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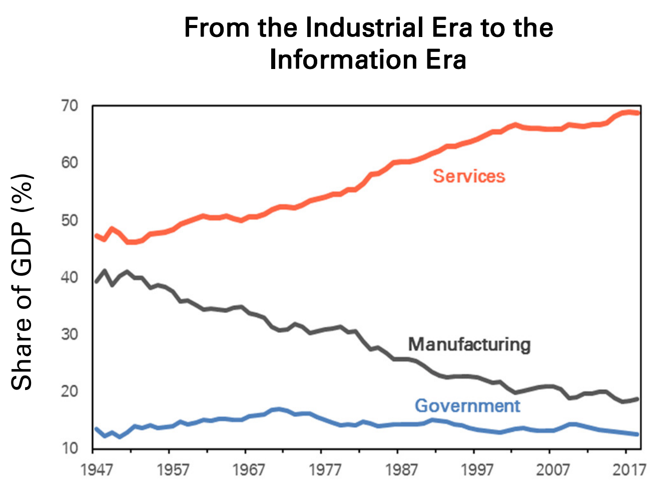
High Pointe

Nobel Thoughts

High Pointe was gratified to see Paul Romer and William Nordhaus awarded this year's Nobel Prize in Economics because their research validates the basic tenets of High Pointe's investment strategy, namely the shift to an information-based economy and the value of intangibles. Specifically, Romer has given us new tools for understanding how human creativity and technological change positively impact a market economy, while William D. Nordhaus has pioneered a framework for understanding how the economy and our environment are mutually dependent on each other.

Romer's work detailing the importance of knowledge in an economy and its central role as a driver of wealth and value dovetails with our work at High Pointe highlighting the increasing importance of intangible assets in an economy that has radically transformed from manufacturing to one based on services. As Gautam noted in his original paper on this topic in 2002 *(Intangibles: The Next Frontier in Stock Valuation)* "the magnitude of this transformation has been dramatic, as illustrated by the chart below [since updated] which shows the share of the services sector relative to manufacturing."



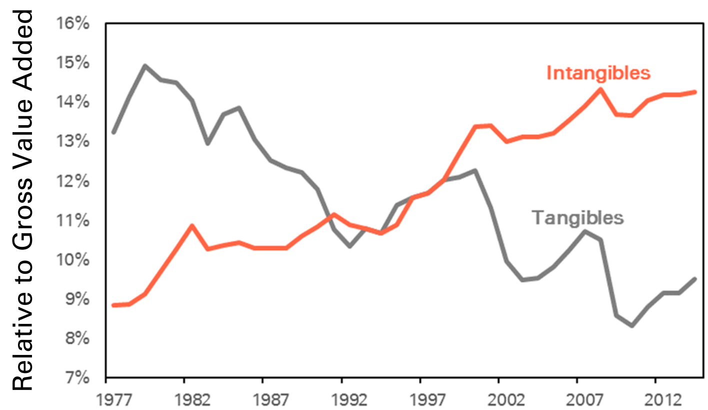
Source: Bureau of Economic Analysis.

As current accounting standards were first developed during the industrial era and were designed for companies that were engaged primarily in manufacturing activities, they failed to keep pace in a services-based economy characterized by rapid technological and financial innovation.

Investments in patents, brands, information technology, business processes and human capital, among others, were not adequately reflected in a firm's accounting statements. These investments in intangible assets are usually expensed and their value is not readily apparent in financial statements.

Yet the shift to the Information Era forced companies to invest in these intangible assets to an increasing degree if they were to remain competitive and relevant. This shift in the nature of company investments is readily apparent in the chart below:

Private Investment in Tangible and Intangible Assets



Source: Feng Gu and Baruch Lev, "Time to Change Your Investment Model," *Financial Analysts Journal,* vol. 72 (2017), no. 4: p. 23-33

A combination of revolutionary technological changes and a shift to greater free market forces created a massively more robust and competitive global economy. Constant process and product innovation became key to survival. Smart companies realized that the best way to do this was to invest in intangible assets, not just plant, equipment and labor.

Both Romer and High Pointe understood and acknowledged the increasing importance and integration of human creativity and technological innovation in the world economy. For Romer, this led to a focus on the growth of economies, and for High Pointe a focus on the growth of companies and ultimately stock returns.

Nordhaus highlights another area we find of increasing importance – ESG (Environmental, Social and Governance) factors. In his particular case, he notes the impact of the environment, most notably climate change, on economic development and growth.

Environmental, social and governance factors are also intangible factors that are not adequately reflected in a company's financial statements but increasingly do have an impact on a company's business and the sustainability of its operations. Companies do not act in isolation. They interact with their employees, their community, the government and their environment in addition to their competitors, customers and suppliers. Leaving out the former leaves one with an incomplete perspective.

Our research at High Pointe has shown that ESG considerations do not act as a constraint on one's ability to maximize investment returns but in fact give us an insight into the totality of the company's business. It is incumbent upon investors to apply ESG factors as part of a holistic investment process to extract the value inherent in them, and that is what we do at High Pointe.

Good investment frameworks and processes are not set in stone and unchangeable. They need to constantly be updated and improved if they are to keep pace with the world around us. At High Pointe it is our job to pay attention to these developments and incorporate them into our investment framework to improve our ability to enhance our clients' returns and help them meet their financial objectives.

Chris Olson and Gautam Dhingra
October 19, 2018