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How A No. 1 Fund Survived, Learned From Great Recession

By **Juliette Fairley**

ARIEL INVESTMENTS CELEBRATED A MILEstone in New York yesterday with a press breakfast announcing that its Ariel Fund ranked No.1 out of 219 in Lipper's Mid-Cap Core universe since the market bottom on March 9, 2009 through December 31, 2018.

The mutual fund firm also released a study of lessons learned from the 2008 global financial crisis called From the Front Lines of the Financial Crisis. "This study is a reflection on the tough decisions we faced during this challenging time, what we learned and how this knowledge enabled us to strengthen our investment process," said John W. Rogers Jr., chairman, CEO and CIO of Ariel Investments.

Ariel Investments President Mellody Hobson moderated a panel that featured Rogers; Charles K. Bobrinskoy, Ariel Investment vice chairman and head of investments; and Timothy Fidler, Ariel investment director of research and co-portfolio manager of the Ariel Appreciation Fund. Below are key takeaways:

Practice Time Arbitrage

Although speed is of the essence because of cell phone communication, the internet and real-time data, Rogers practices time arbitrage, which is the ability to envision the future beyond where herds of investors are focused at any given time.

"Stocks are often mispriced when everybody gets excited about the current moment, and that's where the opportunities emerge to take advantage of the volatility that comes from all the short termism in our society," said Rogers, who majored in economics at Princeton University. "But if you're willing to look beyond it, that's where you can foresee opportunity."

During the financial crisis, Rogers consulted with a number of longtime colleagues and acquaintances including his former Princeton professor Burton Malkiel and value investor Mario Gabelli. After showing Gabelli his portfolio in early 2009, he was encouraged when Gabelli told him it was likely to do very well. As it turned out, 2009 was the best year in Ariel's history.

Devise A Method To Measure A Company's Strength

After the crisis, Ariel Investments implemented its own debt-rating process rather than continue to use existing rating agencies. "Rating agencies are slow to downgrade a company because it's an admission of a mistake and because the companies pay for the debt ratings," said Bobrinskoy, who is a high school classmate of Rogers. "An inherent bias exists. That's when we decided to create our own debt-rating process."

During the crisis, strongly performing but highly indebted companies were forced, by panic-stricken banks, to issue equity at very low prices, which diluted Ariel Investments. As a result, Ariel implemented new rules for how much stronger balance sheets needed to be before its fund managers would invest in a stock.

"We think that these new standards for strong balance sheets will be very helpful during the next downturn," Bobrinskoy said. "The strong balance sheets of our investments give us a competitive advantage, and it's the No.1 lesson that we learned from the 2008 financial crash."

Assign A Devil's Advocate

The management team recognized that having a devil's advocate on staff would bring balance to investing in companies long term. "We get along well as a team, so we assign the devil's advocate's job because it enables that person to yell and argue," Fidler said. "The devil's advocate role ensures that arguments are fresh."

The responsibility of playing devil's advocate is shared among various team members from industry group to industry group, but Bobrinskoy says he is the most vocal. "The equity market is an old-fashioned Republican that hopes to have its way and return America to a more free trade environment, which would be good for our numbers," he said.

Avoid Mixing Politics With Investment Decisions

Rogers' mother, Jewel Lafontant, was a republican who worked for the Republican administration of President George H.W. Bush as the deputy solicitor general after being the first African-American woman to graduate from the University of Chicago law school. Rogers himself is a Democrat who doesn't allow politics to influence his decisions about investing who has been close to President Obama.

"There were people during 2009, 2010 and 2011 that didn't invest in the markets out of cautiousness and conservatism because they didn't believe in President Obama," said Rogers, whose father John Rogers Sr. was a Tuskegee airman and Chicago circuit court judge. "As a result, they missed out on this extraordinary bull market and its happening again. Certain people are unhappy with some of the things President Trump says and does, and they've allowed it to influence their investment decisions. We don't do that."

Drop Losing Stocks Fast

Redemptions make for a better investor during a great recession, according to Rogers.

"Redemptions force you to take cash away from your weakest holdings and forces you to determine what are your weakest and most expensive holdings," he said. "That allows you then to have your confident holdings become a larger and larger percentage of the portfolio."

A perfect example are media companies that collapsed in 2008. But by the time he became aware, it was too late.

"We wish we had figured it out a year before," said Rogers. "We did get rid of those names eventually and then moved into some of our favorites that had gotten clobbered like leisure company Royal Caribbean and real estate services companies, such as Jones Lang Lasalle and CB Richard Ellis."

According to Rogers, during the crash, investors thought real estate services were worthless. "They ended up being the most extraordinary winners," he said. The same can be said for Rogers and his Ariel Investments mutual fund firm.

When it comes to making mistakes Rogers cited the observation of NBA superstar Michael Jordan, who he once publicly defeated in a one-on-game during a 2003 charity basketball tournament. Whether it's an investment or a basketball shot, one can't let a past mistake instill fear from taking the next shot at the buzzer or making another investment decision under pressure. FA