Investment memos and decision-making

Translating better memos into stronger returns

By Barbara McEvilley, Ashby Monk and Dane Rook

1. Welcome

Investment memos are the foundation of most investment processes: they condense large amounts of diligence, expertise and analysis into a document that leads to an investment decision. Despite their ubiquity and importance, there's practically no published research in either academia or industry on best practices in crafting or using investment memos.[1]

Many institutions consider their investment memos to be highly confidential documents that draw upon their firm's 'secret sauce' (investment strategy). As such, many investment professionals — including Addepar clients — are in the dark regarding how their peers write and use them. There's widespread curiosity surrounding what investors *should* be doing with investment memos, relative to what they're actually doing.

This Addepar research brief (ARB) addresses that uncertainty by shedding light on the typical content, quality and functions of both pre- and post-investment memos. Our findings illustrate new methods and processes in the crafting and use of memos. We conclude that memos aren't merely paperwork; they can enhance investors' performance by meaningfully improving investment processes.

2. NTK

Here are the key takeaways you need to know (NTK) from this brief.

[1] Google Scholar has zero peer-reviewed journal articles on investment memos as of March 2023.

- **Pervasive:** 97% of the professional investors we surveyed have a formal investment memo template and process, and 78% of their firms require a memo approval before making any investment.
- **Key sections:** We observed a standard set of memo sections (see 4. Context, below). The most important among these are: deal description, risk factors, team bios and deal terms.
- **Memo process:** We identified a standard process for memo construction and usage, and this includes screening, writing, critiquing, rating, approving, storing, learning and improving.
- **Friction-filled:** Many investors perceive the process of writing memos to be arduous and friction-filled, which can have ramifications for the quality of memos and how they're used once an investment has been made.

In light of these findings, please see the ARB-itrage section for our synthesis of what goals seem prudent for all investors to consider.

3. Significance

Nearly all professional investment organizations write investment memos. These memos can be informal documents for internal investment officers or formal documents that emerge from well-defined processes, which are ultimately reviewed by investment committees and boards of directors. The memos serve as valuable windows into the inner workings of an organization's decision-making by including the following:

- **Investment logic:** Most professional investment firms require documentation of the process and inputs that lead to an investment decision.
- **Investment assumptions**: Memos offer insights into the thinking and assumptions that an investor relied on to make a specific investment.
- **Investment processes**: Memos shed light on decision-making and execution, from risk management and portfolio construction to even deal sourcing. Hence, memos can serve as diagnostic tools for bettering organizational processes.

4. Context

Although the process-flow varies across organizations, the goal of writing memos is essentially to aid concrete investment decisions associated with specific, actionable opportunities. Such opportunities are generally deal-based and often concern a new investment in an external fund or a direct investment in a company or asset.

Memos are typically written by a firm's internal investment experts, but — depending on the nature of a firm's resources — may also be written by external investment consultants. At private firms, the audience of investment memos typically consists of chief investment officers and members of the investment committee. At public firms (e.g., state pensions), the target audience is generally board members.

From our close study of investors, we've found that many memos have the same prototypical structure, including sections on the:

- Proposed investment
- People involved (both internally and externally)
- Prospective deal terms
- Associated risks
- Performance benchmarks
- An opportunity's fit within the investor's broader strategy or portfolio

Some memos deviate from this basic structure, and those deviations are usually due to either: 1) a particular investment being novel enough to warrant a unique memo format; or 2) an investor having an idiosyncratic approval process for new investments. Regardless of their precise structure, most memos address three topics, which we break down as follows: opportunity, fit and process.

The opportunity: This topic provides key information such as the following:

- ***Deal specifics:*** Memos will often start with the following: asset classification (e.g., first-time buyout fund, commercial real estate, cryptocurrency fund); size of the opportunity; mode of participation (e.g., via an external fund or direct investment in an individual company or private/public asset); and footprint (e.g., definitions of what the opportunity consists of or excludes).

- ***Historical context:*** Background on the opportunity and biographical information about its key people (e.g., executives, founders, board members).
- ***Valuation:*** An assessment of the opportunity's current value. These valuations are (ideally) a combination of internal analyses and independent appraisals.
- ***Geography:*** Information and statistics about the geographies in which the fund, company or project operates, with special attention devoted to local regulations and risks (e.g., threats of military conflicts or human rights concerns).
- ***Track record:*** Past performance of the company or project on a range of relevant criteria, such as risk-adjusted returns, returns according to fund vintages or investment strategy or peer benchmarks.
- ***Terms:*** Analysis of the likely fees and costs (both one-time and recurring) for the proposed investment.

Portfolio fit: Next, portfolio fit considers the candidate investment in the context of the fund's goals and current needs. The following subsections will often be included:

- ***Investment logic:*** This is the overarching rationale for why an opportunity may be attractive. The logic tends to emphasize the investment rationale (e.g., rapidly growing industry, market inefficiency or underserved consumer needs).
- ***Relevant risks:*** Relevant risks may include reputation, technology disruption, political or geopolitical risks.
- ***Projections:*** Detailed expectations for future performance, typically presented as a spectrum of scenarios (e.g., upside, base and downside cases) or sensitivity analysis.
- ***Assumptions:*** These are explanations of the forecasted quantities that 'drive' performance projections. These explanations generally include some justification of reliability, given that forecasts may come from various sources.
- ***Benchmark:*** Examples of benchmarks might include performance of the S&P 500 or the performance threshold for top-quartile funds of an applicable type. This section might provide analysis and valid low-cost index alternatives.

- ***Structure alignment:*** An assessment of positive and negative incentives in a given opportunity, as well as any adverse incentives. For example, the risk that a hedge fund manager may manipulate valuations of portfolio companies.
- ***ESG:*** Statement of any portfolio-level requirements around sustainability (such as carbon net zero by a particular year), as well as ESG performance attributes of the opportunity and any associated liabilities.

Due diligence list: Investment memos can also document the work an investor must complete prior to making an investment. The following elements are often considered:

- ***Sourcing pathway:*** Information on the provenance of the opportunity — i.e., how an opportunity reached a given stage of consideration, via a traceable succession of brokers, bankers, professional networks or consultants.
- ***Internal 'deal team':*** A list of the investor's own employees who have either sourced or worked on the opportunity, such as in-house lawyers.
- ***External consultants:*** A statement from any technical experts, which includes their opinions on various aspects of the opportunity.
- ***Checks:*** Background checks on key individuals within a company or project, identifying the firm that conducted the check.
- ***Follow-ups:*** A memo should define the terms under which a decision would be reviewed or reversed as part of a risk exposure summary.
- ***Author conflicts:*** The authors may detail potential conflicts or share additional information related to their function in the process.

5. Approach

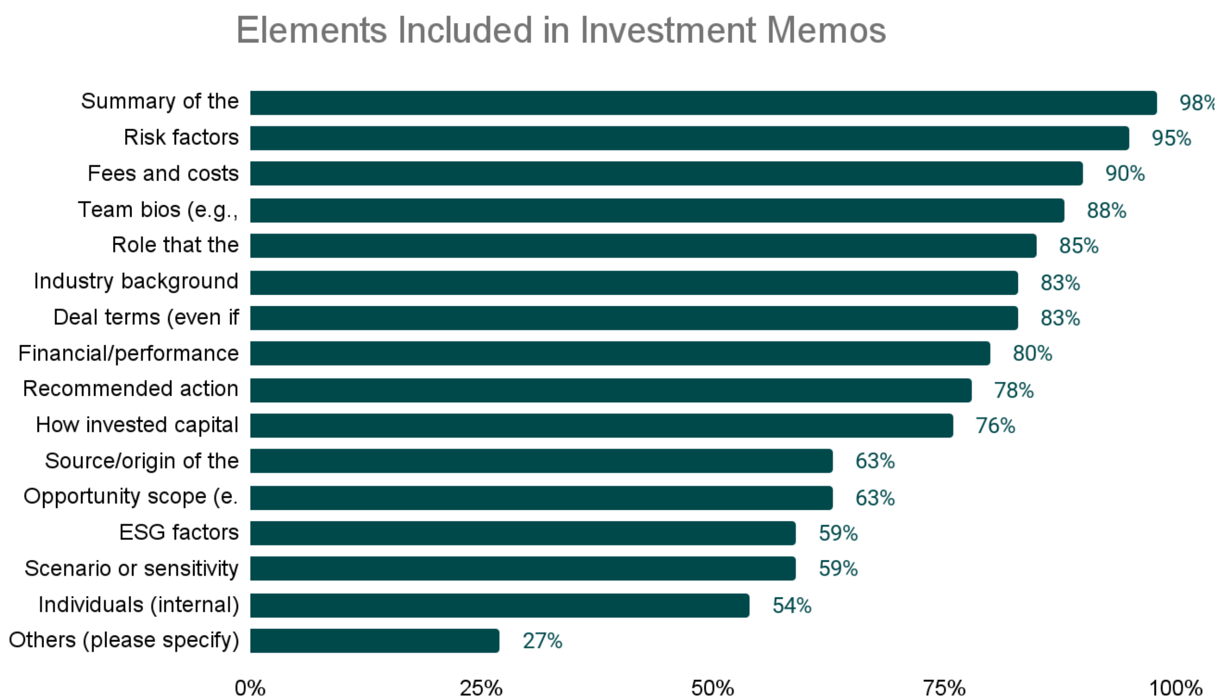
A key aim of our research is to reveal how professional investors use investment memos in their decision-making. To gain these insights, we fielded a survey in partnership with the Stanford Initiative in Long-Term Investing in June 2022 about investment memos, the audience of which included Addepar clients as well as contacts within our broader investment community. The 54 responding organizations spanned a broad range of types and geographies (details on these characteristics appear in the appendix).

To augment our survey findings, we completed six case studies in October 2022 on four pension funds, an endowment and a multi-family office. These case studies entailed in-depth, 60-minute interviews with professionals responsible for investment memo processes at their respective firms.[2]

6. Findings

Our survey revealed that the vast majority (97%) of professional investors employ investment memos as a means of making investment decisions. Of those organizations, 78% make memo completion and review a requirement before an investment can be made. The majority of firms (86%) also stated that they use standard templates for memos.[3]

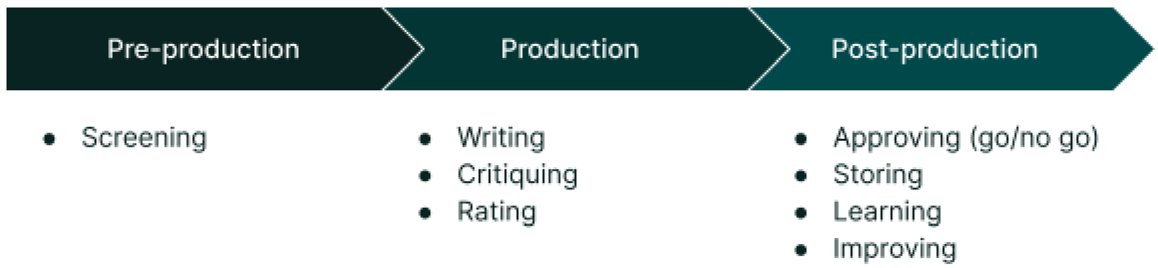
The survey also discovered that many investors use the same basic sections in their memos. Topping the list were: summary of the opportunity (98%), risk factors (95%), fees and costs (90%), team bios (88%) and the role that the deal plays within the overall investment portfolio (85%). The figure below depicts the popularity of these sections.



[2] In accordance with case study and ethnographic methodologies, we anonymize these findings.
[3] This template is practically never the same for any two investors who might use one.

We also uncovered similarities in the processes investors use for writing, approving and subsequent (i.e., post-investment) use of memos. These similarities are synthesized below.

Investment Memo Process



Screening: It's standard to have a gated approval process for investment memos. This first gate represents an initial draft and is intended to avoid wasted time and effort by the deal team. It distills the investment thesis, context for the opportunity, and an assessment of portfolio fit and the key pros (returns) and cons (risks).

Writing: After initial screening, a team of experts — internal or external — completes the memo's key sections, using a memo template usually built as a PowerPoint or Word document. The time frame from initial concept to completed final memo can be as quick as two weeks (assuming it's a continuation deal with an existing firm/strategy for which all new data is easily accessible) or as long as a year. On average, we heard that it takes a team two months to complete the entire investment memo writing and review process.

Critiquing: Some organizations bring in 'red teams,' which are internal investment teams assembled to critique an opportunity. The objective is to stress-test the opportunity to develop a deeper understanding of unexplored risks or to uncover new problems. If the deal is within infrastructure, for example, then the team may enlist the help of a non-team member who works in the same sector but in a different geography.

Rating: Some of the firms we interviewed also use scoring mechanisms to assess opportunities relative to similar ones within a strategy type (e.g., a real estate fund raising capital would be compared to peer real estate funds). In other cases, opportunities are assessed on a total portfolio basis. In these instances, the authors may consult a broader set of stakeholders and include capital market assumptions for a range of asset classes.

Whatever the case, most raters are asked to assign numerical scores to three components:

- The opportunity (e.g., the investment itself in terms of the team, time and risks)
- The terms (e.g., the fees, level of transparency and level of control)
- The fit (i.e., does it solve problems for portfolio diversification, and so on)

In order for a candidate investment opportunity to advance, a minimum score equivalent to 6/10 or 7/10 is usually needed. (Unsurprisingly, this varies by investment firm.)

Approving: After all diligence has been completed, the final investment memos typically are sent for approval with critiques and ratings appended. They are approved or rejected by a person or committee with the appropriate and relevant delegated authorities.

Storing: Once approved, investors tend to keep memos in places where they can be easily referenced. Some use less tech-centric solutions (e.g., digital folders of PowerPoint presentations); others use more sophisticated solutions (e.g., research management systems like Dynamo).

Learning: We asked our interviewees whether they have structured processes for ex-post analysis of memos. The majority do not, which is noteworthy in that it reveals how much value is not being captured in current memo processes. That said, some firms still succeed at learning from their memos. Some anonymized examples of these learnings include:

- ***Two-part evaluation:*** Firm #1 consistently employs a two-part process for evaluating past memos. The first part is the ‘postmortem’ that occurs within one month of each deal. The second part occurs within 12–18 months and is a more in-depth audit of each deal to reassess its risks and evaluate whether its performance proved adequate, relative to the initial investment thesis.

- ***Annual team offsite postmortem:*** Firm #2 does a postmortem of its investment memos and process at an annual team offsite.

- ***Revisiting memos on per-manager basis:*** Firm #3 evaluates memos when considering additional opportunities by the same manager. The firm focuses on initial strategy and concerns, performance versus expectations and notes any shifts to consider (i.e., changes in key personnel or a firm’s strategy).

Improving: Beyond this process, we also asked our respondents how they might enhance the process for investment memos. This is what we learned:

- ***Improve tracking:*** Increase the speed of creating investment memos or of updating key data. The latter is especially relevant for evergreen investments that require regular maintenance of metrics such as performance.
- ***Reduce resources:*** Investors frequently cite the 'pain' involved in writing these memos, which we interpret as the time and resources needed to write an 'approvable' memo. Some felt this could be achieved by established word count limits and tables of contents that encourage authors to create memos that are concise, digestible and actionable.
- ***Improve automation:*** The writing of memos could be automated by populating required fields with outputs from other systems — perhaps even with the assistance of generative AI — leaving the memo writer to handle only the higher-order functions of analysis and recommendations.
- ***Track assumptions:*** If applicable, implement assumption tracking after an investment is made. For example, if interest rates are a key assumption, then if they were to change meaningfully, a red flag would be sent to the original deal team.

On a final note, we found the governance and oversight of memos to be idiosyncratic, owing to the respective firms' histories, natures, mandates and shareholders. For example, in one case we found investment memos were written by external consultants for non-expert trustees — a process that could represent a failure of governance should consultants not be properly credentialed or their work couldn't be independently validated. In another case, the memos were written by in-house experts for a management investment committee. Both of these findings represent potentially improvable areas for investors in the memo writing/use process.

7. The ARB-itrage

The professional investors we studied are all strong performers among their peer groups. Although investment memos aren't the sole ingredient to their success, it's safe to assume that solid memos — and the processes for crafting them — are clear enablers of that success. Prior to our work here, there were very few established facts about investment memos ‘in the wild.’ From what we’ve learned so far, the following goals seem prudent for all investors:

- **Consistent quality**: High-quality memos are those that yield investment choices that are well-informed and made with confidence. The key to that quality appears to lie in clear standards for what every memo should contain (as well as clarity on *why* that content is relevant to end decisions).
- **Process integrity**: Investors need a transparent, well-governed workflow for completing memos. Integrity of these processes is required not only to guarantee that there are no skipped steps or undue exceptions in memo content, but also to ensure that the completion of memos is efficient. Any given memo represents the investment of significant time on behalf of an investor — time which can translate into a drag on performance if improperly spent.
- **Persistent usefulness**: Investors aren’t extracting enough value from their memos *after* the point at which an investment decision is taken. Any single memo is a rich repository of information that’s potentially applicable to future decisions. Memo templates (and supporting governance) unlock their future value by making them easily searchable and able to be analyzed.[4]

8. Coda

The vast majority of investment organizations are using investment memos to summarize the key details of investment opportunities in the context of their broader portfolios. Based on our findings, those involved in the investment memo process find it to be arduous yet necessary. In an effort to streamline their respective processes, all have created templatized reports that they continue to refine to better meet the needs of the memo authors and readers.

[4] Given the pace at which analytical technology (in specific, that for natural-language processing) is advancing, designing memos for subsequent use as part of organizational knowledge bases is a worthwhile consideration, now or in the near future.

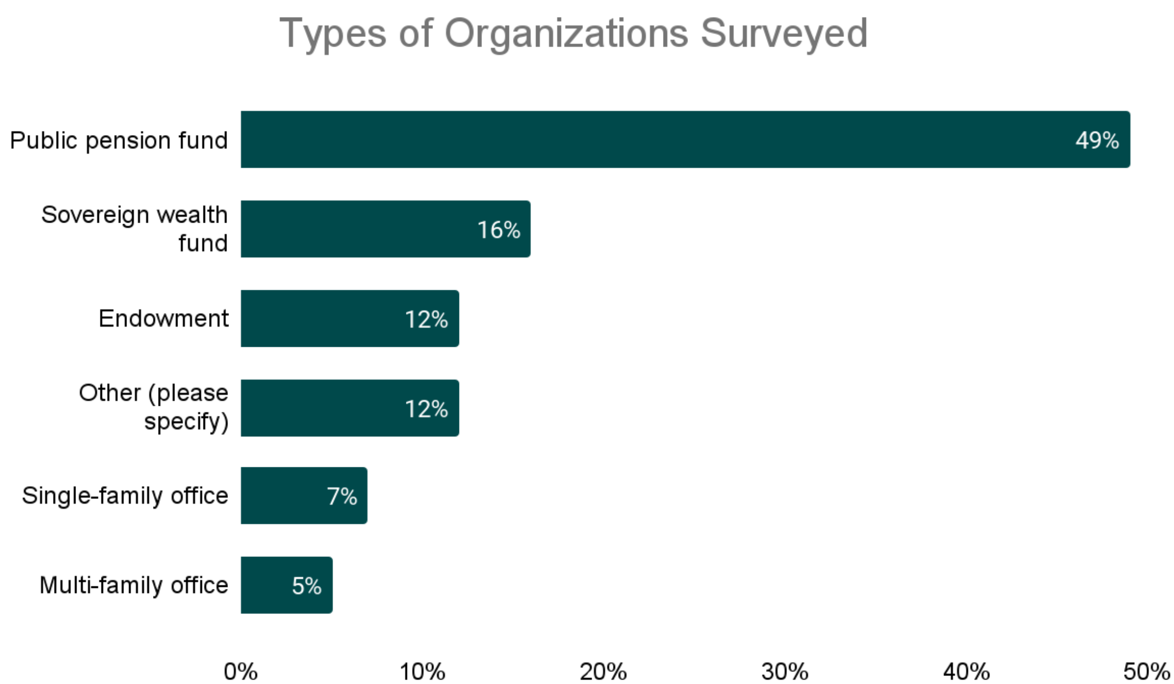
Acknowledgements

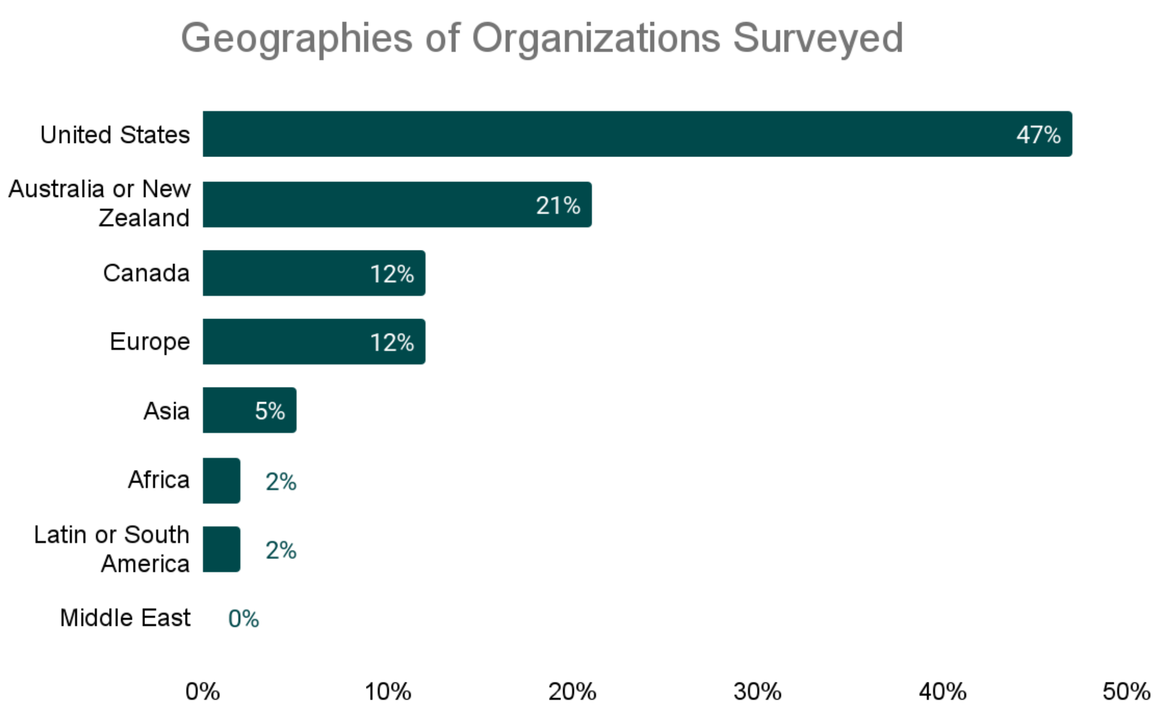
The authors would like to thank two anonymous peer reviewers for their feedback on a prior draft. We'd also like to thank the Stanford SLTI for partnering on this work and the collection of survey data. None of the above should be held accountable for any of our errors or omissions.

Authors

Barbara McEvilly, Research Director (barbara.mcevilley@addepar.com)
Ashby Monk, Head of Addepar Research (ashby.monk@addepar.com)
Dane Rook, Senior Research Director (dane.rook@addepar.com)

Appendix


Types of Organizations Surveyed
Public pension fund
49%
Sovereign wealth fund
16%
Endowment
12%
Other (please specify)
12%
Single-family office
7%
Multi-family office
5%
0%
10%
20%
30%
40%
50%


Geographies of Organizations Surveyed
United States
47%
Australia or New Zealand
21%
Canada
12%
Europe
12%
Asia
5%
Africa
2%
Latin or South America
2%
Middle East
0%
0%
10%
20%
30%
40%
50%

Notice and Disclaimers

All information provided by Addepar, Inc. or its subsidiaries (collectively, “Addepar”), including without limitation, all text, data, graphs and charts (collectively, the “Information”), is the property of Addepar and is provided for informational purposes only. The Information may not be modified, reverse-engineered, reproduced or re-disseminated in whole or in part without prior written permission from Addepar. All rights to the Information are reserved by Addepar.

The Information may not be used to create derivative works or to verify or correct other data or information without prior written permission from Addepar. For example (but without limitation), the Information may not be used to create indexes, databases, risk models, analytics, software or in connection with the issuing, offering, sponsoring, managing or marketing of any securities, portfolios, financial products or other investment vehicles utilizing or based on, linked to, tracking or otherwise derived from the Information or any other Addepar data, information, products or services.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the information.

Addepar makes no express or implied warranties or representations with respect to the information (or the results to be obtained, but rather the use thereof), and to the maximum extent permitted by applicable law, Addepar expressly disclaims all implied warranties (including, without limitation, any implied warranties of originality, accuracy, timeliness, non-infringement, completeness, merchantability and fitness for a particular purpose) with respect to any of the information.

Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.

The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons.

None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), any security, financial product or other investment vehicle or any trading strategy.

Addepar does not recommend, endorse, approve or otherwise express any opinion regarding any issuer, securities, financial products or instruments or trading strategies and Addepar’s research products or services are not intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

Addepar, Investment Sentiment Index and other Addepar brands and product names are the trademarks, service marks or registered marks of Addepar or its subsidiaries in the United States and other jurisdictions.