CONSUELO MACK | WEALTHTRACK

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On this week's ***Consuelo Mack WEALTHTRACK*:** why a slow, steady and contrarian approach wins the investment race over the long haul with Ariel Fund's Founder and Portfolio Manager John Rogers.

John Rogers
Founder, CEO, Chief Investment Officer
Ariel Investments

CONSUELO MACK: This week on WEALTHTRACK, only six mutual funds have been run by the same manager for 30 years. This week's market beating guest is one of them. Ariel Fund's John Rogers is next on Consuelo Mack WEALTHTRACK.

Hello and welcome to this edition of WEALTHTRACK, I'm Consuelo Mack.
Do you have what it takes to stay the investment course? Many mutual funds do not. Over the last fifteen years more than 58% of domestic equity funds were either merged or liquidated, almost 52% of global/international stock funds disappeared and 49% of fixed income funds did not survive as distinct identities.

Long term survival is especially difficult for the fund managers themselves. *The Wall Street Journal'*s "The Intelligent Investor" columnist and WEALTHTRACK guest, Jason Zweig analyzed the situation recently using numbers from *Morningstar.*
*"Of the 525 U.S. stock mutual funds that existed 30 years ago, 223 still are operating today…"* *(* that is a 42% survival rate- but here's the clincher*) "…only six are still run by the same manager."*

In his analysis of the survivors Zweig identified two key intertwined qualities: stamina and patience. As he wrote, "*…stamina is the key to success and patience is the key to stamina*."

One of the six marathon mutual fund managers is this week's guest. He is John Rogers, Founder, Chairman, Chief Executive Officer and Chief Investment Officer of Ariel Investments the firm he started in 1983 at the tender age of 24.From the very beginning, on the masthead of his "Patient Investor" newsletter, Rogers has used the Aesop's fables "Slow and steady wins the race" expression along with the tortoise and the hare as symbols of Ariel's investment approach. In 1986 he launched the value-oriented Ariel Fund which he manages to this day, now with the help of two colleagues. The fund celebrated its $30^{th}$ anniversary in November of 2016 and has delivered 11.5% plus annualized returns since the beginning, beating the S&P 500 by a percentage point a year, matching its mid-small cap value benchmark and placing it in the top ten percent of all equity funds.

I began the interview by asking Rogers to explain his, and his fund's longevity.

JOHN ROGERS: I think part of the answer is that I did start young. In 1986 I was just about 28 years old getting started, and so it's given me a chance to really build a track record over these last 30 years. But at the end of the day your fund exists and stays in business because of the performance, and we've been able to show over those 30 years 11 and a half percent a year compounded with all the ups and downs of the market and all the dramatic swings that we've all seen and experienced. I think the fact that we've been able to outperform and persevere has helped us to last a long time. Also we've stayed very true to our philosophy around patient investing and our turtle logo and really ...

CONSUELO MACK: Slow and steady wins the race.

JOHN ROGERS: Slow and steady wins the race, and I think people have been able to see that we've been able to live those values and also be contrarian value managers. So when you had the crash in 1987, we were in there buying, and when we had the Internet bubble, we were being very cautious and conservative. Then when the financial crisis happened in '07 and '08 and early '09, we were in there buying. So people have been able to see that we actually execute around the values that we believe in.

CONSUELO MACK: So the question is, where did those values come from?

JOHN ROGERS: I think my strategy and philosophy came from partly growing up as an independent person. I was an only child. I grew up in Hyde Park of Chicago which is a part of the University of Chicago community where they really do try to push you to think for yourself and to think independently, and I think that helped give me the confidence to actually start Ariel in 1983 when I was 24 years old. Now I think the other thing that happened was I tried to read a lot, and of course when I was at Princeton, Burton Malkiel had written *A Random Walk Down Wall Street*. He was the Chairman of the Economics Department, and I remember going to see him, and he really was the one that started me down this thinking that if you didn't follow the crowd, you could be a successful investor. That book had a profound impact on me, and then when I got out of college I remember reading John Train's *The Money Masters* and reading about John Templeton.

CONSUELO MACK: John Templeton.

JOHN ROGERS: And Warren Buffett and Ben Graham, and those folks just sort of spoke to me. I just loved everything that they said, everything that was written about them. I loved watching them whenever I could see them on television someplace. So I think having those men as role models at that time in my life just had a profound impact on me, and being a contrarian and independent thinker, it just resonated with me.

CONSUELO MACK: Is value investing by its very nature ... is that a contrarian approach?

JOHN ROGERS: I think value investing is a contrarian approach. You're going to be buying when others are selling. When there's a lot of fear out there, you're going to be the one feeling confident going in and buying those stocks at bargain prices.

CONSUELO MACK: The longevity issue... how did you survive given let's say the 1990s, the tech bubble, when you and every other value investor underperformed? Looking at what's happened in the markets now where unless you own the FANG stocks you underperform the S&P 500, what enabled you to survive and have an independent firm?

JOHN ROGERS: I think a couple things helped me to survive these difficult markets over this now 34 years. One is building relationships with peers that you respect a lot, that you can call and sometimes keep each other's confidence going during those tough times. I can remember times when we've been zigging when everyone else is zagging to be able to talk to a Bill Miller, a Tom Russo, a Mason Hawkins.

CONSUELO MACK: Chris Davis. Actually I remember Chris and Bill told me that they kind of had what they call the value therapy group. It was because the world seemed to be going against all of you.

JOHN ROGERS: Exactly. You need that kind of value therapy group and those friends you can talk to, and of course you're always going to try to find a way to talk with Warren Buffett and go to his annual meeting and watch him on television to get that reinforcement sometimes at tough times. But the other thing that helps that we try to do and we've also borrowed from Warren is to write about what we're thinking and what we're doing, and every quarter now we write a *Patient Investor* newsletter to all of our shareholders and trying to reinforce with them the importance of thinking long term, and I think that we've been able to reinforce that over time so people are more likely to stick with us during those inevitable downturns because we've been able to make the case that if you think long term, you're going to outperform, and by communicating that strategy consistently and then executing it consistently, I think it builds confidence in customers.

CONSUELO MACK: What are the key take-aways that you've gotten from Warren Buffett and Charlie Munger for instance?

JOHN ROGERS: Well, there's a couple things they reinforce over and over again that I think are critical, and the one that I love is Charlie Munger often talks and Warren often talks about staying within your circle of competence, investing in what you understand, and he also talks about, which is a part of that theme, is waiting for the perfect pitch. Only swing at a company when you find a company that you truly believe in that you think has a deep moat around it that's going to stop competitors from coming in and causing all kinds of competitive difficulty over the long run.

CONSUELO MACK: With the Ariel Fund you run a pretty focused portfolio. It's about 40 companies, and you have low turnover in your fund as well. So how do you choose the companies that make the cut?

JOHN ROGERS: You really are looking for those companies that have a strong brand, a strong franchise, and they're in a sector where it's difficult for new competitors to come in, and we're going to constantly talk to our companies and the management teams about how are they going to maintain that moat over a five to seven to ten-year timeframe, and they say very few people ever are thinking that way. They say all of our competitors are coming in and asking about their earnings for the next five to seven or ten weeks, and for us to be thinking about that in five to seven to ten years makes us very unique and very unusual in the way that we do our research. The other thing that we do is that we have our analysts now. They are focused on that first and foremost of understanding how strong and how deep that moat is, and we can't overemphasize how important that is, but at the same time sometimes you're going to be wrong, and so make sure that company also has that strong balance sheet to weather the storms if they do occur, and if you didn't quite get it right, at least the company isn't going to have a permanent downturn where they're going to have a permanent loss of capital because the balance sheet failed the company. So I think that balance sheet strength is critical. That's one of the lessons we've learned over the years. We learned during the financial crisis that some of the companies we thought were financially strong were not as strong. So we had to go out and figure out how we could recreate our whole process of understanding balance sheets and create another margin of safety, another layer of safety when we were doing our research. Create our own proprietary debt ratings.

CONSUELO MACK: Oh, interesting. So thinking more like a credit analyst, like a bond analyst in addition to thinking like an equity analyst where you're looking at the income statement. Now you're looking at the balance sheet as well and ...

JOHN ROGERS: You're exactly right to say that we've decided that often equity analysts are not very good at being bond analysts, fixed income analysts, and Charlie Bobrinskoy, our vice chairman, worked at Salomon Brothers. He was there for over 20 years, and he was an investment banker, and they were experts at fixed income. They issued a lot of fixed income bonds, and he's brought that expertise to us and that was something he thought we could just do better. So he's in charge of sort of being our quality control to make sure that we created our own proprietary debt ratings, doing our own original research and understanding that you can't count on the sell side, buy side research that you often read on the street around the balance sheet strength of a company.

CONSUELO MACK: Bond analysts tend to be much more pessimistic than equity analysts and they also tend to be much more risk averse because they're worried about potential default. So are you becoming more risk averse? Bringing that type of analysis into the process?

JOHN ROGERS: Well, I think that we have become more risk averse over the years. After you've been doing this 34 years, you learn a lot from your experiences and you learn a lot from your mistakes. Going through that financial crisis, it was a big lesson for us that companies that you thought had financial controls to weather a recession, weather a difficult time, they really didn't. So it's something that we've had to learn the hard way, that to focus on the balance sheet is of critical importance, and sometimes our peers maybe are not as in-depth in that work. So being a good bond analyst and understanding the fixed income markets and understanding the credit default swaps and all the different ways that bonds are trading, it helps you understand the equity value of your company more effectively.

CONSUELO MACK: Was there an example of a company in the financial crisis that you thought was financially strong that turned out not to be that you owned or at least that the market treated much more poorly than you would have anticipated before the crisis?

JOHN ROGERS: During the financial crisis, our biggest mistake happened to be in one sector, and it was really the media/newspaper sector.

CONSUELO MACK: Oh, not the financials.

JOHN ROGERS: We held our own there, but what happened with the media sector, there's a couple things that were happening all at once. Craigslist and some of the other internet companies were really destroying the classified advertising in the newspapers. We understood that circulation was going to be declining. We understood traditional advertising was going to decline, but the classified advertising was this high margin revenue for newspapers that just got devastated. So we missed that part of it. At the same time, the newspapers were all on acquisition binges. You might recall back during that time period that McClatchy bought Knight Ridder. The Tribune bought Times Mirror. There were so many companies that were being bought. Lee Enterprises bought Pulitzer papers. So all of a sudden these companies had levered up as if there was never going to be a recession, never a downturn, and so you had the fundamentals of the business deteriorating and at the same time the economy started to deteriorate much more rapidly and, therefore, their balance sheets were vulnerable because they had loaded up on debt to make these acquisitions. Even companies like McClatchy that sold off strategic assets to strengthen their balance sheet, they hadn't done enough. So when I look back at that period, that sector really hurt us a lot, and companies like McClatchy probably were the most disappointing where the balance sheet just withered away and we had a real permanent loss of capital in that investment.

CONSUELO MACK: Disruptive technologies, there seem to be a lot of them right now…

JOHN ROGERS: Now with everything done through technology, you can have balance sheets that are much stronger, generating lots of cash flow and not having all the risk that's inherent in a capital-intensive business. So there are some real pluses to this new technology world that should add productivity to America and growth to our GDP that I think sometimes gets underestimated. But the part of your question that is important, I think there are a lot of brands that are really being disrupted, and particularly the ones that we've been very concerned about have been all the retailers. Big, strong retail brands..it's all just under assault. It's unraveling so rapidly, and you wonder the future of a shopping mall and the big, giant retailers. It's just going to be extraordinarily difficult for that to I think succeed.

CONSUELO MACK: Are you investing either contrary to that trend or with that trend, or I mean as an investor is that a space that you want to play, or is it just too risky and too uncertain?

JOHN ROGERS: I think it's too risky and too uncertain to get into these businesses where the internet and the technology is coming in and causing enormous disruption. Our experience is once that ball starts rolling down the hill, it just rolls faster and faster and it gets more and more difficult to make it. There's always people that are hopeful and have a hopeful story and an optimistic story how it's going to be different this time, but I just don't see it, and so we've been very cautious when we see that first disruption coming along. It worries us quite a bit.

CONSUELO MACK: What about the FANGs? I mean what about Facebook and Amazon? I mean you tend to be a mid to small cap fund, so that's probably ... at one point they were small cap and mid cap.

JOHN ROGERS: I think the FANG companies are extraordinarily well managed. You've got tremendous CEOs with great vision. Warren Buffett often talked about that actually at the annual meeting again this year how he missed some of those great stories, that he missed the opportunity with Amazon and Jeff Bezos and how much money he's left on the table. So those are just extraordinary businesses, extraordinary franchises. The only issue, of course, is they just got to be so large, and it's going to be harder for them to grow as rapidly at this size, and the valuations have gotten to be quite expensive in a lot of the names, and so I think it is a time maybe to be a little cautious and realize that that world can be disrupted again with newer technologies, and these young folks in Silicon Valley are always coming up with something new and different and better. All these companies will not survive in the same way that they are today, at least that would be my perspective.

CONSUELO MACK: Your analysis as far as looking at the moat and the balance sheets and everything else, is that a reason why Facebook or Amazon wouldn't have made the cut at Ariel?

JOHN ROGERS: Those fast-growing technology companies are not our cup of tea. They're not in our circle of competence, and it's very hard to see how that's all going to play out.

CONSUELO MACK: So let's talk about what your cup of tea would be or your circle of competence. What are some of the companies in your portfolio that are emblematic of the Ariel approach?

JOHN ROGERS: One of the things, you'll see a big space for us is the alternative investment area, and I've been fortunate to serve on a lot of investment committees, and I'm on the University of Chicago investment committee. I used to be on the Princeton investment committee, and it's just fun. You learn a lot. You get to see a lot, and you know that all these endowments and more and more pension funds are putting money into alternative asset classes. So we have big holdings in companies like KKR. They are the preeminent brand when it comes to private equity.

CONSUELO MACK: Private equity.

JOHN ROGERS: More assets are going into the private equity than ever. The performance has been terrific for the long term. KKR has great performance specifically, and the stocks are quite cheap. It's sort of unbelievable to me how cheap they are even when you see the great brand that's there and seeing all the asset flows throughout the world going toward more and more private equity. It's enhanced by the problems that the hedge funds are having. Hedge funds are struggling. People are more and more resistant to pay the two and 20 fee structure to the lower returns that hedge funds have provided over the last 20 years. So KKR is our biggest in the alternative asset space from an equity standpoint. We also own a lot of the real estate asset plays. So Jones Lang LaSalle, JLL it's called, CBRE, CB Richard Ellis, and those are wonderful businesses where they do the real estate leasing. They do the outsourcing for real estate of giant multinational companies, but they also do investment management for pension funds and endowments where they will manage real estate assets for those types of institutions.

CONSUELO MACK: So they do it all kind of in the commercial real estate space.

JOHN ROGERS: They do everything in the commercial real estate space. It's a wonderful business. The stocks are very, very cheap. People are too concerned that there's going to be a rollover in the real estate market, and people won't buy and sell real estate anymore, and the capital markets business will not be as strong. But they're forgetting about the geographic diversity that CBRE and JLL have. They're not understanding the product diversity now that they have leasing and outsourcing and investment management to go with traditional capital markets. So those companies are really well positioned. I think they're in a terrific spot. Then finally I would just add Northern Trust is kind of seen as a stodgy bank, but they are a huge money management operation, and they do so much of the back office for mutual funds and the custody for large pension plans and endowments, and it's a worldwide business, and they are preeminent at that, doing a lot also with wealth management. So it's not like a traditional bank.The main thing about Northern Trust, they're not dependent on the traditional spread income. They're not the big lending company, so all these are companies that are going to benefit from this sort of again asset management happening throughout our world where people need to pay fees to get alternative assets out there performing for them.

CONSUELO MACK: Let me ask you. You mentioned cycles. Where are we in the economic cycle and in the market cycle at this point? We're nearly eight years in to an economic recovery, and I think it's the third longest economic recovery on record so far . How concerned are you about the current maturation of the cycle?

JOHN ROGERS: I'm not concerned about where we are in this market cycle. We've had this remarkable recovery that started under President Obama's leadership in '09. You're right. It has lasted quite a long time, but we still are nowhere near euphoria. We think we can get GDP growth to be much stronger than people anticipate. More than that three and a half percent kind of range is what I'd be looking for.

CONSUELO MACK: Really. I mean but we're like one and a half to two percent now. So where's that extra percent and a half coming from?

JOHN ROGERS: The extra growth in GDP growth I think will happen because partly the momentum from what's been happening. Consumer confidence will continue to grow. People out there in the industrial sector will feel more confident. That's going to help with growth, but I also do think that as we have more infrastructure spending – there seems to be bipartisan support for more infrastructure spending – I think there is a lot of support for having some regulation sort of pulled back and having a less regulated environment. I think that'll be kind of a big deal.

CONSUELO MACK: It is for business.

JOHN ROGERS: No matter what side of the aisle you're on or if you're a conservative or if you're a liberal, lower taxes in the short term will be a boost to the economy. So all those things coming together after all the great work of the prior administration, you have these extra what I would call icing on the cake that will help boost the growth of the American economy.

CONSUELO MACK: What if they don't happen?

JOHN ROGERS: I think a lot of the new kind of economic stimulus things that are out there maybe won't happen as fast as people had anticipated. There is a lot of drama in Washington.

CONSUELO MACK: There is.

JOHN ROGERS: But eventually people come around to doing the right thing for America, to strengthen our economy, to provide the jobs and growth that we need.
So I think that common sense will prevail and people will come together and do what's right for the country. I know it doesn't feel that way today. I get that, but you go through cycles, and Warren Buffett often talks about that. The last century you had world wars.

CONSUELO MACK: Oh, absolutely.

JOHN ROGERS: You had Great Depressions and all kinds of challenges that our country faces or faced at the time. So I think this will pass also, and we'll get back to some...

CONSUELO MACK: From your lips to Washington's ears that common sense will prevail, John.

JOHN ROGERS: Exactly. Common sense will prevail. We'll get back to some type of normality.

CONSUELO MACK: So a couple more questions. As far as the level of the stock market, you are also pretty bullish now about the stock market, and you mentioned that a lot of people don't recognize the productivity gains that we've seen. Can you explain that?

JOHN ROGERS: I think part of our disconnect with sort of the common wisdom is that people really don't realize that earnings can grow faster than people anticipated, and some of it will be because of some of the things like the infrastructure spending that'll help, but also this realization that you can grow and keep inflation low because you have great productivity gains coming out in this market environment. All this technology is going to make our country more productive. There are so many things you can do on your phone and you'll have driverless cars. You'll be able to get so much done at once. It's going to make our country stronger. It's going to make us grow faster, and we'll be able to do it I think in a relatively low inflation environment which is critical because that'll help keep interest rates very low.
As long as rates are within some reasonable range of where they are today, P/E multiples are quite reasonable, and I continue to sit in meetings all the time where people say the market's expensive and we've had this great bull market, and they forget to realize that these rates are at historic lows and, therefore, the stocks are not overvalued as long as rates stay within this reasonable range. Also I have to say that when there's a common wisdom where everyone thinks the market's expensive and it's prime for a fall, typically that means that there's still room to run on the upside.

CONSUELO MACK: Final question. One investment for a long-term diversified portfolio. What do you think we should all own some of?

JOHN ROGERS: For the long run, if I had to pick one stock, I think it would be KKR. I really do believe that private equity is here for the long run and to be able to get this great franchise at a very cheap multiple, extremely well managed and of all the assets around the world needing a haven and a place to be placed, I think KKR is very poised to benefit from that.

CONSUELO MACK: So John Rogers, what a treat to have you here on WEALTHTRACK. Thanks so much for joining us.

JOHN ROGERS: It's been fun.

CONSUELO MACK: At the close of every WEALTHTRACK we try to give you one suggestion to help you build and protect your wealth over the long term.
This week's action point is: Adopt some of John Roger's slow and steady wins the race philosophy. Regardless of your age, most of us have a longer investment time horizon than we realize. The ability to stick with a well thought out, disciplined investment strategy is a key characteristic great investors share and one we can adopt as well.

Next week, as we begin a new season on WEALTHTRACK , why you might want to consider a donor advised fund to maximize the impact and efficiency of your charitable giving. Pamela Norley, the President of Fidelity Charitable the oldest and largest donor advised fund joins us to discuss the options.

In the meantime find out why John Rogers believes that not having email or even having a computer on his desk at work makes him a better investor. That's in our EXTRA feature on our website WEALTHTRACK.com.

For those of you who do have a computer and use email, keep reaching out to us on Facebook and Twitter. Thank you for watching. Have a great weekend, a Happy Father's Day and make the week ahead a profitable and a productive one!