Striving to Deliver Better Risk-Adjusted Returns

An Interview with Jeffrey Sherman, Deputy Chief Investment Officer, DoubleLine

Jeffrey Sherman

EDITORS' NOTE *As DoubleLine's Deputy Chief Investment Officer, Jeffrey Sherman oversees and administers DoubleLine's Investment Management sub-committee coordinating and implementing policies and processes across the investment teams. He also serves as lead portfolio manager for multi-sector and derivative-based strategies. He is a member of DoubleLine's Executive Management and Fixed Income Asset Allocation Committees. He can be heard regularly on his podcast "The Sherman Show" (@ShermanShowPod) where he interviews distinguished guests, giving listeners insight into DoubleLine's current views. In 2018,* Money Management Executive *named Sherman as one of "10 Fund Managers to Watch" in their yearly special report. Prior to joining DoubleLine in 2009, he was a Senior Vice President at TCW where he worked as a portfolio manager and quantitative analyst focused on fixed income and real-asset portfolios. Sherman was a statistics and mathematics instructor at both the University of the Pacific and Florida State University. He taught Quantitative Methods for Level I candidates in the CFA LA/USC Review Program for many years. He holds a BS in Applied Mathematics from the University of the Pacific and an MS in Financial Engineering from the Claremont Graduate University. He is a CFA® charterholder.*

FIRM BRIEF *DoubleLine (doubleline.com) is an independent, employee-owned money management firm with more than $134 billion in combined assets under management invested across a wide array of investment strategies. The firm's experienced team of portfolio managers have worked together on average 15 years. DoubleLine's investment strategies include U.S. Fixed Income, Global Fixed Income, Emerging Markets Fixed Income, U.S. Equity, Commodities, and Global Multi-Asset products.*

Will you discuss the history of DoubleLine and how the firm has evolved?

DoubleLine is an independent, majority employee-owned money management firm founded by Jeffrey Gundlach in December 2009 under a cardinal mandate: striving to deliver better risk-adjusted returns. This mandate includes the avoidance of risk-taking that even under seemingly improbable scenarios could lead to catastrophic portfolio losses. In pursuit of this mandate, DoubleLine works to integrate an array of factors, all of which are critical to success. These include bottom-up security selection, trade execution, portfolio construction, top-down sector allocation, resourcing of the firm's personnel and systems and, ultimately, the ownership structure of DoubleLine. Employee ownership reinforces the stability of the investment team and its accountability: No outside decision-makers stand between the team and our valued clients.

We started with 45 individuals focusing on delivering financial strategies that can help our investors navigate various macroeconomic environments and achieve their investment goals. DoubleLine today employs more than 280 people, of whom 110 are investment professionals, and manages more than 20 distinct strategies. Our investment strategies span the gamut of the global opportunity set: U.S. fixed income, global fixed income, U.S. equities, commodities and global multi-asset products. In addition, we deliver our strategies via a variety of distribution channels, including mutual funds, exchange-traded funds, separate accounts, and other vehicles. This diversity of product and distribution allows investors access to DoubleLine's thought leadership and expertise in forms tailored to their risk profiles and preferred paths of execution.

How do you define DoubleLine's mission and values?

We want our clients to have the best experience possible, and we put our clients' interests first. Achieving that investment goal and maintaining that investor focus starts with our employees. Nothing builds a stronger foundation for a company than its most valued asset – its people. This foundation is hardwired through ownership structure and nourished by in-house environment. Our interests are aligned with those of our clients. We strive to continue to cultivate the collaborative environment formed in our foundation: a group of people who love working together toward our common goals. Our culture is collaborative in that all employees are valued and respected. Through this team approach, creative ideas are fostered and elaborated into effective solutions.

What is the philosophy around DoubleLine's investment strategy?

To some extent, investment processes vary in adaptation to the particulars of asset class and strategy. That said, the following general principles are embedded across investment groups:

First, let's take bottom-up investment ideas as the individual building blocks of a portfolio. Investment ideas must offer an asymmetric, positively skewed risk-reward profile. In other words, selected securities must appear through careful fundamental analysis to offer greater potential payoff than potential loss.

Then, the next question becomes, how might these building blocks perform as an ensemble? DoubleLine believes that all investments need to start with risk analysis intrinsic to the portfolio, not relativized in benchmark comparisons, which is probably the conventional approach outside DoubleLine. In our view, it is not how investments within a portfolio compare to benchmarks, but how their risks relate to each other across a broad range of scenarios, including scenarios others might disregard as improbable. Risk-integration techniques enable DoubleLine to build what we believe are more successful portfolio foundations.

Portfolios must be constructed with an aim to outperform under a range of future scenarios. In other words, DoubleLine shuns risk-taking based on unidirectional forecasts regarding interest rates, default rates or other variables that drive return. If we develop strong base-case scenarios, we can bias a portfolio somewhat toward that outcome, but only so far, as we strive to construct portfolios to perform in the event our base-case outlook proves wrong. Even in the hypothetical case where a favored forecast proves to be early or wrong – choose your adjective – in the interim, but right over the fullness of time, there are serious limits to the tracking error that investors, especially investors in fixed income, can stomach.

What have been the keys to DoubleLine's success, and how do you describe the DoubleLine difference?

One of the key differences that distinguishes DoubleLine is the stability of the portfolio management team. Although founded in 2009, the portfolio management team averages 23 years of investment experience and 15 years of working together, as many of us worked together for years at a prior firm. We believe the longer the team has worked together, the more consistent its philosophy and process. Together, the team has navigated multiple market and macroeconomic cycles. Thanks to the longevity of that shared learning under trending conditions, under range-bound conditions and under battlefield conditions, the team brings together a rare collective expertise when markets change in ways that can either rhyme with past precedent or confront the world with something new.

I am probably repeating myself, but if anything bears repeating, this does: We believe that active risk-management should form the cornerstone of portfolio construction. We closely integrate our top-down, committee-based approach to allocation and portfolio construction with the bottom-up fundamental analysis from investment teams specialized in different investment sectors and asset classes. In this risk-management framework, investments are not only analyzed for their return-to-risk prospects, but also for their fit into the overall portfolio.

Will you highlight DoubleLine's commitment to building a diverse and inclusive workforce to bring diverse perspectives and experiences to the table when making investment decisions?

The key to fostering a collaborative work environment is to treat your fellow employees with respect and value the opinions around the table. Not everyone has the same experiences as you have, and from those differences we learn from one another. Having diverse backgrounds – such as gender, race, ethnicity, socioeconomic background, education, and professional experience – allows us to approach problems from different angles and glean new perspectives. I'd also add that while successful organizations require strong leadership, we never want hierarchy to become the enemy of dialogue and innovation. Senior staff encourage ideas from all colleagues, regardless of seniority. The atmosphere in the workplace is a friendly and open one. I think our size, under 300 employees, also helps new hires become familiar with the staff and organization.

What do you see as DoubleLine's responsibility to support the communities it serves?

As an investment adviser and as a fiduciary to its clients, DoubleLine is committed to maintaining the trust and confidence of those with whom we conduct business and to upholding high standards of integrity and business ethics.

In support of the community, DoubleLine is a platinum sponsor of Women in Institutional Investments Network in Los Angeles. We've hosted an event for 100 Women in Finance. In addition, one of our portfolio managers serves on the educational committee for 100 Women in Finance and is a founder of the Bloomberg Women's Buy-Side Network. DoubleLine encourages employees to participate in community events, such as the annual Los Angeles YMCA Stair Climb.

DoubleLine is an equal-opportunity employer. The firm recognizes diversity and inclusion and works with recruitment programs for women and first-generation college students. Over half of DoubleLine's employees identify as a member of an ethnic minority group. As part of our ongoing efforts to promote cultural connectivity across the firm and be inclusive of new employees, we recently launched a formal mentorship program.

What are you views on the state of the U.S. economy?

The U.S. economy is slowing from an elevated level of economic activity in 2021. Given that the inflation rate has persisted significantly above the Federal Reserve's comfort level, we can expect the Fed to continue to tighten monetary policy. The central bank will do this by both raising official short-term interest rates and reducing the extraordinary liquidity it provided out the longer end of the fixed income market through its purchases of treasuries and agency mortgage-backed securities. In a typical business cycle, the Fed does not significantly tighten monetary policy once the economy is already slowing, but this high level of inflation is problematic and will force the Fed to keep applying the monetary brakes.

However, there are still bright spots within the economy, namely the labor market. After the July jobs report, the U.S. now has more people working than prior to the onset of the pandemic lockdowns. This has led to an unemployment rate of 3.5 percent, with the number of job openings available still above the number of people deemed to be unemployed. This imbalance in the labor market has led to the largest broad-based wage growth seen in over 40 years. That said, the labor market operates with a lag to GDP growth. We're monitoring the labor market for any signs of weakness.

What is the upshot? I'm not yet ready to rule out the possibility that the Fed engineers a "soft landing" or lucks into one. However, persistent inflation is making the avoiding of recession increasingly difficult. The odds are rising for the Federal Reserve to continue to tighten policy beyond neutral.

What do you see as the keys to effective leadership, and how do you describe your management style?

I believe that an effective leader is one who can create a team that is greater than the sum of its parts. That starts by having an inclusive culture that encourages idea sharing, provides educational support to newer employees, and broadly shares the lived market experiences from senior staff. Having a collaborative environment where all ideas are welcome allows team members to pursue intellectual, personal, and professional growth.

My management style focuses on team collaboration across various investment segments and communicating ideas in their simplest form. On my Macro Asset Allocation team, for example, I encourage my portfolio managers, analysts, and traders to distill complex concepts into their core building blocks. This provides a greater understanding of risks and opportunities. Lastly, I believe that there are no "bad ideas." I remember a story where the great chemist and two-time Nobel laureate, Linus Pauling, was asked how he had so many great ideas. He replied that it was because he had so many bad ones. Of the many hypotheses one tests over a career, only a relative few get out of the laboratory to become effective solutions in the real world, but you need the many to find the few. And when a concept is rejected by other team members, there needs to be rationale for its exclusion, and those reasons should be effectively communicated so that we can learn from one another.

Did you always know that you wanted to pursue a career in finance, and how did you end up in the business?

My educational foundation is in applied mathematics, and I have always had an affinity for problem-solving. I started off thinking that I would end up in the teaching profession. When I was in graduate school, I learned that the applications of higher-level mathematics not only applied to physics, but to finance as well. This led to me to stop focusing on a PhD in mathematics, and I pursued a master's degree in financial engineering. As part of the program, I was required to do an internship, which landed me at an asset management firm, and that started me on my career. I joined that firm, first as an analyst in its portfolio analytics team, and subsequently as a member of the fixed income team led at the time by Jeffrey Gundlach. In December 2009, when Jeffrey started DoubleLine and invited me aboard along with 40 of our teammates, naturally I jumped at the chance. I have spent my entire career with this team, and I continue to enjoy the challenge that the investment industry provides.

What do you enjoy most about the investment industry?

What I enjoy most about the investment industry is the continuous innovation from market participants and how those ideas allow us to construct portfolios that have the potential for a higher likelihood of success. These innovations can come from many different directions such as a new asset type, new analytical tools, new data sets, new ways of tackling old problems. New challenges are always stemming from the macroeconomic environment, the business cycle, exogenous factors. Every day presents something new. I find working with our team to solve such problems intellectually rewarding.

What advice do you offer to young people interested in building a career in finance?

I think that anyone interested in finance should start with getting academic training in finance, learning both fundamental analysis as well as quantitative techniques of portfolio management. Next, get an education in financial history so that you can learn about different economic environments, other people's mistakes, and try to draw parallels to, or distinctions from, the current environment. Once you have those foundations, surround yourself with people who have significant experience and can provide mentorship. It's also important to learn about human psychology and how sentiment drives investor behavior. Read everything that you can get your hands on, ask questions from veterans around you and, most importantly, scrutinize opinions contrary to your own so that you avoid falling prey to confirmation bias. Hunting for people or opinions in agreement with your own has doomed careers as well as portfolios. ●