from Century Club Companies":

- **From careful study of the common characteristics of companies more than 100 years old, she found five lessons:** 1. Strong corporate mission and culture, 2. Unique core strengths and change management, 3. Close relationships with business partners, 4. Long-term employee relationships, and 5. Active members in their local communities. Note that TenHaken's success driver findings line up nicely with the value-creation drivers Bartley Badden postulates in his Pragmatic Theory of the Firm. This convergence strengthens the case for using Bartley Madden's Pragmatic Theory of the Firm as the investment model through which to implement the ownership investing paradigm.

How does all this relate to the 'context clarity' this *Letter* advocates?

Back To 'Context Clarity'

Long dissertations on 'investment theory' may play well in academia, but they are not very helpful in the real world. To emphasize the point, we repeat the three theory questions posed to open this *Letter*:

- Is it about understanding how the Capital Asset Pricing Model and Arbitrage Pricing Theory can help you set realistic investment return targets?
- Is it about understanding how the Efficient Markets Hypothesis impacts the potential value of corporate security analysis?
- Is it about setting time-frames for investment decision-making and for results evaluation? For example, what are the implications of the clear 'long-termism' views set out above by wise investors like John Maynard Keynes and Warren Buffett?

These theory application questions cannot be answered without clear contexts, and the goal of the six cited *Letter*s was to provide such contexts. Hopefully, future *Letter*s will continue to do so. Indeed, we will not be alone. Bartley Madden's new book "Value Creation Insights" will be released this Fall. Its contents are summarized on the next page as an Appendix to this *Letter*.

Keith Ambachtsheer

VALUE CREATION INSIGHTS

By *Bartley J. Madden*

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