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LAUREN Hi, everyone. Welcome to the Take 15 Podcast, I'm Lauren. And this week we have a really great episode for you. The big picture is fixed income but as you'll hear, there's so much more to the conversation. My guest is Daniela Mitrovic, she's a CFA charter holder and co head of US multi-sector fixed income at Macquarie Asset Management. We talk about something called mutant capitalism. Now don't worry she explains what the term means and what the long term ramifications are. We also discussed the importance of standing against the tide when it comes to investing.

I played devil's advocate and asked her why, buy bonds when yields are so low? That question by the way, is the one question she's been asked the most times over her two decade career in the bond market. So let's jump right in. Please enjoy my conversation with Daniela Mitrovic. Daniela welcome to the show, it's great to have you on today.

**DANIELA
MITROVIC:**

It's great to be here Lauren.

LAUREN:

So one of the things I love about hosting a podcast is that I get to hear people's stories, sort of like where it all began, how they ended up sort of where they ended up or will call I guess the investing origin story and you have a really interesting story. So I'd love to hear how you sort of made that journey from Moldova to the bond markets.

**DANIELA
MITROVIC:**

So it's interesting I get to actually say I was born in the USSR maybe Moldova I'm Romanian ethnically but Moldova was one of the USSR republics and I was fortunate enough to be born in a family where my parents thought their daughters could do anything despite the fact that they were born in villages. And during a time that really defined people's thinking about life in general and how they pursued possibility because as USSR was sort of going through its definales, my family was part of the uprising against the USSR.

So we were very much sort of taught to question authority to not take anything for granted. And through the years as I became an adult before I came to the United States, my first job out of college was actually at the Chicago Board of Trade which was the quintessence of, it is what it is, you either have a view that validates-- that's validated by the market or not.

And the ability to question authority and being comfortable standing against the tide became defining in how I thought about markets and sort of where my perspective on risk taking ended up being. So it's remarkable how much of the risk sticks that we develop as investors have been created early on.

LAUREN:

Absolutely And those are fascinating things I think later I'd love to sort of talk a bit more about those. One thing I'm so curious about is what made you fall in love with the markets?

**DANIELA
MITROVIC:**

Everything. I think I often laugh because I've had the pleasure of explaining portfolio management to seven-year-olds and eight-year-olds over the years for career days. Portfolio management is a lot like if you had a mind that could not settle down anywhere properly and was constantly ping ponging everywhere, but at the same time you liked the idea of having your hypothesis tested, a very sort of clean cut process of what is success, how do you define that? It was always very objective in nature.

So I think my mind responded very well to the nature of the markets and that's because as I traded my first bond at the time that was the rest of it I was in love.

LAUREN: So I'm very curious, you've been in the market for I guess 20 years or so. A sort of a personal question, what was the experience like for you over the past year? I mean markets of being up, down, everywhere, what was it like?

DANIELA So that's a very interesting question because it has somewhat different answers depending on the perspective.

MITROVIC: From a pure investment perspective for Macquarie fixed income, we had a fantastic year in the sense that it was precisely the type of environment that our philosophy does particularly well and right. So our idea had always been look, when liquidity is ample, and that remember the beginning of 2020, liquidity was ample. And compensation for risk was poor, that's precisely the time to take a step back, build the liquid capital reserve with a pure expectation that at some point, something eventually breaks.

So you don't there's no requirement that exactly the path but just understanding the idea that markets tend to overdo it in the extremes. So because of that as you might imagine and our comfort standing against the tide, March and early summer of 2020 were remarkable periods of investment creativity and interacting with a research team and we're talking about airlines. Who survives, who doesn't, why. That was phenomenal. That was-- that feeds the creative mind and the intellectual curiosity of the entire team.

And then also builds camaraderie. But then on a sort of human and personal level that's where it gets tough, because the best thing about the GFC for example as I think back-- and look I need to acknowledge the human suffering in the background is significant. But focusing strictly on one investing, it was that we go through a crisis together as a team on a trading desk with the adrenaline associated with it, it builds a remarkable sense of togetherness. That's what makes this business really neat in that sense.

And even with clients, that that's the other aspect of it. You go through this process with your clients, they are just as aware of how remarkable-- how incredible things are. But what was different about this process is as you might imagine, I like to talk with my hands and everything else that I have, interacting with people is a requirement for my well being and being sort of behind screens really tempered with that process. On a personal level, and I do want to talk about this quite a bit, our mental health hasn't been easy this year.

And just as much I think as you think about decision making in general and what makes investing effective. What is a process that's effective? Well investing without debate does not exist. There's no effective investing without debate and the problem is that online and on screen, even though one on one we seem to function OK to have a group of people trying to have a live debate that's quite limiting.

LAUREN: Yes. A few moments ago you talked about sort of markets and extreme and I just want to sort of set the context for the audience. Now we're having this conversation, it's July 20th. Yesterday was one of the worst days in the stock market in many months and bond yields were also fell to the lowest level in months. I was reading a note John authors he's a columnist at Bloomberg had this note, the good news if the market is to be believed is that we can forget about the inflation scare. So I want us to try and take the long view here, the bond market has not been following the script many had expected this summer, what is your view, how should listeners be thinking about events at the moment but taking the long view?

**DANIELA
MITROVIC:**

What often happens during periods of inflection like this or when things don't quite work out as consensus would expect would happen is we fall back to our compulsion to create stories. And you can create any story, this is how it works, right? The markets are incredibly complex systems and there is a lot of model uncertainty around, OK what is fair value and range. Do you know? No, we don't know that with a high degree of certainty, of course not.

So what is in fact a natural model uncertainty, humans don't accept that as difficult process. So we need to create stories around that. And I think what we've noticed quite a bit, after the FOMC meeting in particular in June, the great abandoning average inflation targeting meeting the market processors were chose to process this as, ah, your playbook is back the Fed will be too aggressive, it will stifle inflation, they're afraid of this animal and in the process kill the recovery.

And that has been sort of the most convenient narrative around what we've seen in the markets. In practice things are a little both simpler and more complicated. On the one hand is as you think about how quickly interest rates moved from about 50 basis points at the low last year to a one to 1.75% this year, that was without pause, that was incredibly rapid. And equally it was around a tremendous amount of consensus, around that view, right? Most people really did think that inflation was here and recovery would be remarkable when you have fiscal policy. All the stars were aligning around this view.

And when you have that many people transition to one side of the equation many left to sell, right? Many people left to sell bonds. So what we found was that we needed some rebalancing in the market. You still have the Fed purchasing tremendous amounts of treasuries and agency mortgage backed securities. So naturally it created a little bit of supply-demand imbalance, and it's fine. More recently however and specific to this week, it had that backdrop but now the market is choosing to focus again on the virus.

And this reaction function is a bit more familiar, with know how it works, it manifested in more obvious ways that equities actually sold off. When bonds did particularly well and yields declined we had a little bit of a pause in the risk rally overall. So the market is trying to come to terms with the fact that the virus may well be with us for an extended period of time.

I guess the real conclusion to this point is just the realization that, used to call it inflation extremism and that it seemed like people wouldn't accept that anything nuanced was possible. You either believe disinflation was going to destroy the world or you believed inflation would destroy bond markets and there would be no purpose for bonds and the reality is clearly here in the middle one. Yeah, cyclical impulses strong but the underlying secular trends are equally strong.

LAUREN:

Yes. So when we're speaking of markets a bit earlier you mentioned a term I've never heard before. Mutant capitalism, I guess it's a term that you've coined. Tell listeners what exactly is mutant capitalism and why should we be thinking about mutant capitalism?

**DANIELA
MITROVIC:**

So firstly, it is our attempt at being funny. Full acknowledgment, there's no official-- there's no official definition to mutant capitalism. But as we reflect it on the last decade of investing so especially or specifically post GFC, as we enter the era of quantitative easing, right? One of the things that became quite evident is the fact that government was now playing a central role in markets.

So when you think back and look at JP Morgan the man not the company back in the day you would say, well, what's the purpose of markets and capitalism? Very simple. Their purpose is to make sure that capital is allocated to its most efficient users. That was easy. reflecting on the last 10 years, not so much capital. That is not quite what we've experienced. So to frame, given the pandemic, to frame sort of this new era of investing differently we decided to call it mutant capitalism because it wants to be capitalism but in practice doesn't function as such.

So from-- but more importantly, what are the implications of this era? There are many fold. For one we know full well that the markets haven't really been allowed to recalibrate because the euphemism of global financial conditions otherwise known as equities are selling off has generally meant that monetary policy for the longest time would come in and save the day for various forms or most recently, and this is sort of where this monster or whatever the current regime has become, has taken an entirely different form as fiscal policy has now joined monetary policy as a way to mitigate problems in markets.

So what that has meant from a practical perspective is as you've had these imbalances built up and as you've had monetary policy a Band-Aid every occurrence of problem or fiscal policy Band-Aid every occurrence of problem, think about BP and its impact on the economy not everything is as intended when it comes to these types of solutions. It has created an entirely different market. And what we've noticed is in this market the speed of reaction has changed. It's become much, much higher than it's ever been before.

And we call it the market stock in permanent fast forward. We've had last year an entire pandemic, a crisis unseen by modern markets condensed in less than a year, there's no real explanation for that other than this new environment. And the problem is that once you inhabit this reality, the market periodically lets off steam.

So dislocations end up happening with a much higher frequency than in the past, which is why from our perspective as we were talking about needing to have a liquid capital reserve and how do you approach markets when they are this volatile, when there are multiple derivatives to keep in mind, when you interpret data or number, good data is good data unless it's bad data unless it's good news unless it's-- this is the market we're in and the only way to really navigate these markets is to use agility as the necessary currency to capitalize on value.

Put differently in the extremes is where the best value exists but you have to be able to be prepared to have the liquid reserve and you have to have the agility, the actual speed of deployment in order to function and monetize the new regime.

LAUREN: So you've talked about the passive investing in the extremes and also sort of standing against the tide and how, I guess your childhood sort of impressed upon you those sort of I guess values or disciplines, tell me how it is with your team. I presume that you spread around the globe. It's been a very sort of funky workwise, how do you get your team to also think this way to sort of take that stand against the tide?

DANIELA MITROVIC: So I think one of the real interesting features around how Macquarie Fixed Income functions is that we are 115 individuals, four hubs, three different continents. And I tell you this at this time around it certainly has been-- was very useful to have an office in Australia. It gave that Asian early Asian perspective that we wanted to have. But even though it's a large organization it has always-- I always laugh it's operated like a kindergarten class that's gone together through every single class all the way through college.

So that personal rapport as well as a clear understanding of how we operate. Every regime has a mode of what types of questions we ask. So for example for us and that becomes important even if you have disruption in how we can communicate.

So for example, it was abundantly clear based on our research into market efficiency that because the best value resides in the extremes and because we look at evidence for fundamental evidence but also behavioral evidence to decide where value exists, whether it was our analysts or security specialists or EEM team, everybody pursued the environment starting in March as an environment of opportunity to add value rather than an environment where you cut risk.

And that became very important because we were asking the right questions. We weren't asking what are we selling when everybody else is running for the hills, we were asking what are we buying. And the type of conversations we have particularly early on when visibility was very poor, we wanted to focus strictly where we had confidence that the entities could get across the bridge.

So as a result, we used to laugh and say, hey, if it requires financial engineering to decide to go to the next bond because the investable universe is 20,000 individual issues in the bond market.

LAUREN:

So speaking of buying, I wanted to be sort of be a bit of a provocateur for a moment, I know that you're a long term believer in bonds that's what you do, but there are some people out there who are really decidedly not anti-bond they just don't pull any punches when it comes to the fixed income market.

So for example Buffett in his shareholder letter this year was saying bonds are not the place to be these days. Ray Dalio posted something on LinkedIn he said, why in the world would you own bonds when the bond markets offer ridiculously low yields. So I'm going to put that question to you. Why should investors own bonds, what is the role of fixed income and how do you add value in this environment?

DANIELA

MITROVIC:

I think my first reaction, for I do get very defensive about what but my first reaction is that my entire 20 year career I've spent answering one question more than any other and that was, why would you possibly buy bonds when the yields are so low? Or if you look at history that has been the case for 20 years and bonds have certainly more than delivered and more importantly active fixed-income has more than delivered. This is still one component of the market that lends itself to active management, you can actually add value.

So just noting that then as an example in particular, if you look not 20 years back but you look at the end of 2018 that was very much the conversation. Why should you own bonds if rates are clearly going higher, that was quite a very famous person who was calling for interest rates to get to 5% of the time, very prosperous. If our flagship fund I think for 2019 returned 11% which even by equity standards is an entirely acceptable rate of return.

And fast forward to the end of 2019 as we all recall and that environment was actually quite similar to this environment, the discussion was the same, right? Interest rates were incredibly low, they were just unbelievably low. The compensation for risk in credit or securities was very poor, why would you possibly own bonds. And when pandemic comes about and you also remember why treasuries, specifically treasuries are the one safe haven you always would have wanted to own no matter what's happening, including if you think back when the US was downgraded.

Rally, what was your safe haven when the US was downgraded, when treasuries were downgraded? Treasuries rallied. So the answer to the question of why own bonds is the same reason you did last year and the year before but bigger picture and from a longer term perspective bonds are a store of value, bonds are a source of liquidity, because remember that the entire mutants capitalism story you want to source. Even Warren Buffett in 2008 he did well because he had money to spend. That's all there is to it and that's what bonds can offer.

But I will insert a small cautionary note here. One because of the sort of generalized belief that bonds will have to go higher for the past decade, what's happened was that bond funds or bond solutions became denature. So not all bonds are quite what you think they are. And investors have gotten into the habit of increasingly investing in very risky bonds that are highly correlated with equities.

So when we have and again in the spirit of being super silly, but also to the point, we call them baby equities. Because in the scheme of things you have not diversified if all the bonds you own are high yield and Yeah, there's a role for them but that's not really what the fixed income anchor in the portfolio should be. So that is our big sort of cautionary note is understand what bonds is, understand exactly which element will provide stability and access to liquidity and in the meanwhile take advantage of all the opportunities that present themselves in an area like this.

LAUREN: Great. Well now it's time for us to get to our closing questions. And as I had told you before I asked the same three questions to every guest. The first is what we call the ray of sunshine, it's a sort of a left over from I guess early in the pandemic when we're just trying to find something to anchor us to something positive. You spoke about how difficult it was for a mental health perspective last year, we've seen lots of changes that have come about as a result of the pandemic. So read the question is just, what is one I guess long lasting change that you hope will stick around because of the pandemic or as a result from the pandemic?

DANIELA MITROVIC: So it's interesting. The temptation is to look at so many things we've been talking about flexible work and so on. In my view though, as I talk to people I can't think of a single one who hasn't had that death bed philosophical moment in their lives last year. It's the question of what matters? Why am I here? If I die tomorrow being faced with mortality, maybe I'm exaggerating but I've certainly gone through it and I feel like many folks have, what will I have-- what's the legacy for my children.

And I think that process in the same way that during the Great war-- after the Great Depression a lot of people became more frugal. I feel like that will be the stamp on our generation, that self reflection making sure that what you do matters.

LAUREN: So the second question I used to call the nursery question because that's, actually where I first saw it was obviously a middle school nursery working question. But I think I should call it like the space tourism question because like the last week, we've seen two billionaires go up to space, Sir Richard Branson last week, today Jeff Bezos. So we will kind of quote the space tourism question. So you're about to get on a plane, it won't be the 10 minute flight like the Jeff Bezos's this going to be a long space duration flight, you can take one object with you, what do you take?

DANIELA MITROVIC: I have to recognize that-- so admit that being an astronaut was more part of my realm of possibilities growing up than being a bond manager. This has always been part of my special dream. I don't think it-- It's the dream, it's the process, it's the unknown. So to be honest with you we have flexibility, if it weren't an object, it would be my kids, my husband and my sister. I would just take them along because it would be such a remarkable experience.

LAUREN: But if you couldn't take them, is there something else you'd have to take?

DANIELA
MITROVIC: That's nothing, that's the idea.

[LAUGHING]

It's just being that. It's just remind of the process of when you take pictures and I have children and God knows I have many pictures. But your experience of anything that happens to your children when you take pictures or you busy with any of that changes. I just want to be present. And I would assume things like oxygen and cameras would exist on board.

LAUREN: Yeah I certainly hope so. I will stick with space for the last question and this is the super power question and you have to pick one super power, that's flights or invisibility. Whichever one you pick, you're the only person in the world that has that super power, which one do you pick, but more importantly, what do you do with it?

DANIELA
MITROVIC: So this one is tricky. It really is complicated because from a pragmatic perspective one would argue that invisibility has greater applicability, particularly if legality is not an issue. However, invisibility even if you believe legality alone and even if your objective is really to change the world for the better, invisibility has a deceitfulness to it it's just not my cup of tea. So I'm going with flight.

LAUREN: OK. And what are going to do with it, though? And again it might be just one experience that like you and me present in the space flight, it might be the same.

DANIELA
MITROVIC: People know that you can do anything, I don't know, open the scope of possibilities. Haven't quite explored this enough, I'll have to take it home for homework.

LAUREN: OK. Well Daniel it's been a lot of fun today. Thank you so much for joining us.

DANIELA
MITROVIC: And thank you, it's been lovely.

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