Dream Machine

Episode 6: Richard Woolnough

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Alex Matcham: Welcome to Dream Machine with me, Alex Matcham, and my colleague Laura Brown. Each episode we're going to speak to one of our fund managers in an attempt to get to know the people behind the portfolios.

Laura Brown: That's right. Every episode we're going to be asking our investment expert what their favourite drink, packet of crisps or chocolate bar is.

Alex: As well as some other questions to help to get you to know them a little bit better.

Laura: Obviously we should say this isn't a promotion for any of the items that we're talking about. There is a whole world of snacks out there.

Alex: Indeed, as always, none of the content on Dream Machine should be taken as financial advice or nutritional advice. If you are unsure, you should speak to a financial advisor or a nutritionist.

Laura: Right, so with those disclaimers well and truly out of the way, let's begin. This episode, we're joined by Richard Woolnough, Fund Manager on our fixed income team at M&G Investments. Richard's been at M&G for 20 years and has a particular focus on credit. Welcome Richard to Dream Machine.

Richard Woolnough: Hello

Alex: So Richard, how did you react when we asked you to do this podcast?

Richard: I was travelling with you on the train and it's always a good idea to get together and chat and at M&G we try to be as transparent and open as we can so I'm looking forward to the interview.

Alex: Excellent, excellent, well we look forward to hearing your selections in due course.

Laura: And perhaps if we start Richard, with a bit of understanding of how you entered the world of investment, how did you get into the world of investment?

Richard: Really I've always had an interest in economics and so I went to University in London, London School of Economics. Always enjoyed it. The 70s was a time when there wasn't much on television. There were only three channels. After children’s programmes the news was on. News was full of economics and so I had a very good economics teacher. I enjoyed the subject and then was living in London and entered the industry.

Laura: And do you start on the equity side? Is that right?

Richard: I started on the sales side, so Alex often asks me for tips. So yeah, I started on the sales side, but Alex is a far better salesman than me.

Laura: Excellent.

Alex: But you did run equity strategies for a period of time.

Richard: Yes, I spent a lot of time doing equities and it puts us in a slightly different position, especially these days when people get specialised and segmentised early on in their career and not only necessarily by asset class, but part of the asset class, whether it be tech, commodities, growth, value, whatever it might be. Or by country or region, or by all of them. So, you know, being a generalist is far more interesting, and I think it's far more appropriate to being a bond fund manager where what drives returns changes over time.

Alex: And what made you make the shift from equities to bonds? Was it just about opportunities?

Richard: It's a growing market, I mean the bond market in the sterling wasn't really started, really was de minimis in terms of issuance in 87 to 88, 89 and slowly and surely it got bigger and bigger as the international capital markets developed. Then it went from being 10 issuers, well can't have a career when there are 10 issuers and they're all double A and triple A, but slowly and surely the capital markets broadened up. And so, you had lots of investment-grade issuers, lots of pension fund demand for long-dated assets, lots of annuity demand for long-dated assets. So, the investment universe grew tremendously. Now as the investment universe grew tremendously, then obviously it was a great place to be. And it continues to grow, which is a surprising thing, you know. A number of years on, the development of the euro has created a huge European capital market.

Global trade has resulted in a huge US capital market. And those things have been a big change and whether that be, before it was governments or quasi governments, now obviously the debt universe is populated by a great deal of lower investment grade and a great deal of high yield as well, so the universe has changed. I think the big driver over the last, 10-15 years of that, has been the banking market. So, the banking market used to borrow short and lend long. They're no longer permitted to do that as much as they did before post-financial crisis, when it was shown that growing short and lending long could result in liquidity issues. And so that financing has now moved into our marketplace. Like any market, once it gets bigger, it begets more things. And there's a symbiotic relationship. More and more investors come, more and more issuers come, more and more issuers come, more and more investors come.

Laura: Shall we kick off formal proceedings on the vending machine side? So, we're starting off with your dream drink item, Richard.

Alex: So, what have you gone for Richard?

Richard: I've gone for a Coke original, so a full fat it has to be. So, there's more value for money presuming in a full fat than a non-full fat. So yes, this is what we've gone for, a classic any time-of-day drink.

Laura: Any time of day, really. Pre – breakfast?

Alex: So, you'd have that anytime.

Richard: Breakfast, if need be, yes.

Laura: I tend to have a psychological pre-ten o'clock, no fizzies.

Alex: No, but if the situation determines that you need a full-fat Coke, there are scenarios.

Laura: Yes, that is true, that is true.

Alex: You talked about the more value for money for a full fat versus Diet Coke. As a bond investor, I've heard you often describe yourself as a value investor in bonds. Is that something that kind of permeates throughout your life?

Richard: Everybody's like that, everybody's trying to find, you know, what's appropriate, what's the appropriate risk reward, what's the appropriate value. So yes, it's something that you spend all your time thinking about odds, thinking about what's likely, what's not likely. I spend a lot more time doing it at work where that framework is established than obviously at home. So, you know, that's the various.

Alex: But I quite like the idea now that I can apply it to Coke, because I think you're right, is that actually you're getting probably for a similar price, you're getting more.

Richard: Well we have the same value for discussion on the train again. Go back to train, it's like season ticket, not season ticket**.**

Laura: And what was the conclusion?

Alex: It's an exhilarating chat.

Richard: We have a different outcome.

Laura: Okay, so you're a season ticket and you're a non-season ticket.

Alex: I am, yeah. Rich is much better at that though, hence my question. So, he gets full value. You obviously had a very successful long investment career, what keeps you motivated?

Richard: That's the opportunity set. There's usually something to be done, something interesting. There's something that's a challenge in terms of trying to interpret where the markets are priced and where the data is. So, it's solving that puzzle of where, how to invest, where to invest, what's the risk reward? And that's what drives what we do and makes us different. It makes us different from people who get in the market, get in the morning and say, what shall I do? Oh, I'll just rebalance the index. That might be what motivates them, but it's not what motivates me.

Alex: And on the flip side, how do you kind of switch off from markets?

Richard: I'm quite sensible, so you compartmentalise your day, so you have a time when you're thinking about work and then times when you're not. Sometimes you might suddenly have an idea when you're away from the office that something's churning away in the back of your head and then you go and check to see if it makes sense when you return there. So really it's just a function of seeing the broad opportunities out there and keeping an eye on how the data changes. And if there's information that changes your view, you work out if you want to change your view or not, or if price changes does that change your view and that's the way we work through it. So we try to think from basics every time we recognise that the rules the game keep changing and as those rules change then it makes sense to adapt with them**.**

Laura: The only question I was going to ask and I wasn't sure, was if you're going into the industry today where would be your areas of interest?

Richard: That's a good one.

Richard: I think it's a very different world, I think it's become a lot more specialised, a lot more filtering goes on, about how people come in, it's generally a lot more ordered.

Laura: Your point about segmentation, like almost everything's in a bucket now, that creates more, you have to focus more quickly, I suppose in that?

Richard: Yes, I mean, you, well it's a strange thing. You might argue become segmented and specialised you start really early, but you don't get segmentized or specialised till you're really old. So you go for the generalist training. So graduate, probably a postgraduate now because a number of people are going to university to get in, graduate recruitment programme, it's two years, a round of desks. How old are you going to be before you actually, then you're given a speciality and then you might work on that for two or three years before you make a decision.

So in one way, you should say, oh, your specialty, that's good, you're starting young, but that speciality is occurring when you're maybe nearer 30, as opposed to when you're nearer 20. So it's a strange change in culture.

It's understandable. People are going to education longer, going to university longer. So that's what's happening and that's working very well, but it's become a lot more formalised and dominated by large institutions as opposed to entrepreneurial institutions. And therefore they have to work in a particular way in order for them to work. So I think that's why it's, why we're different. And when I look at the people I work with, one thing we always try to do with them on our team is give them responsibility pretty quickly because then they get used to making decisions and get used to making good decisions and bad decisions because they’re going to make both.

But if you only ask somebody to do something once in a blue moon, how can you know that they're good and how can they know that they're good and how can they learn? So, I think it's that sort of trying to get exposure to things and I know. I've not worked anywhere else for a long time but you know this definitely is amongst our team a desire for people to make a decision and choose to do something.

Laura: I don't think I'd have liked that personally having to make a decision. I think we did a lot of rotating around for a long time.

Richard: Oh, you both, you were grad programs?

Alex: One of the ironic things is that when I, remember you interviewing me, and when you asked me what I wanted to do, I said anything but sales.

Laura Yes, you did!

Alex: It's funny where you end up.

Richard: Your dreams came true.

Alex: So look, I think Coke is a very solid option. I'm a fan of a full-fat Coke. So yes, please do give it a go. Moving on to our second item, your dream crisps, Richard Woolnough.

Richard: Awesome, they go well with Coke.

Alex: So this is a complimentary...

Laura: Oh, it's a sweet. Okay, I like the portfolio. A well-constructed portfolio.

Alex: Salt and vinegar. Specifically, any particular brand? We've got Walker's here.

Richard: So, Coke's been around the longest. Walker's have been around the longest as far as I can work out. It's a good solid. It's probably, I mean ready salted is just too plain. So, this is probably the first ever flavoured crisp and they've got all imaginative and went for salt and vinegar and they've tried everything since.

Laura: Are you a fan of the kind of more exotic?

Richard: I've tried them, but I think, go back to where you want to be, which is something like this. And that works very well with a drink of Coke.

Alex: I like the fact that you've done complementary items as opposed to individual things.

Richard: I think that might be a problem with the next item because it's not really complementary with either of these two. So that's an outlier.

Alex: Mm, indeed. But again, I would say, you know, very solid. You can't question salt and vinegar crisps with a Coke. So that's excellent. You talked earlier on about the bond market evolving in your time. We've obviously seen, particularly more recently, the kind of rise of passive investing in particular, how do you respond to that or how have you responded to that, and do you continue to respond?

Richard: There's a place of passive investing. How appropriate it is for different asset classes is a question. How appropriate it is for equities, for bonds. I mean, the ultimate passive investing is just putting your money in a bank account. It's all pretty passive. And the question is, when you decide to not be passive, you still have to make a choice. Do you want to buy something that tracks something? Well, what you going to decide to track? That's a big decision, that's not passive. So it's very, very hard to see a truly passive investment. It might be described as passive but designed to buy it as an action. Only purely passive investment obviously is cash, where you just do nothing. You just leave it in your back pocket and do nothing with it. That's passive. So once you start doing something else, you've made that decision. And that decision, it could be appropriate to do it through a passive way, it could be appropriate to do it in an active way.

It's a question if you want to make active decisions. If you took a world where an individual is completely passive, they'll never have an investment. If you took a world where they're completely active, they'd do it all themselves. There might be a few people completely passive, there might be a few people completely active, but people do a mixture of those two things and as an industry that's what we provide and different sectors and these things will go in and out of fashion as time goes by.

And as an active manager you want to take advantage of things going in and out of fashion whereas a passive manager you make the decision you stick with it. Which is strange, because it can't be the right decision all the time. Surely you should change your passive decision at some point. So how can you do something now that's appropriate for the next 40 years? Because your passive doesn't make sense to me.

Alex: And in terms of the, you talked about the more high yield today than, you know, than there's ever been. In terms of kind of the bonds that are coming to market. Do you, what do you think the future looks like? Do you think it will get material change in the kind of currency outlook or the areas of the market that are growing? Do you see any particular trends playing out?

Richard: It's a function of what the capital is needed for. So if the industry is full of intensive capital and the cheapest way to raise that is through the debt market, then obviously there'll be more and more debt issued to finance that. So in previous years, a classic example would be, let's say, the mortgage market, which is the thing that most people are familiar with in terms of entering into some kind of debt contract or any some kind of liability or a large asset of some description. With that it depends on the population. So if you have lots of population growth and obviously there'll be lots of demand for mortgages and lots of building etc and if you have a country with less population growth and demand for housing be less and so the mortgage market be less and borrowing will be less so you could take a classic example. Take a growing society in the emerging market with a highly growing population, let's call that India, and take somewhere else that's got a decline in population, let's call that, Japan, and you're going to have different economic scenarios, different levels of borrowing, different ways forward.

So this will change over time. And the same applies to industries. So if in industry there's lots of house building, maybe house associations will be borrowing, the government might be borrowing, or if they're financing the housing, or it'll be the mortgage market, and that will drive that. But if there's no house building, then that market won't grow as much. It's best what drives it. And it gives them a strange secular thing, because obviously the big investment boom at the moment is more tech. And the strange thing about technology is it seems to throw off enough cash to be able to reinvest in this business class.

So something like Microsoft, which is the forefront of AI as it's reinvented itself, it's AAA rated. It's better rated than governments because it throws off lots of cash. It doesn't need to borrow to grow. Apple doesn't need to borrow to grow. It's got a calculated balance sheet. So it's quite strange. You've got different set of things about growth, that's done in a different way that we've never really seen before. So those sectors will be dominant in the equity market where their high P multiple means their financing is cheap but they'll tend not to issue too much in the bond market because they don't need to. So there are areas that will need to.

I think the big sort of change over time is the emerging markets are becoming more and more developed, it's a growth market, they're the areas that are growing. As those areas get bigger, their populations grow, they need to borrow money, they need to upgrade from their living standards, which generally means building and growing and doing things, developing infrastructure, developing industry, developing new technology, developing education, developing defense. So as those things happen, then you can expect the emerging market area to grow and become more important, whether they finance themselves in dollars or finance in euros or yen, wherever they finance themselves. But there'll be possibly quite heavier borrowers and societies that are fully developed don't need to borrow. It's a bit like a life cycle. People tend not to borrow a great deal of money when they're very old and they tend to borrow no money at all when they're young because nobody will lend it to them. There's obviously that part where you're growing a family where borrowing does occur.

Alex: Yes, plenty of opportunity ahead. Yes, right in the midst of that.

Laura: Maybe we'll get off that cheery topic for the two of us and get on to the final item of your vending machine, which is your dream chocolate bar.

Richard: Crunchy, yes. So, again, it's one that's been around a long time. Not too filling, it's not too heavy, so it's sweet so it goes very well with a cup of tea.

Laura: So in the dream vending machine concept, you would have your cup of tea with this.

Richard: You would go for the free cup of tea with the Crunchy. Yes, absolutely. As opposed to having to go to the extravagance. Oh no, I wouldn't think of things like that. I've never been a dunker. Not my way.

Alex: Full disclosure, this is my favourite chocolate bar, this would be in my dream machine as well and I'm not just saying that, I think it's one of the best chocolate bars I really do. I like the fact you're your complementary items, you're thinking about how they to interact with other things and it's like portfolio building.

Richard: It's like food and drink, you should always think about the two together.

Alex: Indeed. Richard, thank you very much for your time. All that remains for me is to play back to you your dream vending machine items. So, it's your drink, you have your full fat Coke, any time of day, in the right circumstance obviously. Your salt and vinegar crisp was a complement. Again, pretty much any time of day. On a Crunchy, any time of day as well. Midnight, 6am, if the situation calls for it.

Richard: If the situation calls for it, you know.

Laura: A nice light Crunchy.

Richard: Right, just to keep you going to the next proper bit.

Laura: Thanks very much for joining us.

Richard: Thank you, very kind. Thank you.

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