Interview with Tim Fortier @ Drawbridge Strategies

Introductions

- **Who are you?**
    - I've been in the financial / investment industry for 30+ years
    - Gravitated towards the portfolio management side early on
        - Specialize in quant based / rules based management programs
        - Develops algorithm for clients worldwide
    - "We're using predefined rules to define what we're buying, when we're buying, and when we sell"

- **How'd you get started in the financial services industry?**
    - Started out as a financial advisor, and quickly became independent (this was back in the 1990s)
    - Began building rules based systems using the technology available back then
    - Got involved with some other companies doing risk management
    - 2001, was hired as CIO for a family wealth office
        - Did quite well in that period post-dot-com bubble
    - Did some consulting work and built "structured products"
        - They're relatively new in the United States.
        - Usually it's a fixed income security with some other source of return.
            - Example: an index linked CD.
        - Structuring the return stream and downside risk.
            - "I'm very big on risk adjusted returns"
        - "Think of this like a note or a corporate bond"
            - Example: Dogs of the Dow stocks that was structured as a note. Gives a different form of getting exposure to a strategy.
    - Today, we publish a lot of the work we produce and apply it via publishers, institutions, and advisors.
        - "We have other financial advisors to use our strategies to manage client money"
        - "I manage money for financial advisors"

        - "Through publications, we give individual investors access to the signals who can then apply it themselves"

The Opportunity

- **What is the Mega Trend?**
    - The popularity of passive index investing
    - This negates the research process and price discovery process
        - When you put money into a cap weighted fund, it gives the Amazons and Microsofts a much bigger percentage of funds
            - As money gets put into indexes, more and more money gets allocated to these bigger stocks vs smaller companies
        - EXAMPLE: FAANG stocks
            - These stocks alone have a combined market cap of the bottom 371 companies in the S&P 500
    - S&P Cap Weight vs S&P Equal Weight
        - The cap weight is up
        - The equal weight is down
    -
- **How big is the opportunity?**
    - According to Morning Star, there's as much money invested in active funds as index funds
        - $450 Trillion in both sides of the equations
    - Never been a time in history with so much money in one industry: TECHNOLOGY
        - This is creating more sizeable bets and you're not getting as much "index" as people might think

- **Who are the major players in the space?**
    - Vanguard
        - Jack Boggle in the 1970's popularized "passive indexed"
    - Blind indexing is one of the big trends
        - The reason? It's been well marketed
        - The big message from the index world is "Most active managers don't beat the index, therefore, go with a low cost index and you're better off"

The Problem

- **What is the story about this opportunity no one is telling?**
    - Why history is unlikely to repeat
        - In the 1970's no one was interested in index investing
            - People were throwing money hand over fist into tax shelters
        - It wasn't until August of 1982 where the market broke out to the upside
    - Interest rates were falling because of Fed Policy
    - We had demographics we don't have today
        - Baby Boomers were coming of age where they realized they needed to save
        - Today, we have a much different makeup of demographics.
            - Much lower rate of savings
    - We had a "perfect storm" of forces driving the rise.

- **What are the major problems no one is talking about?**
    - The financial industry has a lot of "half truths"
        - If you went to Vanguard and asked "will an index fund meet my financial goals in the future"
            - No one can answer this, because the future is unknown.
    - "There are very few things you can say with certainty, but the fall from 15% interest rates to nearly zero is unlikely to ever happen again"
        - Now, we have trillions of dollars in new debt from the FED that's been injected into the market
        - Eventually, there's so much debt, the cost to carry is so high, it eventually robs from future productivity.
            - This is the box the FED is in, and they know it
            - But we're becoming more dependent on these injections, and this is causing greater instability and more debt.
        - The FED cannot afford interest rates to go higher
            - Now the FED controls the yield curve
            - There's no real price discovery
            - Teams like Blackrock are buying and trying to keep prices in check

- **What are the major problems investors face they don't know about?**
    - "Past performance is not indicative of future returns"
        - Making money in the past doesn't work
    - "There are a lot of financial planners plugging in these old expected returns and projecting 7-8%"
        - We know bonds have very little return, so, in a classic 60/40 portfolio, those return essentially nothing.

- "Passive indexing totally ignores downside risk"
  - Einstein says compounding is the 8th wonder of the world.
  - But it only works with positive returns. You can't compound negative returns and you can't eat your losses.
    - You take the end results of your prior period, and then compound it by the return in the current period
    - The key is the end result of the prior period.
  - "You'll never get back lost time when you have large losses"
    - It can take decades to recover from a 45-60% drawdown
- You have planners and managers making broad allocations…
  - But there's no planning for what happens if we have another period of significant declines
  - It takes the person well off the path of a secure future
- It's looking in the rear view mirror
  - Stocks and bonds have done well in the prior period.
  - But to extrapolate those returns into the future is dangerous
- Higher allocations to traditional asset classes and only token allocation to alternatives
  - Alts could be a higher stream of return going forward.
  - Traditional portfolio might be 10-15% in alts.
    - But if you look at a pension, they usually have a larger exposure to this.
    - A lot of individuals have only a token amount of exposure.

The Catalyst

- **Why is NOW the best time for this type of investment / investing strategy?**
  - "The Century Portfolio"
    - If you want a portfolio to have a duration of a century and go through all types of economic climates, what you find is that the classic portfolio works well in the period we came through… but not in inflation or reflation
    - You need more exposure to hard assets and private assets.

- **What happens if they don't act right now to solve this problem?**
  - Not recover the losses you just took from COVID
  - Expecting a certain level of return to get you to your goals, you might not hit it.
  - Further losses if you're not allocated correctly.
    - The FED has given us a false sense of security that we can't have losses again. This is foolish

The Mechanism

- **How do people take advantage of the new opportunity?**
  - After decades of bashing active managers, I think it will become more in vogue
    - Take this year in example. You have the biggest swath of zombie companies in the S&P that are being propped up by indexing
    - As much as 15 cents of every dollar in the index goes into dying industries.
  - Much better is to have a process in place that lets you identify the smaller opportunities that are doing better.
  - Some of these big tech companies are facing more competition, regulatory risk, and potential tax implications.
    - This would have a huge implication on profits for these companies.
  - There will be new companies in smaller/emerging markets that could be the next winners
    - Remote Workforce and Zoom
    - The way people are traveling (RVs)
  - Would you be exposed to these trends in an index? Not in any meaningful way
    - But if you are taking a more active approach, you can be.

- **Are active funds the answer?**
  - Not necessarily. Active funds will benchmark on a relative basis
    - If the benchmark is down 20% and they are down 18%, they “beat their benchmark”
    - Most fund managers are closet indexers.
      - Their fear is losing their job
  - You have to seek out managers who are taking a completely different approach
    - This could be separate accounts
    - This could be hedge funds
    - The key is to understand the underlying process

- **What does your investment process look like?**
  - How are you buying and selling the securities?
  - You have to know yourself and find an approach you’re comfortable with
    - If you don’t, you’ll abandon the process
    - There will be periods of time where you feel uncomfortable and you underperform the market
  - There is a lot of emotional pressure to abandon a working strategy

- **Does the process you’re using give you an edge?**
  - If not, you shouldn’t be in the game.
  - Example: gambling industry

        - On the surface, roulette looks like an even game. 18 red and 18 black. But they do something sneaky… one or two green squares
            - All of a sudden, it's not 18/36… it's 18/38
                - This gives the casino a 5% edge
    - As an investor, you need to find your own roulette and be the house
        - For me, it's rules based investing. I've got a 70-80% win rate, and my average win is larger than my average loss.
        - The more time I can pull the lever, the more I can win.
    - Find what it is, understand it backwards and forward, and know how your edge is created.

- **The key to understanding compound interest…**
    - How can a small edge be interesting? The key is consistency
        - If you compound a small advantage month in and month out, the returns can be meaningful
    - Most people are striving for big home runs and they make big mistakes
        - They lose their chance of compound growth.
    - You have to keep capital in hand.

The Solution

- **How can people watching this interview get started with this new opportunity (and using this new information/strategy)**

    - **Start with the basic books.**
            - If you want to invest in growth stocks…
                - William O'Neils "How to make money in stocks"
                    - Founder of Investors Business Daily
            - Start with something proven…
                - Jim O'shaughnessy "What works on Wall Street"
                    - He's a quant guy.

- **Investing Styles and Strategies**
    - People can play breakouts, swing trade, trend follow…
    - It's hard to be a day trader if they have a 9-to-5
        - Most people want to have a "life" and not do what Time

- **How can you meet both your financial goals and lifestyle goals?**

        - Do you even know what those things are?
            - We've been told again and again we should measure up to an arbitrary index, which is foolish.
            - It's a benchmark, but not even an accurate one.
            - EXAMPLE: A cap weighted index isn't how normal people would build a portfolio. They'd do an equal weight.

        - Looking at your "Personal Benchmark"
            - Most of us are investing for income whether we realize it or not. We're either investing for income today or income tomorrow.
            - People need to sit down and spend a little bit of time with a financial calculator to determine this
                - How much income do you need to live your lifestyle?
                - How much money can you save/allocate?
                - How can I increase my returns based on what I have?

    - **Turn your investing style into a rules based "fund"**
        - Many of the top performing hedge funds globally are quant based / rules based.
        - The advantages are huge…
            - It eliminates human emotions and biases that kick in.
            - If rely on a rules based process, we can override these things

        - **Your investment business should have an objective…**
            - What is the process you're going to use?
            - Are you willing to stick to this process?
            - Is it a proven process in different market conditions?

        - **Asset allocation…**
            - Think more in terms of investing processes.
            - What is the process being used in Portfolio A vs Portfolio B
                - Process diversification gives you better diversity and more consistent returns.
                - If you're using a momentum system for one pool of money, mean reversion could be considered the opposite of that.
                    - What is the correlation between those two styles?
                - Don't assume that because you have 5 different managers you are diversified.
                - The goal is to build a portfolio that meets your need

- **"If you look at anyone who is really wealthy, the primary source of wealth is business ownership"**

        - What can you, the individual do, to create a business and monetize your intellectual property?
        - There's always opportunities in the real estate markets
            - People always need a place to live
        - In terms of the markets…
            - I look at rules based processes.
            - Once you have it all set up, you can spend 15 min to 1 hour a month adjusting your portfolio and adjusting things.
            - It's like navigating a plane…
                - If you talk to a modern day pilot, their job is to monitor the computer they are flying.
                - The portfolio should be adapting and adjusting just like that.
            - We're told to use a static portfolio and make few adjustments, but we're given a volatile market
                - I want my portfolio to adapt to the market.

- **The future is unknown…**
    - There is a large "predictions market" that is fun and fascinating to follow.
    - Instead, pick a system that means you don't have to predict the future, but can adapt to what is happening in the market now.
        - This removes uncertainty because you don't have to know anymore.
        - The portfolio is doing the adjustment for you.

- **Look for fund managers with a proven strategy that's been battle tested with real money, and ideally the fund managers money.**
    - "If it means underperforming for a brief period of time, to me that's acceptable if I know the trade off is I won't be exposed to major losses"
    - "Know the devil you're dancing with"

- **When you have a slight edge, and you know you have the slight edge, the goal is to flip that coin as many times as possible.**