A Q&A with Portfolio Manager Thomas Reynolds

Artisan Partners U.S. Value Team

PORTFOLIO MANAGER
Viewpoints

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Thomas A. Reynolds IV
Portfolio Manager

26 Years Investment Experience

Tom recently celebrated his 7-year anniversary with the Artisan Partners U.S. Value Team. To commemorate his time with Artisan, we asked him a few questions to get to know him better as an investor.

You had an unconventional start to your career as you were an anthropology major in college. What was your path from anthropology to becoming a portfolio manager, and how have you been able to apply your social sciences background?

Reynolds: I grew up in the suburbs of Chicago, which had a large physical footprint in the financial industry back then with commodity and options trading pits. In high school, I found myself drawn to the city instead of typical jobs with better hours like waiting tables or caddying. I interned in trading operations at some large banks and then in research in high school and college. The tangible experience in the financial world gave me the confidence to explore new areas in my college studies. Anthropology is a wonderful major, and I wouldn't trade it for the world. As a generalist, I'm dropping into new industries and having to learn the unique customs of all the participants—management, customers, employees, investors and so on. My first job was in a fixed income department, where I became more interested in the companies buying the securities than the securities themselves. I then went to business school at the University of Chicago to check all the requisite nerd boxes to transition my career. From there, I followed one of the many paths into the investment profession, working in investment banking and then moving to the buyside. All these experiences help me today. I can dive deeply and narrowly into a single company thanks to the banking pressure cooker. I can understand securities on balance sheets, which helped our funds greatly during the Silicon Valley Bank Fun Run. Most importantly, I can drop into new areas where I have no experience with a process but feel comfortable that I can translate the unfamiliar to the familiar.

You've described your investment approach as seeking "better, safer and cheaper" companies in order to tilt the odds in your favor. Yet, business is dynamic. Industries, competition and technologies are constantly in flux. As an investor, how do you respond to new information?

Reynolds: Early in my career, I would grind to understand every nook and cranny of a business. A wise veteran told me there are five things you need to know about a stock, and by the time you know three of them, it's too late. Find the most important drivers. Estimate the odds of positive and negative outcomes within those drivers. When the potential for positives significantly outweighs the potential for negatives, invest. That's the essence of probabilistic investing. On the flip side, when confronted with new, negative information that changes the probability distribution, it's time to sell. I'm more likely to move on when I feel the odds have tilted against me than to dig in. After all, the odds of having a "perfect" portfolio at any moment in time are zero. As the size of the probability bubbles of different outcomes change, positive or negative, position sizing needs to be adjusted accordingly.

Investment Risks: Investments will rise and fall with market fluctuations and investor capital is at risk. Investors investing in strategies denominated in non-local currency should be aware of the risk of currency exchange fluctuations that may cause a loss of principal.

How do you think about macroeconomic risks with respect to your decisions and portfolio positioning?

Reynolds: I think about macroeconomic risks with a similar probabilistic approach as with individual stocks. Anybody who tells you with certainty what the 10-year US Treasury yield will be in a year, what economic output will be, what politicians will do, what other countries will do, is nuts. Go back to the end of 2019. Did anyone's medium-term outlook call for a pandemic, a stock market crash, massive stimulus or a massive market rally, followed by a surge in inflation, supply chain chaos and a land war in Europe? No. We don't know what's going to happen. Instead, we consider a reasonable range of possible outcomes and have an eye toward surviving risks from both tails.

The trend toward passive investing has been persistent, with the share of assets in passive mutual funds and exchange-traded funds eclipsing their active counterparts in 2023. Does active management still have a role to play in investors' portfolios?

Reynolds: The asset management industry is going through a period of structural change. Some firms are handling this by deemphasizing active equity management and attempting to build scale and/or diversify with M&A. Artisan believes in active investment management and commits resources to its existing teams while growing in new areas through talent acquisition. I believe active, passive and alternative investing will all have important seats at the table when the industry shakes out.

I realize the S&P 500® Index has been on an awesome winning streak since the global financial crisis. However, we don't have to go back that far in history to see extended periods where active management added significant value. I graduated college in June 1999. The S&P 500 peaked the following spring and bottomed in late 2002—down about 50% peak to trough. The index didn't achieve its early 2000 record high until late 2007, which you recall was promptly followed by a ~55% drawdown over the next 18 months. The S&P didn't surpass that 2000/2007 high again until 2013. My first few years of savings eked out around a 3.5% annualized total return over the first 14 years of my career! The Barclays (Lehman) US Aggregate Bond Index beat the S&P 500 by ~220bps. While it is tempting to focus on the 12 years since then for the S&P 500 cranking out 14.1% annualized total returns to the bond market's 1.7%, investors must remember the market's cyclical time horizons can monopolize significant portions of investors' careers. Any investor or allocator who began their career post-GFC has only experienced buy-the-dip up markets and massive government stimulus. That's a long way of saying that I believe active will come back and Artisan's investment teams and clients may be positioned to benefit when it does.

The legendary Charlie Munger passed away in 2023. What's one of his lessons, whether about investing or another topic, that most resonates with you?

Reynolds: Mr. Munger spoke a lot about creating win-wins in business and treating people with respect. Essentially, don't let the MBA textbook or the spreadsheet lead you astray. In one of his last interviews, he said business school students can take the notion of an item like capital efficiency and misuse it.

"They learn for instance, that if you just pay the suppliers in 90 days and sell in 30 days, then you get all this—somebody else is furnishing your working gaps. So they abuse the supplier, who's a little supplier, because they can get by with it. I don't think those models are safe or good. I think that's a dumb way to treat little suppliers. So I don't believe in that kind of brutality to little suppliers."

Let's extend this to the real world. It might have looked good in a spreadsheet for Boeing to spin off capital-intensive parts of its business, such as Spirit AeroSystems, and then squeeze them brutally. Indeed, it seemed to work for a few years. But eventually the strain Boeing applied to Spirit broke a critical supplier's operations, which in turn caused a Boeing 737 MAX to have part of its fuselage blow out midflight, Boeing to halt production again, the FAA to focus (finally) on Boeing and place limits on how many 737 MAX's it could build. The C-suite didn't put that in the spreadsheet, and now the company just raised $21 billion to fix its balance sheet from the resulting cash burn. Extend it to how Boeing treated its union, and we can see why the union is so dug in and mistrusting of management. Treating people fairly isn't just the right thing to do, it's smart business.

Munger's business partner, Warren Buffett, has said: "Investing is simple, but not easy. The key is to have patience and discipline." How do you keep emotions at bay?

Reynolds: We find our patience and discipline in our process and humility. Leaning on our process keeps emotions out of decision making. People may associate big market sell offs with emotions like fear and anxiety. Our team actually gets excited in these drawdowns because we can smell opportunity, and our process keeps us from getting overly enthusiastic to "buy the dip" if the probabilistic outcomes aren't in our favor. Humility helps us evaluate our investments based on new information. If one of our stocks reports earnings and the stock falls 10%, we do not assume the market is wrong. We use our process to take a fresh look at the new information and invest or divest accordingly. The same logic applies to the positive outcomes. If a stock has a large runup, typical value-investor emotions yell "SELL!", but we re-evaluate the situation as if it were a fresh buy. If the probability bubbles have changed to the positive, let it run. If not, sell.

Are there any books you've been reading or movies and podcasts you would recommend?

Reynolds: Chris Miller's *Chip War: The Fight for the World's Most Critical Technology* is a great history of the semiconductor industry that takes us from its roots to today's geopolitical flashpoint of Taiwan.

I enjoy listening to *The Decoder* with Nilay Patel, editor in chief of The Verge. It focuses on today's big issues in the areas of innovation, government policy and business strategy.

Tae Kim's *The Nvidia Way* shows how managerial strategy, culture, work ethic, raw PhD horsepower and most importantly the fear of being out-competed built the most important company in the world today.

For those into war books, I've been enjoying James Holland's recent works on Sicily, Italy and the Sherwood Rangers. He also co-hosts a World War II podcast, "*We Have Ways of Making You Talk*". Also, John McManus' recent book on D-Day is a great example of how intense preparation and planning for an event can provide order, structure and a framework for success, even when the event presents unforeseen chaos.

What would you be doing if you weren't doing this?

Reynolds: I really enjoy investing. If I wasn't investing in public securities, I would be investing in private ones. I do think it would be fun to invest in a small business and have an immersive operations experience such as upgrading the technology platform. Being on a corporate board would be interesting as well; being a sounding board for management and hopefully providing level-headed advice on strategy, risks and opportunities.

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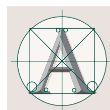
A R T I S A N  P A R T N E R S