RAY'S CORNER

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Economic and Market Commentary

Perhaps one of the saddest chapters in American history was the forced relocation of the Native American peoples living in America's deep South in the early 1830s. Although its official name was the Indian Removal Act of 1830, it's more common name appropriately describes it, for it has come to be known as the "Trail of Tears."

For hundreds of years the people of the Cherokee, Chickasaw, Choctaw, Muskogee and Seminole nations maintained complex agrarian societies with sophisticated governments, laws and religious systems. They lived in towns and traded freely amongst themselves. After the Revolutionary War, a young nation led by George Washington worked hard to help process a cultural transformation which would assimilate these people into the new Republic. At first the process gained momentum. These many First Nations people adopted Western dress, they developed manufacturing facilities and produced their own newspapers. But this was not to last.

With the United States population growing and slavery expanding in the South, a groundswell grew for the removal of these Native Americans so that white settlers could move into these lands. President Andrew Jackson became an ardent proponent of this forced removal, and thus began an American tragedy. First to go were the Choctaw in 1831, quickly followed by the Seminoles in 1832. Next, the Creek, and then the Chickasaw, and in 1838, the removal was complete with the forced exodus of the Cherokee.

When it was all over, more than 50,000 men, women and children were driven off of 25 million acres of their fertile, forested homeland. A dry and inhospitable land waited for them at the end of their long journey. Thousands died en route to their new home in the Oklahoma Territory, west of the Mississippi.

In 1837, the Chickasaws were assigned land within the Red River Plains area, Indian Territory Oklahoma. Over the years, they once again would begin to prosper through hard work and toil, farming and raising cattle along the banks of the Red River and its tributaries.

By the 1880s, the town of Ardmore, Oklahoma, began to grow in Pickens County, Indian Territory, Chickasaw Nation. The Santa Fe Railroad was its lifeline. It grew into a major trading post for the region. In 1894, Big Bill Dalton of the Dalton Gang fame, was gunned down by a posse while trying to escape from his hideout on the outskirts of Ardmore. Four years later, my friend Charlie Sammons was born less than a mile down the road.

A Most Remarkable Life

To say Charles A. Sammons was born into humble circumstances would be an understatement of grand proportions. Orphaned by age 11, he went to live with his aunt in Plano, Texas. Bright and capable, nurtured but not spoiled, Charlie demonstrated a knack for business at a very young age. He started his first company at age 16, and by 19 he owned a grain and hay business. Never one to rest on his laurels, Charlie moved to Dallas in his early 20s. At the time, Dallas was fast becoming an industrial banking and finance center. Fashion and retailing began to flourish with the founding of Neiman Marcus and Sanger Brothers. The city had its first municipal airport and became the location of the 11th regional branch of the Federal Reserve Bank. It was around this time Charlie decided to get into the life insurance business.

By 1928, Charlie was a successful “debit insurance man,” meaning he had a route and would personally collect premiums from clients on a weekly basis. Many years later he would tell me how he had a tailor sew a double layer of fabric into his trouser pockets to support the weight of all the coins he’d collect during the day. He said people would hear him coming before he turned the corner due to the racket he’d make from all the change jangling in his pockets.

In the early 1930s, with the rest of the country in the depths of the Depression, business in Dallas was booming. Marion “Dad” Joiner struck oil in Kilgore, Texas, 100 miles to the east, and the great East Texas oil boom took full flight. Dallas was its financial center, and Charlie, along with two friends, started their first insurance company, the Postal Indemnity Company. Their company grew rapidly, acquiring other insurance companies along the way. In 1938, Charlie formed the Reserve Life Insurance Company, which became the basis for his future fortune.

As the Sammons’ empire grew, Charlie never forgot his humble beginnings. He gave generously to charitable organizations and was a benefactor to health care, education and the arts. He gave away hundreds of millions of dollars during his lifetime, and at the time of his death in 1988, his personal wealth was estimated to be in excess of $1.3 billion by *Forbes* magazine. Charles A. Sammons was widely regarded as one of the most admirable and philanthropic businessmen in America. Today Sammons Enterprises employs over 5000 employees, manages assets in excess of 60 billion dollars and continues to conduct their business committed to the highest standards of personal and corporate responsibility. Charlie set the bar high and firmly believed in the importance of “making a difference.”

The College Kid and the Billionaire

Charlie and I first crossed paths when I took my first job out of college. I came out West to go to law school and had six months before the fall semester began. I landed a job as a risk management trainee for one of Charlie's companies, the Reserve Life Insurance Company, Charlie's first big success. My office was at 1255 Post Street in San Francisco, in the old Jack Tar Towers, the twin 12-story, mid-century monstrosities every architectural critic in the West loved to hate. When the building opened in 1960, columnist Herb Cain wrote, "The best view in all of San Francisco is from the roof of the Jack Tar hotel because that way you don't have to look at it." The "Tar," as we called it, didn't bother me any. I was living large. I was making about $400 per week, a princely sum at the time. I had a robin's egg blue Thunderbird with suicide doors and a pretty girlfriend with her own TV show on one of the Spanish television stations. Life didn't get much better than this, and then it did.

A few weeks into my job at Reserve Life, I came to work one morning and the office was abuzz. You see, word was out that Mr. Sammons was coming to town. Not only did Reserve Life have their offices in the penthouse of the Jack Tar, but they owned the building as well. And since Charlie owned Reserve Life and personally liked to look in on his investments, he'd be paying us a visit in the next several days.

We Didn't Wait Long

The big day arrived later that week. Charlie showed up one day with little fanfare and no big entourage. He stood about 5' 7", square shouldered and strong chinned. Neatly dressed in a poplin suit, he looked like a cross between Fred Astaire and Colonel Sanders. He greeted everyone in the office, made the rounds with a handshake and a smile, and soon retreated into the Western Regional Manager Nick Rogoff's office for the better part of the morning. Around 11:30, Nick's assistant tracked me down, pouring over a Haines directory. She told me Nick would like a word with me. Now Nick was a suave guy with a penchant for double-breasted suits and silk pocket squares. Dark haired and standing a good 6' 3", he looked like a middle-aged Cesar Romero. I liked Nick. Nick told me when he hired me that "I could go as far as I want because I was born with the gift of gab." Nick had a way of telling people what they wanted to hear. On this day, he told me that Charlie wanted a word with me. I asked what in the world did Charlie want with me. He said he didn't know; that I'd have to ask him myself. Now Charlie was a considerate man. Even though there were no smoking ordinances on the books back then, Charlie chose to smoke his Honduran cigars on the Penthouse patio so as to not offend anyone. I found him on the west side of the building, stretched out on a chaise contemplating the ash on his foot long Punch. "You wanted to see me, Mr. Sammons?" Without looking up, he said, "Yes, I do, but I want you to call me Charlie." Pretty heady stuff for a kid meeting his first billionaire.

He invited me to sit with him. He wanted to know how I liked it at Reserve Life. I told him I liked it fine, that people were treating me well, and I was learning a great deal. I also told him that, come the fall, I'd be heading off to law school. What a dope. It never dawned on me in my naive state what a stupid thing that was to say. Why in the world would they want to invest time in a guy's training who would be gone in six months. It didn't faze Charlie for a moment. He blew on his inch-long ash and said, "If you want to be an attorney, maybe you should try prospecting amongst lawyers here in town. If you've got the law in common, maybe they'll give you an appointment." Pretty clever, I thought, I'll have to give that a try.

It's at this point, in an effort to hold up my end of the conversation, I asked Charlie what brought him to town. He told me that he was working on a deal for a new company spokesperson. Charlie was always working on a deal, and with any luck, in a few weeks he might have someone I'd like to meet.

Taking Charlie's Advice

It wasn't long before I took Charlie's advice to heart and started meeting attorneys and getting insight into a profession I professed I wanted to pursue but really knew little about. I knew it was a white-collar job and that you needed good communication and research skills. What I hadn't thought about was the prospect of living a professional life in constant conflict, nor did I realize just how many attorneys there already were in Baghdad by the Bay. I'd have to process this.

About six weeks after our first meeting, word had it that Charlie was coming back to town and had a big surprise. The day of his arrival the office was humming, and once again, Nick's assistant told me that Charlie had someone he'd like me to meet. I wound up heading into Nick's office and found the three of them with their backs to me looking out the window at the city below. Nick and Charlie were easy to recognize. After all, I was expecting them to be in the room. It was the third man whom I didn't know who wound up throwing me for a loop. He was clearly well-built, maybe 6' 1", 210 pounds, broad shouldered, with short, cropped blonde hair turning gray at the temples. When he turned around, you could've knocked me over with a feather. It was "The Mick," Mickey Charles Mantle, the great Yankees center fielder and baseball idol of my youth.

Well, it turns out the Mick was from Spavinaw, Oklahoma, and thought the world of Charlie. The two of them had just penned a deal, and Mickey Mantle was the new spokesperson for Reserve Life. Charlie went on to tell Mick, "Ray here is a pretty fair golfer like yourself," at which point the Mick tells us a story about having just played in a charity golf tournament where one of his playing partners drilled a two iron, and the ball hit the Mick squarely in the left temple, some 75 yards down range. Knocked down but not out, Mick told us he dusted himself off and finished the round. That's what I call a spokesperson.

Charlie's Rules

That spring and into the summer, I continued to work hard, but as law school loomed closer and closer, I started having second thoughts about becoming a lawyer. I started thinking, did I really want to always be in conflict, or did I want to find a career path where I could work collaboratively with others. Eventually collaboratively won out, and I decided I wanted to get into investments.

Toward the end of the summer, Charlie came back into town and asked to see me. I couldn't wait. He told me he had heard I'd been rethinking my career path and was considering a career in investment management. I told him he had heard right, and in large part, I owed my epiphany to him. If it wasn't for him, I never would have reassessed my commitment to studying law. Charlie was never one to take credit for anything. He took pleasure in helping smart people make good decisions, so he told me if it was my intention to get into money management, he had three basic rules that he wanted to share with me:

Rule Number One: ***People don't like to lose money.***
Rule Number Two: ***They like other people to lose it for them even less.***
Rule Number Three: ***Never forget rule numbers one and two.***

Charlie's advice has never left me. I have long managed money with the bias toward avoiding an oversized hit in a down market. Why? Simple. Just remember, if your equity investments go down 50% in one year, they have to go up 100% the next year to bring you back to even. Simple, right? But you'd be amazed at how many people don't get it.

Human nature

Behavioral scientists will tell you that after the year we just had in the market, it leaves many with a false sense of security and an unhealthy confidence in their stock picking prowess. Just remember, trees don't grow to the sky, and already January, 2014, has been a cruel reminder of that.

Last Friday, the Dow dropped almost 300 points. What drove the decline? No clear answer. Is it coming to grips with December's weak labor numbers? Is it fear of a hard landing for the Chinese economy, or maybe the 15% decline last week in the Argentine peso? Do you know how many times the country of Argentina has defaulted on their national debt since I left college? Three. Argentina has defaulted not once, not twice, but three times on their national debt in the last 30-odd years. So the question begs to be asked, with a minefield of dangers lurking about in the equities markets, what can investors do to protect themselves? Well, one of the most important things they can do is deploy capital thoughtfully among asset classes with covariant relationships.

The Three Cs of Portfolio Building

When asset classes move in tandem in a portfolio, they have a positive *covariance*. When investors seek a portfolio whose assets have diversified earnings to smooth out their ride, they need to pick assets that have low covariance to each other. Now, *correlation* is the statistical measure of how asset classes move in relation to each other. Positive correlation is when assets move in lockstep with each other, either up or down, and are assigned a co-efficient of +1. Negative correlation is when asset classes move in the opposite direction to each other and are assigned a correlation coefficient of -1.

The final "C" in our portfolio primer stands for *capital structure*, the mix of debt to equity a company uses to finance its overall operations and growth. Typically, savvy investors would mix both debt instruments with equity instruments to lower their correlation and mix assets that have low covariance to each other to dampen volatility. But these days it's not that simple. In fact, the bond market is now coming into a period of heightened volatility and market risk not seen in more than 30 years.

End of the Bull Run

For more than 30 years, interest rates have trended down, resulting in a bull market of historic proportion for bonds. Fueled by unprecedented aid from the Federal Reserve's near zero short-term policy rate and an $85 billion monthly bond buying program, bonds continued their ludicrously low yields until the wheels flew off last May. Days after the 10-year treasury yield hit a 2013 low of 1.63%, *Barron's* ran a column under the heading *"Abandoning Ship on Bonds."* The article cited not the trough in treasury yields but in junk bond yields, which had just dropped below 5% on average for the first time in market history, only four months after falling below 6% for the first time. Back then, it was observed that "bonds might not be in a bubble, but they certainly aren't doing what they were once supposed to do, i.e., provide reliable, adequate, low-risk income and dampen portfolio volatility."

Perhaps Meg McClellan, head of U.S. fixed income at J.P. Morgan Private Bank, said it best when she wrote, "*Whatever strategy used to work during a 30-year bull market no longer makes sense in a portfolio today. It's not going to protect capital, and it's not going to work as an anchor against stock swings.*"

So Where Does That Leave Us?

Bond managers should never be complacent, and the good ones never are. Look no further than the Pimco family of bond funds to see the lengths managers will go to in order to extract a few extra basis points of total return. Case in point: last year the world's largest bond fund, Pimco's Total Return Fund, had a portfolio turnover rate of 380%. Their GNMA fund had a staggering 1502% turnover rate and produced a -2.76% for the year for their efforts—performance that provides mute testimony for the necessity of tactical changes in client portfolios. But how do you do it without altering a client's portfolio risk level?

One strategy we have been employing successfully since last summer is allocations into quality preferred stocks and convertible bonds with short-term maturities, cumulative features and built value on their conversion privileges relative to their comparable call option prices. This strategy has required active trading and a firm commitment to the model. No home runs here, just "Money Ball," the hope of hitting lots of singles and avoiding strikeouts. More and more fixed income managers are employing alternative strategies that have collectively taken on the moniker of "Unconstrained Bond Funds."

In Conclusion?

Let me just say that my summer at the Jack Tar Hotel so many years ago, under the tutelage of Charlie Sammons, left me with strong convictions to never chase performance, not be afraid to question and innovate and never forget Charlie's rule numbers 1 and 2.

With Best Regards,

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