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Q&A

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PIMCO Total Return Update

PIMCO Chief Investment Officers (CIOs) Scott Mather, Mark Kiesel and Mihir Worah recently took over management of the PIMCO Total Return Strategy, each bringing a depth of investment experience and specialized expertise to the portfolio. In the following Q&A, we asked the three portfolio managers to discuss this new team structure and how they will be positioning Total Return moving forward.

Q: Can you tell us more about the experience that you each bring to the Total Return strategy?

Scott Mather: Of course. Mark, Mihir and I are all CIOs, members of PIMCO's Investment Committee and veteran PIMCO portfolio managers, so we have worked together in various capacities for a long time. Each of us brings a different background and area of expertise to the Total Return management team. Mark is a leading credit expert who originally joined PIMCO in 1996. After serving in various roles, including as a senior credit analyst, Mark now oversees PIMCO's global credit business and credit research. Mihir started his PIMCO career in Analytics in 2001 and eventually helped build our industry-leading inflation-linked bond and commodities businesses. He currently leads PIMCO's real return and asset allocation efforts. I started out in mortgage and asset-backed securities in 1998 and was later responsible for building and leading our European portfolio management team. I eventually moved back to the U.S. as head of global portfolio management, helping grow the business to over $120 billion in assets under management. I would add that each of us is first and foremost an investor, and I am proud to say that we all have strong long-term records of generating performance for clients.

Q: How does your past experience position you to take on management of Total Return, PIMCO's largest strategy?

Mark Kiesel: I think it's important to highlight that all three of us have already been part of the Total Return investment process for many years. The fact is that no one individual could possibly know the ins and outs of every corner of the bond market. As with every other generalist portfolio manager at PIMCO, Bill Gross relied on us – along with the firm's 240 other portfolio managers – for help in generating the trade ideas that have driven the strategy's strong historical performance. So we're intimately familiar with the portfolio and its holdings, and when we took over the strategy there were no surprises. It was a seamless transition.

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Mihir Worah: I'd also point out that, in addition to our roles as specialists, we have contributed to Total Return through our participation in the Investment Committee. Ultimately, the IC is the central investment decision-making body at the firm, responsible for determining investment themes and establishing risk exposures that are applied across all PIMCO strategies, including Total Return.

Q: Total Return now has three portfolio managers instead of one. Will this change the way the strategy is managed?

Worah: As Mark mentioned, Total Return has always benefited from the input of many portfolio managers. The success of Total Return and all of our strategies rests on a time-tested, team-oriented investment process. Our cyclical and secular forum processes bring together portfolio managers from around the world to formulate top-down themes, while our generalists and specialists work together to build portfolios from the bottom up. That said, we believe that a more explicit team approach actually brings a lot of benefits to the strategy. We now have three senior portfolio managers, each with a unique background and set of skills, coming together to directly own the management of the portfolio. Given that each of us has a long history of working with the specialists in our area of expertise, the team structure also provides a more direct link between the specialist desks and the Total Return portfolio.

Q: There is always the possibility that the three of you might not agree. What happens then?

Mather: First of all, it's important to keep in mind that most of the really "big" investment decisions at PIMCO are not made by individual PMs or even PM teams but by the Investment Committee. It will continue to be up to the IC to decide, for instance, whether the strategy should be over or underweight duration and by how much. Of course we as a portfolio management team will still be responsible for making decisions related to implementation and bottom-up security selection, and we will hold regular Total Return strategy meetings to discuss these types of issues and come to a consensus. Since we all have different specialties, we're likely to give more weight to the opinion of the relevant specialist when resolving differences of opinion. Even so, you are right that there may be times when we simply can't come to an agreement. Should that happen, I will make the call.

Q: Given that sometimes a change in portfolio manager results in outflows, some clients are asking how we will handle liquidity in the event of such flows. How would you answer that question?

Worah: PIMCO has always been a good liquidity manager. We have some of the best tools and practices in the industry in terms of managing liquidity, and they've enabled us to successfully navigate some pretty difficult market conditions in recent years, including 2008 and 2009. I'd stress, however, that the biggest difference between now and the financial crisis is that markets are functioning normally today. Given that Total Return is invested in highly liquid securities, and currently has above-average liquidity simply due to the strategies we've had in place in recent months, we are confident that we will be able to handle even significant levels of client redemptions from the portfolio.

Q: Let's move on to PIMCO's current views. How is Total Return being positioned for the environment ahead?

Mather: Our belief in The New Neutral continues to anchor our views. We believe the Fed has been looking, and will continue to look, to reflate the U.S. economy. Therefore, it is likely to be slow to raise policy rates and any increases will be gradual. Meanwhile, central banks elsewhere, particularly in Europe, Japan and many emerging market countries, are likely to move in the direction of even further monetary accommodation. There are a few implications: Liquidity in the global markets is likely to remain ample for some time to come. And although the global economic recovery remains uneven and substandard, it continues at a robust enough pace to provide a supportive background for many spread sectors and pushes out the timeframe for a turn in the risk cycle. Finally, since not all central banks are moving in the same direction there are likely to be many more cross-market opportunities.

Kiesel: I agree with Scott. Certainly there are many opportunities in the credit markets. Credit spreads may be relatively tight, but with liquidity likely to remain plentiful and corporate profits still very healthy in many sectors, we don't see room for spreads to widen significantly. It is important to be selective, but we think there are some great investment opportunities in companies with strong growth profiles and pricing power and in industries with high barriers to entry and improving credit fundamentals. For instance, European banks, US energy and Asia gaming come to mind.

Worah: Central banks are also creating opportunities in the currency and rates markets. Divergent monetary policy is likely to mean continued strength in the dollar, particularly against the euro and yen, and the portfolio is positioned to take advantage of that. Also, though there is currently little inflation, the Fed's reflationary mindset makes inflation protection via Treasury Inflation-Protected Securities (TIPS) a sensible hedge, since they are quite attractively priced compared to nominal bonds.

Q: Any additional thoughts?

Mather: Just that Mark, Mihir and I could not be more excited about working together to take Total Return forward. The strategy continues to benefit from an array of global resources that are unparalleled in the industry. Delivering returns and managing risks for our clients has been PIMCO's primary goal for more than 40 years, and investors can feel confident that we will continue to deliver the same world-class investment management they have come to expect from PIMCO.

Mark R. Kiesel

Mr. Kiesel is CIO Global Credit and a managing director in the Newport Beach office. He is a member of the PIMCO Investment Committee, a generalist portfolio manager and the global head of corporate bond portfolio management, with oversight for the firm's investment grade, high yield, bank loan, municipal and insurance business as well as credit research. Morningstar named him Fixed-Income Fund Manager of the Year in 2012 and a finalist in 2010. He has written extensively on the topic of global credit markets, founded the firm's Global Credit Perspectives publication and regularly appears in the financial media. He joined PIMCO in 1996 and previously served as PIMCO's global head of investment grade corporate bonds and as a senior credit analyst. He has 22 years of investment experience and holds an MBA from the University of Chicago's Graduate School of Business. He received his undergraduate degree from the University of Michigan.

Scott A. Mather

Mr. Mather is CIO U.S. Core Strategies and a managing director in the Newport Beach office. Previously, he was head of global portfolio management. Before that, he led portfolio management in Europe, managed euro and pan-European portfolios and worked closely with many Allianz-related companies. He also served as a managing director of Allianz Global Investors KAG. Prior to these roles, Mr. Mather co-headed PIMCO's mortgage- and asset-backed securities team. Prior to joining PIMCO in 1998, he was a fixed income trader specializing in mortgage-backed securities at Goldman Sachs in New York. He has 20 years of investment experience and holds a master's degree in engineering, as well as undergraduate degrees, from the University of Pennsylvania.

Mihir P. Worah

Mr. Worah is CIO Real Return and Asset Allocation and a managing director in the Newport Beach office, a portfolio manager, and head of the real return and multi-asset portfolio management teams. Prior to joining PIMCO in 2001, he was a postdoctoral research associate at the University of California, Berkeley and the Stanford Linear Accelerator Center, where he built models to explain the difference between matter and anti-matter. In 2012 he co-authored "Intelligent Commodity Indexing," published by McGraw-Hill. He has 12 years of investment experience and holds a Ph.D. in theoretical physics from the University of Chicago.

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