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Walking out the Door – *The long term value of experience*

Headlines proclaim the loss of jobs in the financial services industry, particularly on Wall Street and in London. It has been six or seven years since the last major purge. As I read the stories and hear the news, I ask myself, if there is anyone working in financial services who remembers any of the following events: the S&L implosion, the New York City Financial Crisis, Prime Minister Healy's request for a loan from the IMF to prop up the Pound, the Mexican Peso Devaluation of 1976, Fed Chairman Paul Volker's attack on inflation and, lastly, the market events of October 1987.

Markets have a serious advantage over people. Their knowledge is cumulative and deep, and at each opening bell, they know how all the cards are dealt. It seems that markets never forget and are incredibly intolerant of mistakes. George Soros once said, "I am far too rich to suffer the indignities inflicted by markets." Markets are happy to teach their lessons over and over again, or at least until your money runs out. Yet markets are a product of people; they exist only when there are people to trade. The more people involved, the more trading, the better the market. But what about the people who make up the markets?

People actively engaged in capital markets are forced to constantly learn. Remember, the market is a ruthless teacher. It is what traders do not know that costs them money. The breadth and scope of this knowledge seems limitless. It is more than the knowledge of finance, a company or industry, a particular asset. It includes understanding how the market behaves and what calms it down or makes it jumpy. It also requires past experience, knowing how the market behaved under similar circumstances in the past. Some of this is captured in aphorisms senior traders know: the trend is your friend; never catch a falling knife; there is no crime in being wrong, the crime is staying wrong; the shorts always know more than the longs. But some of the knowledge, the deeper knowledge, cannot be distilled into pithy sayings. Sometimes market participants will express this in terms of how the market "feels" or how they see it "behaving."

I was once talking to a seasoned portfolio manager who said to me that we were heading into a recession. I asked him how he knew that and he said "all I have to do is watch my screen; I can see it in how the market behaves." He had been managing money for more 40 years. He was more than just smart; he was wise. Experience had made him so.

My personal background is not in capital markets. Economics, accounting and finance are my intellectual foundation. However, for a brief moment, I spent some time working at a small hedge fund. After laboring diligently on a particular company, applying all my knowledge and skill to assessing the investment, I sat with the senior partner as we began to build the position. I will never forget the painful baptism I received. As the ticker went from green to red, the market coolly informed me of exactly how wrong I was, in instantly calculated dollars and cents.

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Though my wounds have healed, the lesson of that day will never be forgotten. It was a lesson I could only have learned by being in the market. I learned many more, some painful, some joyous, all priceless.

Many have commented on how Wall Street manages its human capital; few comment positively. When times are good, people are hired with abandon; when times are bad, the baby is tossed out with the bathwater. Room is made for the younger by removing the older. It may be that ambition and energy are more valuable attributes of human capital than experience and wisdom. It may also be that some of the recurring cycles the industry experiences are due, in part, to the continued departure of those who have long suffered the indignities of the markets.

Given the time it takes to “learn” the markets, it seems a terrible waste to let this valuable knowledge walk out the door. These individuals with 20 or 30 years of experience are still young and many, if not most, have one or two entire careers ahead of them. Why expose the institution to the market risk of inexperience when a guiding seasoned hand is available? That is not to say that they should stay in their prior positions. It is to say that there are a wide range of other functions that would benefit greatly from their knowledge; risk management immediately comes to mind.

Regulators should also be mindful of the value of this talent. Maybe the shrewd young trader can fool a regulator, but the former head of a desk? Who better to understand what the trading strategy of a hedge fund might be, than someone who traded the other side in a prior life?

So the over-riding theme here is that there may be a relationship between how firms regard experience-based wisdom and some of the cycles of the industry. As they say: the crime is not being wrong; the crime is staying wrong.

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