

# InvestmentNews™

Vol. 5, No. 45, November 12, 2001

The Weekly Newspaper for Financial Advisers

## Crystal ball worth a fortune to customers

### *Inferential Focus gets high fees for insights*

By Brooke Southall

At a time when many Wall Street analysts are struggling to prove their credibility in the wake of the tech stock crash, Charlie Hess exudes it.

His four-person firm, Inferential Focus in New York, uses a fact-only method distilled from reading dozens of top publications to ferret out economic changes early. The idea is to get the essentials for decision-making.

"It's like a mosaic," says Mr. Hess, the company's president and co-founder. "You get a picture even if a lot of the pieces are still missing".

### SPOTTING TRENDS

After 20 years in business, Inferential has a long list of clients and a string of new converts who swear by its methods and research.

Fidelity Investments is the company's largest client, and other firms such as Goldman Sachs & Co. adorn its gilt-edged customer list.

In contrast, the defunct Long Term Capital Management, which collapsed in the late '90s and touched off a worldwide financial crisis, chose not to buy Inferential's research, perhaps at its peril.

Mr. Hess issued early warnings about the Asian financial crisis, which precipitated the titanic failure of the Greenwich, Conn.-based company.

Ironically, he picked up the New York Federal Reserve as a client in the wake of the debacle. The bank was part of a consortium that bailed out Long Term Capital.

"From time to time, we say, 'Are we really getting something out of this?'" says Kevin J. Bannon, chief investment officer overseeing \$60 billion at the Bank of New York and a 20-year customer. "We always get back to that it really helps us spot the trends before they become traceable through data."

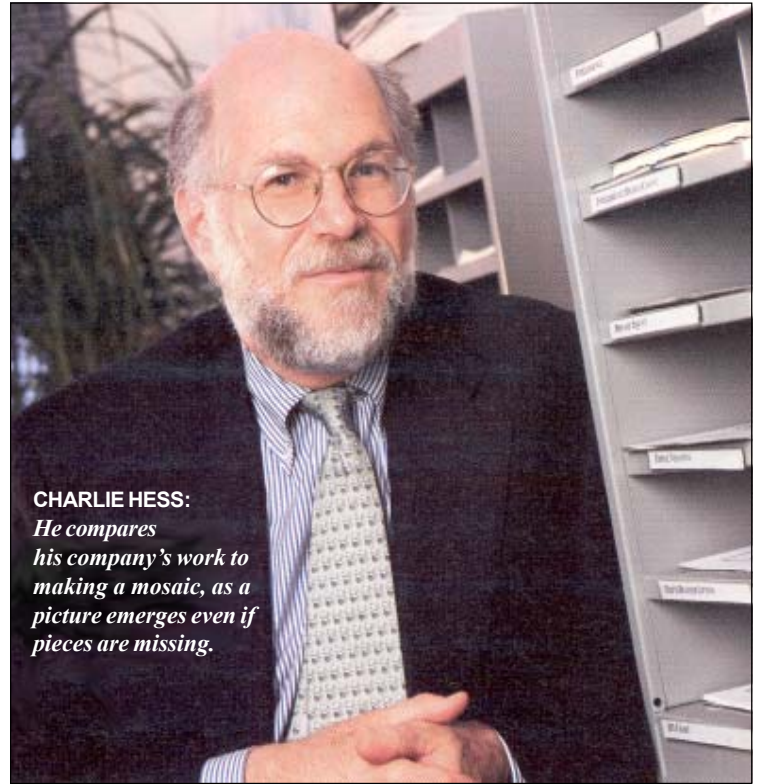
Mr. Bannon says that a big part of his firm's analysis comes down to whether a company is more likely to get an upside or downside surprise. Mr. Hess' analysis aids greatly in those assessments, he adds.

Perhaps the entities that most closely match Inferential's research style are Washington-based think tanks. The difference is that those firms have agendas.

Commercially, he competes with Yankelovich Inc., based in Chapel Hill, N.C., and Roper Starch World-Wide Inc. in N.Y. But, Mr. Hess says the surveys those companies conduct and the research that Wall Street produces are a completely different species from his product.

His company abides by rules as strict as information gathered for evidence for court of law, he says. That means he focuses almost exclusively on events.

His four researchers have an eclectic mix of backgrounds in American studies, engineering, political science and retailing,



**CHARLIE HESS:**  
*He compares his company's work to making a mosaic, as a picture emerges even if pieces are missing.*

and they gather all their information from 150 periodicals ranging from Oil and Gas Journal to Sports Illustrated.

For instance, Mr. Hess says that he spotted an article in the International Herald Tribune in 1998 indicating that Prince Abdullah of Saudi Arabia had met with President Clinton in South Africa.

That was peculiar, he thought.

Through a series of complex inferences, he told his readers that oil prices appeared to be headed higher. Subsequently they rose to \$30 a barrel, from \$11.

For the most part, he says, independent financial advisors are not using those sources of intelligence, because they deem it too expensive.

Inferential charges its smallest customers \$40,000, while its biggest clients may spend several hundred thousand dollars on the research.

Still, Richard L. Arvedlund, managing principal with Cypress Capital Management Ltd. in Wilmington, Del., which has \$250 million in assets, says he has found that the big bucks he has spent for the Inferential Focus subscription over the past 20 years have paid off.

"We focus on numbers," says Mr. Arvedlund. "We focus on economics. We're bean counters. They come in from the other side through a conceptual framework."

Mr. Arvedlund says he is still impressed by Inferential's ability

# A crystal ball worth a fortune

## Continued

in 1980 to predict the end of the energy crisis at a time when such an outcome was considered unthinkable.

Mr. Hess says he was tipped off by an article in The Hartford Courant noting that oil tankers were leaving the East Coast without unloading their cargo.

Another example of how Mr. Hess gleaned a shift was how he predicted the fiber-optics glut.

The firm noted that the slow roll-out of the digital subscriber line did not jibe with the bandwidth leaps being made in the core networks.

A key piece of that puzzle was an article in Multichannel News that said that Broadcom Corp., a maker of chips used in fiber optics, was investing in content to try to drive up the demand for bandwidth capacity.

In its Sept. 5, 2000, briefing, Inferential Focus warned about the heightened threat of terrorism because seemingly disparate terrorist organizations were communicating.

## LOOKING AHEAD

Michael Baldwin, managing partner of Baldwin Brothers Inc. in Marion, Mass., which manages \$1 billion, says the accuracy of that report and others are continuously uncanny.

"He's prescient", he says. "He's almost, like a psychic. I don't quite know how they all pull it off."

Because of its success in auguring doom, Mr. Hess says, his firm's revenues are growing as customers use Inferential Focus' data more intensively.

"Our process has become more of the decisive process instead of a respected one out of 40," he says.

For all customers, Inferential Focus provides a quarterly in-person session, but at an additional cost, firms can get much-more-intensive consulting.

Still, advisors and Inferential Focus executives say that the whole-grain nature of the advice is an acquired taste.

He says that most people still want advice distilled to a "buy," "sell" or "hold" signal.

"Our likely candidates are individuals who are humble and confident," he explains. "It really takes a leap of faith."

"I have trouble selling it in my own shop," says Mr. Arvedlund. "It's not obvious, and people in the business want the clear-cut one in bold print. You have to have an open mind to things that seem off the beaten path."

So what does Mr. Hess see now? Women are reassessing priorities in a major way.

Kids are calling home from college more frequently. Kids are moving home more frequently.

"On our own' is being redefined", Mr. Hess says.

He believes that that means financial advisors have a big job ahead of them in changing around client asset mixes to reflect those changing needs.