Markets | Odd Lots

John Rogers on the Art of Security Selection

Why the legendary stock picker is so bullish on The Sphere

by Joe Weisenthal and Tracy Alloway
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These days if you talk to people about the stock market, they might talk to you about the effect of the Fed. Or they'll talk about the Mag 7 and AI capex spend. Or they'll extoll the virtues of passive, low-cost investing. It seems like you hear less and less about the art of security selection: Finding cheap diamonds in the rough that have been overlooked by other investors. But some people are still keeping that world alive. John Rogers is the founder and co-CEO of Ariel Investments, and in his primary mutual fund he invests only in mid- and small-cap companies. Recorded live on stage at the Future Proof Festival in Huntington Beach, CA, we talk about his approach. He explains why he believes value investing still works, and the process he uses to select individual names. We also discuss what he looks for and how he researches stock picks. Among other things, he tells us why he's invested in The Sphere (yes, that Sphere in Vegas) as well as the company that makes the McFlurry machines for McDonald's. This transcript has been lightly edited for clarity.

John Rogers, founder and co-chief executive officer of Ariel Investments LLC, speaks during an interview in Chicago, Illinois, US, on Monday, March 11, 2024. Rogers says his peers on Wall Street are too pessimistic on media giant Paramount Global and real estate company Jones Lang LaSalle Inc.Photographer: Taylor Glascock/Bloomberg

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Joe Weisenthal (00:20):
Hello and welcome to another episode of the Odd Lots podcast. I'm Joe Weisenthal.

Tracy Alloway (00:25):
And I'm Tracy Alloway.

Joe (00:27):
Today, you're going to be listening to a special episode that we did recorded live on the beach in Huntington Beach, California.

Tracy (00:33):
That's right. We are back at the Future Proof festival. It is a very special event that gathers a lot of investment professionals to talk about markets and how they're actually investing through these very interesting times. And one of the most interesting investors out there, I think, has to be our guest for this episode.

Joe (00:54):
Totally. So, these days, I feel like when you talk to investors, we talk to people about the market, it's very binary. It's like, what do you think about the Mag 7? What's your view on AI? What's your view on CapEx spending? What's your view on the Fed, et cetera? And you don't really hear many of those like good old fashioned stock picking, security selection. And I miss that. I think it was interesting back in the days when like, you know, there's sort of like [Warren] Buffett and Graham & Dodd style of investing where like, 'Here is an interesting company. A lot of people don't know about it, but I found it. I like this stock, I like this company. And I think it going to grow bigger.' You just don't really get much of that discourse these days.

Tracy (01:38):
This also dovetails with my favorite ever style of analysis, which is just when an investor or an analyst just goes to one of the like companies or locations of the potential investment and just observes how everything is working and talks to potential customers and things like that. I love that style of investment. And we are actually speaking to one of the most famous stock pickers of all time.

Joe (02:01):
That's right. You're going to be hearing our interview with John Rogers. He's the founder and co-CEO of Ariel Investment Management, and he's very different. He's truly old school. It's all mid-cap and small cap-stocks. He's been running his mutual fund for decades now, and he's like this old schoo, classic-style stock picker. And you're going to hear our conversation about how he goes out and finds companies and talks to management and tries to uncover these diamonds in the rough, so to speak.

Tracy (02:32):
So take a listen. As a reminder, this was recorded live on stage at Huntington Beach as part of the Future Proof conference. You might hear some background noise. It was very windy that day. There was also a drone, which was an interesting experience, but we hope you enjoy it. Here is our conversation with John Rogers.

John Rogers (02:50):
It's great to be here. Never been to an event like this before.

Joe (02:53):
I know it's such an extraordinary event. I don't even know what would be like an equivalent thing that anyone could have been to before but, very excited to be here. So, in investing right now, there's a couple big themes that come up over and over again. There's the rise of passive investing in various flavors of that. They're just the incredible dominance over the last several years of the Mag 7 and big tech and their momentum and the sector specific stuff. You are a stock picker and you eschew that, that you're not just one of these people riding the Mag 7 and you buy a lot of mid cap and small cap stocks that are in fields that maybe people don't think about. What's your pitch when people look at the rise of the Mag 7 or indexing, what's your pitch for security selection in other realms of the market?

John (03:43):
Well, I think it starts with the fact that Ariel Investments is almost 42 years old. So we've been through a lot of markets. Of course, we've studied market history and read about what happened in all the great bubbles that have happened throughout the world, and all the great corrections and all the big booms that happen. And we have these massive ups and downs in the market, but ultimately, it is very cyclical. So I was just reading Chuck Royce, who's been managing small cap stocks for over 50 years, the legendary investor. He's finally retiring and he talks about how these waves come and go. And this one in particular reminds him of the Nifty Fifty, when Polaroid, and Xerox, and Johnson & Johnson, and IBM all sold at extraordinary multiples.

People thought it was going to last forever. They were called "one decision stocks." You'd buy them and you own them. But of course, that changed. 1973, 1974, the market's collapsed, and we've all seen the ups and downs. So for us, what we tell people is, when you get these extremes and everyone's buying a stock because it's gone up a lot yesterday, it's part of an index, you're getting toward the top, and the multiples show that. The valuation differences between large cap growth and small cap value is one of the largest in history. So we feel highly confident it's going to be a better time for the smaller undervalued securities.

Tracy (05:05):
You mentioned waves of investments kind of coming and going. I feel like I have to ask the obvious question, since we're here with one of the most famous stock pickers of all time, but is value investing dead? You're still here, you're still going. You seem very much alive. Why do people think it's dead?

John (05:25):
I think they think it's dead because this period of growth stocks outperforming value stocks has lasted so much longer than normal history. But again, if you go and read the famous book by Burton Malkiel, A Random Walk Down Wall Street, he always explains and shows you these bubbles and how they burst. And when you, of course, you study Warren Buffett, and he always reminds you that you want to be greedy when others are fearful and be fearful when others are greedy. He's always so consistent about that because he realizes that things get out of hand. When everyone chases the hot stock of the moment, those securities get overvalued, and the ones that are left over – I call them the orphans – they're selling at very, very cheap prices. And eventually companies are going to sell at the discounted present values of their cash flows. And if you can get them at bargain prices, it's a really great, great thing. And these cycles always end and they always end when everyone's convinced that they can't end.

Joe (06:20):
You know, you used that word 'orphans,' and I think that actually leads to something that I was thinking about as I was preparing for this interview. You know, like on a day-to-day basis, sometimes you'll see like, oh, "small caps outperforming," or "the Russell [2000] outperforming" and so forth.

But it seems to me that one of the reasons one might go into smaller stocks is not necessarily because they're small, but because they're literally orphaned, they don't have the analyst coverage, people aren't familiar with the names, people aren't familiar with the industries. If someone is interested in small caps, does it make sense to do it on an index level, but rather do it on a, 'find those orphan stocks that nobody knows about' level?

John (07:01):
Well, I do believe strongly that the opportunity to take advantage of the very rare inefficiencies in the market are in the small cap sector because there's less well-qualified and thoughtful research being done in the smaller stocks. Investment banks can't get paid as much working in the small cap sector.

And so in my 41 years, I've seen the number of small cap analysts decline significantly. The ones that are out there are sort of following a lots and lots of companies sort of a mile wide and inch deep. They don't know their companies in depth. So it creates this opportunity, these orphans to be able to find some inefficiencies in the marketplace, where the research isn't being very well done, and you can just find some magical, hidden nuggets out there in the marketplace. And these things happen from time to time. And I do feel we're in a period now where there's a lot of opportunity there.

Tracy (07:53):
How do you come across those types of orphan stocks? Because, as Joe just mentioned, these are often smaller companies that don't actually have analyst coverage. There are still a lot of them out there. So how do they come across your desk, I guess?

John (08:07):
Well, it's a couple of ways.

Of course, at Ariel now, we have 130 people, a lot of people helping us do the research, and we have the industries that are in our circle of competence that we follow. So we have a lot of people looking and searching for ideas and understanding all the cheapest stocks in their sector, the most expensive stocks in their sector, and becoming true experts over the years in their sectors. So I think that's first and foremost. We're working to focus on those areas that we know really, really well. So we know where the bargains are, we know where the expensive stocks are.

The second thing, though, in case we miss something, we use the computer and screen for cheap stocks, and we think that's really, really important. I noticed the Morningstar banner here. We love to read and study what other small cap value managers own. And as the years go on, you get to know who are the people you respect, because as we touched on earlier, there's not as many active small cap value managers left, but those that are out there, we just love to see their list of top 30 holdings.

Get their quarterly reports and get all their holdings and see where there are some creative ideas that maybe you haven't thought about or hadn't thought about in a long time. And then finally, of course, just reading extensively, you know, reading every publication you can, you know, on the plane here, you know, you're reading Barron's, you're reading Businessweek, you're reading Bloomberg.

Tracy (09:29):
Thank you for the plug. Appreciate that.

John (09:32):
You know, you were getting the research reports from all the major brokerage firms, just reading and reading and reading and reading, searching for ideas, seeing ideas that you might have missed. I think there's no substitute for doing that work.

Tracy (09:45):
And what counts as a cheap stock in your book? And has that perhaps changed over time? Like, is a stock that was considered cheap in the 1980s perhaps different or measured differently to a stock that might be considered cheap nowadays?

John (10:00):
I think the basic principles of value investing is still the same. You want to buy stocks that are selling at low multiples. Now, maybe a generation ago we talked more about price-to-earnings ratios. Now you're looking at price-to-EBITDA ratios and understanding whether stock's undervalued. But that's really, really important, to look for cheap, cheap companies. Second thing you're looking for is we want to make sure the company's selling at a 40% discount to the private market value. So we do the discounted cash flow analysis that they teach you in business school. You get the idea of looking at those future cash flows and discounting them back and finding out the true value of a business. And that's an inexact science, but we want to buy those stocks at a 40% or more discount. And that's the way that we define what a bargain is.

Joe (11:01):
So anyway, I'm a really big fan of the Sphere. I went there, I saw Dead & Co earlier this year.

Tracy (11:06):
You're a Sphan. That's a good word.

Joe (11:06):
Yes, a Sphan.

But it's one of your bigger holdings of your portfolio. And I don't know if everyone knows that The Sphere in Las Vegas, this extraordinary venue, is publicly traded. But just because, I'm interested, we're interested in how the art of stock picking, can you talk [to] us a little bit about the thinking of how you wind up with a few percent of your portfolio in this Sphere?

John (11:28):
Yeah, it ended up kind of by accident, I have to say. You know, we owned Madison Square Garden Entertainment, which, in the old days was, one, you own The Garden, which is an extraordinary company, extraordinary event place, of course, the world's greatest arena. And you know, Warren Buffett always says, you want to buy a company where it's hard to replicate it, you know, where there's a true moat around it. There's only one Garden. It's something really special. And they own the Knicks and they own the Rangers. They owned the regional sports network. They had everything under one roof.

Over time, they all split up into separate companies, sports companies, a separate public company that's the Knicks and the Rangers. The Garden is separate. They own the Beacon Theater and, the Chicago Theater and Radio City Music Hall they control, and the Rockettes and the Christmas show.

And then they spun off the Sphere. Jim Dolan started the Sphere when it was under the umbrella of Madison Square Garden. And so we got it in spinoff, never dreaming we would have assets in one new business like this. But the stock seemed extremely, extremely cheap. It seemed like it was being given away. As we did our homework, we got quite excited about it. We went out and took the hard hat tour while the Sphere was being built. We went to Southern California and outside of LA and went to visit in Burbank. We went to see their sort of mini-Sphere where you could see...

Joe (12:56):
I didn't know there was a mini Sphere.

John (12:57):
Yeah. It's a place where they could show you how the sound was go, look how the visuals are going to look. Everything was right there at that mini-Sphere. And it was magical. You walked in there and said, they are transforming the way you're going to be able to experience entertainment. And I was talking to the general counsel of the Garden. He was saying he remembered sitting down for dinner once with Jim Dolan and Jim Dolan sort of writing it on a napkin and just drawing the sphere and saying there would be nothing like it in the world. And he's actually accomplished it. You know, it's this huge globe, most of you know, out right in the middle of Las Vegas, not far from the Wynn Theater. And it seats 20,000 people. And it has, it's like virtual reality on steroids, on double steroids. You know, everywhere you look, you see these magical images when you're ever, you're in the Sphere and they have great video. You know, they have right now the postcards from Earth the rumors are the next big video is going to be the Wizard of Oz using that content in a magical way. And of course they have concerts and U2 is opening night. Yeah. they got the Eagles coming, they've had the dead there. And people everywhere, you talk to anyone who's gone to one of the concerts, they just say they've never seen anything like it.

Joe (14:14):
I could confirm.

Tracy (14:15):
Joe went to the sphere earlier this year and wouldn't stop talking about it.

Joe (14:19):
That's right.

John (14:21):
But I guess one thing, I'm sorry to jump in, One thing, looking forward, you gotta believe that they're going to come up with more interesting and exciting content outside. They'll be able to advertise on the outside of what they call the Exosphere. You have to also believe that eventually more countries will want to have their own sphere, you know, South Korea, The Middle East, Asia, wherever you think about it, that'll be what is the catalyst that can really create a lot of value.

Tracy (14:47):
So one thing I was curious about, and you know, you kind of touched on this, but one thing about The Sphere is it is very unusual, right? Yeah. Like, there hasn't been anything like it before. How do you evaluate the comparables for that business model? Like what are the comps for a giant sphere in Las Vegas?

John (15:06):
There really is nothing like it in the world. So there's, there really are no comps. Because It's never been done before. And it's not typically an Ariel Stock, you know, because we like to find companies that have a long history of success where you can have comparables. It's a really excellent point, but there's just everything's being done for the first time. And kind of the idea is that as they experiment, the technology will get better, the sound will get better, they'll learn new ways to use the content. Right now they have a movie playing that is a concert video of YouTube playing there. They don't even know how to describe it because they've never been anything like it. So you've gotta believe corporations are using it for the first time for big events. Hewlett Packard used it fora strategy session for all their most important clients and employees, QVCs used it, but it's all, it's all new, it's all fresh. You gotta believe in Jim Dolan, who's a very controversial person that they'll be able to pull this, pull this off in a spectacular way.

Joe (16:08):
You know, one thing that struck me when you were telling this fear story there is getting to see it with construction and that relationship that you can build with management. And I have to imagine that, again, when we're talking about opportunities and smaller names, stocks, that can be, you know, part of the opportunity to find alpha can be getting to really know management teams in a way that I imagine is not as easy or is more commodified perhaps with the mega cap companies. Can you talk a little bit more about your communication with companies and getting to really know who's running them as part of your investment process?

John (16:44):
I think it's a very important point. I think part of the benefit of being around almost 42 years now and having a reputation of being a long-term patient investor – you know, we have a turtle as a logo – and then people can see that we buy stocks while they're out of favor and hold them for the long run. So you can imagine companies love having us as shareholders. People are going to show up when everybody else is selling. And the fact that there's a group of us grizzled veterans I call us who've been together, most of us for more than 20 of the 42 years been through the financial crisis together, the USA downgrade together, Covid together. I think the management likes talking to experienced analysts. Experienced portfolio managers. And so we talk to our companies every single quarter. We're all on the line together.

We build those relationships in time and then we go visit companies. We were just down somewhere, not far from here, but we went to visit Invista, which is a large dental company. It's really cheap. They do dental products and helping people with implants and alignment and many, many other products. They're one of, you know, three or four major dental products companies in the United States. It's a worldwide company also. But you know, there's a new CEO. He took his time to be with us today and he had his top, at least a dozen of his top management there to visit with us.

You know, that I think that happens because of the reputation that we've built over time. But we like that one-on-one opportunity to look people in the eye and determine whether we believe in them or not. You know, a couple weeks ago we were in Florida to visit a ADT the security company. We just think we are going to constantly be in front of these people face-to-face and then of course invite them to Chicago or to our New York office and visit with them also in, in, in those face-to-face opportunities.

Tracy (18:35):
So you mentioned the long investing timeframe that your company has or the patient capital idea. And I guess one question I always have when it comes to value investing is what is the timeframe in which an investment counts as successful? Because if I was being facetious, I could say, well, on a long enough timeline, everyone is a successful value investor. But like when do you decide, okay, this has been really successful for us?

John (19:04):
Well for us, if we're buying a stock at a 40% discount to private market value and, and low multiples to EBITDA and earnings and cash flow, it's when the stock no longer sells at a discount to private market value. When we think the market is recognizing all the underlying fundamentals of the business, people understand the story. There's a lot of bullish analysts on the company, everyone's sort of piling into the stock. You start to realize then that maybe you don't have an insight that the market doesn't have. And it's no longer that undiscovered orphan. It's a company that's got lots and lots of friends talking it up and enjoying it. That's the time we'll start to lighten up under security when it's on the good news. And of course we have to always work like all of us do at getting away from the bad hands.

When you've made a mistake, learning how to sell a company that maybe doesn't have the future that you thought it had, it's not going to be able to grow the way you thought it had. It's hard to get away from those stocks. So inevitably they, they get to be very, very cheap. But that's something we're constantly working on, with our learning about our own behavioral biases, studying behavioral finance, trying to make sure that, you know, again, you don't fall in love on the upside and you have the courage to sell and get away from the company when it's not going to achieve the goals that you originally thought.

Joe (20:19):
You know, something that occurred to me, you know, you mentioned a dental company and a security company and I think I was looking at your portfolio earlier and there was a manufacturer of equipment for food companies in there, if I recall. Do companies that are in industries that aren't hot have a moat by virtue of the fact that they don't have a lot of new upstarts attacking that field?

John (20:41):
Yes. That's what we're always looking for is that mode. That is probably the most important question we have with management, is constantly pounding away in every way that we can with our questioning to determine whether they have a moat that inhibits new competition from coming in and causing problems and causing trouble. So you mentioned the restaurant equipment company, Middleby, they're one of the largest manufacturers of restaurant equipment in the world. Really well-known brands, but they bought a company that we used to own years ago when it was an independent company called Specialty Equipment. And it's a good example of a manufacturer with a moat. They make the Taylor ice cream machines that you see in every McDonald's that make the McFlurry's and the milkshakes. And you see them in many ice cream company or stores and restaurants all over the, all over the world. But they have the preeminent brand.

So anytime a new McDonald's gets built, they're going to have a Taylor ice cream machine in there, or two or three of them. You're going to have a Taylor clam-shaped grill to cook the hamburgers. And whenever they come up with a new model that can refresh the restaurant, they have to go and get new Taylor grills in every restaurant around the world. That's a great company with a great mode. Plus they provide the service to keep the machines running. You might have read that sometimes these ice cream machines break down. I have heard that. Yeah. So you gotta be in there using their service people to fix those machines. You can't just go anywhere a lot of times. So those are the kind of things that really we find, think you can find moats in, in, in some of the strangest places.

Tracy (22:24):
So I take the point about moats for certain companies, but a lot of your big investments right now have to do with entertainment. So we talked about the sphere, we talked or you mentioned Madison Square Gardens. A lot of those feel to me like they are tied to the general consumer outlook, the macro outlook. How are you thinking about that at the moment? I know you're not a macro person, but you did have a call that proved to be correct last year. A lot of people were expecting recession in 2023. You said you thought there wasn't going to be a recession and ultimately you proved Right. So how are you thinking about the connection to the macro environment in terms of your investments?

John (23:05):
Well, currently, I mean, we continue to believe that the economy is stronger than most people have anticipated. There, there are no signs of real recession, broadly speaking. And we're optimistic that the lower interest rates that are coming will, will. The Fed has it about right. We think they'll keep us in a good place and have a softer landing. The thing that, where we see most of the problem and trouble is in the lower socioeconomic part of our economy, where people, you know, are struggling with inflation, struggling with some of the unemployment, struggling with certain industries, have had a really difficult, difficult time. So you'll see disappointments in companies like Starbucks and McDonald's in the past where, you know, people have struggled to be able to afford to spend as much money in those restaurants as they could have. Where we have found success is really with the higher end consumer people who are, you know, who are making a good income.

So example, Royal Caribbean, the average income of a, of a, of someone on one of their ships is roughly $150,000. People who can afford to go on a cruise and enjoy the cruise and have a, you know, get a massage and enjoy the whole experience. We think that's important. We talked about the garden, those are expensive seats. You have people who can afford those seats. We own Manchester United, the soccer franchise. And again, you know, people have to be wealthier to have season tickets, to buy a sky box or what have you, to go to radio, radio city music hall at Christmas time. So we think that we've been trying to protect ourselves that if, if, if we're wrong and the economy is weaker than we anticipate, it'll hurt the, the smaller consumer, the less wealthy consumer, much more dramatically than the wealthier consumer.

Tracy (24:46):
Joe, I was at the cruise terminal at Long Beach on Saturday, not to go on a cruise obviously, because I'm here now. But just to look at the very large ships and all the containers. Yeah. And I can confirm there are still a lot of demand for cruises.

Joe (24:59):
Tell us more about the cruise business, because this was a, you know, thinking back to four and a half years ago, this was ground zero. It was probably the first industry that truly just went to zero overnight, basically when Covid hit. And then there were all these questions and then those were some of the first stocks that rocketed back. Tell us about the state of Royal Caribbean and the cruise industry right now.

John (25:20):
Well it is really a good example of what Ariel does Right now. The cruise lines are all doing extraordinarily well. Carnival is doing really well. One spa that that does the spa treatments. People are there not only getting massages and manicures and pedicures, some people are going there and getting Botox and other types of surgeries. You'd be surprised the amount of money being spent on these ships. So they're all doing extremely well. All the forecast and the bookings going looking out are terrific. But it also epitomizes Ariel though, because we've owned that stock Royal Caribbean probably going on definitely more than 15 years, closer to 20 years. It's a name we've known really, really well. Ken, Kuhrt, who follows that name for us, is a true expert in the industry. He goes to all the conferences, goes on the, the, the cruises to make sure that we are understanding what's going on there.

But we bought more of those stocks during 2008 and 2009 in the middle of the financial crisis. The cruise stocks got quite quite cheap. And then to what you referred to during the Covid crisis, we, you know, we didn't wait for the dust to settle. We talked to our management teams. We've been talking to them every quarter for, again, between 15 and 20 years. We could feel their confidence start to rebuild as we started to figure out that, you know, COVID crisis, the first first couple weeks of course were no man's land, right. But eventually, you know, things started to move in the right direction. We could start to feel their confidence build. So we added aggressively in our small-cap strategies and our SMID-cap strategies.

Companies like one spot in Royal Caribbean built bigger positions even though the stocks have been crushed, everyone hated them. It was the worst place to be in the middle of a, of a pandemic owning a cruise stock. But we said we want to buy more. And of course they've come back so remarkably well. They've been our absolute best performers since Covid.

Tracy (27:14):
Do you worry at all about this idea of pent up demand? So, okay, demand went to, for cruises went to zero during COVID,

but then it has come roaring back and a lot of people who were stuck at home for a year or so really want to get out and do stuff like go to sports games, buy concert tickets, go on cruises. Some people argue that like, okay, eventually that pent up demand is going to slow down a little bit. Is that something on your radar or something you're seeing?

John (27:43):
We keep asking the management teams there that over and over again testing them to see if they're seeing any signs of that. And so far, you know, the cruise lines have been holding up extraordinarily well. Now you never know, as we know, this is the most humbling business in the world. All of you know that. But we feel highly confident there. But it's interesting, our two, actually, our two of our worst stocks are stocks that did really well coming out of Covid because exactly your reason. Everyone was rushing toward them and now they got overconfident thought those cash flows were…

Joe (28:14):
Which, who are we talking about here?

John (28:15):
Those two. One was Invista, the dental company. They did really well with pent up demand for problems with your teeth.You know, it's a real issue, a worldwide issue. People could only put it off so long, but they've again struggled afterwards. They got their expectations way, way ahead. The same thing happened with Leslie's Pool Supplies. And after this, I'm going to go visit a a Leslie's pool store and there's a couple right nearby here. And how many of you guys have pools? Several hope you're using Leslie's

Joe (28:51):
This is really grinding it out, working the pavement, making the sales pitch to the audience here. It's a true value investor. I I respect it.

John (28:58):
So, you know, they they compete with Pinch-a-Penny, which is really big in Florida. That's expanding in Texas. But what happened, again, everyone was staying home during COD. New pools were being built. People needed to go to Leslie's and get the chemicals to keep their pools clean for their families. You know, new heater, new whatever. And then all of a sudden their expectations got high, they got too much inventory, everyone got too optimistic. Ended up with a cool colder summer, the summer before colder than anticipated, and all of a sudden their sales blew up. So those are our two that have been the most susceptible to phenomenon that you rightly identify, but we think now the worst is behind them and looking forward, we're quite optimistic and in both cases now they have a new CEO where we're getting to know and, and doing all our homework and channel checks on the quality of the people that have been brought in to get those businesses back on track.

Joe (29:53):
Yeah. You mentioned going to the shops and you're going to check them out on your while you're out here. Is that something you do regularly? Like, okay, we talked about meeting with the management, but actually just going in to see the consumer facing experience. Like do you go to McDonald's and see like, hey, are they keeping up their is the…

Tracy (30:08):
Mcflurry machine broken

Joe (30:08):
Is McFlurry machine broken? Like, is that, how is that, is that part of your consistent process across a lot of your companies?

John (30:15):
Yes. I think it's a big part of the process. It's not only going yourself and experiencing the product, but then talking to all the other, all your friends and family and any context and relationships you have to understand different perspectives, different points of view. So it's just not my perspective or point of view. If you want to get as many candid independent voices as possible and encourage all of our teammates at Ariel to do that. Maintain relationships with experts in the field, but also just, you know, again, getting common sense perspectives of whether the sphere is a special experience or not. Yeah. is the McFlurry really going to work when it came out? You know, it's, you want to do that. And for me that was an easy one because I, everyone knows I try to go to McDonald's every day. <Laugh>, I love it there. And I, I ultimately, I loved it so much. I talked about it so much. I got to serve on the board for 20 years. Wow.

Joe (31:07):
The dream.

Tracy (31:08):
I have an important question. Do you order in store or on the app?

John (31:13):
Well, I mostly order in in store, but I've learned how delivery works now and literally I can call and they deliver to my apartment in less than 10 minutes sometimes.

Joe (31:23):
Hmm. I think we should do an episode one day with you in McDonald's. because Tracy and I both are big fans of McDonald's as well and we had a meeting, we took a meeting at one several weeks ago, I think maybe next year. Like let's do one in a McDonald's and like you can just sort of, we can just listen to hear what you observe and what you watch and what trends you see. I think that'd be fun.

John (31:42):
I would wove that. It's my home away from home, so I'd be happy to be there.

Joe (31:46):
You know, it occurs to me experiences, even prior to Covid was a big thing. People talk about the change in consumption from goods to services goods to experiences and that fits with The Sphere and Royal Caribbean. And obviously events like this where people are coming from all over the country to hang out on a beach and, you know, talk about markets and finance and investing and stuff. Is that a secular trend that you expect to see continuing?

John (32:13):
Well, I hope not. because we are over-indexed to companies that have experience. I just think the experiences are getting better and I think Americans are enjoying them and it's a worldwide phenom-

enon. You know, my my daughter and I went to the Paris Olympics this summer. You know, she can't wait to go back to Los Angeles. We've gone to the garden to see Billy Joel recently. We went to Radio City Music Hall to see the Rockettes at Christmas. We just love those experiences and it's parts. I always say I'm doing my homework. I'm getting, you know, being, being paid to have these experiences. They're really special.

Tracy (32:49):
But so listening to talk about your overall investment philosophy, a lot of it seems like identifying market mispricing, so things that are underpriced by other investors. And I guess I'm curious over the years do you think markets have gotten more or less efficient? And one of the reasons I ask is, because Joe and I have been recording a lot of episodes about the rise of multi-strategy hedge funds, pod shops. And a lot of what they do seems to be also identifying dislocations in the market and then reacting to them very, very quickly. Probably not in the same way that a value investor does, but it seems like the reaction to news has gotten faster and faster. So I wonder how you think about that.

John (33:35):
Some of you know, I played basketball at Princeton and the stock market was my hobby while I was there. I had a broker across the street from campus. I loved the stock market. That inspired me to become a financial advisor when I first graduated. And then two and a half years later started Ariel. But you know, when I was at Princeton, Burton Malkiel was the head of the economics department there and he had just written A Random Walk Down Wall Street, you know, that legendary book that's now over 50 years old and has been reprinted time and time again. And he made such a great case literally 50 years ago about how efficient the market is. And then I grew up in Chicago, in Hyde Park as part of the University of Chicago community. And I dunno how many people know that, you know, university of Chicago has a kindergarten through high school.

And so I went to the University of Chicago High School and a lot of my friends parents were doing great work around efficient markets. Fama's daughter was in high school with me. And so I got to study everything that was going on at the University of Chicago. Took it very, very seriously and have been a big believer in efficient markets ever since. So I think that it gets more and more visibility as the years go on. But I would say I don't think there's any big shift in this. I think markets have been efficient for a long time. And I think that there are rare opportunities when you can find some inefficiencies. And, and I think it happens in an industry or the overall markets are in crisis or in euphoria, one or the other. That's when you can do homework and make some market deci make some individual decisions in an inefficient market. But those happen very, very, very rarely. And I think it's it's really hard game to play.

Joe (35:22):
Can you just talk more about this? because I'm fascinated by this idea because it does seem like generally markets are efficient, yet you wouldn't be in the business of identifying stocks if markets were fully efficient or always efficient. Can you talk a little bit more about this sort of the situations that you've seen that cause efficiency to break down and clear opportunities to emerge?

John (35:46):
Well, I think the best experience in my, my career, you know, again, I say you read about some of the craziness in the world and say that could never happen again. Yeah. And things that have happened over the last several hundred years that are just, you know, mind-boggling, the South Seaport and all the other, you know, 1929 and gold and the late seventies and silver, you know, you remember the Hunt Brothers being on the cover, I think business week with all the money they were making. And you know, so these things sort of come and gone. And I think that I was going to get to through looking at those past bubbles is that oh eight and oh nine happened and I was around in 1987 when the stock market went down 22% in one day. We were calling all our clients, say send us more money at the middle of that downdraft in the market.

And I remember telling everyone on the phone, this is a once in a lifetime opportunity, this is never going to happen again. And of course, 08-09 happened, which was much, much, much worse. And at the height of that, you know, you have stocks that you liked at 30, went to 15, you know, in the fall of '08. And by March of '09, those stocks were $4 or $5. And all the analysts had given up, you know, people who had said, buy at $30 were saying sell it at $5, the companies have no future. And he said, that can't be, you know, it didn't make sense. And if you looked out over the horizon, three to four years down the road, these were companies that had been around for generations and things would get back to normal someday the sun would come out and the storm clouds would go away.

But those kind of crazy experiences don't happen very often. But those are just so memorable because everyone gave up right at the bottom of March 9th, 2009, and all the clients that called up and fired us and all the analysts and the consultants who gave up right at the time when it was a time to buy. The guy who covered us in Morningstar was the one person Michael, who said, these are good companies. I'm looking at the cash flows of the companies looking at their profitability over the next three years. They don't, they're selling at prices that don't make sense, but it's a rare person who could see that and, and feel comfortable recommending buying the fund that's out of favor at the height of the decline of the bubble. Yeah.

Tracy (38:05):
What was early August like for you this year? The most, the most recent sell off, like, okay, it wasn't as bad as 2008, 2009 obviously, or 87, but there was a pretty substantial drawdown that happened over the course of a couple days. What happens at aerial investments during a period of that type of volatility

John (38:26):
When you, well you, when you get the kind of volatility that we, we've experienced a lot lately and even day-to-day volatility is greater than I've ever seen. You know, you just find from the opening to lunchtime to the close. So we are talking to each other throughout the day saying where, where's the, what stocks have declined the most? Let's see if there's some opportunities to pick up some of our favorite names and bargain prices. because Sometimes you'll see a stock down 10%, 12% that doesn't make any sense. Or a company that's had an earnings disappointment after maybe a couple of quarters of earnings disappointment. And again, everyone gives up after that third or fourth disappointment. And the stock's down 15, 20%. You do your channel checks as rapidly as possible. You talk to all the experts, you can, you talk to the management, of course, you talk to other buy side owners and sell side analysts. And then you, we come together and have emergency meetings ready to go in and buy more. Most of the time. Sometimes you'll find out something's changed, something's different. But most of the time, again, people panic together after

there's been a series of disappointments and you're in an uncomfortable environment. So we always look at that as opportunity and that's the way that we think about investing as value investors.

Joe (39:40):
John Rogers, this has been such a treat. Really appreciate you joining us and getting the opportunity to do this in front of the future proof conference. So thank you so much.

John (39:50):
Thank you. This has been really fun. Thank you.

Joe (39:52):
Thank you.

Tracy (40:06):
But that was a really fun conversation, Joe. I love

Joe (40:08):
That. I just, I love how old school it was. I love just talk. When I first got into investing years and years ago, I've mentioned a couple times I had this brief stint at a portfolio management company and that's what we did. We like, looked through like we looked for cheap stocks and we, it wasn't just about are we exposed to a few big names or not. And I really do miss that. So to me that was a total blast.

Tracy (40:30):
Also the McFlurry machine as a viable business mode. Yeah, that was kind of fun. Let's

Joe (40:35):
Really, we should do that episode with John and the McDonald's.

Tracy (40:38):
Yeah. Okay. Mcdonald's. Here we come. Shall we leave it there?

Joe (40:41):
Let's leave it there.