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Special Edition

Advantages of research-driven asset management

- Interview with Kinji Kato by Sadayuki Horie -

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Executive Summary

Quite a few globally renowned asset management companies are largely unknown in Japan. One such company is Natixis, a multi-affiliate organization of research-oriented asset management boutiques. NRI spoke with Natixis Asset Management Japan's CEO Kinji Kato about the strengths of such a business model.

Kinji Kato

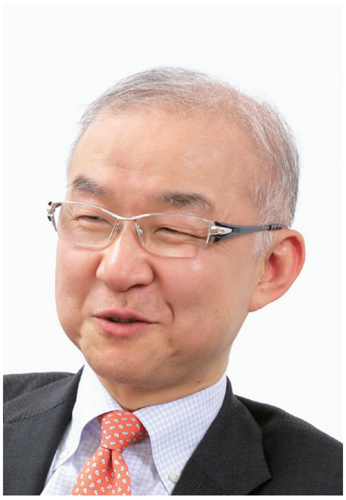
CEO, Natixis Asset Management Japan

Joined Dai-Ichi Kangyo Bank (now Mizuho Bank) after graduating from The University of Tokyo in 1981. Joined Salomon Brothers' in product development in 1986. Hired by Nomura Securities' New York branch in 1988; involved in new product development and asset management while also serving as CEO of an affiliate. Joined Loomis Sayles's Boston head office in 1997 as head of Asia/Japan. Transferred to Natixis Asset Management Japan in 2007; appointed CEO in March 2008.

Sadayuki Horie

Senior Researcher
Financial Technology and Market Research Department,
Nomura Research Institute

Joined Nomura Research Institute in 1981. Seconded to Nomura Asset Management from 1996 to 2001. Currently a visiting professor at Osaka University of Economics' Graduate School of Business Information Systems. Served as member of FSA's Council of Experts Concerning the Japanese Version of the Stewardship Code, Vice Chairman of Government Pension Investment Fund's Investment Committee, and member of FSA's Council of Experts Concerning the Corporate Governance Code. Prolific author, most recently of Corporate Governance Code (Nikkei Publishing).



Multi-affiliate asset management company

Sadayuki Horie: Natixis Global Asset Management has a large group of specialized asset management affiliates. While well-known and highly regarded globally, Global Asset Management is largely unknown in Japan. When did you enter the Japanese market?

Kinji Kato: Loomis Sayles first ventured into Japan in 1997, the year I joined its Boston head office. In 2000 Loomis, Harris Associates, AEW and others were bought by France's CDC Asset Management from US life insurer MetLife. They started operating as an integrated group in Japan from 2000.

Through a subsequent process of privatization and reorganization CDC Asset Management became today's Global Asset Management.

Horie: Has Global Asset Management's multi-affiliate structure not fundamentally changed from when the CDC era?

Kato: Through further acquisitions we now have more asset managers, especially alternative managers.

Horie: Why are many of Global Asset Management's affiliated asset management companies American when its parent company is French?

Kato: Because it was a serial acquirer of asset management companies with reputable brands in fixed income, equities, real estate and other major asset classes from the time it was a MetLife subsidiary.

Horie: When acquiring asset management companies, does Global Asset Management acquire majority stakes?

Kato: We acquire them entirely in most cases. Because the asset managers we acquire are highly specialized, the biggest risk we face is the departure of top executives and portfolio managers. Before we agree to acquire a company, we require its key personnel to agree in writing to stay with the company for a long while.

In return, they receive a generous share of the company's revenues even after the acquisition.

Horie: Do you have any other such rules when you make acquisitions?

Kato: We don't want to own more than one company for any given strategy or investment style. In other groups that own multiple asset management companies with similar strategies, we've seen complications arise with merits on the acquiree side.

Horie: You must be very selective in identifying acquisition targets in specific market niches.

Kato: In February, Barron's again ranked Global Asset Management as the overall top fund family of 2016 in its annual Best Fund Families feature. This top ranking accurately reflects what distinguishes Global Asset Management from other fund managers. Global Asset Management was ranked near the top in the US Equity and World Equity categories. The funds in both categories are managed by Harris Associates. Global Asset Management was ranked near the top in the taxable bond category also. Those funds are managed by Loomis.

Horie: How much assets do you manage for clients in Japan?

Kato: On a group-wide basis, we currently manage over ¥3 trillion for Japanese clients. We've been gaining a lot of financial institution clients in Japan.

Horie: How much of your Japanese AUM do financial institutions account for? Two thirds?

Kato: I think it's around 60%.

Retail investors don't account for much of our Japanese AUM, partly because Dan Fuss, Loomis's Vice Chairman, is sometimes conservative on double-decker currency overlay funds. Dan is still going strong, managing bond funds at over 80 years of age. Executives of major brokerages and fund distributors with which we have close relationships have personally asked him to launch a US high-yield bond with Brazilian real currency overlay, but he has stubbornly refused.

Horie: Dan Fuss is a legendary bond investor. Why would he refuse?

Kato: Because he has an unwavering conviction in research-based investing. He also adamantly believes that certain risks are unacceptable for clients. This is shared across Global Asset Management's investment firms.

Research-intensive fund management

Horie: How do you explain Global Asset Management's strengths to clients?

Kato: We basically tell them we have many distinctive, value-oriented asset management firms. Research is of utmost importance to Loomis, Harris Associates and AEW, which manages real estate funds. AEW has its own research boutique, AEW Research, which is tremendously important to it. We make sure prospective clients are aware of all this.

Horie: When large institutional investors with substantial in-house capabilities outsource assets to external managers, I believe they tend to select managers with unique capabilities that they lack internally or managers that can deliver abundant alpha. Alternatively, they may select asset managers that propose comprehensive solutions.

Kato: Global Asset Management has affiliates that can meet both needs. We have high alpha firms like Loomis, Harris, AEW and Natixis Asset Management, and we also have a hedge fund called H2O that invests in bonds and currencies. H2O also heavily allocates resources to research. It proactively pursues returns with a high degree of conviction.

Horie: How much do your affiliates spend on research?

Kato: I recall that in 1997, the year I joined Loomis, Forbes reported that Loomis's research budget $13 million versus PIMCO's $10 million budget. Last year, Loomis' research budget had increased more than sevenfold from 1997 to $92 million. Such spending is one reason for Loomis's reputation as a research house.

Horie: Is that for credit research only?

Kato: Loomis has 52 people in its credit research team. It has also strengthened quant strategies, asset allocation and risk management, and its research staff is now well over 100-strong,.

Horie: Loomis spends the equivalent of about ¥10 billion on research annually.

Kato: Loomis was hiring even in 2008, amid the Lehman crisis. Global Asset Management gives its affiliates considerable free rein management-wise, partly because they cover most of their overhead expenses themselves. So if an affiliate says it needs to spend money on research, Global Asset Management does not object.

Horie: Did Dan Fuss, a longtime credit maven, combine research and trading functions?

Kato: I feel he joined serendipitously. Loomis has had its own credit rating system, called the Red Book, since the 1930s, before Standard & Poor's did. Dan Fuss has been there for 42 years, since credit markets were in their infancy. Loomis has since been contributing to credit markets' utilization and development.

Horie: Does Dan Fuss's investment mandate encompass all bonds, both investment-grade and high-yield?

Kato: Yes, his greatest strength is his multi-sector strategy.

Horie: How would you categorize that investment strategy?

Kato: Long-term investment that is both research-focused and a liquidity provider.

Horie: Could you elaborate?

Kato: With its own internal credit rating system, Loomis is renowned within the industry for accurately predicting rating upgrades and downgrades. Its analysts cover nearly every bond issue across industrial sectors. Its investment-grade coverage universe comprises 97% of US corporate issuers and 91% of corporate issuers globally. In other words, Loomis covers essentially every investable bond.

Loomis always rates nearly every bond and it issues predictions of rating upgrades and downgrades. The market has confidence that Loomis stands ready to immediately bid on bonds that have sold off. That's what I mean by liquidity provider.

Horie: I see. So Loomis gets offered good deals first.

Kato: It's definitely one of the two or three bond investors that sellers go to first. It immediately bids on offered bonds and is frequently able to buy cheaply.

Latest investment styles

Horie: From recent visits with global pension funds, I get the impression that fund managers now commonly look at a fund as a single balance sheet and seek out investments with advantageous risk-return profiles instead of constructing portfolios in terms of asset classes.

Loomis typifies such an approach where, say, an equity team and a credit team, each with its own investment strategies, collaborate in analyzing prospective investee companies. How long has such collaboration been going on?

Kato: It was already happening when I joined Loomis.

Of 10 companies in a sector, perhaps only seven have issued investment-grade bonds, and the other three may have subordinated bonds or bank loans. However, all of the companies compete against each other in the same sector. And on the liability side of their balance sheets, they all have equity plus some combination of senior bonds, subordinated bonds and/or bank loans. It's important for equity and credit analysts to collaboratively analyze the companies' capital structures from each other's perspective. Such analysis is aided by meetings between equity and bond analysts.

Horie: I thought such an approach was a recent development.

Kato: Loomis divides debt markets into a dozen or so investment sectors such as investment-grade, high-yield and bank loans and it assigns "sector team" to each sector. The teams consist of portfolio managers, analysts and traders. Portfolio managers may be assigned to multiple teams. The teams discuss their sector's market environment, issue-specific risks and returns and so on, forecast performance over the next 6-12 months, rank bond issues, and input the information to Loomis's internal rating system. Using this information, portfolio management teams construct portfolios. If, for example, high-yield bonds have sold off sharply and offer attractive expected returns, Dan Fuss's team can substantially increase their high-yield allocations.

Horie: In other words, they can drastically change their portfolio allocations immediately upon identifying an investment opportunity. I understand market timing strategies in theory but how do you implement them in the real world?

Kato: There are two key factors. One is individual bond issues' expected returns and risks. The other is clients' risk tolerance.

The first is acquired from sources such as the internal rating system. And portfolio managers have access to data that enables them to assess bond issues' risk.

The second is that portfolio managers ultimately decide how much assets to allocate to an undervalued sector in light of the client's investment objectives, investment guidelines and risk tolerance.

Horie: So they have to be able to forecast returns, effectively manage risk and construct portfolios in accord with each client's guidelines.

Proposing strategies that capitalize on institutional investors' advantages

Horie: When clients first approach Global Asset Management, are they already familiar with your affiliates' distinctive strengths?

Kato: In the past, we would typically ask new clients what kind of products they wanted and then pitch products to them. We've since evolved into a solution provider. We now focus more on solving clients' problems and meeting their needs than on their product wants. For example, we offer a wide range of solutions to clients in need of additional yen-bond substitutes. Such solutions include AEW's US core property and preferred REIT funds, H2O's Adagio and Loomis's bank loan and unconstrained funds.

Horie: As Global Asset Management's regional head of North Asia, you are in contact with Asian institutional investors outside of Japan. Do you notice any differences between countries?

Kato: Korea's major institutional investors have a lot of personnel turnover.

Horie: So job-hopping is a viable career path in Korea?

Kato: People educated overseas who can speak in English have the opportunity to work at many different companies.

The turnover is sometimes frustrating, like when personal connections are abruptly severed, but everyone learns fast and makes decisions quickly most of the time. Another notable trait of Korean investors is they sometimes make market timing decisions themselves.

Horie: What about Taiwan?

Kato: In Taiwan, some clients sign four-year contracts, and no matter what happens, these are never canceled prematurely. If a contract is renewed after its initial four years, we are assured of another four years.

Horie: Nice! How about Mainland China?

Kato: China has changed enormously over the past few years, but the Chinese have now become frugal with capital as reported in the media. I believe asset management companies that mainly offer simple products and plain-vanilla strategies are having a hard time in China. But the Chinese are now looking to improve real estate investment efficiency. Global Asset Management can meet such needs through AEW.

Horie: Lastly, what are your expectations with respect to Japanese clients?

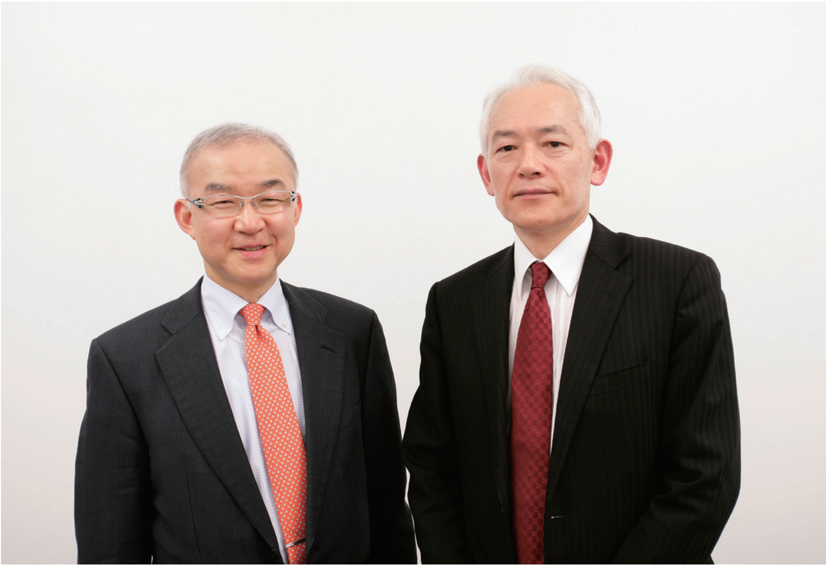
Kato: With many of Global Asset Management's affiliates offering research-based value investing strategies, it's important for clients to have a medium- to long-term investment horizon. I'm confident we can deliver satisfactory returns as long as clients understand that Harris, Loomis, AEW and H2O funds in particular are medium- to long-term investments.

Horie: I think many institutional investors understand the importance of a longer-term investment horizon. On the other hand, short-termism can be a hard habit to break. I believe your perspective gleaned from frequent contact with overseas investors is extremely valuable.

Kato: Retail investors tend to have a quick trigger finger even in the US. If an equity or high-yield fund performs well, it would be promptly deluged with asset inflows. Conversely, it would be swamped with redemptions if it performed poorly. Institutional investors are at an advantage if they can hold positions for a medium-term timeframe. I believe that identifying the resources that are sources of alpha is the key to being able to invest over the medium to long term.

Horie: I hope Japanese institutional investors likewise come to realize their own strength in furnishing capital advantageously.

Thank you for the insightful conversation.



about NRI

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