

## Update - PIMCO

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I just returned from a trip to Newport Beach, California, where I had the chance to spend three days at the PIMCO headquarters and listen to presentations from a dozen or so portfolio managers. As you may be aware, PIMCO has been front-page news recently due to the recent announcement of the departure of its co-CIO, Mohammed El-Erian. This comes on the heels of news that PIMCO had record outflows in 2013 (*Reuters Jan 3, 2014*). I thought that it was important for me to hear the message directly rather than through the eyes of the media. I wanted to share with you some of my observations and opinions that have resulted from this experience with PIMCO.

Mohammed El-Erian worked with Bill Gross, PIMCO's founding partner, who built the flagship PIMCO Total Return Fund. Mohammed's departure came as a surprise even to those closest to him, but as we've all read in the newspaper, PIMCO's culture was anything but benign. It has been stated that Bill Gross wields a heavy hand, maintaining a firm grip on the ultimate decision-making and the hiring and firing of personnel (*WSJ Feb 28, 2014*). Whether you endorse this management style or not, I believe Bill Gross has earned his stripes in the investment world. In my opinion, he still maintains the distinction as one of the most successful fixed income managers in the business. When speaking with a number of other Managing Directors of the firm, and there are 60, each of them acknowledged the high level of expectations but quickly followed up by commenting that this type of environment was one designed to foster exceptional results. I met with one portfolio manager who arrives at the office at 2:30am to trade the European markets and heads home after 6pm to hand off trading the Japanese markets to his counterparts. I can't imagine that bodes well for a marriage, but that is the life he's chosen. I came away feeling that I was in the company of some of the smartest people in the investment business. I put a great deal of emphasis on people when I decide to employ a money manager, and the people that I met didn't disappoint.

Based on my conversations, Mohammed El-Erian was widely acknowledged by those he worked with as being brilliant, scarily brilliant, and a good complement to Bill Gross, who is more of a down-in-the-trenches type trader. Mohammed was the big picture guy, having spent 15 years at the International Monetary Fund and briefly serving in the role as CEO of Harvard Management Company, the entity that manages the Harvard endowment fund. Mohammed was hand-picked by Bill Gross to be his successor. It's my best guess that Bill's inability to loosen his grip and share authority was likely the cause of Mohammed's departure. I'm always suspicious when the departing individual cites "family reasons."

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Back to the outflows. Wall Street can create heroes and turn them into a villain in an instant, and this is what appears to be happening to Bill Gross at the moment. The massive capital outflows that occurred in 2013 were, in my opinion, prompted more by a change in investor attitude about bonds and the direction of interest rates than it was about a problem with any specific fund. Being one of the largest fixed-income money managers, it would only make sense that it would have largest outflows in terms of gross dollars, and the company's high profile lends itself to front page news, prolific public opinion and potential additional outflows; it's self-reinforcing. But don't be too quick to write off Bill Gross and his team at PIMCO. In the words of John Calamos, founder of Calamos Funds who so succinctly described a similar situation at a lunch that I attended several years ago, "*After 30 years of consistently strong performance, we didn't just get stupid overnight.*"

2014 has been an about-face for the bond market. Fed tapering appeared to prompt a sell-off in the emerging markets which affected both the US and Europe, and outflows from bonds turned into inflows almost overnight (*Lipper Fund Flow Report*). While we do believe that the global economy is recovering, and the US economy is leading that recovery, we continue to believe that interest rates will work their way higher over the next few years, challenging all bond funds and a good reason to have a talented team overseeing those funds.

The bottom line is that I'm very comfortable with PIMCO and their team of managers. They are client-focused and highly competitive in the investment management business. These are some of the most intelligent and driven people that I've met, and I will continue to use both their bond and equity products in the future for appropriate investors. A manager the size of PIMCO is a force to be reckoned with in the investment management business. They have some of the deepest resources, including numerous credit analysts, who help to give them insight.

One final note: I had a chance to visit the trading floor, soon to be moving to a new location down the street. One of the things that struck me was that everything was located in one open space including Bill Gross' desk, indistinguishable from any of the others, sitting squarely in the center of the floor. It's an environment where idea exchange happens freely and is conducive to a high degree of interaction between employees. Maybe that says more about Bill than the slings and arrows of which he's been a recent target.

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