Long Term Generation of Wealth

Ronald P. Joelson

An Interview with Ronald P. Joelson, Executive Vice President and Chief Investment Officer, Northwestern Mutual

EDITORS' NOTE *Ronald Joelson is also a member of the company's Executive Leadership Team. Prior to joining Northwestern Mutual in 2012, Joelson successfully managed investments for two global insurance companies. He served as Chief Investment Officer of Genworth Financial. He also served as Chief Investment Officer for Prudential Financial from 2000 to 2007. During his 23-year tenure with Prudential, Joelson held several other roles, including President of the company's Guaranteed Products business and head of both the Structured Finance Group and the Enterprise Planning Group. Joelson graduated from Hamilton College with a bachelor's degree in economics and government. He earned his M.B.A. in Finance and Accounting from Columbia University in New York City in 1983. Joelson is currently on the boards of Conning Holdings Corporation and the Milwaukee Art Museum.*

COMPANY BRIEF *Northwestern Mutual (northwesternmutual.com) has helped clients achieve financial security for 157 years. Northwestern Mutual and its subsidiaries offer a distinctive approach to financial security solutions including life insurance, long-term care insurance, disability income insurance, annuities, investment products, and advisory products and services.*

How do you define your role?

I'm responsible for the company's $186-billion general account and managing the performance of that portfolio in terms of total return and generating income that is ultimately used to help fund the company's operations and ability to pay dividends for policyowners. This includes the overall broad asset allocation. We have specialized teams that work on investing. For example, our real estate group invests in both commercial mortgage loans and real estate equity, and Northwestern Mutual Capital invests both in private debt placements and private equity. Our public markets area manages about $100 billon of public bonds and equity, and then there is an overall strategy group that is framing the allocations within the context of the liabilities that we write as an insurance company.

The role is to make sure we're able to tactically respond to changes in the markets while maintaining a long-term outlook, and this is what distinguishes mutual companies and particularly us – we don't worry about quarterly earnings; we worry about long-term generation of wealth, be it through capital gains or ordinary income. This is different from public companies that tilt toward predictable operating income, which is something stock analysts like to see. We have none of those short-term pressures.

What is the secret to the firm's consistently strong investment performance?

It has to do with the whole business model of the company, and it starts with the fact that we invest between $1 billion and $1.5 billion on a monthly basis. Because there is so much cash flow and liquidity, we are able to consider investments that have less liquidity and, therefore, we're going to get paid extra for that.

Private debt placements, for example, deliver somewhere between 20 and 40 basis points of additional returns. Commercial mortgage loans, which are also less liquid, generate as much as 50 to 60 basis points versus a corporate security with comparable risk.

We look for structured investments that also deliver more yield because their complex structures generate similar liquidity premiums. Again, this strategy makes sense because there is so much liquidity in our system that we can afford to commit to less liquid investments where some others cannot.

We also need investment people to analyze those investments because we are buy-and-hold investors who believe generally that you can't easily trade out of your problems.

We hold a significant amount of public bonds, but on the margin, it's those more illiquid investments that generate the premium returns.

We also have about 16 percent of our assets in risk positions, which includes private equity, real estate equity, and high-yield public and private bonds. We generally take on a bit more risk than our competitors and the ratings agencies are comfortable with that because of both the sheer size of our surplus and the fact that our cash flow consistency continued even during the crisis. They are comfortable with the fact that we have a business model with a highly loyal customer base and consistent cash flow. This enables us to take more prudent investment risk than our peers.

Has it become more complex to evaluate and manage risk?

As an insurance company, it's part of the company's DNA, be it on the asset or liabilities side – it's all about risk and return. But it is more complex.

The great news is that we have both classically trained investors on our team as well as actuaries who also have a strong understanding of risk within the context of an insurance company. A post-crisis phenomenon is that when there are global dislocations, there tends to be a higher correlation of assets.

As a result, post the financial crisis, we are holding a bit more surplus than we used to, in order to make up for that correlation effect, and that is all part of understanding the risk management of the portfolios and how they move together. In turn, that enables us to figure out how much overall investment risk we can take.

As far as the equity markets are concerned, higher multiples suggest that, looking forward, individual security selection choices may outweigh the allocation decision. So we need an even better credit capability today to help us understand which companies are going to do well as opposed to playing the index and riding that wave. We think asset selection is equally important on the fixed income side.

Is there still strong growth potential for the U.S. and is the recovery sustainable?

It is sustainable, but it's not a high-growth recovery – we're looking at a fairly steady 2 to 3 percent growth rate.

There is very good evidence to support continuation of that modest growth rate. Manufacturing is more competitive than it has been in the past, as the differential of labor costs relative to other countries has fallen more dramatically. Our production of natural gas and hydrocarbons has lowered the transportation costs for U.S. companies, and we're seeing this reflected in the U.S. in the margins of the companies that we are now investing in.

We add to that the fact that there is still a lot of capital stock obsolescence and even if companies don't think they will grow a lot, they have to replace that capital stock. In addition, the commercial real estate markets and the strength we have seen there, along with housing starts and autos, are all leading indicators that look relatively strong.

We'd like to see higher employment levels. The labor participation rate continues to lag, yet companies are showing they can still grow – just with fewer full-time employees. This is not good from a social perspective but it hasn't hurt the engine of the economy as much as one would expect. ●