3 Takeaways Podcast Transcript
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Ep 50: Risk vs. Opportunity in the Market: Investing the Assets of Michael Bloomberg with Steve Rattner

OUTRO male voice: Welcome to the 3 Takeaways Podcast, which features short memorable conversations with the world's best thinkers, business leaders, writers, politicians, scientists, and other newsmakers. Each episode ends with the three key takeaways that person has learned over their lives and their careers. And now your host, and board member of schools at Harvard, Princeton and Columbia, Lynn Thoman.

Lynn Thoman: Hi everyone, it's Lynn Thoman, welcome to another episode. Today I'm excited to be talking with Steve Rattner. He manages the personal and philanthropic investments of Michael Bloomberg and Bloomberg Philanthropies. In addition, he's a contributing writer for The New York Times and he previously led the Obama administration's successful restructuring of the car industry during the 2008 financial crisis. I'm excited to learn what he's investing in now and how he sees the opportunities and risks in the market. I'm also excited to learn how he sees government spending and the deficit, as a former counselor to the Secretary of the Treasury. Steve, welcome, and thanks so much for our conversation today.

Steve Rattner: Lynn, thanks so much for having me. I'm looking forward to it.

LT: My pleasure. You manage Mike Bloomberg's personal and philanthropic assets. How long have you known Mike and how would you describe him? I know he has a number of wonderful sayings that he incorporates as principals in his business and in his philanthropy.

SR: Yes, so I've known Mike for 25-plus years. It really has been for that entire period a friendship, that about 12 or 13 years ago evolved into this business relationship where he asked me to look after his investments. And at the time he was mayor of New York, as you'll recall, and so his investments were all in what was essentially a blind trust, and he wanted someone who he trusted, no pun intended, to look after it.

SR: And I said, "Mike, this isn't what I do, I'm in a different part of the financial world." And he said, "Well, you'll figure it out." And so for the last 12 years I've been trying to figure it out. And yes, Mike is a very data-driven, results-oriented CEO, and I've learned a lot from watching him, about how to run a business and how to manage money even. And so we try to bring those principles into... Well, the sayings of his that I particularly like, are, "In God we trust. All others, bring data". Another one, which is really more applicable probably to a company is "If you can't measure it you can't manage it". And so we spend a lot of time benchmarking ourselves, being very self-critical about how well we're doing, where we could do better and so forth.

LT: Bloomberg philanthropies focuses on five areas: The environment, public health, the arts, government, innovation and education. Do you invest in these areas and how do you see the role, if any, of investments in supporting the mission of Bloomberg Philanthropies?

SR: Mike sees the world in a very specific way which, fortunately or unfortunately, I happen to

agree with, which is that he has a group of wonderful colleagues whose job it is to give away money in those five areas that you just mentioned, and they do a terrific job of it. But on the asset side of the balance sheet, if you want to think about it that way, which is us, we're told to basically maximize his returns. We do not invest in some areas that he considers prohibited, like Tobacco, Firearms, things like that, coal certainly, but beyond that our mission is to make as much money as we can, and obviously ethically, responsibly, legally, and let our colleagues over at Bloomberg Philanthropies give it away. And so we do try to keep the two sides of the house reasonably separate in that respect.

LT: And how do you think about investments, how do you, as you say, maximize returns?

SR: Our investment strategy would look a bit like that of a typical foundation or endowment, in that we invest in essentially every... Or at least theoretically, in every asset class in every part of the world. So it could be public equity, it could be private equity, it could be the US, it could be China, it could be Europe, it could be venture capital, it could be real estate. And so on and so forth.

SR: And we do most of it by using external managers who we think are sharpshooters who are really experts. We couldn't possibly invest directly in all those things in every part of the world, so we in fact subcontract it or use intermediaries to manage the actual stocks or the assets that they buy. The one thing that we do somewhat differently than a typical endowment or foundation, which we think is a bit of our secret sauce, is that we do manage a significant portion of the capital in private investments that we do directly. That's what I did for a living for a long time, I have a group with very talented colleagues who are very good at that, and we feel very comfortable that we can achieve superior results in that kind of direct private investing. And we have done that.

LT: So the stock market recently hit a record high and it's up, what, about 30% or so since before the start of COVID. How high is it compared to historic highs, and what do you think the outlook for the stock market is now?

SR: Well, it's at a record high as you pointed out, and so that is where it is compared to historic highs. I think we all have to have some level of humility about the stock market, I don't believe there is anybody on this planet who honestly, under truth serum, could tell you 18 months ago that they thought the stock market was going to go up well over 30%, actually it was probably close to 35%, in the course of that period, from its low anyway, in March. Well, even from the beginning of last year, in that period of time. Nobody would have guessed it, I wouldn't have guessed it.

SR: And so it makes you even... It makes me, anyway, at least even more humble about trying to predict where it's going. In retrospect it's not that hard to see why this happened, which is the unbelievable amount of liquidity that has been poured into the system by the Fed, by other central banks, by the Treasury, in terms of deficit spending, and by individuals and households and companies that have saved an enormous amount of money during this crisis, ironically.

SR: And all of that has made the financial system awash in liquidity and has driven up stocks. And the other related thing that, in my opinion, has always been an enormous influence on where stocks go is interest rates. When you can achieve a higher rate of current return, i.e. dividends, simply by the S&P stocks, the S&P 500 stocks, then you can by US treasuries and you have the potential for upside.

SR: You also have risk, of course, but you have the potential for upside, you can imagine what people do, they say, "Why am I getting 1.5% on Treasuries when I can get a little bit more than that on stocks and have the possibility of appreciation?" So low interest rates are the opioid, if you will, of the stock market, it pushes it to new highs.

LT: Some people are looking at the price-earnings multiple, the PE multiple of stocks, and say they're really high and say they may revert to the mean. How do you see the PE multiples?

SR: The PE multiples are exceptionally high. They're in, I think, the 99th percentile of historic PE multiples, meaning they are essentially as high as they've ever been, maybe except for the dot-com bubble or this or that, but they are way up there. But if you looked at another set of ranking, "Where are dividend yields in relation to Treasuries?" you would find that they're actually relatively cheap, stocks would be relatively cheap if you looked at it that way. And so that's the yin and the yang of it, that on a PE basis the market looks really high, relative to where interest rates are, and where the Fed says interest rates are going, at least for the next couple of years. It does not look expensive. My fundamental conclusion is that it is really, really hard to predict markets, and we don't predict markets. We simply try to make the best investments we can and avoid things that look just ridiculous.

LT: How do you see the so-called FAANG stocks, Facebook, Apple, Amazon, Netflix, and Google? And many would also add in Microsoft.

SR: The irony of this is that those are the stocks everybody looks at, and they say, "Wow, Apple has a $2 trillion market cap and Microsoft just crossed a trillion," and so on and so forth. And those are huge numbers, but those stocks are actually... Many people would look at those stocks as actually among the relatively cheaper stocks in the stock market, even on a PE basis, when you consider how fast all those companies... And they're different business models, and some I think are better business models than others.

SR: But nonetheless, when you look at some of those companies that are still growing 20-25% a year and trading at PE multiples that are not as high as many other companies in the market, they actually look a little bit cheap. And the reason they're a little bit cheap, in part anyway, is because of the regulatory overhang, the threat that Washington's going to do something, break them up, change their business practices, who knows what. And that's been a depressant on the value of at least some of those companies. So they're actually not that expensive as a group.

LT: What do you see as the major risks to the market, and how are you either protecting against these risks or positioning to take advantage of them if they occur?

SR: The major risks, I think, as I said, as I've indicated, is rising interest rates. And why would we get rising interest rates? We'd get rising interest rates in large part if inflation comes back and essentially forces the Fed to raise the interest rates that it controls, which are short-term interest rates. Long-term interest rates are really controlled by the market. And if inflation starts, that's where you will see it. Right now the market is not worried about it at all, interestingly, but that's where you'll see it, and that's what would cause, I think, the most likely downward pressure on the market.

SR: The other traditional source of downward pressure on the market is bad earnings, and we may

get bad earnings. We particularly would get weaker earnings if companies find that their cost pressures become greater and they can't raise their prices enough to offset it, so profit margins get squeezed. There's no evidence of that happening at the moment, and I personally think that there's so much cash out there, so much liquidity out there, so much money has been put in people's pockets, the government is running such a large deficit, that it's very likely that we're going to have very robust economic growth for the next year or two, at a minimum. It's hard to predict beyond that. But the idea that the economy is going to somehow roll over, recession, corporate profits fall, doesn't seem that likely, but that has historically been the other reason why markets have turned down.

LT: How do you see inflation?

SR: I worry about inflation, and it's very interesting because the professional economist class, and I'm a huge fan of Larry Summers...

LT: As am I.

SR: Good. Huge fan of Larry Summers, and other smart people like Jason Furman who have worked with Larry and are colleagues and so forth, and then even people who are from the Republican side, the Greg Mankiws, Glenn Hubbards of the world. I think the economist profession in general, not all of them, is quite worried about inflation. Not double-digit inflation, but enough to cause interest rates to go up, the Fed to have to move, and all the other things that we talked about.

SR: But what's interesting, as I alluded to a minute ago, the market is not worried about inflation. And in fact, in the last couple of weeks, the 10-year Treasury yields have come down substantially. And so you're in this very interesting period, which we have seen before of "Is the market right? Are the economists right? Is the Fed right?", which has its own view about all this. And time will tell. I think particularly for those of us of a certain age, who were adults when we had huge inflation in the early '70s, we do have a bit of PTSD about it, I will freely admit that. And so far over the last 20 years we've all been wrong, those of us who have felt that way.

SR: But it does feel like this time could be different in the sense of, again, not double-digit inflation, but even if we had sustained 4% or 5%, 6% inflation, well above the Fed's target of 2%, the Fed would have to move and that would be bad for stocks, it would be bad for the economy, it would be bad for housing, it would be bad for a whole lot of things.

LT: How do you think about allocating the investment portfolio across different asset classes, such as US equities, global equities, real estate, natural resources and other areas?

SR: There's a couple of different ways to slice asset allocation. One way is geographic, one way is by type of asset, and so those are really the two basic ways. From a geographic point of view we start from a baseline that we are a US entity, most of our expenses, i.e. the money that Mike gives away, is given away in dollars. And so we want to make sure that we are pretty firmly anchored to the dollar. The US stock market is about 55 percentage or so of global stock market capitalizations, and so if you look at that as a benchmark we're always going to have a majority of our assets in the US.

SR: And then you look around the rest of the world and we say, "Well what looks interesting and

what looks uninteresting?" And what has looked interesting to us, but I will again freely admit at the moment there are some issues around it, is China. I haven't been to China in a year and a half, but I used to go a couple times a year since the 2005 period, and I've been a believer, I think the drive to succeed, the fact that they are really in some ways more capitalist than we are.

SR: The companies, the innovation that they have created, is extraordinary. At the moment there are definitely questions around that. But also China's stock market trades much cheaper than the US. And that difference, in part, is essentially the kind of risks that we're looking at now, which are really more political risks than economics. "What will Xi do about the technology companies? What will Xi do about US trade relations? What will Xi do about Hong Kong?" And so forth.

SR: And then Europe, which is the other general big market, we're very unenthusiastic about Europe. They seem to have gotten themselves together on the vaccine finally, but just as an economic engine it is a pretty weak economic engine. The fossilization, if you will, of the economy there, the lack of flexibility, the lack of movement, of labor, and capital freely, the regulatory... It's a tough place and so we tend to be pretty under-invested there. And then the rest of the world, some of it's interesting but it's just too hard for us to access.

SR: Vietnam is a fascinating market, we just made our first private investment there. But very hard to invest in, in any scale. And India we certainly have been invested in and continue to be up to a point. Japan, up to a point. But Brazil, not interesting at all. South Africa, definitely not interesting. I'm thinking about the BRICS [Brazil, Russia, India, China, and South Africa]. And then the rest of the countries are really just too small for us to spend time on, frankly.

LT: And as you look across asset classes how do you think about investing in those?

SR: I did miss that part of your question, apologies for that. We invest in really all kinds of public investments, whether it be long equities or hedge funds, things like that. And then on the private side, everything from mature typical leverage buy-outs, to more growth investments, and all the way down to venture capital. And in general we want to maintain a fair amount of liquidity in our portfolio, so we would never want our private investment to be the majority of our investments. But we do believe that can be a very, very substantial part.

SR: As a matter of corporate finance theory, which has worked out in practice historically, but again, the future will be whatever it is, but as a matter of corporate finance theory you should get a so-called illiquidity premium. You should be able to get a higher return investing in a liquid assets, because you're giving up some liquidity, and you should in effect get paid something for that. And that has been the way, it has been really throughout time, and we think it will continue to be.

SR: So we like private equity. Again, it's where my DNA is. Venture capital we've had, including biotech, has been an extraordinary, extraordinary, out-performer for the last several years. Probably won't always be, but on the other hand we believe, and I think the evidence so far supports it, that the companies we're investing in are real companies doing real things, creating real products, or real drugs in the case of pharma companies, that are going to produce real profits.

LT: How do you see real estate?

SR: It was interesting, we were looking at our real estate numbers the other day. Obviously,

COVID has been an unusual force, shall we say, on the real estate market, but real estate over time has been a pretty "Steady Eddie" performer. It's not going to produce the outsized returns you get from a great venture capital investment or even a great LDL. But as long as you can hold it through a cycle, because real estate has cycles, over a cycle it has produced very solid low double-digit returns on a private basis. Low, maybe mid double digit returns. In a bull market more, in a bear market less. But again, we are very, very long-term investors. And so owning real estate as a long-term investment is a good solid core part of our business.

SR: Within real estate, of course, there's now a furious debate about how much office space does the world need, are people going back to offices? How much retail space does the world need, and there we have been avoiding retail for several years now, because of the obvious reasons. What is called "industrial", which often means really just warehouses, is a boom area in real estate, because of Amazon and all of the other online merchants. And then there's housing, we don't invest in single-family houses but we have a fair amount of multi-family. And housing has been very, very strong recently because essentially we've been under-building housing since the great financial crisis, and so now you suddenly have all this demand and not enough houses or apartments for people to live in.

SR: So real estate, as an asset class, we think is good. But we do tend to pick our shots within real estate of the sub-sectors, we call them sub-sectors, that we think are particularly interesting.

LT: And do you focus on particular geographic markets, like Florida or Texas, that are growing?

SR: That's a good question. I wouldn't say we think about it exactly that way. We really look at it... Everything is relative to return, if you could buy something in the North East, if you want to take that as a weaker market, if you pay a small enough price for you can still do very well.

SR: So I wouldn't say we think about it exactly that way. I'm just thinking about our portfolio. I would say we're probably overweight to the faster-growing markets, that's probably true. But it's not a kind of firm policy or asset allocation decision, it's just what happens to meet our return criteria.

LT: How do you see Bitcoin and the other crypto currencies?

SR: We've spent a lot of time on Bitcoin over the last several years, trying to just understand it, to start with. One of my views of investing is, "If you can't understand it you shouldn't be investing in it." How can you invest in something, if you really don't know what it is? And I put Bitcoin into that category. I don't understand it, I don't understand why it should become a store of value when it fluctuates itself so wildly. We have no way to really even know, if Bitcoin itself exists the way people says it is. Some guy invented it and there's only going to be so many of them and you have to crack this code to create a Bitcoin, blah, blah, blah. We don't know any of this, really. And so we have stayed pretty far away from it. There are some applications of what's called the blockchain technology.

SR: Which is the way that Bitcoins are accounted for, that do seem interesting, and some applications that we've probably got some investments here and there. And there are some ancillary things to what are called stable coins, which are digital currencies tied to the dollar or another existing currency, that we think is somewhat interesting to invest in, but not the cryptocurrencies themselves. There's no reason to believe that they will be a store of value or anything other than a

hobby.

LT: What's happening now in the stock market with AMC and individual investors is wild. Can you talk a little about what's going on and how you see it?

SR: What's going on is that you've had a lot of individuals piling the market. We've seen this before, we saw this in '99 and 2000. I remember in that period having taxi drivers ask me about options on internet companies and all this crazy stuff, and that's when you know the world is a bit out of hand. This time around I think you had a few factors that came together, somewhat coincidentally or whatever. One is that people had a lot more free time, because they were home basically. Secondly, they had more cash, because of what we talked about before, the savings rate was very high, it was stimulus checks, and so they couldn't spend money.

SR: And thirdly, you had the creation of things like Robinhood, which allowed for no-commission trading, because Robinhood essentially was being paid by other firms to give the orders that the customers were giving them, to these other firms, to actually execute. And the other firms were willing to pay for those orders because it gave them an information advantage that they could use in their other training businesses.

SR: And that is all not a great system, the idea that people can trade for free because something else is happening over here that may not be ideal itself, is not a great system. And we've just had a change in administration, there's a new chairman of the SEC, who's a very good guy, and I'm sure they're going to take a look at all this. I'm not in any way suggesting, I don't think they're suggesting, I don't think we want... They'll have some ban on people trading or saying you can only buy stocks if you have a net worth of X or Y. Although we do have Net Worth tests for certain kinds of investing.

SR: But I do think there needs to be some more regulatory controls around this kind of stuff. Actually, the other thing that I didn't mention that was part of all this is you had the advent of these Reddit boards where people could go online and talk about all these stocks and get each other sort of ginned up and so on and so forth. And then lastly, there is this anti-establishment sensibility in parts of the country. We see that in the political world but you also see it a bit in the financial world, with people saying, "I don't need to be in the hands of Wall Street, I can make my own decisions and we can decide where GameStop trades, we don't need a bunch of hedge funds deciding where GameStop should trade." And so there's a lot of different things that happened to come together in this. It's not great, it's not the worst thing that's ever happened either.

LT: So let's switch and talk about government. You served in President Obama's administration as a Counselor to the Secretary of the Treasury, how do you see government spending?

SR: You mean at the moment?

LT: At the moment. I have seen a great quote of yours, and I can't find exactly where you said it or when you said it, so I'm not 100% sure you've even said it, but it is "Thanks to decades of accumulated federal budget deficits, and more significantly imprudent Medicare and social security policies, we've stolen almost $60 trillion from our children".

SR: Yeah, I'm not sure if I said it that way, but it's consistent with what I have said and what I

believe, which is that we're running this enormous deficit, $3 trillion or whatever it's going to be. We're running the enormous deficit, and we're running it for a reason that I think we all understand, some of it is getting the economy out of the COVID abyss, if you will, and some of it is re-investing in our economy to try to improve productivity, improve growth rates going forward. And those are both very commendable goals.

SR: One, I'm not sure they're being perfectly executed, we can come back to that part of the conversation. But two, we are adding very substantially to the debt. If you go back to the late 1990s, President Clinton left the government with a surplus. That was not all his doing, a lot of it was a booming economy, the Republicans also wanted the deficit down, a lot of good things came together and we had a surplus.

SR: President Bush 43 came in and essentially said, "We don't want to have this surplus, there's no reason to have a surplus, let’s give it back to the people." And we had tax cuts in 2001, we tax cuts in 2003 that eliminated the surplus. And so when the financial crisis came, the only way to address that was to spend more money and have a trillion dollar deficit for the first time in our history. And then for the next seven or eight years we whittled it down by about half, and then President Trump arrived and decided we needed more tax cuts, and we needed more spending, and so the deficit was already heading back past a trillion dollars when COVID hit. And now we know how that unfolded.

SR: And my point is simply I'm not worried. Some people are worried, "Well, the US won't be able to borrow money anymore, people will stop being willing to own our debt, the dollar will collapse in value. This, that, or the other thing." It's possible, but there's too many cases of the boy crying wolf about that for me to go down that rabbit hole. But the rabbit hole I will go down, which I think is inarguable, is that we are adding all this debt which doesn't ever have to really get paid off, but the interest on it has to get paid.

SR: And yes, at the moment interest rates are low, but if you believe, as I do, that interest rates will normalize at some point, then the government's interest bill will go up, and that will put pressure on other spending. It will basically force the government to cut back on other kinds of spending, whether it be Medicare, Medicaid, Social Security, or transportation, or research and development, or defense or whatever.

0:25:30.5 SR: And that's the legacy we're leaving for our children, and that's what really bothers me about the deficit. It would be a bit like a family that decides that instead of saving some money and leaving a little bit of money to their kids, or even just leaving their kids with a clean balance sheet, they're going to go out and they're going to blow it all in the last few years of their lives on trips to Las Vegas and buying cars and whatever, and when they die they're going to actually leave their kids with a bunch of debt so that the kids are going to have to deal with it. That's essentially what we're doing, and that's what I find so upsetting.

LT: Yeah, I agree with that. The Fed has injected enormous liquidity into the economy and they continue to add even more liquidity. Can you put the Fed's policy in perspective? By about what percentage has the money supply increased?

SR: I don't have, honestly, those numbers off the top of my head. And we don't really think about it. When I was a young journalist we tracked M1 & M2 so carefully, but money has become such an elusive concept, we don't really think about it that way anymore. The number that people tend to

look at is the Fed's balance sheet, which I think historically... You're testing my memory... Was something under a trillion dollars, and now it's something well over 3 trillion dollars.

SR: And what is, I think, concerning about the current policy is not just that the Fed is keeping interest rates low, but that they are still buying, I think, $120 billion a month of corporate and government debt. And they're even still buying mortgage debt, so you have record house prices, you have people not able to afford houses, and the Fed is holding down mortgage rates to make houses even more expensive. And I think that's all kind of crazy, and I'm not even sure the Fed disagrees with me.

SR: I think their problem is they're trying to figure out how to get out of this, how to get out of this in a way that doesn't destabilize the markets, because there have been times in the past, 2013, 1994, when the Fed has tried to taper and the markets have revolted against it. And that's what I think the Fed is trying to avoid this time, and I commend them for trying to avoid it, but they have got to get out it.

LT: Steve, before I ask for the three takeaways that you'd like to leave the audience with today, is there anything else you'd like to discuss that you haven't already mentioned? What should I have asked you that I didn't?

SR: The only subject we didn't really cover that concerns me is the de-polarization in this country, and the fact that the only way to get anything done in Washington is with one-party rule, basically, is that one party control enough of the branches of the government that they can get their stuff done more or less on their own. Yes we have this bipartisan agreement now about some infrastructure spending, there's some other stuff that gets done bipartisan, but when you think back, at least when I was a reporter, 30 or 40 years ago in Washington, and even into the 80s, the Reagan tax reform bill of 1986 was passed with 70 or 80 votes in the Senate, on a hugely bipartisan basis.

SR: It lowered rates, closed loopholes, a lot of good stuff that we should be doing now, but you can't get these two sides to barely talk to each other. And that's a reflection where the country is, one feeds on the other. We could have spent a whole half hour on that, which we won't. But it is depressing when you think about it.

LT: It certainly is. What are the three takeaways you'd like to leave the audience with?

SR: Yeah, I will give you three on two different subjects, if you want to think about it that way. The first, which you triggered in my mind in the course of this conversation, is something that I say to many people, which is the insanity of the fact that many Americans think they can manage their own money. If you had a problem with a faulty electrical outlet in your house, you would not try to fix it yourself. If you're sink got so clogged that a plunger didn't work anymore, you would not trying to fix it yourself, you'd call a plumber. If your roof was leaking, you'd call a roofer.

SR: And yet people think they can manage their own money, and they sit glued to CNBC or on these chat boards or wherever, buying and selling stocks that they really honestly don't know anything about. And it's the craziest thing in the world, and I have absolutely no idea why this is the one thing that should be in the realm of the professionals... And I'm not looking for business, I have one client and that's all I want... That people think they can do. So that's number one.

SR: Number two, which we touched on, and you triggered this also in my mind, is the folly of trying to predict stock markets. I don't believe anybody can predict stock markets. I don't believe any of the most successful investors, or many of them, anyway, in history, from Warren Buffet down, would say they could predict stock markets. What you can believe is that over time markets do go up, as long as economies are growing stocks should appreciate over time, and therefore if you invest for the long term, in a thoughtful way, with professionals, you should do fine. But trying to trade in and out of markets is kind of nuts.

SR: And then the third one, on a subject we were just talking about, that I want to just underscore, in a different subject, is the terrible fiscal policies that the government has been running for a very long time now, really for the last 20 years. And yes we will get through this, yes foreigners and other people will still buy our debt, and so on and so forth. But we are leaving a terrible, terrible legacy for our children who are going to have to untangle the mess we've made and live with the consequences of it. And I hope people will take that away from this really fun conversation, you and I just had.

LT: Steve, thank you so much for our conversation today, this has been terrific.

SR: My pleasure Lynn, thank you.

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