Frank and Steve featured on Sterling Shea's podcast from Barron's, "The Way Forward"

Sterling Shea (SS): Hi everyone. This is Sterling Shea from Barron's and I want to thank you for joining us for another episode of "The Way Forward." This week we have a discussion with two great RIA principals who lead a firm called GM Advisory Group. It's a New York City based registered investment advisor, perennially ranked in our top independent advisory firms list. I'd like to welcome Frank Marzano, who is Founder and Managing principal, and Steven Raneri, who is the chief investment officer. Frank, Steve – thanks so much for making some time for us.

Frank Marzano (FM) & Steve Raneri (SR): Thanks Sterling, great to be here. It's great to be here.

SS: One of the things that we want to talk to you guys about is your investment outlook and in particular how you're articulating and positioning it for the clients that you're talking to. One of the interesting facts about your firm is that you've had a very strong run of referral-driven organic growth for as long as we've been looking at your business. But you've done that, while maintaining a nearly impeccable long term client retention. So we want to hear a little bit about how you're positioning the market outlook, given all the uncertainty that we're facing right now. So let's start right there. Can you lay out for us – what's your opinion of the market turmoil and volatility that we've experienced and when clients ask you, "where do you think we're headed in the next six months," how do you answer that, Steve.

SR: So, let's start with how our clients were positioned coming into the pandemic and the recession, which was very defensively positioned. We had been recommending very high allocations to gold and long term treasuries since really late 2018, that's when the economy started to decelerate. And, of course, once the pandemic hit both those asset classes were in very strong demand in the teeth of the crisis so that certainly put our clients in a good position, kind of going into it, and our initial move was to get incrementally even more defensive on the margin, just to preserve as much capital as possible. But then, you know, as we all know as the Fed strategy of flooding the markets and backstopping the credit markets, and the stimulus packages kicked in, we started to systematically increase risk at that point. Once it became clear that these efforts to bridge the economy to the post-pandemic future would be successful for the time being. So we're still cautious overall but in the short term, there's a lot of reasons to think that the market can move higher, our asset allocations to the defensive assets remain, but a little bit less so than before.

SS: Well, it's the whole name of the game is buying quality assets at a lower valuations. When you look across the market right now, where are you seeing opportunity, what sectors are you looking at when you say you think there's going to be opportunity for buying.

SR: Well, let's see I would focus on three sectors. And that's where we've been allocating, in biotech and therapeutics, credit markets with various niches, and gold which is obviously not down, it has actually broken out to new highs, but I would still say, sometimes you can make more money averaging up than averaging down so I'd still call that an opportunity. And if it goes lower I just buy more, but let's start with biotech and therapeutics. You know, “demographics are destiny,” we like to say, and we all know that healthcare consumption increases sharply with age. And so, now in the COVID-19 pandemic environment, you have a shift where biotech and pharma companies are now, sort of seen, as essential components of the solving of the problem and we believe that the political pressures that there have been, more prior to the pandemic, of increasing regulation and drug pricing pressure, are going to be lessened and actually we think that the COVID-19 situation will create an environment of winners and losers within all sectors but specifically within therapeutics where there's going to be safe and effective therapies that are very commercially successful, there will be safe and effective therapies that companies can't get paid for. And then there are some that are just gonna outright fail. And there's an investment opportunity there for those who can navigate the environment and analyze the commercial potential of these compounds and then how it's gonna impact the company. As far as credit markets, we all know that corporate leverage surged over the last 10 years to all time highs. Now you get hit with a pandemic and a recession and demand destruction, and you have earnings pressures and revenue pressures on these companies. You have companies that had okay balance sheets that are now stressed. Then you have companies that had stressed balance sheets that are now more stressed or even distressed. You've got good companies and bad balance sheets, in some cases. And when you put your money into the hands of managers that are sophisticated, that know how to isolate the opportunities – really identify the baby that's getting thrown out with the bathwater – and buying the oversold instruments, you can take advantage of that. Then there's also an environment where the traditional capital lenders, the typical providers of solutions like banks or, say Reed's or, direct lenders are more constrained, and they're focused on the easier trades the higher grade borrowers… the larger trades. So this creates a tremendous opportunity that we've been taking advantage of.

SS: Can I ask in regards to biotech and therapeutics, for example. How are you accessing that asset class –are you researching and looking at individual companies yourself or you looking at sector or passive instruments or active managers, what's the preferred approach for GMAG?

SR: Sure Sterling, great question. So, in general, we very much like cheap, passive, tax efficient instruments, in general, and we use that throughout our portfolio construction. But in a situation like this where… actually both of these situations the credit one and the therapeutics, that's really where active management is called for where you've got significant divergence and dispersion between winners and losers. And so, as far as how we're accessing it, we have identified the active manager that we choose, and there's there's several choices in that sector and you can do the work on on all of them but, we're bringing specific manager to our clients that we think is going to be able to capitalize on that environment, so active management is the answer in the case of both of these.

SS: While we're on that theme, do you find yourself working differently with some of your largest and most trusted third party asset managers now than you did say before the covid crisis.

SR: Well I think it ties into how we're working with our clients, it's the same way that that the asset managers work with with us. It's a much higher rate of communication, there's obviously a lot more going on. It's much more frequent communication. We're definitely working harder than ever. And that's a good thing.

SS: Yeah, good, good, just curious about that. Let's come back though to your outlook, you've talked about some areas that you think are very positive… where you see the opportunity to buy into but conversely, there's risk out there. What sectors of the market, do you see, as having risk right now that hasn't fully been appreciated.

SR: There's always something that comes to mind when you're asking me about concerns. What concerns us is, it's a little bit more of a longer term concern, but it's really massive money printing, and the long term consequences of the massive money printing. So when you think from the perspective of a wealthy individual or family. They own a lot of financial assets. Most, many, even all, are domestic assets, in a lot of cases, denominated in the US dollar. One of the things that can really hurt them is the debasement of the US dollar. We, Sterling, have been in a deflationary environment for the past four decades, and that recency bias is something that you always have to overcome. And also, a lot of investors have an investment bias towards their home country, which for many of our clients is the USA, and we, the USA, happen to have the sort of so called exorbitant privilege of having our own currency being the international reserve currency. And one way of thinking about it is, it cost us nothing to print up a new $100 bill, but other countries have to pony up $100 worth of stuff to obtain one. And we've been printing a lot of them lately. In fact, the Federal Reserve is probably projected to have printed up 3.5 trillion just to buy government bonds this year alone. So, if we shift from a deflationary environment to an inflationary environment, and we think that's likely to happen sometime in our lifetimes, then investors won't be able to get their hands on inflation hedges like commodities, precious metals and foreign assets fast enough and they won't be able to dump bonds fast enough. So, hence our large allocation to gold at this point in the cycle.

SS: Interesting. Speaking broadly about alternatives, has your allocation for an average high-net-worth client shifted dramatically… say from where you were before the crisis hit to where you are now?

SR: From an alternatives perspective, I would say there's definitely a little bit more of a pivot into alternatives. Not necessarily because we want to have less directional beta or we want to have more. We can manage our market beta using passive instruments, so it's not just, “Oh we want to get defensive. Let’s buy alts.” It's really more about identifying like say therapeutics or credit or structured credit, these are relatively esoteric asset classes, you really want to have your money in the hands of the best and brightest and a lot of cases that those are alternative managers.

SS: A last question question on markets and your perspective here – i'm sure we're going to go through this COVID situation either to follow the current trajectory or it'll get a little worse or a little better. But whatever case, whatever direction, it goes and I'm sure we will lead from this into what will be a relaxed, friendly, and genteel election cycle with no impact on the market right (laughs). How is this going to play out? You know markets don't change because of fundamentals, market change markets change because of beliefs and behaviors, and it'll be a heightened sensitivity in this political cycle, how do you think that's gonna play out in markets?

SR: For sure, a great way of asking it and you kind of have a little bit of the answer embedded in the question. With regard to assessing an election, we are focusing on… the decision that we make and the recommendations that we make to clients are really based on data – economic data, market data. We read it, we read the market data, we read the indicators, study the base effects and the indicators, and then we adjust our client positioning as needed. So we actually don't recommend major positioning changes based on how we handicap an election, because it's too difficult to predict the winner, then it's too difficult to predict the policies that they're gonna be able to put in place, then you have to predict what the long term reaction of the market will be to whatever those policies are. And all the other more important things, the observable non election related market drivers can kind of overwhelm your election call. And while your clients are waiting for your election call to hopefully be right, this can wreak havoc on your overall strategy. So, given the recession that we're in, and given the amount of debt that's been encouraged to cushion the blow, no matter who's elected, we're going to experience some blend of higher taxes and lower growth. That I can tell you, I can't tell you exactly who's going to win and what that's going to do to the market, but that's probably about all I can do in regard to anticipating the election.

SS: All right. Thanks, Steve. Let's pivot for a moment here, I want to talk a little bit about the lessons you've learned and your approach to managing the business right now. As I said at the onset of the call, you guys have achieved a great track record and referral-driven consistent organic growth through various market cycles and outstanding long term client retention. Frank, come in on this, you've been through a few market cycles. By your observation in this kind of environment, what are some of the do's and don'ts that advisors should be doing? Where do inexperienced advisors who haven't been through this kind of environment before, go astray in this kind of thing. There's huge opportunity, but there's risk to running a wealth advisory business right now, share a little insight.

FM: I think as an advisor, you always have to realize that, and keep in mind, you're getting paid to advise. Often times in periods of volatility, it's very easy to allow the clients' emotions to prevent you from offering sound financial guidance. So, I think, in times like this, it's incredibly important to keep your clients emotions in check. And to do that, you have to know your client. You have to know how they think and you also have to communicate frequently, and in a way that resonates with each client. So, based on what I see and mistakes that I've made in my own career. I see inexperienced advisors are much more likely to allow their clients' emotions to run wild and to actually impact their recommendations to the client.

SS: So you have to be a behavioral coach as much as a financial planner in this environment.

FM: Exactly. And my advice in these types of situations is to communicate frequently and do the best you can to control clients' emotions and to make sure that you are not allowing their emotions to get in the way of providing sound financial guidance.

SS: Listening skills, empathy, that EQ side of the brain… is that part of the formula?

FM: That is part of the formula. But the most important key to success is just making sure you're communicating… you're listening to them.

SS: Yeah, that's great advice. I saw study, a few years ago, that I think rings true today that said the number one reason why wealthy clients leave their financial advisors is lack of contact, lack of communication. Interesting you're exploring that. Well you know, if there are people though who are not satisfied now, that aren't getting communicated to in the way they would prefer, they're looking. There's money in motion right now, what are your thoughts about new business opportunity and approaching growth. It's obviously a different paradigm right now, people are very sensitive about being sold to how do you engage potential new client opportunities differently now, in light of this environment?

FM: We've all heard of the quote from Winston Churchill, "Never let a good crisis go to waste." And in our view, this pandemic and the recession has created a tremendous opportunity for new business. I mean, it's basically been a complete reset, in every way, of an individual's life. And, clients are evaluatingtheir financial relationships, and whether or not they feel like they were in good hands, guided appropriately in time of crisis. It's very easy, as we all know, for a client to feel comfortable when things are going well, when it's a less stressful situation. But the real value that they get is how they feel in situations like this pandemic. And I would recommend, and what we've been doing, is reaching out to all prospective clients that we've had, no matter how stale the relationship may be, and just check in. And what we've been doing is identifying reasons to reach out, it could be the economic stimulus package, tax provisions, the PPP loan, and it's very likely they're evaluating the relationship with their advisor and it's created a bunch of opportunities for us.

SS: Is the discovery process a little more challenging in the virtual format? How, what have you learned about getting clients to open up when you're doing a screen-to-screen rather than face-to-face.

FM: I think it's more challenging. I mean, I think a large part of the service that we provide and the comfort that our clients feel is in the eye contact, and in the connection that they have with us, and it's much more difficult, using video conferencing. So it's been a challenge, but it's something that we try to overcome by making sure that we're using the right technology for video conferencing, making sure that we're dressed appropriately for video conferencing and just all the details to give us the best chance to make that connection.

SS: And I'm sure it puts a premium on listening skills as well.

FM: Oh, for sure!

SS: Another question I have for you is around leading your team. You guys run a dynamic business, you have a large team focused on delivering the service promise to this group of clients that you have, what have you learned about leadership in this new environment and how is it different in terms of driving the efficiencies and productivity of your team in the work from home and virtual environment?

FM: Well, I think what we feel, and sort of the view that we have is working from home cannot take the place of collaboration. It's incredibly difficult to collaborate, when you are in a work from home environment. As a firm we identified this early and try to overcome it by using technology such as Slack, setting up spontaneous Zoom calls to collaborate, but it's still not the same as being in the office. It's still a work in progress. One of our four core values as a firm is collective intelligence, which basically means that collaboration is a huge component of our success. So we need to figure out how to collaborate even more when working from home than we would from working in the office and as I said, it's a work in progress and something we're constantly working on. But as far as what I've learned in leadership in this environment is that you need to trust your team members. I, by nature, am a serial micromanager, and it's been a big component of the success that we've had over the years, paying attention to all the details, making sure every i is dotted and every T is crossed. But, one of the things that we've come to realize is, this pandemic has impacted many of us in different ways. And many of us have handled the pandemic differently. So it was very important not to micromanage, trust that each and every one of our team members will remain accountable to their own productivity, and keep up with the momentum of the firm. And I think that's what will change differently and permanently in how I lead – less micromanagement and more trust.

SS: Yeah, as you envision a year from now and you have, let's say a potential vaccine and the covid crisis is a distant memory, let's all hope. What fixtures, of what we're doing now, do you think will be permanent. In terms of characterizing a new workplace, a new office life at GM Advisory?

FM: Well, I could just speak to some of the changes that I think that we're making, we're setting up a lot of our conference rooms to be set up for video, much more video conference-friendly. We're making substantial investments in technology. I see team members and I'm hearing this from a lot of our clients as well, requesting a work from home environment in some structure, permanently. So like maybe every Friday or, so I think that this work from home is something that's going to be a permanent structure in

the work environment and something that we are going to need to learn how to manage and deal with in a way that increases production.
SR: One of the, if I can just weigh in, one of the things that we are in the process of planning... as the firm's growing... we are taking more office space out in our headquarters on Long Island. And we, somewhat luckily, haven't finalized the layout. So if you look at the layouts that we were envisioning last year, and compare it to what the layout is going to be now, it's going to be completely different. More spacing, different conference room setups, so we're going to be working differently in the office and we're going to be working differently at home in the future. And luckily, we're in a position where we can make those adjustments and make sure that everybody can continue to work at the pace, which is pretty fast.

SS: Well, between markets, and leadership, and new business, and client communication, you guys have given us some very useful perspective and I appreciate it. I wonder though, if you humor us, by ending in the classic Barron's tradition of offering a single high conviction actionable idea to the advisors who are listening in, Steve, do you want to start?

SR: Sure, I'll go first. So my suggestion is and I'll keep it short and pithy, like you usually like in these – If you do not have a gold allocation in your client portfolios, you need to start to do some work on that and make a decision about why they should or they shouldn't. And keep in mind it's a very underowned asset, and I think it should get a hard look by anyone that does what we do for a living,

SS: Can I put you on the spot to ask for a ballpark percentage range allocation for a moderate-risk high-net-worth family that you're serving.

SR: Sure, you can. I would just preface that by saying we are not gold bugs, we have had zero percent gold for many many many years. So this is not some promo gold bug trade but 10% is a number I could see for someone like that. It could be a little lower, could be a little higher even. But that's what I'd say.

SS: That's great and I appreciate the conviction. Frank, how about you? What's an actionable idea you would offer to the advisors who are listening in?

FM: If you believe in your value proposition... and you're confident that your business is going to grow and you're confident in your ability to generate business in periods like this, you need to invest in your business and you need to lean in hard and do the things that others aren't doing. Your business, very likely, will be permanently impaired or moved further faster, and by investing in your business, and specifically investing in technology, like your CRM system, making sure that your process of communicating with your clients are efficient. We are investing in a client portal, so that our clients have a permanent place to store their permanent documents that they can access. We've also invested in hard technology, where each one of our team members receive a laptop, each one of our team members have two screens while working from home. So, my advice would be to invest in your business, specifically in technology.

SS: Don't be afraid to spend.

FM: Don't be afraid to spend, exactly.

SS: Well, that's a great one. Frank Steve, thank you so much for your insights, we really appreciate it.

FM: Thanks, Sterling!

SS: And I'd like to thank everyone for listening. We'll be back next week with another newsletter, and another episode of “The Way Forward.”