Reprinted From
American Medical News
American Medical Association • March 11, 1996 • Volume 39 • Number 10

Use clinical knowledge to make stock market pay off

By Howard Larkin
AMNEWS STAFF

Some physicians are finding their clinical knowledge can be as valuable in the marketplace as it is in the hospital or examining room. They're partnering with investment specialists to identify companies with promising new medical products.

For some, the results have been spectacular. From Jan. 1, 1991, through Dec. 31, 1995, physician investors pursuing an aggressive growth strategy with fund manager Steven Abernathy at New York investment house Cowen & Co. have seen their money grow by more than 1,000%. That's among the highest rates of return for any money manager on Wall Street, according to Barron's, about 10 times the growth in the Standard & Poor's 500 during the same period.

Even physicians choosing a conservative growth strategy – one that avoided aggressive tactics such as leveraged stock purchases and selling short – saw gains of 127% from January 1992 to December 1995. The S&P 500 grew 56% during the same period.

These gains are largely the result of obtaining and exploiting superior information about new medical technologies, says Steven Abernathy, a director of Cowen's private-client group. That information comes not only from traditional investment research, but from a select group of physician clients who invest both money and expertise in selecting stocks.

The process, which Abernathy has dubbed "interactive investing," works like this:

Cowen, with its expertise in financial and business analysis, finds well-managed companies with high growth potential. Generally, that potential comes from firms with products in development that have major market potential. Abernathy calls these firms the "creators," the health care and technology companies that are growing fastest as the nation shifts to a knowledge-based economy.

But a popular new technology is not enough. The key to a growth strategy is to select companies that can dramatically increase their value over time. They may be small companies that will enjoy a huge growth spurt when they launch popular new products, or established firms that have good underlying management but have temporarily fallen out of favor with investors. They may be companies that have brought on new managers capable of expanding the business. In any case, they are companies with long-term favorable fundamentals. "We expect this superior growth to occur over a lifetime," says Gary D. Leet, senior vice president at Cowen.

But the challenge of investing is making reliable predictions about what will or won't make it in the marketplace. That requires market information.

Not satisfied with Wall Street's standard ways of garnering such information – consulting with financial and market experts – Abernathy goes a step further. He asks his physician investors their opinion of a company's products. "What's really needed is information from the ultimate users of the technology, the people who will put it into use in the real world. Maybe I can't talk to all doctors, but I can talk to a few leaders in the profession and find out what they are using for, say, gall bladder removal," Abernathy says.

'Interactive investing' means investing in what you know. The challenge is making reliable predictions about what will or won't make it to the marketplace.

Abernathy believes his physician clients are generally more reliable than hired consultants because they are primarily clinicians, and therefore more in touch with their colleagues and less exposed to product developers' hype; and because their own money is at stake. They are not going to risk money on something their clinical knowledge tells them isn't going to work.

That kind of down-to-earth reasoning has helped the group avoid what turned out to be poor investments, Abernathy said. In 1992, for example, advice from clients that two gram-negative sepsis drugs were expensive and not well-proven prevented an investment, even though the drugs were the darling of Wall Street. Ultimately, they did not receive approval from the Food and Drug Administration.

Currently, Abernathy has about 120 physicians in his client group, and manages about $100 million in assets for them. He wants to keep the group small enough so that he can maintain personal contact with members – maybe 200 to 300. He talks with clients once or twice a year, both to maintain contact and to seek analysis and opinions of prospective buys. "Interactive investment is just that – we really need to have access once or twice a year."

Most of the physicians in the group were invited to join. Now, people are starting to call. They were chosen because they are leaders in their fields and fill a specific information need. "We always believed that if we could build a critical mass of intellect, it would serve us well," says Abernathy, who began building the group in 1989. He is presently looking for physicians with expertise in neurology and cardiac surgery.

Abernathy believes that his approach to investing could be used by other groups. "Invest in what you know about, not in what you don't know about." To physicians interested in the approach, he suggests getting together with colleagues and finding an investment manager willing to listen and work with you. Make your base of knowledge available to that person, but also respect their ability to analyze business performance, Abernathy says. Many physicians lose plenty of money on investments not because they don't understand the products, but because they don't know how to evaluate a business. "Don't be a trader. Find someone who has time to do it and pay them for performance."