Heather Brilliant - Intentionally Constrained
The Business Brew

In this episode Heather Brilliant stops by The Business Brew to discuss what it is like to run a valuation focused asset manager in 2021. Heather has a unique view on asset management and what she is trying to accomplish at Diamond Hill. She is stakeholder focused and believes constraining asset management capacity helps align client and manager incentives. She currently serves as Chief Executive Officer and President for Diamond Hill Capital Management, an independent active asset management firm providing valuation-driven investment management services across a range of asset classes. Heather joined the firm in 2019 bringing more than 20 years of domestic and international investment industry experience to the role.

Previously, Heather served as Chief Executive Officer, Americas with First State Investments. Prior to that role, she spent nearly 14 years with Morningstar where she served as Global Head of Equity & Credit Research before advancing to Chief Executive Officer, Morningstar Australasia. Earlier in her career, she held several roles analyzing both credit and equity at firms including Bank of America and Driehaus Capital Management.

Heather is a long-standing member of the CFA Institute, a global credentialing organization for the investment industry. She served on the board of the CFA Institute from 2013 to 2020 and was chair of the board from 2018 to 2019. As chair she provided leadership and governance to a board of 15 senior investment management executives. She is also a member of the CFA Society of Columbus.

She is a member of the Columbus Partnership, a non-profit, membership-based organization of more than 70 CEOs from Columbus' leading businesses and institutions focused on improving the economic vitality of the Columbus Region, and YPO (Young President's Organization), a global leadership community of chief executives that are committed to lifelong learning and idea exchange.

Heather is on the executive committee of the Ohio chapter of the International Women's Forum (IWF), an invitation-only membership organization made up of more than 7,000 diverse and accomplished women from 33 nations. IWF's mission is to support women leaders and build better leadership across careers, continents and cultures by connecting accomplished women both locally and globally.

She is a frequent speaker at industry conferences and is a volunteer teacher for Rock the Street, Wall Street, a non-profit organization that aims to spark interest in finance among high school girls. Heather was recently named a 2021 Women WELDing the Way® honoree by Women for Economic and Leadership Development (WELD) for supporting the leadership development of other women and women-owned businesses in the community.

Heather earned her MBA from the University of Chicago Booth School of Business and has a degree in economics from Northwestern University.

[intro]

Bill: Ladies and gentlemen, welcome to The Business Brew. I'm your host, Bill Brewster. I'm thrilled to be joined today by Heather Brilliant, the CEO of Diamond Hill Capital Management. We're going to have a discussion on whatever Heather wants to, but a lot of it's going to be capacity-constrained asset management and why that's a good idea.

Typical disclaimers. None of this is investment advice. This is not a solicitation or invitation to purchase or sell any securities mentioned and do your own due diligence. I think that's all we got. I may have to drop a little more in as compliance takes a look. Heather, how you doing?

Heather: Great, thanks. Thanks for having me, Bill.

Bill: Yeah. Well, thank you for joining. We were introduced by Todd Wenning.

Heather: Yes, we were.

Bill: And you know Todd from?

Heather: Todd and I worked together at Morningstar what feels like a million years ago.

Bill: Yeah. What do you do at Morningstar?

Heather: Well, at the time, I was the Director of Research for the equity research group there. He was an analyst on the team. So, we got to know each other a little bit in that capacity.

Bill: You said that your time at Morningstar took you quite a few places in the globe, right?

Heather: Yes. Well, in addition to Chicago where Morningstar is headquartered, I did also live in Australia for about three and a half years, and Sydney in particular, and got to run Morningstar's business in Australia and New Zealand.

Bill: When you were in Sydney, and you were looking at the map, did you say, "Cincinnati is the place that I want to go back to?"

Heather: [chuckles] No, and I don't live in Cincinnati. I live in Columbus. [laughs]

Bill: There you have it. That's fair. What did bring you back? Why did you take the position at Diamond Hill?

Heather: Well, I actually had a position between Morningstar and Diamond Hill also. I spent not quite two years at a company called First State Investments, which is now called First Sentier. It was a business that-- or is a business that is headquartered in Australia, and they were looking for someone to run their business in the Americas. I knew the Australian people from the business, and they hired me to move to New York and run their business there. I did that for a couple of years. The business ended up getting sold to Mitsubishi. The timing was quite fortuitous that when Diamond Hill called, I was very open minded to new opportunities, and so we ended up figuring out that it would be a good fit from an investment philosophy standpoint, and leadership background.

I was really excited to join Diamond Hill for a number of reasons but the most important couple that I'll mention is that I think everyone in this industry says that they are put client interests first, but I've never come across a firm that so consistently does that and has policies and procedures and expectations to reinforce it as Diamond Hill. That's some of what I'm sure we'll get into talking about more, but the authenticity of the commitment to good outcomes for clients was so clear at Diamond Hill, that just led me to feel really confident that it would be a great place and a great culture to be a part of.

Bill: I really like your shareholder letter that you wrote. I think it's-

Heather: Thank you.

Bill: -very well done. One thing, as I was reading it, you mentioned that you're valuation focused. That's a smart distinction to make between valuation focused and value focused, or growth focused or anything like that. I assume that a lot of that may come from your background at Morningstar decoupling the idea of value growth versus valuation. Is that fair?

Heather: Definitely, yes. I think that is something that has been a long-held belief at Diamond Hill is that we really focus on intrinsic value or estimating the future cash flows of the businesses we invest in. That is very different than a market definition of value investing versus growth investing. It really allows for any type of company, but it most importantly requires that when we make an investment, it's in a business that we believe is worth more than where it's currently trading.

Bill: This isn't necessarily a Diamond Hill question, this is just in-your-past question. What has gone on in the market, is value, typical value has really gotten has underperformed as an asset class? Do you attribute that to one specific factor? Is it a number of things? Is it traditional value, maybe not morphing in the way that the world has morphed? What are your thoughts on that? I know you did mention that your benchmark to those benchmarks in people’s minds, not how you define it.

Heather: Right. I'd say one of the biggest reasons for that or drivers of why value has underperformed over the last decade or so, is really the trajectory of interest rates. As interest rates come down, then it really allows you to use a lower discount rate when looking at future cash flows. So, businesses that are more likely to generate cash flows in the future, as opposed to currently, are worth more than they would otherwise be in comparison to those old economy businesses that are currently earning cash flows, and maybe don't have as high of growth rates as some technology companies, for example. I think that is a big part of it.

You can see the impact of the concentration of the indexes when you look at how much of the S&P 500 is being driven by the top five or six holdings, for example, right now. That is personally a similar effect to what I was just describing where you can look well into the future for cash flows when you have very low interest rates. It's also part of the impact of the move towards passive and less security selection happening than a decade ago. There are a number of other factors too that can play into this. Certainly, the way intangible assets are accounted for on balance sheets and some of the implications of the way accounting has defined how we value companies, I think, has implications as well. Overall, it is unlikely that value will continue to underperform as much as it has in the past decade. No one ever knows exactly when things will turn around. It feels like we might be at a turning point in the market or some shift going on, but that is a very hard call to make without hindsight.

Bill: Where I made some errors back in the day was, I would look at a company like Netflix, and I was asking questions like-- The question that I was asking myself is, how are the debt markets financing this spend? I think that it's a nuanced question, but I think the smarter question would have been why are the debt markets doing it? The question that I asked myself precluded the answer from coming into my head, and I didn't recognize that the appetite for debt and what interest rates were doing to people-- or, maybe people's time horizons were much longer than I thought a long time ago. Whatever it was, I had a disconnect between what I thought the market should be looking at, what the market actually was willing to look through. That's probably one of my biggest lessons over the last five years now.

Heather: It's a tricky lesson, though, because if you had that same lesson in 1999, I think you would have really regretted giving up your principles, right?

[laughter]

Bill: Yeah. That's fair. Yes, at least for a long time. It takes quite a while to get back from a drawdown like that.

Heather: Yeah. I can tell you even just from the time when I was working with the analyst team at Morningstar, we had so many debates as interest rates were in decline, about when to change our discount rates or how to think about at what level you're discounting cash flows, and you have to believe low rates will persist for a very long time in order to justify lowering your discount rate. It took a long time for some of the benefits of low rates to get priced into stocks like Netflix. Some of it is related to that as well.

Bill: Yeah, that makes sense, because if you're doing or if someone is doing a five-year terminal value, you almost have to be looking at least 10 years out to have a view on the rates, because that's going to be priced--

Heather: Yeah.

Bill: How is your job change now that you're the CEO of an asset manager versus overseeing research and whatnot? Is it a completely different role? I personally would think given your background, it's hard to let the research team go. You know what I mean? I would be like, “I know how to do it better,” something like that.

[laughter]

Heather: The hardest transition that I made in my career was going from being an analyst to being a leader and manager. That was actually almost 15 years ago now that I made that transition. I remember an internal challenge and challenge to feel comfortable making that decision, because I loved being an analyst and I loved a lot of things about it. I just think it's one of the careers, I guess, where having a really balanced view and being able to see both sides and understand what the buyers and sellers would be thinking and still be able to have conviction about what you believe and advocate for that, it's such a satisfying career to me. I really enjoyed it.

Ultimately, I knew that while I was good at it and I could do it, that it wasn't my superpower. I do feel over time, I have really enjoyed working with people. I almost think if I ever go back to college, I'll study sociology or psychology. I just really like thinking about what makes people tick and how different individuals are, and how everyone's motivated by different things. Some of those things are really essential to being a great leader. Even though I hadn't managed a lot of people, I was really excited about the opportunity that Morningstar gave me to take on running this team. I was more comfortable to take that opportunity, because I was managing a research team. I always told myself, if this doesn't work out or it's not as great as I think it might be, then I can go back to being an analyst. That safety net of like, “Well, there's always my analyst background to fall back on,” made me feel more comfortable moving in a leadership direction.

Bill: How long did it take you before you were like, “Okay, the analysts have this, I don't need to micromanage” or whatever? Was it a pretty natural transition? I'm more internalizing what it would be like for me, I think it would be pretty tough.

Heather: Well, I am inherently not a micromanager, so that part wasn't too hard for me. I actually so much prefer to be at a strategic level as opposed to in the weeds. One of the things I always am thinking about is, am I sufficiently in the detail on this topic, as opposed to am I micromanaging people? [crosstalk] Yeah, go ahead.

Bill: Oh, no, I'm thinking through and I don't mean to cut you off, but I like-- when we had done a background call, you had talked about running a capacity-constrained organization. You are fundamentally not in the business of gathering assets, because you want returns to clients, right?

Heather: Yes.

Bill: That's one of the reasons that I was like, “Oh, I definitely want to interview her. She'll say yes.” [chuckles] Thank you for saying yes. I wonder whether or not your background as an analyst, and the ability to think strategically helped you come to that conclusion in some way, because that's a very counterculture way to run an asset manager, given that fees are coming down to then add the layer of capacity constriction, can't be an easy decision.

Heather: Well, first of all, I cannot claim to have made the decision for Diamond Hill. It is one of the things that was already in place long before I got here that gave me the comfort to join, because I do think philosophically, I have long believed that capacity constraint is critical to ensure better investment outcomes for the end investor. It's so true that it's near impossible to find firms in this industry that are willing to make that commitment. Even when you do, it's usually on the hedge fund side of things, it's much less frequently in more traditional asset management where fees have really been coming down and where there are a lot of incentives to grow to as big a size as you possibly can.

Ultimately, our philosophy at Diamond Hill, and one that I very much feel aligned with personally, is that if we focus on great outcomes for the clients, then that will give us a lot more opportunity to succeed as a business. I think that has held true. We just announced earlier this month that we're closing our large-cap strategy to new investors, soft closing, and that is something that, I think, is a very challenging decision for investment managers to make. One thing that makes it easier, I think, for us to make it a Diamond Hill is that, we're very open about where we believe our capacity limits to be. It's not like we will just randomly decide at some point in the future, should we close down? Should we close later? We actually publicly state these are the levels at which we believe we will need to close.

Sometimes, things change. Markets evolve, there are changes in liquidity for names or there could be more companies listed, less companies listed. The trend has been towards less companies being listed over the last 20 years. All of those things factor in and even overlap between our strategies, because some of our capacity calculations really come down to how much we believe we can hold of a given security of a particular size across our strategies. All of those things factor in, and they do change over time. When they change, we are very open about changing where we think our capacity limits are, as opposed to waiting until we're above capacity and saying, “Oh, whoops, actually, we have more capacity, because we know that will lead to more revenue.”

Bill: Yeah. One thing that I thought was interesting as I was reading, that you are closing to new money or at least soft closing the large cap strategy, but you're leaning into a large concentrated strategy, right?

Heather: Yes.

Bill: What's behind some of the thought there?

Heather: Well, there's a couple things. I mean, our large cap strategy can invest in companies as small as 5 billion. In order to make sure that we have the same ability to invest in smaller large cap companies that we have had throughout the duration of our large cap strategy, we need to make sure we only manage as many assets as allow us to do that. Also, you probably know this already, but our strategies in general are quite concentrated. We generally have 50 or 60 companies in our large cap strategy that leads to a certain calculation where we say, “Okay, if we get about $15 or $20 billion in assets, then we need to be really careful, because that's where--" if we came across a great idea that was only a $5 billion market cap, we might hesitate, if we were managing $70 billion, or something some of our competitors might be more comfortable with.

In the large cap concentrated strategy, we have a higher minimum market cap, and fewer names. It's a different strategy, because it is more highly concentrated, but we are able to have capacity to do large cap concentrated even where large cap is soft closed, because we have the opportunity to change the minimum market cap. With large cap concentrated, it's always consistently been more like $15 billion and up. That gives us another bit of room, I'd say, to still engage in large cap space.

Bill: How do you run an effective business if you constrain your capacity? It is so counter to what it seems the incentives in the industry are.

Heather: Yes, I definitely think the incentives in the industry are to get as big as you can. That is one of the reasons why we are in such a rare company by constraining our capacity. Ultimately, as I alluded to before, I really do think it's in the best interest of our clients, and so it leads to more interest from our clients and investing with us. I believe, philosophically anyway, that it should be easier for us to get to those capacity limits that we're trying to grow to. Even if you just look across the strategies that we have today, we have plenty of capacity. We don't feel like we can't grow just because we limit capacity, but you can define the maximum amount of assets, we would have given the existing strategies. What that means for us is that if we choose to grow beyond that, it will be through new strategies. I think that's good too, because it gives us an incentive to innovate and to be thinking about where can we apply our investing competitive advantages, and which parts of the market will most benefit from the way we behave, which is to be very long-term, valuation-oriented investors who believe in concentrated portfolios, and take a very active approach. When you take all of that into consideration, I don't see how you can succeed without being capacity constrained.

Bill: Yeah, one of the things that I was thinking about your job and what it might feel if I was in your seat, is managing stakeholder relationships, because I would think that there's some shareholders that would prefer to not hear the words ‘capacity constraint.’ As you're saying it, incentivizing innovation, and creating new strategies is a way to grow without sacrificing your principles.

Heather: Exactly, and it really gives us the opportunity to partner with our clients, because they know we're committed to great outcomes for them. We get ideas from our clients. Whenever we have a new idea for a new capability, we start out by talking to some of our clients about it, seeing if there would be interest from them in investing with us in that way. It really helps us build that partnership and feel like we're on the same side of the table.

Bill: Here's the question that I have for real, I'll just lay it out there. I had a relationship with a firm, and we saw eye to eye upfront, but I think maybe I didn't ask the right questions to figure out if I would be a good partner over the long term for them, and I would also argue that they did some things that maybe they could have done a little bit better. What's a really good marriage look like for you all? Because you're not talking about hot money in and out. It is closer to a marriage, it's a long-term relationship. Who are you really looking for as a partner?

Heather: You're absolutely right, that we try to have as long-term relationships with our clients as we possibly can. That has been true for our best clients. Some of our clients have been with us for well over a decade. I think that really does speak to that partnership mentality. We can find those relationships in many parts of the market, but I would say for us, working with independent RIAs has been an area where we've been able to strike that partnership with some higher level of frequency. That's been just a really great opportunity for us. Then, certainly some home office relationships where we might work with the home office of a larger advice network, those have been very good relationships too, because we're so committed to delivering on those returns for our clients that when home office puts us in their model or chooses us for their advisors to use, they have had a good experience. That's been those relationships that lasted a long time as well.

Bill: I know that you said that you're benchmarked against value indexes, is it hard to get out at-- do you want to get out of the value benchmark? Do you find it hard to have that conversation around that, or is that not really an issue?

Heather: Frankly, different clients have different preferences with regard to what bucket they put you in, or how they think about what you offer for them. Ultimately, in the long run over a full market cycle, which would be more than the last decade even--

Bill: Yeah.

Heather: [laughs] --I really do think over a full market cycle, we need to be able to outperform the broad market. That is what we genuinely try to do. But when we go through periods like the last decade, where value is so out of favor and what we see as dislocations in the market in terms of how some companies are being valued, can persist for a very long time. We definitely try to work with our clients to make sure that they understand that we're comfortable with very long periods of what could look like underperformance to a core benchmark.

In some cases, that comfort comes from looking at a value benchmark and saying, “Okay, well, at least if we look at how we could have done if we just invested in more direct value without necessarily having active management, would we have outperformed in that case?” I think that is a necessary but not sufficient criteria for us in the long run, if that makes sense.

Bill: Yeah.

Heather: Some clients say, “I hire you to provide value exposure. If you're outperforming value, you're doing everything I need from you.” That is great in those circumstances, because I feel like we really deliver for those clients in a lot of cases. Ultimately, in the long run, we would like to outperform the broad market as well.

Bill: Yeah, I think that if I were on the other side of the conversation that I mentioned with the firm that I had the relationship with, I would maybe say like, “You did hire us for value exposure.” Maybe overallocated, and then maybe that was my mistake. I was young when I entered the relationship, so I didn't really know the questions to ask. As many young people make mistakes, that was one. I like how you’re talking about a market cycle, and I think that there's a lot of-- it's hard to look at 10 years and say, “This isn't a three-cycle experience.” On the other hand, it's also hard to look at what's gone on and say this is a three-cycle experience. How do you think through the definition of what a full cycle looks like? Does it require sustained drawdowns? Is it economic malaise? How do you think through that generally?

Heather: This is a really good question. I definitely think some recession or economic downturn has to be part of the full cycle. You could definitely look at the path of interest rates as another example. When you've had more than a decade of interest rates going in only one direction, it's pretty hard to call that a cycle.

Bill: Yeah. You think cycles have to cycle. [laughs]

Heather: Right. They have to go up and down.

[laughter]

Bill: That’s right. Otherwise, it's just a hill.

Heather: Yes, exactly. This has been a hill that has helped a lot of people, and certainly a lot of investors, that has been a great opportunity, I think, for many investors. The way we think about things and say, we do not feel like the last decade has represented a cycle.

Bill: Yeah. No, I think that a lot of people would agree. It's been hard to fight some of the style drift in my own head.

Heather: Yeah.

Bill: It incentivizes some behavior that I'm not sure is the right takeaway, but it would also be impossible to argue that I haven't looked in areas that I would not otherwise look.

Heather: Right. I was speaking with a student group earlier this week, and one of the students asked me, how do you put triggers in place? Or, how do you make sure that you don't have style drift or, make investments that maybe are good in the short term, but won't necessarily play out the way you like them to? I just said, I really think the best way to think about making the right investment decision is to think about what you think this business will be doing five years from now. If you could really get past whatever weakness it might have experienced because of COVID or maybe even artificial strength because of COVID, and say it in some normalcy five years out, we don't know what will be happening, but we know that whatever's going on now is probably not likely to last for five years.

Then, you can get some sense of like, “Okay, here's what this business can really do from a cash flow generation perspective.” That gives you the opportunity to hopefully see past what can be short-term trends or what can be maybe things that are more influenced by stock price movements, and even fundamentals. Some of the businesses that have done really well over the last decade have had really strong fundamentals. Then, when you start extrapolating that for another decade, then I think that's where you have to really look closely at the true cashflow generation and potential of these businesses.

Bill: Yeah, the other thing that my buddy, Jake Taylor often reminds me about is, there are base rates and outliers, and applying the outlier results to the average company is where you can get in some real, real trouble.

Heather: Yeah.

Bill: On the other hand--

Heather: There's some investment managers who do a great job identifying outliers. That's their thing. They figure out which companies are going to be the ones that really grow to the moon. Some of my friends at WCM have a claim some real expertise in this area, and I don't know if you've talked to them, but there's a lot of former Morningstar people over there as well. They are, I would say are have a methodology for identifying businesses that they believe will be outliers. That's not what we are trying to do.

Bill: Will you as a firm, are you open to saying, "Okay, well--" I've thought of value has different bands. There's like, high quality value, so you can have compound-- I know the answer is going to be at the end of the day, we underwrite to intrinsic value, and whatever discount to intrinsic value is what we buy. Are you as an investor not firm specific, but would you lean more towards like an 80-cent dollar in a quality company versus a 60-cent dollar in more of a cyclical or does that all go into your discount rate? How do you think through parsing quality and value and where those two things intersect?

Heather: I believe very strongly that it is easier to forecast the cash flows, and ultimately, the valuation of a high-quality business than one that is particularly cyclical.

Bill: Yeah.

Heather: If you take that into consideration, then you would need less of a discount for a quality business than you would for a highly cyclical business. I think that just makes logical sense.

Bill: Yes.

Heather: Maybe just because of the way I think it feels logical.

[laughter]

Bill: No, it makes a lot of sense.

Heather: Ultimately, I'd say most valuation-oriented investors have a quality bias. It's always wonderful when you can find a high-quality business trading at a big discount. That's the fat pitch, right?

Bill: Yeah.

Heather: Ultimately, where some businesses start over some, let's say investment managers start to differentiate themselves is in where those biases fall on the margin. If you aren't getting the fat pitch, what[?] do you go to? Do you go to quality? Do you go to deep value, very cyclical business? That I think, can differ. For us, it really is about thinking through the risk reward and our ability to forecast that company's future cash flows. You can see over time, if you look at our portfolios, different levels of interest in quality versus cyclical and things like that.

Overall, I'd say, I feel that we lean in that quality direction, meaning we'd rather buy a company that we are confident in its future cash flows, trading at a medium discount, than we would to buy one where we're unsure about the future cash flows, but has a huge discount. We'll still buy that investment as soon as it's not out of scope for us, but, obviously, we have to put in more work and get to a higher level of confidence in our ability to rely on those future cash flows.

Bill: I think, probably, if I could nitpick the question that I asked you, the assumption in the question is that you can define the dollar. What's an 80-cent dollar and a 20-cent dollar, and I think that the definition of the dollar in that question is highly dependent on the quality of the business. What I think I've noticed at least for myself is, when you get into the junkier stuff, I have been more in the past willing to say this is dollar, and maybe the dollar is closer to 70-cent comment than actually a true dollar.

Heather: When I think when you're looking at cyclical businesses too, the one thing that you have to keep really top of mind is leverage, because a cyclical business that loses its ability to make it to the other side of whatever cycle it's going through is, I think, where I personally have gotten the most burned as an investor and where I think it really does behoove investors to be really careful. Sometimes, that is financial leverage oriented, but sometimes it can actually be operating leverage oriented. There's a number of ways to get burned. I think it's just really important to think through, can this company come back from whatever it is that is causing it to trade at a big discount?

Bill: As the CEO of an asset manager, obviously the strategies have to deliver. The other side of this and what we're talking about is like training up young analysts and associates and PMs to see the world in whatever way helps them create the most value, however their creativity can work. How do you think through-- just as a manager, you said you're not a micromanager, so I assume that you're maybe more-- How do you assess people's growth in the organization, because your retention is pretty darn good, if I recall correctly?

Heather: Yeah.

Bill: So, there's got to be something culturally that y’all are doing positively. People enjoy working for you. How does that manifest itself?

Heather: Well, that is probably, there's a number of different answers to that, depending on which parts of our business that you're looking at, and things like that. Specific to the investment team, we have had just a very stable group of portfolio managers that, I think, are really committed to our clients. Fundamentally, they are driven more by delivering for our clients than making sure that they're making more than the portfolio manager down the street, or that when things are bad, we are there for them and when things are great, they're there for us.

I think it's more of a collaborative feeling I feel like at Diamond Hill, so that's some of what leads to higher levels of retention, then you maybe see on average in the industry. Also, while certainly there are other firms where you could practice the style of intrinsic value investing that we do, there's not that many. Ultimately, our portfolio managers are really committed to this style of investing. They really believe in how we think about investing. Then, I think we do give our analyst team a lot of autonomy for analysts who are really interested in having their own area of coverage, and really being able to define how they spend their time within that, and how they identify the opportunities that they're going to spend time on and work with the PMs for whichever relevant portfolios that their idea might fit into, I think that level of autonomy is really greatly valued.

Bill: Hmm. It sounds to me they're maybe not assigned a PM, they're assigned to finding good ideas, and then if they have a good idea, I guess, their next internal task is to find the PM that may agree with the idea assuming that the idea is correct-- It's not the sell a flawed notion, that's not what I'm trying to imply, but it's more on the analyst to go out and find the idea, and then, if it fits in a strategy, find the strategy that the idea works in. Is that a fair characterization?

Heather: Yeah, I would say it doesn't always work that way. Sometimes, the ideas come from the PMs, right?

Bill: Yeah.

Heather: Certainly, some of our PMs are more focused on their own idea generation than others, frankly, for a number of different reasons. What I'd say is that our analysts are organized by industries, so each analyst has a number of industries that they cover. One thing that we did over the last year that I think is really interesting and relatively unusual is that we're not only defining analyst coverage by sector or by industries that everybody pairs together. Instead, we thought more broadly about how do these companies interact and what would an analyst learn from having coverage across a vertically integrated set of industries as opposed to a parallel set of industries, for example.

One example I love to give on this is that our analyst who covers beverage companies also covers grocery stores, and also covers canning companies. You can literally see some of the inputs that are big cost drivers to the beverage companies, and then you can also see how are their end clients doing, and how is that relationship with the grocers and then distributors of those beverages. That's a pretty different perspective, because generally, you see, oh, someone's covering grocery stores, and are also covering other retailers, you know what I mean, usually, you line up with, “Oh, this company sells things to the end public, so let's line that up with other companies that do that.” That's not always the way to get the best insights, I think, into how some of these companies work. We've been trying to think differently about that.

Part of the progress of doing that or the project, I'd say, was also to really assess our analyst team's interests and areas of expertise. We had an analyst who had worked for a medical device company, but was not covering anything related to medical devices, so we had the opportunity to move some of our medical device coverage over to him, and still keep him on some of his other companies, and so it provides a level of diversity for analysts that I think is also rare. Because while analysts love to become experts in their area of domain, they also really love to continue learning. I think making sure we're providing those opportunities and thinking about as we continue to evolve coverage has been an opportunity as well.

Bill: That's really smart, because that explicitly puts the job of calling the different parts of the value chain, that explicitly puts that in the roll. I think that almost certainly will lead to better analysis, because I think sometimes it's-- again, maybe I'm just talking about myself and this is my own weakness, but I'd like to think I'm not that much of an outlier in certain ways. The best insights that I've gotten there, when I understand the whole supply chain, and not necessarily just the competitors, and maybe lack some of the idea of what the end user is going through, or whatever. I'm thinking airlines, for instance, I spent a lot of time on. I don't think I could have understood the people that sold the components into the airlines without really understanding what the airlines go through, but if I was just looking at the components, it's easy to be the airlines are not very fun businesses to understand, so I'll just cover these good businesses, you can lose some stuff in that.

Heather: Absolutely. [crosstalk]

Bill: How'd you come up with that? I know it wasn't you. I know it was a team, I get it. But how do you facilitate those conversations? That's cultural, to think differently in that way.

Heather: Yeah, it is, from the sense that, it's very clear that we are open to new ways of thinking, and you like to think about how we can make incremental enhancements to our philosophy, even if our fundamental philosophy is nonnegotiable. We brought in a new director of research who was a promotion from internal. It was really his idea to rethink the way we were thinking about coverage. He put in so much time to this project himself, he literally went through the Russell 3000 and looked at what the primary business and secondary business of pretty much every company in the Russell 3000 is to make sure that we were getting the right level of overlap in assignments. Certainly, we already had an analyst team, and they already had coverage, so that was a starting point. We didn't want to necessarily change everybody's coverage by--

[laughter]

Bill: Everything you've been doing, it's all changing. [laughs]

Heather: Right. On the margin, it allowed us to be really flexible and be able to implement some of these ideas that we just talked about.

Bill: Yeah, that's cool. Well, I'm sure some people push back, they're like, “I don't want to cover groceries.” Groceries are actually a pretty interesting business. I used to bank food companies. I was not the banker. I was the analyst, but that's a hard business. The margins are so tight, you talk about operating leverage, and then you’ve got financial leverage on top of it. It can be a recipe for some rough operating conditions.

Heather: Yeah, half of your product goes bad if somebody doesn't come in and buy it within a week. It's pretty tough.

Bill: Yeah.

Heather: Yeah.

Bill: When you were an analyst, or in your past, did you have any favorite industries that you covered?

Heather: I covered a few different ones. I covered different parts of the healthcare, value chain, including pharma, and even some biotech companies. I covered business services, and I covered retail at one point and actually--

Bill: Retail is tough, huh?

Heather: Yeah, definitely. It was a really interesting time too. I think I was a very early analyst to call the death of Sears but by a decade makes you just wrong.

[laughter]

Bill: Well, you were right.

Heather: I was right, except I said that I thought Sears was going to zero and then Eddie Lampert came in after that, and so Sears had quite a good run after that.

Bill: Yeah.

Heather: I did not-- [crosstalk]

Bill: As a stock, not as a business.

Heather: As a stock. Yes.

Bill: What did you see in Sears that made you early on that call?

Heather: Well, I'm from Chicago, and Sears was headquartered in Chicago, and I felt the deterioration of the business was really clear if you are local, if you went into any of their stores, or ask anybody where they shop for things, there were really only two fundamental assets that Sears had to work with that were left, and this is also as department stores were all very out of favor. Nobody really wanted to go shop at a department store unless there was some reason to go to that store. Sears' only reasons were Lands' End and Craftsman Tools. To the extent that you can value what are those worth, and how much ancillary shopping will that really lead to, it was not that hard to figure out that Sears would not as a retail business generate enough cash flow to even meet its debt payments.

The thing that really changed with Eddie Lampert coming in is that he was obviously very much more focused on the real estate that Sears owned, which was essentially off-balance sheet asset, because of the way everything was accounted for. Yeah, so that's what I missed. I definitely did not see the real estate value and the ability to monetize it. It's good learning. You can't be a decade early and be right. [laughs]

Bill: Yeah, well now that’s-- [crosstalk]

Heather: Especially with the short. [laughs]

Bill: Now, they're trying to do with Seritage. I just remember walking through Sears and looking at the inventory of the clothing, whatever the ancillaries that they were trying to sell. I was just like this, “I'm not a professional shopper, but I know this is no good.”

[laughter]

Heather: Well, I'm not a shopper either. Actually, in some ways, I was the worst retail analyst, because I hate shopping, and I do it as little as possible, and now, I pretty much do it all online, because why go to a store if you don't have to? I had to force myself to go to some of these stores and check things out, because it has never been a passion of mine.

Bill: The saddest retail experience in Chicago is what Macy's has done to Marshall Field’s.

Heather: It is sad. Marshall Field’s-- [crosstalk]

Bill: That story was amazing.

Heather: I feel like Marshall Field’s is part of my childhood.

Bill: Yeah.

Heather: I could go for Christmas, and-- [crosstalk]

Bill: You went to the room up top.

Heather: Yeah, exactly--[crosstalk] room. Yeah.

Bill: Yeah.

Heather: It was something that my grandma and I would do together every year. It is sad seeing it deteriorate.

Bill: My wife and I went, and we had a good time, but I digress. You touched on the concept of an aligned boutique in your shareholder letter. I'd love to hear you talk a little bit more about that.

Heather: Yeah, this is something that we've done a lot of work on over the last year, as we've been thinking about Diamond Hill strategy for the future. We came up with this concept of an aligned boutique to indicate that our history had been as a single area boutique. We were very focused on domestic equity. That's where a lot of our historical success has been for sure. Over the last few years, we've added some new capabilities in international, fixed income, but they have not been huge contributors to the overall business at this point. What we were thinking about is, how do we want the business to evolve in the future?

There's a spectrum in our industry from single boutique to, let's say, multi affiliate or multi boutique, to huge behemoth. We know that huge behemoth in that direction is completely off the table for us and wouldn't make any sense for a business like ours. We were trying to figure out, is there some middle ground or place we'd like to live between single boutique and multi boutique, because neither of those felt exactly right for us anymore. We came up with this concept of an aligned boutique, which is to say that there are certain principles that we hold dear, that we believe should be true across any teams or strategies that we offer, but it does not mean that we are a single boutique, because we can still allow different investment classes and variations within those parameters. We're not going as far as a multi boutique, because we don't want competing teams, we don't want to have completely different from what we believe is-- teams who invest completely differently from what we believe is the right way to invest. When we took that all into consideration, we really came up with a few areas of alignment.

I think of an aligned boutique as having an interesting double meaning as well. First of all, means we're aligned with our clients, and that we've talked a lot about already. Making sure, we are capacity constrained that our portfolio managers and really our employees at large are investing alongside our clients, that we are owners of the firm, and that we're really thinking about an underlying basis, how we can ensure that we are aligned with the interests of our clients. That's the first angle or idea of alignment.

Then, the other is to be aligned on certain investment principles. That's where we really articulated a few things, specifically, that we are long-term oriented, both in how we think about making investment decisions, as well as how we run our business, that we believe in active fundamental management. We're not a pawn shop, and it's hard to imagine us going in that direction. We're not a momentum shop, we don't believe that we should be making huge macro bets, we're very fundamental bottom-up oriented. You could think about concentrated portfolios is going in that category as well.

Then, this idea of being valuation disciplined. We've already talked about how that's not the same as being a value investor, but it does very much say that every investment team we have needs to have valuation as a consideration and how they make their investment decisions. When you bring all of those things together, it really gives us parameters to say, this is how we believe we can deliver for our clients, and if we decide in the future to grow new teams internally or bring on new teams, these things we believe should be true across all of those teams. That's the concept, and I think it puts us comfortably where we want to be, strategically.

Bill: When you talk about being aligned, somebody is thinking through like, you said that you're invested alongside or an ownership and part of the strategy. Should people be thinking that employees are owning stock in the overall firm? Or, are you judging that on whether or not they're invested alongside the strategy that they're running? Or, just generally within the firm strategies? If I'm interested in investing with you, what should I be expecting from your employees and yourself on how you're aligned with me?

Heather: You should actually be expecting all of those things. Our portfolio managers do have meaningful investments in the strategies that they manage. We disclose that in our ADB every year, and also our management team is invested in the strategies that we manage as well. I don't think we disclose the proportion of all of our employees that invest alongside our clients, but it is very consistent across our firm that our employees are investing, that they work here, because they believe in what we're doing, and they invest in our strategies.

Another reason why a lot of our employees invest in our strategies is because we have very restrictive personal trading policies. While there are other options besides our own strategies, we don't allow our employees to invest in individual securities, because we feel that would put us in direct conflict with what we're trying to do for our clients. We've been doing a little bit of research to try to understand how many other investment managers have policies that are that committed to this level of alignment, and it's not a lot. I don't feel like I have a really good data point to share with you, but it's somewhere in the neighborhood of 10% to 20%. Otherwise, firms do allow individual employees to buy individual securities. That is a pretty big differentiator, I'd say, fundamentally.

Bill: Yeah, well, it's nice. You force people to say, “Hey, if you're going to be here, then you’ve got to believe in what we're doing.” The other thing that I had noticed that-- I think of the word ‘admire,’ I think that is the right word to say is first of all, I thought your median employee pay was nicely taken care of, and the difference between you and them as the CEO is not egregious by any stretch of the imagination. I was thinking through, just from your communications, I really felt like you all have a very stakeholder focused outlook at the world.

Heather: Yeah, I think that's right, and I think that's critical to succeeding in the long term. If you put any one stakeholder too far above others, then I think that really does cause long-term conflict. Ultimately, the whole ecosystem needs to work together in order for the business to be successful, for our clients to be successful, and for our employees to feel like they are contributing and participating in that success.

Bill: Yeah. One of the things that I've enjoyed about this podcast is I've been able to talk to a lot of people smarter than me, such as yourself, and I try to learn at least one thing from each of you. So far, I think I have. I had this ESG conversation with a woman named Liz Simmie, and I really didn't understand the idea of-- or, I guess I shouldn't say that I didn't understand it. I really discounted the idea of stakeholder focus, because especially in the secondary markets, I was like, “I can't have an impact on any of this stuff, who really cares?” I have some private investments that take very seriously with that. That's because I feel like I can control how the capital is actually deployed. What I've come to appreciate a little bit more through some of these discussions is, if you're going to be investing alongside long-term business owners and running a long-term strategy, like truly long term, I think it's a really important thing to incorporate in the framework. In the past, I more associated value investing with rerating, so I'd be like, "Oh, well, you just buy 50 cents, flip it for 80 cents and go keep doing it." Then I realized one, that's a really hard game. Two, I realized, that's not really what a lot of the people that I admire and thought that I learned from. That was what I took from them, but that wasn't what they were teaching. I've started to learn as I've gotten a little less dumb over time, long way to go but these concepts really are very important to build enduring firms and to invest in enduring firms.

Heather: Absolutely. I agree completely. When we were talking about investing alongside our clients, the one aspect that I neglected to mention, but I do think is also really important is that every employee who comes to Diamond Hill starts out from day one as an owner. When we bring on a new employee, we give them a grant of shares that vests in five years that is meaningful for every employee. That's part of how we start everybody out thinking like an owner from the beginning. Because I do think that also helps, A, ensuring that we are additionally considering that we're running a business effectively. Then, I think it also really helps encourage that long-term mindset and thinking beyond, "How am I going to get paid this year?" Instead thinking, "Wow, if I help grow the value of this firm over time, that's something that I will benefit from as well."

Bill: Yeah, for sure. I've got to ask how was your first year as-- your first year as CEO was 2019, right? When were you hired?

Heather: September of 2019?

Bill: What a first year.

Heather: Yes. [laughs]

Bill: What was that like?

Heather: Well, I wish I'd had more time in person before the pandemic hit, for sure. But I would say, I feel like it was one area where being a really small business, we know we only have about 130 employees, we were really able to pivot to working from home pretty quickly. Fortunately, I think one of the things that comes very naturally to me is communication. I was just joking with somebody the other day that, "Here we are, full year into the pandemic." I've tried every internal communication technique that is available. [laughs] Small town halls, I've sent videos, I've emailed everyone, I'm currently going through a meeting with every employee one-on-one, because I do think there's some fatigue to having group Zoom meetings. It's hard to keep speaking up, and you miss out on all the informality of conversation with people when-- and there's other people on the line, and you have to talk to everybody, about whatever. There's no side conversations on Zoom. In order to help us all get over that latest hurdle, I'm just talking to people individually for the next round.

Anyway, point being it's been interesting period, I feel like we've adjusted as a business better than I would have expected, especially given how early in my tenure we were when I got here, or when the pandemic hit, I should say, but ultimately, I'm really, really proud of how the team has come together and made it work.

Bill: I would think it would be really hard to-- when you're young, especially I just think about sitting around in the analyst pit where we used to sit and bouncing ideas off of each other, and absorbing information that the PMs were talking about, and then we had RMs too. Everybody's in the same room, and a lot of the gold comes in the spontaneity. It's very hard to recreate that, I don't know, call it 20 minutes at the office that actually mattered that day, like really, truly mattered that you couldn't have gotten elsewhere. It's got to be really tough, I would think, as a CEO to try to facilitate those kinds of moments in whatever way you can, or what you're really trying to do is push the managers to facilitate those kinds of moments. To think through how to do that would be a difficult task on top of figuring out the strategic direction of the company that you just took over.

Heather: Right. To your point, a lot of that is what got pushed to the wayside for most firms, especially in the first six months of the pandemic, because it really did feel quite sudden--[crosstalk]

Bill: It was. The world stopped. We never trained for this.

[laughter]

Heather: I think that put everyone in a crisis management mode for the first three to six months. Things were changing so rapidly, like we all went to work from home thinking it might be for a few weeks, or maybe a month or two. Then, all of a sudden, there was no end in sight.

Bill: Yeah.

Heather: All of that evolved in a way that led to it feeling very crisis oriented, I think, for longer than it will when we look at this in retrospect. We'll look back and be like, “Oh, yeah, well, we had to stay home for a year,” but nobody knew it would be a year from the first day. When you remember that, a lot got lost in those first few months. Now, we're trying to do things, have social events, we have quarterly, trivia night that people can sign into and get broken up into little groups to work on trivia questions, and we had a wine tasting events, all virtual-

Bill: Oh, that’s nice.

Heather: -we have cooking classes. Yeah, so we've been trying to provide lots of different activities to get people engaged. It's the people who don't opt in to some activities like that, that you really you have to worry about, because in our industry, we have a lot of introverts and a lot of people who don't necessarily want to spend extra time on Zoom, even if it's for a fun reason, so I just think it's really important for the leaders of this industry to be reaching out to their people and making sure they're making those connections and not letting anyone get left behind.

Bill: Yeah, I'm pretty extroverted, and I don't like to do Zoom anymore. [laughs] I'm a little tired of this. I shook somebody's hand for the first time in a little while ago, and I was like, “Man, skin feels good.” I forgot touching a person matters. It's wild. When you went home, what was your operating assumption when the office went home for the first time? Were you thinking like a month maybe? How do you go through crisis planning in something like that? Do you have different outcomes or is it just all like we'll see what's going to happen? Because this is such a unique situation?

Heather: It was so unique. I don't even remember thinking that it would be any particular length of time, I just remember thinking we need to think about this in a way that everyone is equipped to work from home for however long is needed. We really prioritized in the first couple of days of realizing we need to work from home, making sure everyone had the proper setup at home. Most of our employees at home now have a couple of monitors, they have a laptop, they have whatever they need from office supply standpoint, lots of webcams and things like that. Interestingly, a year after working from home, a lot of people are now requesting chairs, like, "Okay, I've dealt with whatever chairs I have around the house, but I don't have a good work chair." [crosstalk]

Bill: "I want that Aeron chair, whatever it costs."

[laughter]

Heather: We've been looking into some solutions for that, because we do believe as things go back to the office, or as activities return to the office and as people start to come in more often, we think there will be a hybrid way of working. We're not expecting everyone will all of a sudden come to the office all the time. In order to accommodate that, we still think it's important to make sure not only that people have the setup at home that they need for the long run, but also to make sure that we have the right capabilities in the office for there to be a meeting where half the office is in the premise, and the other half is at home.

I think that seems obvious, but I know our capabilities in the office for remote employees were pretty pathetic before. They would be dialed in, voice only, and not really feel like they were part of the meeting. The quick positive feedback we got when we started working from home is how included our remote employees felt, our permanent remote employees.

Bill: Oh, that's nice.

Heather: Yeah, it was good, but it was also a real awakening of, "Oh, we need to do that better forever."

Bill: Yeah.

Heather: We've been testing some functionality that our head of IT calls Zoom Rooms, where you go into a conference room, and you can pretty much at the click of a button, start a video call that people can dial into, and people can see who's in the room, and you have a screen that shows the people who are dialing in by video. I'm hoping that'll help ensure that everybody feels more included, even as some people go back to the office.

Bill: Yeah, what I think is really hard to write right now is, they used to fly consulting teams into hotels. They would be at the hotel for a week in an engagement, and then it was just what they would do. Now they’ve realized, well, a lot of that was wasteful, and all the plane tickets don't necessarily need to be bought and all the hotel rooms don't necessarily need to be bought. And yes, it's necessary for certain instances and maybe certain engagements, but maybe it's only needed for a week and not months on end. Figuring out what the backend of this looks like whether or not it's commercial real estate footprints, or air travel demand or hotel capacity, that stuff is-- Part of me says, we're just going to go back to life as it was, and part of me says that's insane, there's no way it's going to happen. I just don't know how to handicap the outcomes.

Heather: I agree with you, and I'm no expert on this, but my feeling from talking to people is that when travel opens back up, we will see a spike in business travel that makes it feel like things are going back to normal, but I don't think it'll permanently stay there. I think we will see people realizing, “Okay, maybe only half as many people needed to go on that trip,” or, “That due diligence meeting really could have been done over video since we just did them for over video for the last year.” You'll see some of that come through, but I do think initially everyone will say, “Yay, I get to travel again,” and I think I know not everyone feels that way, but I love travel, and I'm also an extrovert. So, I can't wait to get back out there and be meeting with people in person.

Bill: Well, I think a good data point for people's appetite to travel is if you look at how quickly Allegiant and Spirit filled up their load factors, that's a decent proxy for whether or not people are willing to take leisure travel. As early as May, when the pandemic fear was still pretty high, Allegiant had pretty full planes. I do think that there's a willingness to get out there. Business travel is a lot harder though, because a lot of companies are going to be looking at their P&L and say, “There was a lot of expense that could have come out of this,” and what's necessary and what's not. I think Sam Zell said, “This is all nice, in theory, until the first person that flies out closes the deal, and then everybody is going to fly out behind them.”

Heather: [laughs]

Bill: I think there's elements of truth to both. One thing that you're saying that I have thought about or I think you're saying is it's going to be really hard to think long through some of these data points, because there's going to be fits and starts I think where--

Heather: Yeah.

Bill: In the same way that I think some people are improperly capitalizing the demand for digital services right now. People may improperly capitalize some of the reopening and it's going to be a lot of confirming of priors and figuring out fact from fiction, is going to be pretty difficult over the next probably even 18 months. I don't know.

Heather: I agree, but I hope I don't have to wait 18 months to get my hands on an Xbox series X, because it's my 13-year-old son's dream and his birthday is tomorrow. I have tried everything, Bill. It's ridiculous.

Bill: I wish I could release this right now, so that we could get you some help. Has he thought of an Oculus?

Heather: He has one.

Bill: They're very cool. Have you played with it?

Heather: A little. It makes me dizzy, but he likes it.

Bill: They blew my mind. I was like, “Oh, I understand the metaverse now. I get what people are saying that we're going to.”

Heather: I have two kids, and they both keep telling me that there's not a lot of games for the Oculus yet.

Bill: Yeah.

Heather: I think that they just need to get the ecosystem built out.

Bill: Well, what I like about Zuck’s strategy here is he gets that. What I don't love about it is that it's owned by Facebook, and I inherently distrust Facebook. I will disclose that I'm a little long because I view it as today's cigarette companies.

[laughter]

Bill: I do think it's smart to price that where it is, because I think he understands in order for the developers to come, you've got to get it in people's hands, but people can't get it in their hands if people are going to charge $1,000 per set.

Heather: Right.

Bill: It's one of these chicken or the egg type things.

Heather: Yeah.

Bill: It's going to be a weird world.

Heather: When my son played with a VR at a friend's house, this was pre-pandemic. He was completely enamored and obsessed. I actually thought it would be his new future gaming. If he could play Fortnite on it-- which I think you can do now, but he says it's not as good.

Bill: Hmm.

Heather: I do think there is a lot of potential to it.

Bill: Well, the person that I was talking to one of the ways that they're pitching clients is they're sending, I think it's Oculuses, if not Oculus, it's VR headsets to the client. There'll be five people around the room, and they all put them on and you can look left and right and see who you're sitting next to. Now, they have like a full-blown television studio, where they're at, so it's built-out capabilities, but that would really impair business travel.

Heather: That will be fascinating.

Bill: Yeah. Going back to the rate discussion that we had, one of the things that I can't figure out is part of me says, “Well, we're close to zero, we have to go higher.” My head just says that, but there's a lot of deflationary forces out there. Who knows what happens? I think it's crazy to opine, but I can already -- [crosstalk]

Heather: I can use a lot of inflationary ones too though.

Bill: Yeah.

Heather: If you look at the whole housing value chain, just try to get something done on your house, or-

Bill: Yeah, it's terrible.

Heather: -looking at the backlogs and construction of new homes and the lack of inventory for homes even in the US, there's a lot of inflationary pressure there.

Bill: Yeah, and that's got a lot of multiplier effects in it. As the tradespeople start to get employed and make more, they spend more. If you can figure out where the world is going and when, please let me know. You have an open line, anytime you want to take it.

Heather: One of the smartest portfolio managers I know said that the thing to watch really is wage inflation. To your point, if the workers that are part of this value chain we're talking about whether it's the housing market or other parts of the economy, start to see improvement in wages, that's really the sign that we have real inflation. As opposed to some of the materials’ inflation, which to your point can be offset by other areas of deflation more easily.

Bill: I've asked this a couple ways, but I'm fascinated by it. You clearly have a mind for this stuff, and you love thinking about it. It is who you are. How do you just let the PMs do their thing and not get involved? Or, do you? I shouldn't say how don't you, but you did say that you don't micromanage, so I do assume that you have a fair amount of hands off in it. My sense from talking to you and reading what you've written, is you've got a really good stakeholder focus, I've said it before in the interview but I mean it, two, a good perspective of letting people do their thing. That's not an easy skill to develop, I wouldn't think those two things.

Heather: I do think it's challenging. You have to learn to trust the people that you work with. I do think part of that comes with time. The more interactions you have with someone, the more you build trust, and the more trust there is, easier it is to let go and feel comfortable that they are going to do their job and you can do your job. I think that trust is such a fundamental component of any business culture that's going to succeed in an environment without micromanagement, which is the only kind of environment I want to be part of. [chuckles]

The other thing I'd say is, it has been really helpful, I think, that Diamond Hill was a very successful firm even before I got here, and they already had a lot of portfolio manager autonomy in place, and the expectation that it's the PM’s job to decide what they're going to invest in, and they oversee a lot of the risks related to managing their portfolios as well. It actually makes my job a lot easier, because I feel confident and comfortable that they know what they're doing. You're right, I love talking about investing, and I love talking to our PMs, and getting their thoughts about markets and individual names and how they're thinking about different companies evolving and the economy. Ultimately, I don't even feel like it's my expertise anymore. I can probably talk about it more than your average person, but I am not an expert, and I get to spend my day with experts, and I really love that.

I feel like my expertise now is on the leadership management strategy side of things, which I also love, but really when it comes down to the portfolio management, I feel so lucky to be able to have such a great team to rely on and that it never keeps me up at night.

Bill: Yeah, competence can-- it enables the hands off, right?

Heather: Yeah.

Bill: To that point, did you view when you came in and see-- One thing I think if people look at your income statement, they'll see revenues rolled over a little bit, and it was somewhat associated with the CEO change, so you could construct your own narrative if you want to figure that out. Did you view your job as coming in to learn how the organization worked, and maybe put process improvements, or did you think more like, I've got this background from my past, and I need to implement more of it? How much of it is adapting yourself to the organization that you're inheriting versus imposing what your view of the right thing to do for the organization? I've never taken over a company of this size, so that's why I am asking the question. It's very interesting to me.

Heather: Yeah, no, it's a great question. The way I think about it, obviously, you have to have certain areas of expertise that you bring and ideas and things that you think could be beneficial when you come into a role like this. But I think you have to come holding all of those ideas as lightly as possible, because you don't know yet until you really get into the company and start meeting with people individually and learning more about how things work at the organization, that you can really decide which of your ideas actually fit that company.

One of the things I love about strategy is that there are no two companies that should follow the same strategy. It is so specific to the competitive advantages of the underlying business. So, you really have to figure out what are the advantages of a business that you're working with, and which of those are the most durable or sustainable, and how can you build those advantages and possibly grow new ones without compromising on the areas where maybe you're not so competitive or where there might be some table stakes things that you do in order to stay in business that don't differentiate you in any way. So, you want to spend as little time as possible on those and as much time as possible on enhancing your competitive advantages.

The answer to what those things are, literally is different for every single company. Even if you found another roughly $30 billion in assets boutique that was also publicly traded like-- it is even as many parallels as you could possibly draw to Diamond Hill, I still think you'd be looking at a business with completely different advantages and areas of strength. I love the puzzle of it, of figuring out, okay, well, here's what I know, or what I've done before, and here's where this organization has succeeded, and let's figure out the whys to some of that so that we can make sure the path that we decided to pursue is the one that actually fits our advantages.

Bill: How does being a public impact your job at all? I do like that you don't kowtow to the public. You don't do what most public companies do, but I wonder, do you have a shareholder base that wishes that you did a little bit, would it benefit you at all? How does that color how you look at the situation that you've found yourself in?

Heather: Well, I'd say one thing I try to think about, I'm trying to even think about more purposely going forward than I have in the past is that wherever I spend my time as CEO, there's a tradeoff. If I spend my time meeting with clients and making sure our clients are really happy with their experience, and thinking about innovation and new ideas, and meeting with people internally and making sure we have the culture that we want, that's what I do today. If I were to add into that quarterly earnings calls, and lots of time spent with shareholders, and telling the story externally about what we're trying to do from a company perspective, that has to trade off with one of those other areas that I mentioned before.

What we have found as a company, and what I believe individually, is that there's a real benefit to focusing now on making sure we're getting the strategy right and that our clients understand our direction and are happy with it and can help us innovate and think through where we want to take the business, and that we have the culture that we need in order to succeed in the long term. I think it's Buffett who says, “Culture eats strategy for breakfast,” and that resonates to me very much, because if you don't have an employee base, a team that's really excited about moving in the direction that you're trying to go, then it's just not going to happen.

Bill: Hmm.

Heather: Fundamentally, I think all of those things and those areas of focus.

Bill: I’ve got to cut you off.

Heather: Yeah.

Bill: Is that what that means? I guess it is, but that makes perfect sense. If you have a culture of buy in, then your strategy can both morph and people will buy into the strategy. But if your culture sucks, doesn't matter how good your strategy is.

Heather: Right, because you won't be able to execute them.

Bill: Why have I not been able to figure this out? It's because I'm not an operator. So stupid of me to just learn this.

Heather: [laughs] Not at all.

Bill: No, it really is. This is why I love the podcast. I love being able to talk to people like you. I said it to Sanjay, I said like, "I can't tell you or him or anything that y'all don't already know, but I hope that through this interview series, I can get people connected."

Heather: Yeah.

Bill: For instance, I think you and Sean Stannard-Stockton, could have really good conversations with each other. You may know Sean through Todd.

Heather: I don't think I don't know.

Bill: Oh, he's really cool, and he's super thoughtful. I think you guys will probably get along, or I shouldn't say guys, I'm sorry, but I do. [crosstalk]

Heather: Don't worry. [laughs]

Bill: That's what I'm hoping to accomplish here, is to become a little bit more of a connector, and I get the benefit of reducing my stupidity and learning things like that, which just shatter my brain, which I should have already known.

Heather: [laughs] Well, I was going to say as a follow-on to that is that I believe those areas of focus result in better outcomes for our shareholders in the long run. I believe our shareholder base gets that. We've never had a quarterly earnings call, so they know we're not going to have them. We're just not attracting the shareholder base that would have those expectations, and I think that's good.

Bill: Yeah.

Heather: I think it's good for us in the long run, I think it saves us a tremendous amount of time. We hold a shareholder meeting annually, which we think is plenty frequent, given our long-term focus. We do talk to our investors, so we don't stiff arm them or anything. [laughs]

Bill: Yeah. I found your filings are very well written too. The communication is very good.

Heather: Thank you.

Bill: Yeah, it's not impossible to figure out what's going on here.

Heather: Yeah, well, it's a pretty straightforward business really at the end of the day, and we do try to be as clear as possible. In the stuff that we publish, we try to be as transparent as possible, publish things even more frequently than required from a regulatory perspective, so that people know where our assets are standing at the end of any given month or what our holdings are, things like that. We do try to hold ourselves to a pretty high standard of transparency.

Bill: A tidbit I thought was pretty cool is that you have a long/short strategy.

Heather: Yes, we do.

Bill: Yeah, that's cool. Is it more like funding shorts type things? Or is it like active-- we think this thing's going down? I guess it depends on the situation. I've gotten more interested in long/short as I've gotten to know people in the industry. That's a tough game for me to play, because I'm still the guy that's learning that culture eats strategy for breakfast. Adding short selling on top of that is quite a bit harder. That's okay. I don't have to play the game.

Heather: I do think there are elements to succeeding on the short side that are very different than succeeding on the long side, so you definitely have to take that into consideration. Our strategy is net long, but we are trying to protect on the downside and so. To your point, some different positions or different circumstances come about in different ways. It's a really interesting strategy in the sense that it's been around a long time. I think it's one of the strategies that we've had the longest in fact.

Bill: Hmm.

Heather: We were one of the first firms to have a liquid mutual fund doing long/short.

Bill: Oh, really?

Heather: Mm-hmm.

Bill: That's cool.

Heather: Yeah.

Bill: I like that.

Heather: Yeah.

Bill: I have nothing to add, but I think it's cool. Somebody was out on Consuelo Mack, I forget who, it might have been T. Rowe Price. They were saying that they think that long shorts, the new 60/40, and their point was that we've entered a world where it seems as though a lot of asset sell offs are correlated, like long/short is their version of adding diversification. I'm not trying to ask you to comment on that. I'm merely saying that that is on someone else's podcast, and people can go there if they'd like to form their own opinions. I do think long/short is going to be an interesting strategy going forward, and it's been wild to watch this year, what happens when short sellers are a little bit overexposed to certain names. It's been a real learning experience.

Heather: For sure. It has been stunning to watch some of the examples that have transpired this year. I agree.

Bill: I thought that GameStop would be-- I didn't think this would still be news, turns out, this is like actually a somewhat perpetual rerating, I thought it would be like a five-day story and go away, and then we could stop hearing about this thing. It's now 50% yesterday, I was like, “What is going on here?” It's a wild time. Do you think the markets are functioning like they're intended to? I'm not trying to ask you in an official capacity. As an observer, has this always happened around the edges, and it's just getting more attention? Or, is there something going on somewhere that is different this time?

Heather: I do think it's easier for people just share ideas. Social media has changed the way people can communicate around investment ideas, or any other ideas. We've seen the implications of that from via political perspective, as well as from an investment perspective, and many others, too. I don't think it means that there's anything wrong with the way the market is functioning, but I do think-- I worry, I think it's a dangerous game, because to make investment decisions, without the benefit of a full research perspective, some people are going to get burned. That makes me sad, because I think a lot of people who will end up losing a lot of money on a trade like that, don't have the money to lose. I just think that just makes me sad.

Bill: It makes me sad too. A lot of the reason is, and if you’re listening, Mom, I love you, but what I'm about to say is like objectively the truth. She's really, really good at real estate but she's also the type that can get sold an idea, when a newsletter comes out, or something hits her email box, or whatever, and she'll call me. As soon as she starts asking, “I'm not trying to be rude mom when I say this to you, but I say it to you.” I just feel like, “Stop talking. I don't want to hear what this email said. I don't believe it. I think this is all nonsense,” but I love her and she's working hard, her whole life she's tried to put food on the table, and she's making it for herself. I just think of the person that's like her that doesn't have someone like me to call that says, “Yeah, you should go ahead and participate in this”. By the time that-- who knows whether or not GameStop specifically works out, that's not the issue, but the issue is the ethos of buying what's going up and ripping and whatever.

The one thing that I love about the fundamental investor community that I've found myself in and that you're clearly a member of is, I do think a lot of us this time are speaking up and saying like, “Just be really careful with what you’re doing out there.”

Heather: Yeah.

Bill: I hope people are listening.

Heather: One thing that is not different this time is, I feel like every frothy market that I've had the opportunity to directly observe in my investing career is characterized by a lot of new individual investors coming into the market at the top. I don't know if that's what's happening here or not, but I think the idea of people who do not invest for a living and maybe don't even invest regularly, getting excited about stocks and buying well-known names that are in the news for whatever reason, is part of a recurring cycle.

Bill: Yeah.

Heather: It is [crosstalk] it does feel little different.

Bill: I talked to a guy yesterday that's never traded until last year started trading, and now he's going to turn into a financial advisor.

Heather: Wow. [laughs]

Bill: I was like, “All right, man. I've been studying this for a long time, and it's not quite as easy as you may think, but maybe I don't get it, you do. Good luck.”

Heather: This is an industry where it's really hard to separate luck from ability. I do think the best investors have figured out wherever possible, how to make that distinction so you know what you've done that's repeatable and what you've done but you got lucky. That's one thing I would just heed anybody listening to this, who is excited about ideas like GameStop to really think about.

Bill: Yeah, and I would say the inverse of that is also true. It's hard to separate unluck from ability, right?

Heather: Yeah.

Bill: There's a lot of people that are smart that happened to be tied to the wrong factor right now, and just because it's out of favor, they're looked at as not as smart as they are, and then people that are lucky are looked at as better.

Heather: Agree.

Bill: We'll see where it all shakes out. Is there anything else you want to say? I'm super happy that you carve the time out. I know you got a meeting coming up. I don't want to push you all the way to the time limit, but I've really enjoyed speaking with you.

Heather: I have really enjoyed it too. It's been great. Thanks for having me, Bill. I really appreciate it.

Bill: You're welcome. It's not the typical finance podcast, so I appreciate you taking the chance on it.

Heather: Absolutely.

Bill: All right. If anybody wants to connect with you or know anything about Diamond Hill, where should they go?

Heather: Well, they should definitely go to *diamondhill.com*. Our website has lots of great information, and it also has contact information if you want to get in touch with us there.

Bill: All right. If you liked what you heard, do that. All right, have a good one.

Heather: Thanks, Bill.

[outro]