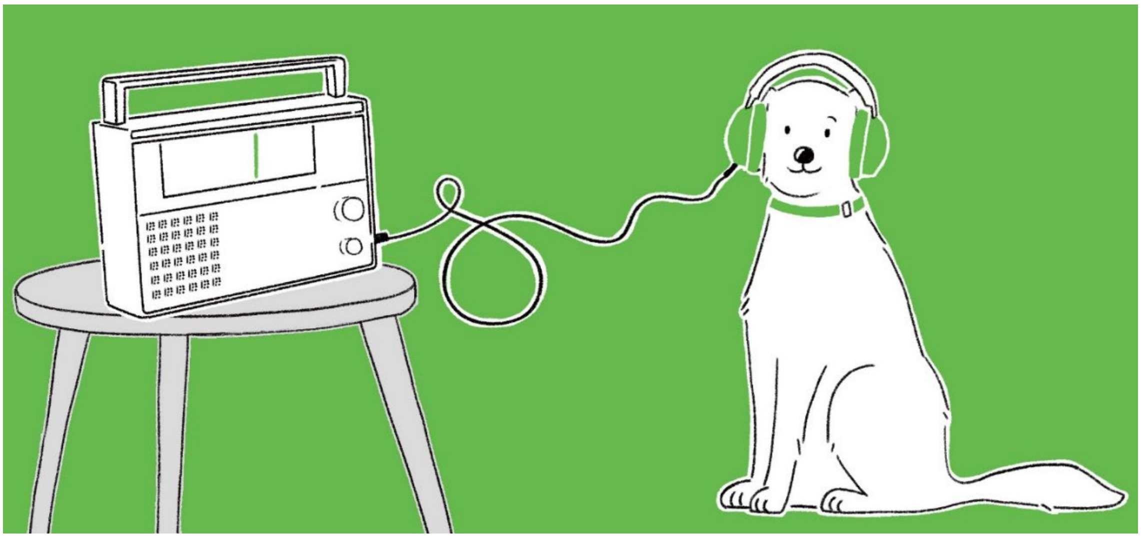
Ruffer Radio

Episode 19 – From the Chairman



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Rory McIvor, Investment Communications Specialist

Welcome to Ruffer Radio, a series of podcasts in which we explore the investment universe and share our interpretation of what's going on. 1994 was a vintage year for cinema. It was the year of Pulp Fiction, Shawshank Redemption and Four Weddings and a Funeral. But it's a line from a different 1994 classic which has come to occupy a special little corner in the consciousness of financially minded folk. Now, I'll spare you the Tom Hanks impression, but it went something like this lieutenant Dan got me invested in some kind of fruit company. So then I got a call from him saying we don't have to worry about money no more, and I said, that's good. One less thing. That was Forrest Gump, of course, and the fruit company was Apple. And so he became that rarest breed of investor who spent a lifetime not worrying about money.

Today, I'm joined by our chairman, Jonathan Ruffer, who's been doing quite the opposite, worrying about money on his client's behalf since founding the business in 1994. We'll cover lots of ground today on Ruffer then and Ruffer now, Jonathan's approach to investing and what it takes to get started, keep going and get started again.

Jonathan, thanks very much for joining.

Jonathan Ruffer, Chairman

It's a great pleasure to be with you.

Rory

So what led you to plant the initial seed that we now know as Ruffer, a global all weather asset manager?

Jonathan

Investment has been around probably as long as the sabre-toothed tiger. And generally speaking, if something's been around for thousands and thousands of years, there isn't any new way of doing things. But I have a particular makeup. I am extremely risk averse, and many investment managers I've met claim to be risk averse. And they don't seem to realize that if your job is making returns out of taking risk, to say that you're risk averse is rather like being a fighter pilot and admitting that you're a coward. It's not a good thing, it's a bad thing, but it's a thing that is true of who I am and whether I'm boasting or apologizing. That is one of the elements that informs the investment decisions that I've always made. But without a yang on the other side of the yin, it seems to me to be doing one's job with a handbrake on.

And the other side of that is that I have a compulsion to take risk and it's often nonplussing big and dangerous risks. And it's the struggle between these two opposites which created a way of investment which we adopted when we opened our doors in 1994, and the articulation of which hasn't missed a beat in the 30 odd years that we've done since then. And I would articulate it like this, that we take genuine and often quite powerful risks with people's money. But instead of using the risks that we take to optimize and maximize the returns that the portfolios make, we do it to try and ensure that net net the portfolio will never lose money. And over what period of time? Quite often when you buy something 20 minutes later, it's cheaper. So you have to have a timescale. And we say commercially, give us a year. If we're not at least all square one year from where were one year ago, then we're failing in the mandate that we invest money against. Now in fact, one year is too short a period of time. But if you ask for 15 years, which is absolutely long enough, people have spent half a lifetime discovering that you weren't the right people to have their money with. So one year is the compromise. We take money for a year from a client. And while I don't want to be judged against shorter timescale as that, it nevertheless puts both sides on notice that if after a year we're not doing very well.

Rory

Jonathan the inversion of return maximization and loss minimization, it's not that common in the world of investors. Why don't you think more firms invest the way we do?

Jonathan

I think half the answer to that is very easy. That if you look at the cadre of clever clogs investors, they're all hedge funds, they all charge performance fees, and if your mandate is trying to see the return that you make as a residual rather than a target, then by definition you disqualify yourself from charging a performance fee. Now, if you look at the work that we do here, it has much in common with the thought processes and disciplines that the hedge funds with their 2% annual charges and 20% performance fee that they make. But we can't do that and look people in the eye. And I have a rule that if you can't look people in the eye, then you shouldn't be looking at them at all.

Rory

Jonathan previously you've described yourself as first and foremost an historian, having worn lots of different hats over the years. Why do you say that? Did you even say that? And if so, why?

Jonathan

I don't remember saying that. I mean, given that I don't think in the panorama of life, historians are a very elevated species. I suspect I was just feeling sorry for myself at the time if I did say it.

Rory

But history is important informing the way that you think about financial markets.

Jonathan

It absolutely is. I'm fascinated by history because it seems to me that it brings two things together one of great simplicity and one of great complexity. And the simplicity is that within a human being there are only so many reactions that are possible to events. You can be intrigued by them, you can be frightened by them, you can be energized by them, and when you top them all up, probably comes to about 15 of them. But if you look back over all the events that have happened since Herodotus first started writing down events that were behind the human race, what you can see is a kaleidoscope of different situations which, on the face of it, have nothing in common with one another. But actually the role of a historian is to sift through events, looking for patterns. And I put it rather cheesily. I say that when a Roman soldier saw Boadicea on a chariot, he felt pretty much the same as a British infantryman felt when he saw General Guderian on a panzer.

Now, panzers can do quite a lot more and quite a lot of different things to a chariot, but it's the fact that sensation of fear is a constant. That what I found is that patterns of events are as much caused by patterns of human reactions as they are to the exogenous historicity of the events themselves.

Rory

It's interesting, and I don't mean to be reductive, but this is about psychology. This is about human behaviour. If we're saying that what really matters, what drives people, is their emotional response to things, that is a unique approach to this sort of infinitely complex financial market environment, is it not?

Jonathan

I think that's right. But whereas the scientist would be digging down into the nuances let's take this fear, let's subdivide it, and let's subdivide those subdivisions. So you would have lots of Latinate words for different degrees of these things. Whereas I see the reactions as blunt instruments because I'm not interested in actually what people think. What I'm interested in is what they do. And that requires much less science of how human beings are. You simply see what they've done. It's rather like looking at the slime that a slug leaves. I'm sure a scientist would be able to say this slug is in a good mood because having tested the chemical construction of its slime, I found this, this and this. I'm only interested in the fact that a slug has been there.

Rory

Not how shiny that slime is. That's pretty broad brush. I think that your approach is characterized more by big picture thinking and much less the granularity. How does that translate that big picture thinking into deciding which assets to put into a portfolio at any given time?

Jonathan

When one's first response? That's a good question. That's usually a synonym for I can't think of the answer, but what it's done for me. And I can't honestly remember whether I thought, here's a way of investing. Now, I've got a lot of prep to do, or whether I was doing it compulsively. And I strongly suspect it was the latter. But I know more about what has happened in the investment market over the last couple of hundred years than anybody else I've ever met. And the reason is that I'm reading, reading, reading what? Particularly contemporary reports. One of the things that those people who've been to the office in 80 Victoria Street will see lots of share certificates, all of which are companies that went bust because otherwise they wouldn't have been hanging on our wall and stock exchange price lists from the 1820s and 1830s. And I find these viscerally exciting. I've got a good marriage and the only time that I have regarded my marriage in difficulties was when Jane and I went off on a holiday to a marvellous hotel and it was just going to be a time of holding hands and eating puddings and just luxuriating in the nothingness of it all. And I took as reading the 1937 Stock Exchange yearbook, which turned out to be galvanically interesting because December the 31st, 1936 was the only occasion in the history of the UK equity market index where it was possible still to behind in real terms after 50 years. And so, in other words, this was a high point beyond high points. And of course, once I'd realized that as fun as holding hands is it didn't compare with the price of Whitbread debentures, which is what I'm afraid took priority.

Rory
That's extraordinary. Now, you clearly acknowledge that's an unusual character trait to have.

Jonathan
Certainly my wife's view.

Rory
Is it an essential one to who you are as an investor?

Jonathan
Yes, it undoubtedly is, because what it does ultimately we spend more time, more energy, more care on our preoccupations than we do on the things that we ought to do. I've just been lucky enough to do my senior management annual exam to check that I'm a proper person. Now, I have to say, if any of the regulators are listening, that I was really really fascinated by the topic, but I think marginally less so than on those myriad of factors which come to make the investment world go round.

Rory
Over the last 30 years, three decades. Jonathan, you've clearly proved that you can invest and invest well. Part of that has been identifying other people who can invest well and who can join you on the investment journey. What do you look for in other people as a good indicator? They might be different to you, but what do you look for in other people as a good indicator of their potential future success as investors?

Jonathan
I would say the first thing that you need is a strong sense that any one person can't do it all. If you look at some of the great firms, there is one person who is the rainmaker. Now, what is interesting to me at Ruffer is that we have several rainmakers and I think I would say I'm a rainmaker, but I define myself by my investment inadequacies, not by my investment strengths.

So what that means is that I absolutely need other people to come in and fill those gaps and that's not.

Rory
Just other people as a foil to your ideas. It probably never has been. These are genuinely different ways of thinking.

Jonathan
Absolutely.

Rory
Now, one such person was Henry Maxey, who joined Ruffer in 1998. I think he might have even been in before that. As an intern, how would you compare and contrast your style with Henry's in the first instance, but then also Neil McLeish, who joined as co-chief investment officer last year.

Jonathan
Henry is one of the remarkable investors of his generation, and his nature is not to hold to himself the knowledge and the insights and the experience that he has. And I think had he done that, he would still be probably the most remarkable of all the investors I've ever met. And I've met some of the very greatest who have been around in the last 50 years. But his style is to open his book and open his mind to other people. So what he has is a network of remarkable people who he can call on at times when that other person's skill is most needed. And that means that there are barely any there's barely any turbulence that Henry is not talking to some key player in that particular neck of the ocean water. And people who reach out to other experts also seem to have the talent, as Henry certainly does, to bring on other people and to train them up in a particular way of thinking.
And you mentioned Neil McLeish. Well, Neil is really a poacher turned gamekeeper. He was one of the people who Henry has been talking to since 1927 or so. And it seemed appropriate and made sense to both sides that Neil should join us, although Neil is quite a new name to Ruffer to the Ruffer investment process he's Mr. Greybeard.

Rory
How do you know when you've made a mistake with an investment?

Jonathan
It's very difficult to know whether one has made a mistake. I think I found it easier in the days when I was running money because for a long time all my investment thoughts translated into my investment action, whereas now that isn't the case. And so the cause and effect is not as it used to be. But what I found was that I was rather surprised to discover when I analysed my work that a lot of my performance came from the fact that although I seemed to make the same number of mistakes as things, that I got right, I'd find that the things that I got right I had a lot more money in than the things that I got wrong. And I tried to think about what it was that caused that to happen. Was it because I had a greater confidence in the things that turned out to be right? And it wasn't that. I think what it was that I was very disciplined on the units of

investment that I made. And I would always want in my initial purchase to be able to go on buying more of that particular asset if and when it fell away in price. And so if I bought a stock which raced upwards, then I'd find I wouldn't have owned very much of it. But if I bought a stock and over the next six months, it kept on falling the effect on me if whenever I analysed and reanalysed the situation, I found it to be as compelling as ever, then I would have the confidence to put a great deal of money into it.

One of the things I'm sure you want to ask me at some point what am I making of the world now? But I'm absolutely bubbling over at the moment with the Japanese yen. The yen is the source of currency which Neville Chamberlain would have enjoyed a faraway place about which we know nothing. But the key to the yen is that it has always, in the last two generations, had a very low yield. And that has meant that at times of mania in the market, it has always been a currency that people who wanted to borrow up to the hilt would use to pay as little as possible interest charges. So if you pay 1% for borrowing a million pounds of yen, but it costs you 6% to borrow a million pounds of sterling, then if you borrow in yen and then immediately convert the yen to sterling, you have a currency mismatch, but you're still only paying 1% on your borrowings. Now, that's fine until it isn't fine. And as more and more people join the party and they hear from their best friend, don't borrow in dollars, don't borrow in euros, don't borrow in sterling, borrow in the yen. That drives the yen further and further down, because on day one, you borrow all the yen and half an hour after you own it, you sell it. You sell it for the currency of the asset that you wanted to own it in. Now, what that means is that for a long time the yen dribbles down until suddenly it snaps back. Now, that is something that I routinely look out for, just in the same way that a dog at the dinner table scouts around for the messiest eater. I do the same thing with the yen. I'm looking for the messiest central banker. And there are circumstances in domestic Japan which indicate that there is a possibility that the local institutions might need to repatriate all the holdings that they have in for them, foreign government bonds. And if they do that, they will be doing it to invest in Japan. So they will need to convert the foreign currencies into yen. So you have two car crashes waiting to happen at a time when everybody hates the yen and where the yen, in terms of what it'll buy in the shop, couldn't be cheaper. Now, I was born in the year of the Battle of Bannockburn, and in my life I cannot offhand think of a better risk reward than that at the moment.

Rory
Than the yen. And that's reflected in portfolios.

Jonathan
It is indeed reflected in the portfolios.

Rory
Jonathan, do you think that investors and clients the world over are adequately served by the investment industry's offering today.

Jonathan
The investment management industry, in my view, is a dishonest one. And I don't mean by that lots and lots of the other people are dishonest. But luckily you're talking to Honest Joe, Jonathan Ruffer. I think we are all under the cosh of the fact that our job is an impossibility. Our job is to foretell the future and it can't be done. And so when people come and say, Shall I bring

you my money? The true answer is, I haven't a clue. Because if I'm about to have a good spell, then the answer is, yes, you should. And if I'm about to have a whoopsie, then the answer is you're better off elsewhere. And what that means is that marketing in the investment management industry has to be obfuscated. I can't get the word out.

Rory
Obfuscating.

Jonathan
Obfuscating.

Rory
There we go. I'm very pleased with myself.

Jonathan
So you don't talk about whether you've made money or lost money, you talk about performance against an index, and at the centre of it, what the band wants, we don't know whether we can provide. And that has distorted the whole way that the industry looks. And we've been in a bull market since 1980, that's 42 years. And the reason is simple, that interest rates have come down for 42 years. Now, from November 2021, interest rates have gone up, and they've gone up very sharply to the sort of level where in 19th and early 20th century terms would be the absolute upper range that interest rates ever got to. The average rate was three, three and a half percent. And here we are at over five. Now, five is consistent with really dangerous market conditions, and yet we're not seeing it yet. Now, I think that when we look back over this period in 50 years time, what one will see is that a bear market started at exactly the time that interest rates went up.

And it will take some pernickety person to think, well, that isn't quite right. It was a couple of years before that really started to kick in. And it just happens that we're in that couple of years at the moment, two years ago, three years ago, just about every player would have said, if interest rates go up to over 5%, what will happen to the market? People would have said, well, you won't see it for dust. But when interest rates did go up and the market didn't collapse, now, everybody's very comfortable that there are six good reasons before breakfast why this isn't consistent with the market falling. Let me say to you, why have I had a good record on reading the tea leaves? I think it's because all the predictions I've made are blindingly obvious, but they are not consistent with putting a timing on it.

Now, here's an example. I think that in three years time, if anybody comes to me and says, Johnson, you were so right about that market, now we can see that interest rates cause the market to go down, that's giving a chimpanzee a banana territory. It's so obvious. But if in November 21 we had invested for that, and luckily I had a team who were bigger and more astute and more nuanced than me, I would have hazarded the ship for it, I would have broken my rule that I never put a timing on anything. And I say, well, this is such an obvious one that I think we can pretty much take it for granted the timing will be immediate. It wasn't. And that oozes rather perversely one half of my mantra, that it's very easy to predict the next big thing, but don't try to put a timing on it.

Rory

And also the difficulty is you've got to own something. I'm interested in the six reasons that investors find for asset prices to rise before breakfast. Over the course of history, asset prices have generally gone up. So are you saying that for a period, undefined period, that's just not going to be the cast?

Jonathan

It only looks as though prices go up because one telescopes those periods when they don't. The Wall Street crash happened in 1929 and it took until 1954 to recover its poise. Now, that defined how people regarded investment opportunities. But when you look at a chart of American shares between 1900 and 2000, you find that in real terms, they went up 200 fold. Now, that's the argument, Elroy Dimson and Marsh wrote a book proving this. And if you are asked for evidence of why equities are a good place to be, that is the authority that's usually quoted. But there were 25 years in America from 1925 and I've already quoted the Stock Exchange yearbook of 1937, where you'd have to wait till the Stock Exchange yearbook of 1986 before you got your money back. So timing is essential.

Rory

There's a question which I'm hesitant to ask because it sounds just a bit blasé. You've talked about the yen. It feels like potentially the currency or asset de jour. Historically you've described the linkers or the index link bonds as jewels in the portfolio crown. Are you still as excited about the potential of index link gilts to protect capital, to preserve capital over the long run?

Jonathan

Index linked bonds were first issued by Britain in 1981, which was the first year for about 30 when the asset class became increasingly irrelevant. And so the truth is that index linked have been an investment to protect the world from something that has not needed that protection ever since they were issued. Now, the relationship between a conventional fixed interest stock and an inflation linked bond is simple. The conventional bond is a domino with just one number on it. It tells you how much yield you will get from the coupon until it matures. The index linked stock has two numbers on the domino. One is the same as the conventional and the other is it says we'll protect you from the fall in the value of money between now and when the bond matures. Nobody has had occasion really to work out what that second number on the domino is worth.

Now I believe that we have finished quite a long period when prices were tending to fall, tending towards deflation with the problems that come with deflation and that now we are in an extended period. It might be five years, it might be 25 years, might be 50 years but it's a long period of time when inflation is going to be sometimes as powerful as a hurricane and sometimes as gentle as a breeze but one way and cumulatively very destructive of what's going on. And so the second number on the domino is the only sure way that one can get an arithmetic idea of the safety from that chronic disease as it will become.

Rory

Was there ever a point in your investing career that you didn't worry about inflation?

Jonathan

I'm a child of the 1970s and so I suspect a psychologist could say that we all manifest the preoccupations of the period that we grew up in. I think it was the Jesuits who said give me the child, I'll give you the man. And I'm a child of a period where inflation was so nonplussingly all consuming. I remember looking at a half crown that was a twelve and a half p coin and thinking in two or three years time this is going to be worth a florin which is a ten p coin and realizing there was absolutely nothing one could do about that.

Rory

Jonathan, is the Ruffer investment strategy in some size, in some weighting of an individual or an institution's portfolio. Is there anyone in the world for whom it's not appropriate who shouldn't be a Ruffer investor?

Jonathan

I didn't think I'd go as far as to say shouldn't but the people who I think what we do is aimed at is the people with money. In other words, if you haven't got money and you need to take a few risks to get money then we're not really the people to do it. Because if getting from aches to gaunt as quickly as you can you probably want to be pillion on a motorbike. We are a car with a well used handbrake so we do everything slowly. Slowly and surely is a formula that works well for those people who are perhaps more keen either because of the arithmetic or because of the way that they're made keeping that safe. But what we have done over 30 years is to provide the best of both worlds. We provided an equity style return for a risk volatility return of enormously less than that.

Now I suspect that in the next 30 years we will outperform equities again but I think the reason for that is that I think equities are something of a busted flush but that's another story.

Rory

And another story for another day. Jonathan, thanks very much for your time and we look forward to hearing that story at some point in the future.

Thanks very much and thank you for listening. You can subscribe to Ruffer Radio on the App Store, Spotify, or wherever you get your podcasts.
