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13+1 - The Podcast - Episode 3: Financial Research in Transition - Independence, Transparency and the Future of Analysis

In this episode, Christoph Schlienkamp talks to Volker Sack, an expert with over 25 years of experience in financial research, about developments in recent years and the future of financial analysis.

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-Transcript-

Moderator

‘13+1’, the DVFA podcast for exciting insights into the world of finance.

Christoph Schlienkamp

Welcome to our DVFA Podcast ‘13+1’. Today is about financial research and I have Volker Sack as my guest. I have titled today's episode ‘Financial Research in Transition. Independence, transparency and the future of analysis.’ Volker has more than 25 years of experience in research, but he will say more about that in a moment when he introduces himself personally. My name is Christoph Schlienkamp, I am a portfolio manager at GS&P Kapitalanlagegesellschaft, and I will guide you through this podcast. Before that, however, as always, I have to point out that this podcast is for information purposes only, is not investment advice and of course also not legal and tax advice and with this directly into the episode. Hello Volker.

Volker Sack

Hello Christoph.

Christoph Schlienkamp

Volker, I would be happy if you could briefly introduce yourself to our listeners in a minute and your minute starts now.

Volker Sack

OK, the countdown is on. My name is Volker Sack, I have been working in the field of financial analysis for – yes, as you said – 25 years, over 20 of which as Senior Head of Research at NordLB in Corporate Research and for two years now self-employed. We have founded our own company, DAN/AG, Deutsches Analyse Netzwerk AG and I am the CEO there. And we offer services that many banks no longer offer.

Christoph Schlienkamp

Volker, that was 35 seconds, if I stopped it correctly. But thanks for your introduction. You know, in this podcast we always want to be entertaining and therefore three personal questions at the beginning before we get to the content topic of financial research - and also the bonus question. And I would kindly ask you to not only give the answer, but also to briefly explain why you chose what. "Spontaneous or planned" is the first question.

Volker Sack

So, I'm more of a strategist. I prefer to plan, so that's clearly the case, although spontaneity is always very much appreciated, especially with people who are more likely to be like that.

Christoph Schlienkamp

The second question is then "train or car".

Volker Sack

Yes, given the fact that I was on the road a lot, I'm more of a train person. Although I have to say that it was quite a lot, especially in recent years, rather associated with – a decent amount of suffering. Um, but if I calculate over the years now, I've gone to the moon and back at least twice – only if I add up the distance, of course.

Christoph Schlienkamp

I think we have all had the same experiences with the German railway, during our careers. And the third question in this round is – Volker, if we look at the topic of apps – 'Which app do you use most often right now?'

Volker Sack

That's a difficult question, Christoph, to be honest. So, if I take a closer look, I would say that I have to go to the official mail account more often to retrieve my messages. If I then use messenger service, then that would be 'Signal'. And if I call up news properly, for example, stock market news, then I'm more likely to be on n-tv.

Christoph Schlienkamp

So, then after all it's the mail app you use most often?

Volker Sack

Absolutely!

Christoph Schlienkamp

OK, Volker, thank you for these personal questions or rather your personal answers. And with that, let's get straight into the topic of financial research. I think we've all experienced quiet and turbulent times on the capital market in the last ten years, or not just in the last ten years. Volker, how do you think the fundamental development of financial research has taken place over the last ten years? Maybe you can tell us about a few positive, but also negative changes?

Volker Sack

Well, you had to fight quite a bit in recent years to be able to survive on the market. Among other things, as we have all noticed, there was the Capital Markets Directive MiFID2 since January 2018. With the separate disclosure of costs for analyses by financial analysts – the unbundling – that has led to quite a few deaths also of research departments, especially on the equity side. And. Um, well, whether this tendency – there are discussions about whether this will be withdrawn again. Let's see, but perhaps this just as a short note on – the topic of regulation. What I have experienced is that – and I think many analysts can confirm this – that they first have condensed the coverage of the colleagues. If they had been covering ten companies, then that was increased to 15 or even more. So, to save costs. The market wanted short response times, and that was sometimes difficult to implement especially during the reporting season. What do I do if two or three companies from my coverage portfolio report their numbers at the same time? I must prioritize then, there was no other way. And that's why we then set up more automated, more efficient processes, but there was always a lot of pressure, so we were feeling the heat and I think everyone who was in this market can understand that. In 2021 alone, several houses then closed research departments on the sales side. Or else. I'm thinking of Commerzbank, Lampe, and NordLB, where I was working. And on the panel 'Research'. And I don't think that was good for the overall market either. You can honestly say so. And that was the second wave, after we had already had a whole number of research departments, which reduced or even stopped their activities during the financial market crisis in 2008/2009. So, I guess that we are still maybe 150 in the industry, or maybe 200 in the German-speaking world. And we must have been ten times as many at the turn of the millennium. Easily fifteen hundred to 2,000 financial analysts.

Christoph Schlienkamp

One more thing comes to mind at this point and that actually leads me directly to the next question, Volker: What challenges are there for the analysts today, after what you have just described? I'm thinking particularly of the topic of 'quality of the reporting by issuers', right?

Volker Sack

Yes, so there. We are still called upon... Not much has changed. The analyst should deliver well, i.e. good quality, understandable, neutral and compliant as well as quickly, so that's clearly the case. However, the analyst has the difficulty, especially from the IR side, that some companies have significantly reduced their reporting, especially on Q1 and Q3. In some cases, they only show sales. In France, this is quite common and at the end of the day it leads to the fact that the analyst actually has difficulties implementing it accordingly. And what is also demanded to a greater extent is to be the contact person for the media at the same time, in order to be able to comment on the latest developments relatively quickly. So that's the professional field, it's still exciting, I love it, it's challenging, but I – you can say that a lot has been added, especially recently. Topics such as social media, artificial intelligence and also ESG issues. That will occupy us, and these are the challenges now for the time forward.

Christoph Schlienkamp

Yes, on your three topics that you just mentioned: We'll certainly come back to social media, artificial intelligence and ESG in a moment, but let me stay on the topic of job description, especially at the beginning of our conversation, and there the topic is always ethical principles that the financial analyst should observe in order to make objective and factual recommendations, as the saying goes. How do you ensure that? How do you ensure your independence and integrity as a financial analyst in preparing research reports?

Volker Sack

So, you have to bring a good, strong set of values with you. That is an important point. At the same time, however, one can – and one must – I always say – be decisive and courageous to speak uncomfortable truths. You can't be afraid of conflict and say 'Oh God, if I write something unpleasant now, then it could possibly lead to – I call it, I don't really like the word that much – but to a shitstorm', or something similar and we have experienced this more often in the past, that not every investor agreed with our recommendations. So, you have to be able to endure that – too. Just as issuers must endure when we write a vote that is not especially positive.

Christoph Schlienkamp

I think, being analysts, we have both noticed that here and there over the long years. And I mean, you just touched on the topic, conflicts of interest! Are there any measures that financial analysts can or should take to minimize these conflicts of interest and still provide independent analysis?

Volker Sack

So, you can actually explain that, even if it is now legally drafted, with common sense. If I want to be independent, then, for example, I am not allowed to have shares in my portfolio of the companies I write about. That goes without saying. We used to have this before, when it was not yet regulated, and let's be honest; a note on a study stating 'The analyst holds shares in XY AG' is actually not very helpful and actually makes –

Christoph Schlienkamp

But don't they always say: "buy where your mouth is"?

Volker Sack

Excuse me?

Christoph Schlienkamp

Isn't it always 'buy where your mouth is', i.e. buy what you recommend to others in this context?

Volker Sack

No, no. Yes, that's what people always like to say, but I'm thinking back, for example, to the wild times of the new market. Where we were often asked by issuers at the IPO whether we would buy the shares of this stock corporation. And I could always say so nicely – and I was always very pleased about that – that on the background of neutrality or independence, this question would not arise for me at all. And what I felt every time as an absolute liberation – a mental liberation. That was really great, and the topic was already off the table and if I try to implement that, then I am much stronger in my vote.

Christoph Schlienkamp

Let's tackle the topic of transparency as the next keyword here. As analysts and investors, we always demand transparency from issuers. If I ask you the question now in connection with financial research: How important is transparency in the documentation of your forecasts in general and especially the valuation models in financial research?

Volker Sack

So, there is the internal and the external view. Internally, of course, you then also have to put the models behind a study, which is what you have used as a basis. And so on and so forth. Disclose the assumptions. But I'm not sure if it's always helpful to completely disclose the respective valuation model. An institutional investor will certainly understand a DCF model, but I'm sometimes not so sure about that with private investors. So, there should be more of a conclusive argumentation in the foreground as to how you came to a certain recommendation. For example, also by naming all important opportunities and risks. This, I think – a DCF model is usually not of interest to a private investor.

Christoph Schlienkamp

No, I can only subscribe to that. I've also had this experience quite often in my long career as an analyst. The topic for financial analysts is also education, qualification, and further education. Has that changed over time, this importance? That it isn't as important anymore to be a trained financial analyst today?

Volker Sack

So training is still the be-all and end-all. And this applies not only to the start of your career in financial analysis, but also to the time afterwards. We, too, as supposedly old hands, are subject to the postulate of lifelong learning, there is no other way. We have to learn and that – and this is important at this point – also adapt to the latest things. What I perceived is that training has become more complex. Topics such as regulatory requirements and sustainability have not diminished, all of which have been added to the general tools that I will say now, the evaluation tools that we have learned over the years and that have not changed that much in principle. So in this respect, yes, training is totally important and I think we will come to it again later – well, from my point of view it would be good to go back to the topic – how this can develop in the future, also against the background of the demographic development that we see here, yes, on the – especially in the area of financial analysis.

Christoph Schlienkamp

Yes, I think we'll come back to that in a moment. But before that, let me ask a substantive question. Uh, I mean companies are characterized by different shareholder structures. Does that play a role for you in the fundamental analysis? Does this have anything to do with transparency? And how does that influence your recommendation or investment decision afterwards?

Volker Sack

So, shareholder structures certainly play an important role in the valuation of companies. For example, companies that are 100% in free float usually have higher liquidity but are certainly also more vulnerable to possible takeovers – meaning in case the business model attracts interest from investors. So yes, that's sometimes the topic that we also perceive, and that such a takeover can lead to considerable unrest, especially among the employees, the customers, or the shareholders. Especially if it is an action that is classified as unfriendly by the management. So, this... In this respect, I sometimes like to say that it is good to have anchor investors with significant shares and a long-term investment, at least that's the intention. And which should provide for more – as a rule – for more calm, even if it is at the expense, perhaps, of the free float at this point. But this area of tension between anchor investors and free float should in any case – in any case – be balanced on a company-specific basis, especially since the free float market capitalization is the decisive criterion for inclusion in indices, such as DAX or SDAX or whatever. By the way: From my point of view, another issue is important, namely the relationship between professional and private investors. This is not necessarily always published, and it is also not known in every case. I think a healthy retail quota of at least 10% for every listed company is right and good and that would...

Christoph Schlienkamp

Whether large-cap or small-cap?

Volker Sack

Yes, exactly, also from the point of view of, and this is also one of our topics which we have again and again in this country, advancing the stock culture

Christoph Schlienkamp

Great, thank you for that. We have just said that there are the new keywords social media, artificial intelligence and ESG. So, let's continue with question eight then feel free to talk about social media.

Volker Sack

Ok.

Christoph Schlienkamp

The question is: What role do you think social media plays in the dissemination of financial research? And above all, I would be interested, Volker, what challenges does this create?

Volker Sack

Well, right now we have addressed this exact issue within the DVFA and within our Commission, the Commission for Corporate Analysis, because, I believe, it is quite certainly an important issue for us. How do we deal with social media basically? And what is important, I think, is that we have now developed a few standards at this point, and we will soon publish those in our new principles for financial research. But perhaps in a short summary of what we have discussed: I think it is important that you should always have a written study first, which is available as a PDF, and which has also been published, released under the four-eyes principle. Which is equipped with the appropriate disclaimers, with the disclosure of conflicts of interest and so forth. So that's still very, very important in this context. And until that hasn't happened, you shouldn't say anything on social media. And now it goes even further. Now it's getting a little tighter at this point, so to say. Basically, you should also avoid judgmental statements. This is a dangerous box, even if you may have provided a link or the study has been attached, it can be difficult: Short comments on the development of individual companies within a post, via LinkedIn or whatever, can be interpreted as an investment recommendation and should be avoided at all costs. So that, that's very, very important at this point. And by the way, there's even more: Recent experiences show that from some colleagues, who are very... I'll say... are 'active' on the economic side, their social media profiles have been hijacked and a fake profile has been installed...

Christoph Schlienkamp

That's the LinkedIn topic, right?

Volker Sack

Yes. And these colleagues suddenly became specialists in French stocks. So, if you agreed on the rule right from the start – 'We don't share things like this via social media' – then it's clear for everyone else who reads a strange post on social media, that this can't be classified as serious.

Christoph Schlienkamp

OK, I see. Then let's get to the next hype topic: Artificial Intelligence. Will artificial intelligence write all investment recommendations in five years from now, and will all investment recommendations be equal and investors buy shares without an intermediate? So, my question is: How is machine learning and artificial intelligence used in financial research and are there perhaps opportunities besides the risks?

Volker Sack

Yes, and then the studies will soon say 'Analyst: A.I.', right? Haha, that's how you could imagine it, but to be honest, I don't think it's very realistic, because then the legal question arises 'Who is 'A.I.'' and that might backfire. But where A.I. can certainly help us at this point is researching. After what we are doing now... And that's a question of prompting, how to set it up and the reading of certain data from annual reports or the like. This can help at one point or another, but it does not replace the conversation with the management, it does not replace the creation of forecasts, it does not create, it does not replace the writing of one's own texts. That will remain on the agenda, that is my firm conviction.

Christoph Schlienkamp

So, the evaluation and investment recommendation are still made by people, by analysts?

Volker Sack

That will be the case, it cannot be accomplished otherwise from my point of view. And we actually have the legal issue, which I have just jokingly hinted at here: At the end of the day, a person must always stand up for what is in there and not Mr. or Mrs. A.I. So, it just won't work that way. But the development is in flux and very dynamic, and the state of knowledge will also change rapidly over time. Well, and I also hear from some – I haven't seen it myself yet – but there are supposed to be some research houses that – at least from hearsay – show in their studies that the study was not prepared by A.I. and supposedly use this as a quality feature. As I said, I've heard, but I haven't seen it yet.

Christoph Schlienkamp

Great, thank you for now for your comments on artificial intelligence and then we get directly to the last question in our question block, the ten-questions block, and it deals with the topic of ESG. ESG criteria in the classic analysis of stocks and bonds are often controversial. To what extent do you think they should be taken into account, and would you tell us your perspective on the topic?

Volker Sack

Yes, a difficult topic...

Christoph Schlienkamp

Yes, I'm sorry.

Volker Sack

... and also a very hot topic. And we are also in the process of exchanging ideas on the topic within the Commission with our, let's say, colleagues, esteemed colleagues, also from the ESG side; there are intensive dialogues taking place. What will be the case is that the sustainability reporting of companies will increase significantly. And then there is standardized data that is made available to everyone. People are really speaking of a veritable flood of data, of more than 1,000 data points. And for us, it's about the question, which of them might be relevant for valuation. And that will be the real issue. An insane amount of data, insanely complex – but probably only a little of it will be necessary for us. What could be cash flow relevant? We have thought about it. These could be foremost topics about CO_2 reduction, i.e. where it is about energy-intensive industries needing to buy CO_2 certificates or something like this. That will certainly become relevant regarding cash flows in the next few years. But especially in the case of soft factors such as employee satisfaction in the context of surveys, it will be difficult to include this in the analysis, but we have already had this discussion in the past with the quality of management, so how do we bring in the soft factors, and that will usually be done through risk assessment. We have now formulated in an article that it would be desirable in principle to limit the amount of ESG data, the target data that is now important for a company's corporate strategy, to a few. And there are already a few good examples on the market. As a representative of all of them, I would like to mention the DHL Group, which has reduced this to seven key figures, which, by the way, are also partly bonus-relevant for the Board of Management. So that goes in that direction.

Christoph Schlienkamp

So, it is exactly this combination of, so to speak, performance initiative, short and long-term incentives. ESG indicators, right?

Volker Sack

Exactly right, precisely, precisely. And we will take a closer look at all these topics, this topic ESG, but also social media and A.I., as part of our Corporate Reporting Day, which will take place on January 16 in Frankfurt. And hopefully we will have a properly controversial discussion.

Christoph Schlienkamp

Exciting, Volker, and one can see how diverse and with how many challenges, but also opportunities and risks, the profession of an analyst presents itself in everyday life. Yes, of course I can't dismiss you here without the so-called bonus question, right? Because I think we should talk about the future of research again. We've done it here and there before. And the question, which is certainly close to the hearts of many, reads: Is it still worth starting out as a Junior Analyst today? What do you think the analyst's picture looks like in, let's say, five years? What will change, what will remain the same? Will the job description of an analyst still exist at all? OK, that was several questions at once, but I think it all goes together.

Volker Sack

So, I assume that there will continue to be analysts and that we will also be more supported in our work by automated processes and also A.I. A.I. will not make us unemployed. I have already hinted at this before and maybe we can try to make it more precise with a picture: If I were to consider A.I. now as the navigation system of a car that takes us from A to B, then we still have disturbances on the road such as accidents such as black ice, however and so on and so forth and we have to use the navigation system from time to time, but still use our sense of direction to be able to use detours or the like at one point, because the navigation system will not always work. And autonomous driving won't be around anytime soon. And that's probably how it should be with analysts. There will be no autonomous work, no autonomous financial analysis, but apparently supportive systems. Perhaps we stay in this image. But – and due to demographic change and the like – I guess, after my observation, we colleagues, who are still active now, are predominantly of a more mature age, yes? And there is likely to be a real generational change in the coming years, and this task is – I believe – also ours. We, as the baby boomers, who are now slowly entering our best time, will have to transfer the experiences to a new generation, either directly as well as via the DVFA. And in this respect: Yes, we are happy to pass on our knowledge to a new generation, which will hopefully then also be willing to fill this field of activity with the appropriate motivation as we did and still continue to do.

Christoph Schlienkamp

I say thank you very, very much for your answers. As always, that was fun with you.

Volker Sack

I do thank you.

Christoph Schlienkamp

So much on the topic of financial research for today. But also again today, I would like to ask you for your feedback. Do you have any suggestions or criticism on how we can improve? We are very happy about it. Of course, we are particularly interested in topic suggestions that come from you, because these are extremely valuable to us. Our email address is podcast@dvfa.org. And that brings us to the listener's feedback on the last episode. In the last episode we had Kai Bommer as our guest. Kai was the managing director, or is the managing director, of the German Investor Relations Association DIRK. And then let's start here with Mandy from Jena. Mandy writes: "The episode was informative, but a bit too superficial for my taste. Some questions could have gone deeper, especially in the area of technological changes in investor relations. Nevertheless, Kai Bommer's insights were interesting. Especially his thoughts on the influence of social media. For future episodes, it would be great if you could bring in more concrete examples." Thank you, Mandy, for this. And this is where Fabian from Berlin actually joins in directly. He is also concerned with the topic of technology and a little deeper illumination of the topic. In a nutshell – Fabian writes: 'Very informative and well structured. The trends and visions for the future of IR work were particularly valuable. The personal questions are a nice change and create a relaxed atmosphere. The only thing I would have liked to see is an in-depth discussion about the role of technology in investor relations. But all in all, a great episode.' Thank you, Fabian, for your feedback and I promise you that we will certainly take up the topic of technology again in one of the next episodes and take it up more intensively. And then let me take two more feedback here at the end. The first comes from Michael from Hanover. Michael writes: 'An excellent episode. The insight into the world of investor relations was extremely captivating. Kai Bommer succeeded in conveying complex topics in an understandable way, while the personal questions showed his sympathetic side. The discussion of the importance of networks in investor relations was particularly enlightening and I am very much looking forward to the next episode.' And then finally, Susanne from Stuttgart. She writes: 'The episode was excellent, practical, the ten questions on investor relations precisely addressed the current challenges we are confronted with in practice. I found Kai Bommer's insights on the growing relevance of retail investors and social media particularly captivating. I would be very happy about more interviews of this kind.' So, at this point, many thanks again to everyone who gave us feedback. Your feedback is very valuable to us, and we will try to bring in more concrete examples in the coming episodes and to shed light on individual aspects in more detail. So that you don't miss an episode, here's a tip: If you like this podcast, feel free to subscribe to it on Spotify, Apple, Amazon or your preferred podcast player of your choice and a 5-star rating would make us very happy and help others to find our podcast. To you, dear Volker, thank you once again for your time and your explanations. And I am happy to hand over to you once again for the final word.

Volker Sack

Yes, Christoph, thank you very much for the opportunity to discuss this with you here. I would just like to refer, perhaps, to the Corporate Reporting Day, which we are planning for next year, on January 16 in Frankfurt, where we will in particular scrutinise the topics of social media, A.I. and ESG properly. That would be it from my side. Thank you very much.

Christoph Schlienkamp

Thank you, Volker. And I would like to thank all the listeners for joining us today and I would be very happy if everyone were here again next month. With this in mind: Thank you and ciao, until next time.

Moderator

This was “13+1”, the DVFA podcast. Until next time. Goodbye.