Michael Goosay

Episode 216: CIO Spotlight: Michael Goosay, CIO and Global Head of Fixed Income at Principal Asset Management

GUEST Q & A

Stewart: Welcome to another edition of the InsuranceAUM.com podcast. My name is Stewart Foley, I'll be your host. Thanks for joining us. It's so nice to have you. We have a CIO spotlight today and we're joined by Michael Goosay, CIO and global head of fixed income, and a portfolio manager at Principal Asset Management. Michael, thanks for taking the time. Thanks for being on. I cannot wait to talk fixed income with you this morning.

Mike: Thank you, Stewart. Looking forward to it as well.

Stewart: It is terrific. We're thrilled to have Principal back on. I want to start this one the way that we start them all, which is what is your hometown, the one that you grew up in? What's the first job you ever had? Not the fancy one. And what makes insurance asset management so cool.

Mike: All good questions. I grew up in a suburb of Scranton, Pennsylvania. Town was actually called Clark Summit, Pennsylvania. And I would say that's probably as far away from Wall Street and the fancy job as you described it. My first job was I was a paperboy, so I used to hop on the back of the bike with the backpack and drive around and throw papers at people's houses. Hopefully hitting the porch. Not always, but that was the goal.

Stewart: How about you join a list of people who were paperboys. There are a number of people on our show have been paperboys. We've done about 212 episodes, and paperboy is one that comes up with some frequency. So in your mind, I mean, insurance asset management is all I've done for a long, long time and same for you. So what do you think makes this industry so cool?

Mike: Yeah, it's a good question. And I think going back to the paperboy component, you had to learn responsibility at a young age. You had to be organized. You had to go out and make collections. You had to think about your P&L and at a young age you wound up creating not necessarily a path to doing what I do today, but just creating a better understanding of how markets work, how to grow a business, how to think about taking that money and investing it to some degree in whatever you were looking for.

I think insurance asset management, you're doing the same thing where you're making promises to people and you need to make sure that you're able to create that income that is required in whatever form of insurance that you are offering through investing in a prudent way through creating wealth for those investors and through those individuals as well as from a corporate perspective, doing so in a risk-controlled framework. So I think it's the intersection of really what investing is all about, which is looking for ways to support people, to create betterment in retirement, to do so in a real risk controlled framework, which is the cornerstone of my mind, what fixed income investing and what investing more generally is all about.

Stewart: Yeah, I love that analogy. I think that brings up a good point about insurance. And I say this a lot and I love the insurance industry and insurance companies make promises and when people need help the most, it's when the insurance industry shows up and writes checks and puts people's lives back together. And I think that's sometimes overlooked. So I want to get right into it with you and talk about a macro overview. You'd mentioned right before I hit the record button, you'd mentioned the term ‘inflection point’, which perked up my ears. What's your outlook on the macro environment and what is the inflection point you were referencing?

Mike: So I think if we just did a little history lesson here, you can think back to four years ago, almost four years ago exactly when COVID overwhelmed the global economy and people were sheltering in place, school was closed, people were trying to figure out how to work from home, and the economy really ground to a halt, not just in terms of obviously the humanitarian part of what was unfolding, but also the economic impact, which was huge. A lot of people lost their jobs, a lot of traditional businesses that require people to walk in the door went out of business.

And you saw the shock to the system both in terms of the employment picture but also the growth environment. And fortunately, that was met with a pretty substantial amount of stimulus. That stimulus played out through both lowering interest rates by global central banks, but also by fiscal stimulus through just a dumping of cash into the system by global governments.

We focus on the U.S., but as you think about this, the effect that that had was not just U.S.-centric, but it was global-centric. And the result was an inflation surge. We got vaccines and people started to get back into their normalcy and it took a while, but you wind up seeing people going back to work and getting back on airplanes and going to restaurants and all those sort of things.

But now we were doing so at a much higher price point than what we had been doing prior to that. And that rolls forward to really '23 into '24 where you saw global central banks needing to address this inflation problem because we were running, in some cases even double digits inflation in places like the United Kingdom. And the U.S. inflation rates were high single digits. And in order to combat that, Federal Reserve (Fed) hiked interest rates dramatically aiming to slow that pace of growth in the economy, slow that rate of inflation ultimately creating maybe an environment that could be resulting in a significant slowdown or a recession.

And that's where we came into 24, which was the expectations were, "Okay, great. Rates have gone up a lot. That should hurt growth rates. It should hurt the employment picture and ultimately combat inflationary pressures." But it hasn't really worked out that way. If you look actually at the prints that we've seen, inflation has remained stubbornly high. Admittedly at lower levels than it was two years ago, but still well above where the central bank is targeting.

The employment picture remains robust. If you want a job by and large, you can get a job. There are more open jobs than there are unemployed people in the economy. And so that's creating this push-pull out right now, which is that expectations are still that the economy is going to slow, that people will lose their jobs, unfortunately, and that will create an environment where interest rates have to go down.

So that's the inflection point that I referred to earlier was when you get to that point where the economy does show some signs of cracks, which we think we're just seeing the nascent beginnings of. When you see an environment where the employment picture starts to deteriorate, which again we're starting to see some signals of. And finally, that credit is deteriorating. And I don't mean credit in that you can't use your credit card or get a loan if you want to buy a house, but that delinquencies, particularly in the lower income spectrum have been rising as people are struggling to keep the same pace of spending up without some of the stimulative programs that I mentioned earlier, giving them free cash.

Stewart: And I actually saw a headline this morning that said something like one in five credit cards are delinquent right now. I just saw that. I don't know. I can't even tell you where I saw it. And it leads me back into this interest rate environment question. So there's talk about, oh, what the Fed is going to do, which I think frankly there's way too much attention paid. It is like this Fed watch, it's like what are you going to do? But at the end of the day, Fed action/inaction, the current yield curve, I mean you've got this yield curve that it used to be that it was the bond vigilantes that were always with the shape of the yield curve, but now governments have come in and impacted the shape of the curve too. So how do you think about the interest rate environment right now and what you see in the short to intermediate term?

Mike: That's a good question because there's some nuances and differences in the bond market that's created effectively a Fed watching industry to your point about the obsession with it. And what that's also done is it's created hypersensitivity around what is the Federal Reserve interest rate. But to your point, what really matters to companies who borrow money or individuals who borrow money are what are some of those longer-term interest rates suggesting that the cost of capital is to them.

And those are lower than the federal funds rate. That inverted curve that you referenced is created with continued higher borrowing costs, but still okay, still not too restrictive to stamp out, really demand being driven through leverage in the economy. And so not getting into the too-geeky stuff of fixed income, but normally when you get into an inverted yield curve, it's a precursor for a recession.

It's something like nine out of nine times when the curve has been inverted. At some point you do get to recession. When you start to move towards a recession, you see the employment picture deteriorate, you see inflation start to come down, you see these delinquencies that you reference and you were right on the screws with one out of five start to rise. And that should drive the Federal Reserve to start to moderate what we think is restrictive monetary policy by cutting interest rates. So long-winded answer, but we do think the Fed will cut rates potentially as soon as July. We think that they will cut up probably two times. And even with today's economic data, which was a little bit softening in the inflation number, retail sales were a little bit weaker, would be suggested that maybe they could go two or even three times. That is usually a really good tailwind for fixed income.

So if you just think about it as an asset class, not just focused on that Federal Reserve rate, when you get into an environment where the Fed is moved from tightening to a pause to now an ease, you get this real tailwind not just for the federal fund's reserve rate, but also for longer maturity fixed income. So we think it's a great time to buy bonds and continue to be in our portfolios a little bit overweight versus our benchmarks.

Stewart: That's really helpful. So private credit has been a huge trend in our industry and in many other institutional investor areas. Do you think that the Fed cutting is going to help ease some of the financial burden on some of the floating rate private credit that's out in the market today?

Mike: It certainly should. As you suggest, a lot of those products are floating rate and they are much more sensitive to changes in federal funds rate, short-term interest rates. But I think private credit as an asset class is here to stay.

Stewart: 100%.

Mike: I mean, whether that's corporate investors, institutional investors, insurance companies, even private investors are starting to get into the game now with different ways that those private credit, private equity, direct lending are being packaged. What it's done from my perspective as a public fixed income portfolio manager is that it's changed the makeup of some of our fixed income asset classes. So imagine our high yield bond index, which was where a lot of these companies that are now accessing the private market used to go for financing.

That has seen the proportion of low quality below investment rates, called that CCC universe, go from about 20% a decade ago to about 10% today. The actual number is 11.8% of the high yield index is CCC rated. So that implies obviously the average quality of the high yield universe has improved. And when I think about it from a public investor perspective, the actual premium that I need to get to invest in high yield now is lower because the quality of the universe of assets is higher. I think this trend will continue. That capital will go where the demand is. So if there is more demand for private assets, which there is and there is more demand than there is supply in the private markets today, that will continue to be an area where companies will look to receive their financing.

Stewart: I'm a hundred percent in agreement with you there. And the other thing, the point I'd make is that you think about banks and where some of this lending used to reside, right? You think about the ALM match up with banks and it's essentially like overnight deposits, funding long data liabilities, and insurance companies go, "Ah, that's a problem." But the FDIC goes, "Yeah, but we'll backstop it all." But then you think about an insurance company that has a set of liabilities that match up beautifully with private credit and you take away the run on the bank, the run on the bank potential. And it just seems like it's such a good match for funding. Insurance companies need long-dated liabilities. They've got long-dated liabilities. They need long-dated assets. And it makes sense to me for a lot of reasons that I agree with you that it is absolutely here to stay.

Mike: I think there's two points, Stewart, to make on that though. You need to make sure you're getting paid the premium for the liquidity risk. In effect you're giving up liquidity to go into the private markets. It's not like you can go ahead and say, "Great, I'm going to sell it today because I want to buy something different or an event occurred." So you have to recognize that it is a less liquid product. I think probably more importantly because it's not public, it doesn't have the same rigor and standards that you get from other private assets that you need to really do a good job of understanding what you're buying. The details of these companies aren't necessarily as publicly available. We have an excellent product. We do an excellent job. This is such an important part of investing in this asset class, is to really have the deep rigor around the credit analysis of those assets.

Stewart: And this is why we bring smart people like you on this podcast. It's a lot easier to be a podcast host than it is to pick the red ones from the blue ones. So speaking of which, let's talk about Principal Global Fixed Income for a second. Can you talk a little bit about the breadth of your capabilities? You mentioned being a public portfolio manager, public security portfolio manager, but you also have considerable private expertise at Principal as well and you've done it for a long, long time. And I just think it would be good for our audience just to get a sense of the broad brushstrokes around Principal Global Fixed Income.

Mike: And so Principal Asset Management is a large asset manager. Those run the gamut from fixed income, which is what I'm responsible for, public fixed income. We have equity business on both private and public equities. We have real estate business that we're managing assets for both private and public real estate offerings. And we do asset allocation. So think about your target date funds and what's involved in rotating across asset classes for those strategies.

Within that, as you noted, I'm responsible for the fixed income group and we do run a reasonable amount of money for the Principal insurance portfolio. So think traditional general account assets, some retirement assets and wrapped products. And the goal there is, as I noted at the outset, is to understand the responsibility of delivering that promise to our investors. But we also do run more traditional asset management products.

So we run institutional products for corporate pensions, for individuals to retail products like mutual funds and ETFs and commingled vehicles. We have a global footprint. So I think it's important to note that it's not just U.S. So we have global fixed income offerings in Europe and in Asia as well as obviously in the U.S. And so across our entire platform, we're really aiming to think about the segments of where our clients really are coming from.

And that is clearly part of our insurance heritage, to understand what those objectives are for insurance companies and for our general account asset allocation, but also thinking about how we create the best retirement solution for our clients, both an institutional as well as an individual sense.

Stewart: You obviously know the Principal GA very well. But as an asset manager, I mean what I found when I was in the seat was it was more challenging to understand the clients and a third party asset management relationship to make sure that we were in tune with what was going on with them, that it required a little effort because you're not sitting in the same building every day. Right? So can you talk a little bit about how the service and management of your insurance clients that aren't Principal?

Mike: Yeah. So it's an excellent question because you can try to make everyone fit into what you want them to have or what you think you're best at. But that's not the way we operate. We're client first. We're client-centric. We want to build products. We want to manage assets that meet our client's objectives. And those come in a lot of different flavors and forms from very conservative-hink money markets or short-term oriented products to more high-octane things like emerging market debt or high yield. Or we'll talk a little bit about in a minute some securitized credit products where we think we really have a competitive advantage.

So it's really important to understand your client's objectives. Now that's easier when you're dealing with an institution, to be quite honest, Stewart. They tell you, they're like, "This is what we want. This is how we want you to manage it. These are the types of risks we expect you're going to take. Go ahead and do better than what we can get from anywhere else." But within the retail-oriented or the individual channel, we really want to create products that achieve different goals.

So you can think about the soon-to-be-retired or existing retiree. They may not want to take risk. But you compare that to one of my kids who are in their twenties and they got a long time until they have to start worrying about it and they need to take risks. They want to take risks so that they can have a better outcome in 30 or 40 years. So we really aim to have a product suite that allows our clients on the individual side to be able to pick what's best for them based on where they are in their life cycle.

And this plays out not just for fixed income, but I mentioned the target date products. As you think about different horizons that you can have. You want to have a different asset allocation mix. And so our goal here is to be client first, to create products that are meeting our client's objectives in whatever realm they find themselves.

Stewart: That's very helpful and I think very well put. The question, I guess where we go next is where can insurance investors find opportunities within fixed income markets today? And it takes me back to someone saying that long-dated credit is at their fifth percentile, tight intermediate credit, 15th percentile tight. We just surveyed the group that's coming to our symposium in June and private credit and private structure we're at the top of the list as far as what people were interested in hearing about.

Where do you think there's opportunities right now as you look out? And the thing is, as a PM, and I'm just thinking where you sit, it's always easy looking back in the rear-view mirror and you go, "Oh, well, that was obvious and whatever." But when you look forward out into the abyss, which is like there's a lot of variables, a lot going on right now. You mentioned the inflection point. I'm really keen to hear what your view is here.

Mike: So from an insurance perspective, the bread and butter is public investment grade, corporate bond investments. Imagine your traditional BBB, single-A rated company. As you noted it's very expensive from a valuation perspective. But looking back and trying to evaluate what is the reason why that those valuations are expensive, we use what we call our FTV scoring. And I think this is a metric that is really important to think about when evaluating any investment, whether it's me sitting here trying to manage a fixed income portfolio or a mom-and-pop sitting at home trying to figure out how they should think about how they should be determining their asset allocation.

FTV, fundamentals, technicals, valuations. So you hit on the V, valuations remain expensive. 5th percentile in terms of long corporates, a little bit less so, 15th percentile. And intermediate corporates, expensive. No doubt about it.

But there's a good reason for that because the fundamentals remain robust. Companies came out of COVID. Some of them obviously didn't survive, but those that did were able to refinance their debt to put themselves in a very good fiscal position to be able to weather any kind of inflection point, slow down in economic growth. So there's not this wall of worry that they have to refinance imminently at higher interest rates and put themselves in a more dire fiscal position.

Technicals. Demand is there. So you can look at an all-in corporate bond yield, an investment grade corporate bond yield that's still five and a half to 6%. Rates we haven't seen in a very long time. And so not only are corporations through their pension plans, insurance companies as well as individuals looking at this from a reasonable fundamental perspective, but that technicals feed on themselves. So Stewart, if you think about that IS-LM curve, the thing we all forgot about from economics, when demand increases, price has to change to find a new equilibrium.

And that's largely what we think is happening today is that the fundamentals remain robust, the technicals are very healthy, and that's driving valuations to remain expensive. But as we think about how do we position accordingly, well, that certainly does question, do you think the next step, the next, as you look into the abyss, the next opportunity is in investment grade corporates or is it something else?

And so one sector of the fixed income market that's gotten really beat up has been anything that's real-estate-centric. So tons of news articles about the office space crisis and people are working from home and the need for these large corporate headquarters are going away. And that's creating opportunities in that market. So one of the things that we really prided ourselves for Principal is because of our insurance company heritage, real estate is a big part of what we've done historically.

And what's really important to get right when evaluating whether that's buying a building or buying a commercial mortgage-backed security, is that deep rigor around understanding the specific securities, what you're buying, how that's financed, what the tenant looks like, all the different things that you take for granted, but not everybody does. And so some of the other areas that we're looking at are things like single asset, single borrower, where actually, it is a real-estate-oriented investment, but it's one thing like a data center for Amazon or it's something that's very tangible that you can understand and really do the deep dive analysis.

Short-dated credit, both asset-backed credit where you can really do your homework. And something that we really pride ourselves on getting right in the asset-backed space is another area where we do think that there are opportunities. You want to try to farm through the things that nobody else wants and find those diamonds in the rough.

Stewart: That's super helpful. Can you talk a little bit about... I'm a little bit of a structure geek. Can you talk a little bit about securitized? And I will say this, just a shout-out to all the people who have ever taken economics and said, "What am I ever going to do with this IS-LM curve?" Let me just tell you that Mike Goosay just threw it out there and just told you exactly

how to use it. So it wasn't all for naught, folks. So this is good stuff. But can we talk a little bit about... I mean, how do you feel about CMBS, CLOs, ABS? Can you give us a little bit of a rundown there?

Mike: Sure. So as I think about CMBS, and I've mentioned office space and some of the concerns about that, certainly there are components of the CMBS market that are worrisome. If you look at some of the mezzanine structures, some of the lower-quality structures, you are starting to see some cracks in that office space that could drive those assets to having some impairments. And so we are aiming to avoid that.

So with CMBS, you're seeing high occupancy rates and where you're seeing, as I mentioned earlier, some of these data center deals which are creating real opportunity because they're being thrown away along with the entirety of the office-based market. And so we do think that there are one-off opportunities. I'm not ignorant to the fact we are likely to have some issues, some defaults, some impairments with these assets, but if you're getting paid for it and you're really doing your homework, we think there are opportunities in CMBS, less so in the CLO market because we do think that that has been an area where you have seen the loan market that is.

You have seen a lot more issuance in lower-quality debt. I mentioned the high-yield market has been improving in its credit quality. The loan market has actually been deteriorating. And those are the segments that will actually get beat up if we do go into some sort of prolonged slowdown in the economy.

Stewart: I have had a great time talking with you about fixed income. It's been a lot of fun. And I want to leave you with a couple of fun ones on the way out the door. There is some optionality here, and you mentioned not wanting to get too far in the fixed income geeky space, but at the end of the day, that's what our audience really wants, right? It's like you can't get too geeky for this bunch. So is there a piece of advice? And a lot of times people come on the show and they're senior in their position, right? They're leaders in this space and they're subject matter experts.

Along the way you've probably picked up a piece of advice or two. And what I would say is there a piece of advice that you would give a 25-year-old Mike Goosay, if you were starting out your career in the insurance asset management business today? And then the second question is, who would you most like to have lunch with alive or dead? You can have a table of up to four, including you, so you could have three guests. You can have just one. But what are your thoughts on those?

Mike: So the piece of advice I would give is patience. It's something I still struggle with 30 years into this business. I think that applies not just to investing, but also just how you manage your career, how you manage your life. Be patient. Nothing happens overnight just because you think it's a terrible idea or a great idea today, it doesn't mean in the dawn of a new day that it still will be. So be patient. And I think that probably the biggest example for that to me is I worked at Prudential when I first came out of school and worked on insurance mandates and managing assets and did a pretty good job at making money for our clients.

I really wanted to jump in and be like a risk taker, a prop trader and a hedge fund guy. Did that for a couple of years. I realized that it's not a great way to invest. Scrolling the P&L on your screen like the national debt in Times Square is not a great way to invest. So being patient both from a professional perspective as well as from an investment perspective.

Stewart: Good stuff. How about lunch?

Mike: I don't want to bring the whole thing down. My father has passed away a number of years ago. I'd love to have lunch with him or talk to him one last time. It's something that you kind of miss when you're looking for someone to ask advice, questions to, whether that's personal or professional, and somebody that may not be in your inner circle from a business perspective, but can give you perspective. So he would be the big one for me.

I would go back to some of my friends from college that I don't get to see anymore that you kind of really just feel comfortable with. And so it doesn't have to be something I'm going to learn from or grow from, but my dad would be the big one. And probably a couple of my buddies from college.

Stewart: There's a lot of people that come on and they mention a parent or a grandparent that they'd like to have, they'd like to see again. I think that's really touching and I can completely relate to that. So it's really been a pleasure to have you on, Michael. I appreciate you taking the time and we appreciate our relationship with Principal Asset Management very much and look forward to having you back on sometime again soon.

Mike: Love to. Thanks so much, Stewart.

Stewart: We've been joined today by Michael Goosay, CIO and global head of fixed income, and a portfolio manager at Principal Asset Management. Thanks for joining us. If you have ideas for the podcast, please shoot me a note. It's stewart@insuranceaum.com. You can rate us, like us and review us in Apple Podcast, Spotify, Amazon, Google Play, Stitcher, or wherever you listen to your favorite shows. My name is Stewart Foley, and this is the InsuranceAUM.com podcast.

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