A Force to Be Reckoned With

Disruptive Forces in Investing **October 17, 2023**

Anu Rajakumar: The asset management industry has experienced numerous disruptions over the years. The great financial crisis, the COVID pandemic, unconventional monetary policy, volatile geopolitics, and incredible advancements in technology and data, just to name a few. At Neuberger Berman, we strive to operate at the leading edge of an increasingly complex and challenging investment environment.

And today, on this 100th episode of the *Disruptive Forces Podcast*, we're diving into the latest innovations that are disrupting the asset management industry today. And who better to discuss this topic than our esteemed chairman and CEO George Walker, who's here to shed light on how Neuberger Berman is evolving and advancing into a new era for asset management. George, thank you for coming onto the show.

George Walker: Thank you, Anu, and thank you for that very generous, overly generous introduction.

Anu: [laughs] Now, George, Neuberger Berman has been an innovator for decades. In 1950, the firm launched one of the first no-load mutual funds in the US. In 2020, we started our annual advanced proxy voting disclosure initiative, NB Votes, and more recently, we've launched a suite of active ETFs, and there's been lots more in between. So to kick this off, what are some of the exciting innovations that the firm is working on today?

George: Gosh, there are a number. If I were to pick just a few, I would probably point to, first, what folks are calling the democratization of alternatives, particularly private equity and customization in core equities. So in retail alternatives, as you know, we work with many of the largest institutional investors in the world, each of whom have been on a journey over time to increase the percentage of assets that they allocate to private equity and private real estate and the like from which they've earned, as a whole, pretty terrific returns.

If you look at smaller individual investors, either for their own account or through defined contribution programs, 401(k) programs and the like, they haven't had that same opportunity to participate. And so, we have been working hard to develop solutions that bring our very best capabilities, that we offer to some of the largest institutions in the world, to smaller accounts. And the opportunity is a large one. If you were to go into a leading wealth manager today and say, "I have X dollars to invest", for some of those clients, they might suggest a 20% allocation to alternatives. And if you look at their books right now, you'll find many of the largest, most important wealth managers have something closer to 2% to 3% of their assets allocated there. So helping those advisors deliver for clients and helping deliver for the end clients in a product that is truly institutional and that we feel very confident delivering to the largest institutions in the world that's namely diversified by manager and strategy and vintage such that it's a real program, I think is a huge opportunity.

And then a second, I would say, is in places where folks are looking for more core beta exposure, hopefully with some alpha as well. Much of that for taxable accounts today is still delivered by the '40 Act. The old US mutual fund, which was in a quite extraordinary innovation in 1940, but clearly needs to be modernized, one. And two, with the explosion of computing technology, we are able to deliver custom separate accounts for individuals in the same strategies that historically they could only access in co-mingled vehicles.

And that enables you to do a series of different things. One customize and two realize the benefits from tax loss harvesting, which can be significant. The difference in after-tax returns on a tax loss harvested strategy versus one that isn't, that delta alone can be many percentage points which frankly represents the difference between some of the best-performing managers and the worst performing managers.

So there's a real opportunity to take both passive and active strategies for taxable investors, particularly in high tax jurisdictions, and materially improve their long-term after-tax return. So those would be two I would point to that I think can really move the needle for individual investors.

Anu: Yep. Sure. You know, the democratization of private markets is such a huge theme for so many of these intermediary wirehouses that we work with, and it sounds like there's a massive gap and opportunity to take advantage of. George, what about the future of equity markets? We've seen disruptions over the years, like smart beta and ETF innovations, but the environment going forward could look quite different. Where are we heading in equities?

George: In terms of how equities are managed, I'd say a couple of things. First, one innovation that's happened over time has been that there's been tremendous fee pressure, both in active and in passive. And that's good. It's good for clients. It means they're getting more value, net-net-net, delivered to their portfolio, which is why we all exist. I do think over time, as passive continues to grow, we will have to grapple as a society with the issue of can everybody be a free-rider?

We're getting to the point now with passive over 50%, that there are fewer and fewer participants who are actually doing the real bottom-up work and, frankly, setting prices. And that's important just in terms, frankly, of capital being allocated efficiently and markets functioning. The second thing is we believe, or I believe for the system to function well, owners need to behave like owners. And so engagement matters tremendously.

And if I am a passive manager, for example, and don't need to know that Coca-Cola is a soft drink company, I'm probably not the right person to be engaging with them as an owner to make sure I'm comfortable with how they're operating the firm. What are their capital spending plans? What does their capital structure look like? Great, big, important strategic issues. And so we've tried really hard to continue to increase our engagement with corporates and increasingly, frankly, to have a voice on behalf of other owners.

So we introduced a program a number of years ago where we're amongst the only US firms that are pre-announcing certain important proxy votes. So coming out, not after the vote, but before the vote, letting the company itself know how we're going to vote and other shareholders such that they can be aware of the issue and how somebody who cares deeply and has engaged with the company and thought deeply about these issues, believe it's most appropriate for other owners to follow.

So those would be two examples of innovations over time or changes we can look forward to over time. What is the role of active managers? Do we all have a responsibility to the system? What is the right balance of passive and active? And how do owners really engage as owners?

Anu: Absolutely. I like that phrase that you used, "Owners need to behave like owners," and certainly this topic, I dove into it pretty deeply with Doug Kramer a few episodes ago. So for those who are interested, I encourage you to listen to that episode. And certainly, again, that NB Votes initiative, you know, really shows Neuberger Berman's thoughtfulness and transparency when it comes to engage with companies, which is so important.

George: I think it's really important. It can make my life a little bit more difficult. About half of the time we support management and half of the time we oppose management. And when we oppose management, these are in companies we like, and oftentimes with management teams we really like, we just disagree with the answer. So we try hard privately to convey what we think they should be doing, in written form to managements and to boards of directors and then, ultimately, if we're unable to change course, then publicly to other shareholders as well so that we can have a real dialogue around the future of these important companies.

Anu: Absolutely. Now, again, Neuberger has been an innovator in alternatives as well. And I'll highlight Dyal, which is now Blue Owl, which really created a new investment segment when it began acquiring minority equity stakes in alternative asset managers, and that product came through Neuberger Berman, what are some other innovations within private markets that you're focused on?

George: Gosh, there are again, so many. If I were to pick two broad ones, I would say evolution within the private credit space has been extraordinary over the course of the past few years, and we expect continued growth there. Is there both, additional opportunities and as banks are increasingly capital constrained in terms of their ability to provide important credit.

I think today we have nine different private credit strategies, and so clients who may have five years ago looked to private credit simply as loans to sponsors, now recognize it's a far broader universe and they have the ability to earn through a more diversified private credit exposures, higher risk-adjusted rates of return over time. So lots of innovation in the private credit space at large.

The second development, I would say, has been the explosion of GP-led secondaries, which is a touchy subject for some as there are many LPs who are quite frustrated with some of the developments and we think reasonably so and the industry is making good progress. The LPs working together, making good progress at improving industry standards. At the same time, this is a space that's growing.

It might represent more than half of secondary volume in the years ahead, and we think presents the opportunity to really earn terrific returns in those cases where you can dig in deeply, work closely with the GP and identify what are frankly win-win-win opportunities for existing LPs, for the companies that are involved, and for those who are willing to step into those shoes of those who would prefer earlier liquidity. So it's a space in flux and it's one that we're spending a lot of time focusing on, both for the benefit of the broad LP community and for the benefit of investors who choose to provide liquidity to it.

Anu: Absolutely. Now George, you've shared some exciting innovations so far, but I'm sure our listeners also want to know what are some of the key issues that are keeping you up at night when you look ahead?

George: Ah, um, [chuckles] there are many. You know, obviously markets are volatile and challenging. We're living in a slightly crazy and uncertain world, both geopolitically and, frankly, within the United States in terms of the polarization that exists right now in some of the dysfunction we see in the context of our political and governance processes. AI is going to transform our industry, I believe. We're still in the top half of the first inning, but we're investing significantly in how to utilize AI to improve our investing itself.

How to improve how we engage with clients and provide them with access and information, and then in terms of just many of the internal processes that we have to operate the firm. I think AI is going to have a far greater impact than many realize. I think the Bill Gates' quote was a good one that, "people tend to overestimate the amount of change that's going to happen in the next year or two and materially underestimate the amount of change that's going to happen in the coming 5 to 10." I think he's right that I think that applies here.

You know, we're also doing a lot of work, frankly, around hybrid, and how do we rethink the work week? How do we better enable our folks to lead happy fulfilled lives, and the same time being increasingly productive and delivering for clients? And that debate and discussion for many is simplified to exactly how many days are folks in the office. And our folks happen to be in the office far more than most of our competitors? But I think that's sort of the wrong question. And the right question is, how do we optimize? And we're at the beginning of that journey to tell you the truth.

Anu: Perfect. Thank you very much. We've spoken all about the investment innovations. You've talked about a few things outside of the investment innovations. What else are you excited about beyond our product lineup?

George: I'm excited about the opportunity to deliver for clients. It's an exciting investment landscape. There is so much change going on right now. We have an extraordinary team, and I think the real ability to help clients fulfill their objectives, which is why we exist. So it might be a more stressful time than most over the course of the past 15 years that I've been in the seat, but it's really an exciting time.

Anu: Great. Thank you. Now, as a follow-up question to that, George, you know, I know that the firm's ownership structure has been something that has been a key focus for you, since our formation. Talk a little bit about that and how that impacts the future of the firm.

George: Sure. Just so folks know, we're a little unique. There are few other firms of our scale that are owned the way that we are, which is that we're a private, independent, 100% employee-owned company. The firm today is owned by over 700 of its employees, and very broadly diversified. There's no single owner who owns a large percentage of the firm. And we've worked hard to increase that number. I think when we started it was far fewer than 200. And we've continued to grow it.

And in my mind, that's important for a couple of reasons. One, alignment, there's only us and clients, right? For many organizations, you think there are two people at the table but there are really three. There are the employees, there are clients, and there are owners. In our case, we really only have two people at the table, and that makes it easier to think long-term, easier to focus on the clients, easier to get things done when there are just two parties, rather than three.

It also influences, frankly, our ability to distribute rewards to individuals and to invest in the franchise. So if a typical money management firm, say, pays 40% of every client revenue dollar to employees, maybe uses 20% for the building and computers and things, and then distributes 40% of pre-tax earnings to owners. In our case, 80% is going to folks who are in the building doing work. And that's part of the reason why our retention statistics are so extraordinary over time. I promise nobody at Neuberger stays here because of its great management.

Anu: [laughs]

George: It's, uh, it's, uh, our structure and our culture [that] are really determinative. So we work hard on alignment. We take 100% of the deferred compensation, for example, that we have and invest it into client portfolios so that we're not running an independent proprietary investment book. As much as we can make it, it's really about driving alignment with clients and-and focusing on their success. And I think our ownership structure and the ability to retain individuals for the long term and the ability to invest in the business, are key attributes and, frankly, have contributed mightily to the success that we've had over the course of the 15 years that I've been here.

Anu: Yeah. I think those comments really resonate with me personally. I've also been here for 15 years and I think that culture of collaboration and innovation have been so enriching to me in my professional career and so many of our colleagues as well. And so I think a key reason why we consistently get recognized by P&Is best places to work in money management. Um..

George: I do worry about that. We finished first or second each of the last nine years.

Anu: Yeah.

George: We've won the last two, and I worry that they won't be able to sell as many magazines **[Anu laughs]** if we keep winning. So at some point, we are destined to lose our top spot which will be devastating to me personally but, uh, is perhaps inevitable.

Anu: Well, let's hope that doesn't happen anytime immediately soon. But, uh, you know, George, as we start to wrap up here, what are some of the other goals that you have for the firm, that you hope to accomplish in your tenure?

George: For me, I just want the firm to be excellent. I want people to be really proud to be here and to feel like they are able to be their authentic selves and contribute as much as they possibly can. And I think we work hard to measure both of those and would be happy to talk about that with anyone who's interested. But continuing to drive that engagement and enablement over time matters a lot.

I want clients to feel great about what we are doing for them, about our long-term investment performance, about how we add Alpha in the context of the broader relationship. And I'd like the firm to be a force for good in our system, making companies that we invest in better, contributing to important issues.

So there's a lot that we're working on that I feel great about. And for us, the path is really focused on excellence. If we can be excellent, if we can truly deliver for clients and for employees, and on the margin, make a positive contribution to the world in which we all live, I sure feel great about that mission.

Anu: Wonderful. That is an excellent place, I think, to wrap up today. But before I let you go, I have to end with a surprise bonus question. So George, in an alternate universe, if you were not the CEO of an asset management company, what would you do with your time?

George: What would I like to do? I'd-I'd like to be a professional tennis player, but unfortunately, I will soon be losing to my 14-year-old son. So it would truly be a deeply alternate universe, or I've always loved being around universities and learning, so perhaps working in some academic institution. I haven't had enough time to think about what I'd be doing. I'm thrilled with my role. I'm going to be here for a long time, unless folks want to throw me out of the place, and have a very very busy engaged life.

Anu: Absolutely. Well, I've had the pleasure of playing alongside you in tennis and you're pretty good, so that would not be a-a terrible backup solution. Well I really appreciate your take on innovations in our industry and at Neuberger Berman. And more so, I also just want to thank you for your leadership: your courage, your vision, your humility. They're such a critical element of the firm's culture and success. And it really is what makes Neuberger Berman a special place to work. So thank you for all that you do. And thank you for coming on the show today.

George: Thank you, Anu, and-and thank you for all that you do. You're extraordinary and proud to be your partner.

Anu: Thank you very much, and to our listeners, if you enjoyed this episode or heard a topic that George mentioned that you'd like to hear more about from our investment teams, we encourage you to explore more by subscribing to the show via Apple Podcasts, Google Podcasts, or Spotify, or you can visit our website, www.nb.com/disruptiveforces for previous episodes, as well as more information about our firm and offerings.