ELECTRONICALLY REPRINTED FROM AUGUST 22, 2017

Wealth Management™

Thornburg's Brady: Active Managers Should Have No Fear of Passive

Financial advisors must be vigilant in educating their clients about the risks present in stock and bond markets.

By Dan Weil

Jason Brady, president of Thornburg Investment Management, a $50 billion fund manager based in Santa Fe, New Mexico, is something of an anomaly.

He and his colleagues at Thornburg are active investment managers, but he has no fear of the rush to passive management. Indeed, he sees it as an opportunity to stand out.

Brady also has a deep respect for financial advisors. He thinks they get a bad rap for mistreating clients and that the industry suffers from an image problem as much as anything else. He says advisors must be vigilant in educating their clients about the risks present in stock and bond markets that have shown great complacency recently.

We recently spoke about these and other issues with the 43-year-old former captain of the Dartmouth College ultimate-frisbee team.

WealthManagement.com: What are the most important elements of your investment philosophy?

Jason Brady: Everyone is looking for value at some level. But people try to narrow their definition of value, and that gets them into trouble. Our saying is that "growth" isn't a dirty word. The second part of this is having some perspective, and understanding that volatility isn't your friend.

I've built a career on the idea that people are generally not good at multiplying, they are good at adding. People generally underappreciate the value of compounding for both stocks and bonds.

This expresses itself in markets over time. Compounding may not help you quarterly, but it's positive over long time periods. If you're able to have a longer-term horizon than your competition or the market, it's extremely valuable.

If your time horizon gets short, you end up chasing things that have great stories, but it adds a lot of volatility to your portfolio. If you don't see the benefits of a long-term focus, you add volatility and subtract return. People get stopped out of positions psychologically and financially at bad times.

WM: Has your investment philosophy changed over the years?

JB: There's more of an appreciation for path dependency. It's not enough to have good performance. It's risk-adjusted performance that matters, taking volatility into account. We have learned that securities purported to be safe have turned out to have more volatility. That creates opportunities to add huge value.

It has become clear how much anyone can learn from the people around you. Over the last 10 to 15 years, markets have become more global and interconnected. We have people here with different focuses. The application of narrow bits of knowledge is pretty high.

When I was a trader on Wall Street, you didn't interact with people holding different books. The lack of robustness in that approach was discovered in 2008. People wish to be experts in small areas, but I don't think that's a good way to go about it. The more perspective you have, the better.

In general, people's confidence about what can happen in the world is too narrow. [People don't see far enough to extremes.] Understanding broad possibilities, being able to see tails is a piece of being effective.

If people buy a bond with a 6 percent yield, they become anchored to that 6 percent return. They are surprised when they lose money, and they say, get out of this thing. So you get volatility more from investor psychology than fundamentals. That can be a great opportunity to buy.

WM: What elements of the current investment environment are most difficult for you to deal with?

JB: The global nature of flows. There's a lot to know about. In Treasuries, it's not just about knowing what the Fed is doing. The amount of global flow affecting them is tremendous. There's an increasing amount of inputs for markets, and figuring out the effects of them is challenging.

When it comes to the increase of passive flows, I worry less than my peers. It's a pendulum swing, though there are secular elements [to the shift toward passive]. People asked me last year, why bother trying [active management]? I'm confident of the investment process. There are great long-term results.

People can't conceive of a different environment. But across the industry this year, active has been successful. There's an idea that this can't be possible. When people ask that question, it's probably an environment where it's interesting to be in my seat. Active management is now an opportunity to stand out more.

People are scared to be different. If you embrace that you'll be different, and let people know, we've shown it can be successful. But you're taking market and career risk. It's a hard thing to do.

WM: What interesting trends do you foresee in the future for the investment business?

JB: Maybe the thing I worry about most is changing correlations. We've built a huge amount of faith and significant data based on the last 35 years of history, where we've seen one direction in interest rates—down. That's paired with a positive environment for risk assets—stocks.

I don't know if those two asset classes will move down as they moved up. But I'm worried about the cushion effect of a balanced asset allocation. There's too much faith in backward-looking data for how the market works. People omit negative experiences like Japan. The flipside of that is if you don't have a dogmatic approach to asset allocation; there's quite an opportunity.

WM: What are financial advisors doing well, and where can they improve?

JB: The vast majority of the ones I've met are trying to do the best thing for clients. One challenge the profession has is the prevailing mood that we need to protect clients from financial advisors. That's unfortunate. You can improve transparency to show that you have nothing to hide. It's more a definition of the industry than anything.

I hope financial advisors can look at clients' portfolios and say, sure, this is what happened in the past, but markets have a way of turning that around dramatically. I hope advisors can keep clients aware of the broader universe of investments.

The last five years have been challenging, because the easiest button to push has been large-cap U.S. stocks, and that has been the best investment. Any advisor who has put their clients into anything else has their clients saying, why am I paying you? When the market has an upheaval, the value of financial advisors will be much more apparent. Those who continue to educate their clients and have a balanced portfolio will be successful.

Thornburg Securities Corporation, Distributor | 2300 North Ridgetop Road | Santa Fe, New Mexico 87506 | 877.215.1330

8/23/17
TH4027

130946