

"Listening and reading are two of the most important activities in our industry. After all, we have two eyes and two ears, but only one mouth"

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Talk is Cheap

by Tom Delic, CFA

The ability to explain a concept or subject to someone else is a challenge. It requires you to both understand the topic you have been asked to discuss, but also communicate it in a way that is understandable to the listener or reader. Listening and reading are two of the most important activities in our industry. After all, we have two eyes and two ears, but only one mouth.

We also have one brain, and whether we care to admit it, by definition, our intelligence is likely to sit somewhere slightly above or below the average level for the human population. When reading a text or listening to someone speak, we often require that person to deliver the information in a way that is understandable to someone of average intelligence.

In the 1950s, American businessman Robert Gunning developed the Gunning fog index, which sought to quantify the readability of a body of text. The index measures the length of sentences and the complexity of words used, coming up with a score that can be compared to school grade reading levels. A fog index score of 12 is comparable to the reading level of an 18-year-old student¹ and is seen as a standard for texts intended for a wide audience.

The world of investor communications contains many forms, including annual reports, earnings call transcripts and periodic fund manager letters. If an index like Gunning fog classifies the readability of such materials as very high, this could be a clue that requires further investigation. Complexity of language may be used because the writer or speaker doesn't understand the topic as well as they think they do. Perhaps more disconcerting however, is the language is being used to conceal something from the reader or listener.

A recent research report from the quantitative team at Nomura found that the complexity of language used in earnings calls corresponded with investor returns. Those management teams that used complex language, as measured by the Gunning fog index, averaged a return

of 9.5% per year, while companies that used simpler language averaged 15.4%².

While detecting deception in the investing world has mostly been concentrated in an assessment of the quantitative data provided by companies, a growing body of research is attempting to build on the insights gleaned from basic readability algorithms such as Gunning fog. Lina Zhou of the China University of Geosciences formalised some of this work into nine categories of deceptive linguistic cues³, which have been successfully used to identify fraudulent financial statements⁴. Examples of these cues include distancing strategies such as the use of third over first-person pronouns (e.g., "they" instead of "we"), and obfuscation methods such as incohesive sentence formation. Together, the cues form a linguistic fingerprint that can help to identify the true intention of the words used in a communication.

An example in practice is the comparison between the annual CEO letters from two, albeit cherry-picked, companies. The thousand-word 2017 CEO letter from fraudulent German fintech business, Wirecard, scores over 19⁵ on the Gunning fog index, a readability level classed as very difficult or confusing for the audience. Similar sized samples from Warren Buffett's much longer Berkshire Hathaway letter of 2020, scores around 13⁶, slightly above the guidance for mainstream consumption.

Inevitably there will be exceptions to the above, where a complex communication is not concealing anything, and vice versa. Perhaps though, Nomura's research also highlights that speaking and writing to stakeholders with both simplicity and clarity, builds a foundation of trust between the parties that ultimately delivers better results. While our communication to clients doesn't directly influence the underlying assets we hold in portfolios for investors, clear and understandable interactions will build a level of trust that gives investors the confidence to remain invested during the more challenging moments that are faced over time.

¹Wikipedia. ²<https://www.bloomberg.com/opinion/articles/2021-09-17/complex-language-on-earnings-calls-is-a-warning-to-investors>

³Zhou L, Burgoon J, Nunamaker J, Twitchell D. Automating linguistics-based cues for detecting deception in text-based asynchronous computer-mediated communication. ⁴Humpherys S, Moffit K, Burns M, Burgoon J, Felix W. Identification of fraudulent financial statements using linguistic credibility analysis.. ⁵& ⁶www.gunning-fog-index.com

Market Focus

- » **Global equities rallied 2.2% last week.**
- » **Supply chain issues, rising energy costs, and labour shortages have affected corporate Q3 releases.**
- » **Brent crude gained +3.0% last week to \$84.9 a barrel.**
- » **Gold gained +0.6% to \$1767.6 per ounce.**

US



- » US equities rallied 1.8% last week, aided by robust investment bank earnings. However, metal, miners and materials sectors outperformed whilst communication and regional banking sectors declined.
- » CPI rose +0.4% on a month-on-month basis in September, +5.4% year-on-year, its highest in 13 years
- » Fed officials broadly agreed tapering should start in mid-November or December, indicated in the minutes from their September meeting, then pandemic stimulus could end by mid-2022.
- » Weekly jobless claims came in at 293k, better than the 319k forecast and down from 329k last week.
- » Bitcoin rose past \$60,000 after the SEC was said to be close to allowing Bitcoin futures ETFs.

Europe



- » European equities rallied 2.6% last week, with basic resources and technology outperforming, while insurance and media sectors declined.
- » ECB will pay “very close attention” to wage talks and other potential second-round effects that could drive prices higher more permanently.
- » German ZEW Economic Sentiment index for October came in at 22.3, lower than the 24.0 forecasts, down from 26.5 previously.
- » The Turkish lira slid to another record low after Recep Tayyip Erdogan fired three central bankers in a midnight decree on Wednesday as they opposed Erdogan’s push for lower rates.

Rest of the World/Asia



UK



- » UK equities rallied 2.0% last week.
- » The Covid-19 new case count is back above mid-July highs.
- » GDP month-on-month came in lower than expected at 0.4% (vs 0.5% forecasted). Manufacturing production for August came in at 0.5% month-on-month, stronger than the 0.1% expected.
- » The FT reported that EU member states are urging Brussels to draw up strict retaliatory measures should the UK carry out its threat to suspend trading arrangements for Northern Ireland.
- » The benchmark Global Emerging Markets index rallied 1.9% last week.
- » Japan’s equities rallied 3.2% last week.
- » China’s economy weakened in Q3 as the property slump and energy crisis took their toll. GDP expanded 4.9% from a year earlier, slowing from 7.9% in the previous quarter and just below the 5.0% consensus.
- » Xi Jinping may not be attending the COP26 in Glasgow, increasing fear that China won’t set new climate change goals. The conference runs from the 31st October until the 12th November.

Market Summary

Cumulative returns					
Asset Class / Region	Currency	Week ending 15 October	Month to date	YTD 2021	12 months
Developed Markets Equities					
United States	USD	1.8%	3.8%	20.0%	29.7%
United Kingdom	GBP	2.0%	2.2%	16.2%	29.6%
Continental Europe	EUR	2.6%	3.1%	19.1%	30.4%
Japan	JPY	3.2%	-0.3%	14.3%	26.6%
Asia Pacific (ex Japan)	USD	1.9%	2.1%	0.0%	14.5%
Australia	AUD	0.6%	0.4%	15.3%	22.8%
Global	USD	2.2%	3.5%	17.0%	29.5%
Emerging Markets Equities					
Emerging Europe	USD	1.7%	6.1%	30.9%	65.4%
Emerging Asia	USD	2.1%	2.1%	-2.2%	11.8%
Emerging Latin America	USD	3.3%	3.1%	-2.7%	25.6%
BRICs	USD	2.1%	3.8%	-3.0%	7.6%
China	USD	2.1%	4.0%	-13.4%	-7.7%
MENA countries	USD	1.3%	1.8%	29.9%	33.9%
South Africa	USD	3.2%	5.2%	9.5%	30.9%
India	USD	2.7%	3.0%	29.0%	55.5%
Global emerging markets	USD	2.1%	2.5%	1.2%	16.9%
Bonds					
US Treasuries	USD	0.3%	-0.1%	-2.9%	-3.5%
US Treasuries (inflation protected)	USD	0.7%	1.1%	4.5%	6.1%
US Corporate (investment grade)	USD	0.7%	-0.1%	-1.3%	1.1%
US High Yield	USD	0.1%	-0.2%	4.4%	9.7%
UK Gilts	GBP	1.4%	0.0%	-7.6%	-7.7%
UK Corporate (investment grade)	GBP	0.8%	-0.4%	-4.2%	-1.1%
Euro Government Bonds	EUR	0.3%	0.1%	-2.9%	-2.7%
Euro Corporate (investment grade)	EUR	0.0%	-0.2%	-0.6%	0.6%
Euro High Yield	EUR	0.0%	-0.5%	3.2%	7.6%
Japanese Government	JPY	0.0%	-0.1%	-0.2%	-0.1%
Australian Government	AUD	-0.2%	-1.1%	-2.9%	-3.9%
Global Government Bonds	USD	0.2%	-0.2%	-5.9%	-3.9%
Global Bonds	USD	0.3%	-0.2%	-4.6%	-2.1%
Global Convertible Bonds	USD	1.2%	1.3%	0.1%	10.0%
Emerging Market Bonds	USD	0.7%	0.1%	-4.1%	0.2%

Source: Bloomberg Finance L.P. Past performance is not indicative of future returns.

Market Summary

Cumulative returns					
Asset Class / Region	Currency	Week ending 15 October	Month to date	YTD 2021	12 months
Property					
US Property Securities	USD	4.0%	5.4%	28.8%	38.1%
Australian Property Securities	AUD	1.6%	0.3%	12.0%	17.7%
Asia Property Securities	USD	1.7%	0.6%	2.4%	10.1%
Global Property Securities	USD	3.2%	3.7%	17.2%	28.8%
Currencies					
Euro	USD	0.3%	0.2%	-5.2%	-0.9%
UK Pound Sterling	USD	1.0%	2.2%	0.8%	6.5%
Japanese Yen	USD	-1.8%	-2.5%	-9.6%	-7.8%
Australian Dollar	USD	1.5%	2.8%	-3.6%	4.7%
South African Rand	USD	2.1%	3.3%	0.2%	13.9%
Swiss Franc	USD	0.4%	1.1%	-4.2%	-1.0%
Chinese Yuan	USD	0.1%	0.1%	1.4%	4.5%
Commodities & Alternatives					
Commodities	USD	2.4%	5.7%	44.1%	61.1%
Agricultural Commodities	USD	-0.5%	1.4%	26.2%	43.3%
Oil	USD	3.0%	8.1%	63.8%	96.6%
Gold	USD	0.6%	0.5%	-6.7%	-7.1%
Hedge funds	USD	0.2%	0.3%	4.1%	8.1%

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