**Axa**

Axa lift-out

**When Axa Group was combing America’s financial centres for individuals to make up a fixed-income unit, it came across a small team from Minnesota Life. So impressed was the insurance giant with this tight-knit group that it lifted them wholesale to form Axa Investment Managers.   
Dalia Fahmy discovers what makes the team so successful**



Wayne Schmidt, an ivory-haired portfolio manager from Minnesota, would hardly remember the day last year in March if he hadn’t received an unexpected phone call from New York. A recruitment consultant had pulled up Schmidt’s name in a search for a top-performing fixed-income team interested in starting up a high-grade fund for a major international client: Axa Investment Managers, a subsidiary of Europe’s largest insurer.

The London-based investment firm had scoured New York and San Francisco for the right team and even considered acquisitions, but the trail led to Minnesota, and Schmidt. The bond portfolios managed by Schmidt, named Core US, consistently outperformed most of the competition, as did the mortgage funds led by his team-mate and real-estate whiz Kent Weber. The recruitment consultant did not reveal the identity of his client, and at the time, Schmidt shrugged off the conversation.

“You get those calls at different points in time with different opportunities, and some seem to fit and some don’t,” he recalls in a soft Minnesota lilt. “We just talked generally about how I manage money and what my background is and I didn’t think too much of it.”

Schmidt had been working at Advantus Capital Management, the $14 billion investment arm of Minnesota Life, for 24 years, most recently managing a variety of high-grade funds as part of Advantus’s $1.8 billion Total Return bond product. Although he had considered switching jobs before, the right opportunity had never presented itself. Advantus was like home: Schmidt had been on the Total Return team since its inception in 1991, and had worked with his boss Fritz Feuerherm, head of fixed income, and Weber for almost 20 years. Even the newest member in the group, Steven Nelson, who managed the money market accounts, had been with them for eight years.

Early last year, however, the tide started to turn. Advantus decided to shut down its equity operations and to sell the distribution of its retail fixed-income products to Waddell & Reed in Kansas. In April, more than a quarter of Schmidt’s colleagues had been given notice, and office morale crashed.

Meanwhile the recruitment consultant, Jacob Navon, was impressed by the initial call. “Quite often you talk to candidates and they have the pieces but they don’t have the whole package,” says Navon. “Schmidt seemed to have a very good grasp of the broader economic factors and how they influence interest rates, which is obviously a very key thing as a bond manager.” But he also knew how to take an individual bond and work out whether it would make a good investment, a skill that some managers never learn, says Navon.

Equally importantly, Schmidt expressed a rare dedication to his long-time boss Feuerherm and the group seemed to work well together, two qualities Navon’s client was looking for in a team.

Today, less than a year later, Schmidt is a senior portfolio manager at Axa Investment Managers based in Minneapolis. He has gone from working for Minnesota Life, a Midwestern insurer with $20 billion under management, to working for one of the world’s largest financial organisations, Axa Group, with $900 billion in assets.

Working with him are his colleagues from the Total Return team: Feuerherm, Weber and Nelson. David Land and Rose Lambros are two credit analysts who joined from Advantus shortly after the group quit, and Debbie Dow is the office manager. And although the team’s assets under management have dropped from $2 billion to $200 million (with another $1.5 billion on the way), and their former employer is suing them for leaving, they agree they’ve made one of the best moves of their careers.

**Pedigree**   
Axa Investment Managers is a money manager within the Axa Group, an international insurer with 130,000 employees and $90 billion in annual revenue. Axa IM employs about 2,100 staff and most of its $250 billion in assets consists of parent company insurance premiums and institutional accounts managed by 14 separate businesses scattered across the globe: a team in Singapore oversees Asian emerging markets, a group in Tokyo buys Japanese high-grade debt, and experts in London, Paris and Frankfurt handle European credits. The overwhelming majority of Axa IM’s clients come from Europe and Asia, and until recently Axa IM was conspicuously absent from the US. Not having a US high-grade capacity posed a serious problem.

“It was clear to us that to have a gap in coverage of the largest and most important market in the world would be a constraint in scaling that market recognition as a leading fixed-income manager,” says Robert Kyprianou, the London-based head of investments for Axa IM.

Kyprianou had hired a high-yield group from Cardinal Capital Management in Greenwich, Connecticut just two years prior, and Axa IM’s equity operation – California-based Axa Rosenberg – was also running smoothly. If possible, Kyprianou wanted to replicate the acquisition of the high-yield group by lifting out an entire team from another asset manager.

When Navon introduced him to the Advantus crew, Kyprianou was thrilled. “It was a very good fit. They had long years of experience working together and they had obviously been successful at Advantus, in exactly the right sector. They’re very nice people as well. There was a nice chemistry with us.”

According to InvestorForce, a firm that tracks the performance of institutional asset managers, Advantus’s Core US bond product managed by Schmidt returned 10.56% in the three years ended March 31, 2003, putting it in the top 10% of its category. Advantus’s mortgage portfolio managed by Weber earned 10.62%, placing it in the top 20%. Advantus’s mutual funds, worth less than $250 million combined, also consistently performed in the top 10%, according to Lipper. The Midwestern outfit had even attracted clients whose portfolios were dominated by heavyweights like BlackRock and Pimco.

Performance aside, the Advantus team fulfilled two other requirements for Axa: experience as a group and a bottom-up approach to investing. The first requirement was a piece of cake. The Total Return team had been in place for 12 years, and some of its members had worked together for 20 years. “They are as intertwined as blood relatives,” says Navon. “They go golfing together, they go hunting together.”

The team’s investment style – known as the bottom-up approach – also fits Axa’s model. Unlike most fund managers who select bonds using macroeconomics and sector calls as their guide, the new Axa crew looks at fundamentals first and context second. Simply put, they find a bond with a solid story and invest in it.

“We are very specific in the issuers and collateral that we select,” says Weber. The mortgage bond market is a relatively inefficient one that favours investors who approach it “like stock-pickers in a bond market”, he says.

Weber, the senior portfolio manager in charge of structured credit and mortgage bonds, visits properties and management before investing in them as often as he can. One of the best-performing specialists in the business, he started out making commercial real-estate loans for Advantus more than 20 years ago. Now, as he is proud to admit, property developers have kicked him out of their offices for asking too many questions during fact-finding tours.

Among his better trades, in 1999 Weber visited 277 Park Avenue in New York, which housed the headquarters of Donaldson, Lufkin & Jenrette at the time and is now one of JPMorgan’s largest buildings. He thought the property showed upside and that the bonds, rated A by Fitch, were undervalued by the market. Since then, the bonds have been upgraded to AA and their spread has tightened from 210 basis points over US Treasuries to 125 basis points with more room for appreciation left, according to Weber.

**Chemistry lessons**  
Part of the reason for the team’s success has been its extraordinary chemistry and commitment to the group. Feuerherm, Schmidt, Weber and Nelson are shy to take credit for their achievements, and when asked to describe their duties at the firm, they insist their efforts are combined.

“We don’t have offices.... we sit out in the open so there is a free exchange of information and ideas,” says Nelson. Once a week, he says, the crew gets together to review its strategy. “Everybody shares their views, and everybody challenges those views. Everybody hears a pretty critical angle and we come out with a consensus.”

Another reason for the team’s success is a passion for the markets, which in Feuerherm’s case dates back to the seventh grade. His father had opened a stockbroker’s account for him, and Feuerherm would call in his bets, sometimes waiting days for confirmation that his trade had been executed. Growing reminiscent in a phone interview, he recalls one of the first successful investments he ever made, in 1967. Just a college junior in Madison, Wisconsin at the time, Feuerherm invested $250 in a company that leased giant IBM computers to corporations, called University Computing. A year later, the stock had soared and with a profit of about $4,200 he was able to buy a brand new Corvette. Today, the stakes may be higher and the market more complex, but the crew at Axa Investment Managers seems as eager as ever to make its mark.

Although Feuerherm, Schmidt, Weber and Nelson were quickly interested in Axa, the move raised many questions. Having worked at Advantus for a combined 73 years, they were still loyal to their employer despite the upheaval on the equities desk. Feuerherm had worked at Advantus for 30 years and many of his bosses at Minnesota Life were his friends. In addition, working for a French company with a minor US presence seemed like a plunge into darkness, even though Axa IM’s parent Axa Group owned American trademarks like Equitable, Alliance Capital and Sanford Bernstein.

“Their main concern at that point was, who is Axa?” says Navon. “And is Axa going to come here and, as a lot of foreigners do, decide they’re not penetrating into the US and then leave?”

The team was also fiercely protective of its investment process; it had taken years to master the art of making decisions by consensus and picking credit over macroeconomics, and they weren’t willing to give that up. “We had a successful process that produced results that were good, strong and were noticed by a lot of people,” says Nelson. “If Axa had told us, ‘we have a better way of doing this, you guys aren’t doing this right,’ it wouldn’t have worked.”

To the team’s delight, Axa promised to let them operate without too much interference. Axa also impressed them with its sheer size and the wide support network it offered at the touch of a button. Being able to consult with credit teams based around the world, with expertise in strategy, economics or risk management on a daily basis has been a boon. “They had resources we couldn’t even dream of at Advantus,” says Weber.

What really tipped the scales was that their efforts to evolve had been frustrated at Advantus. Functioning mainly as a vehicle through which Minnesota Life could earn income on its insurance assets, Advantus had rarely encouraged the team to grow its portfolios or expand its product offering.

“The fixed-income team was never core. They threw nickels and dimes at it in terms of personnel and marketing, but they never had a commitment,” says one former Advantus portfolio manager who worked closely with Feuerherm and his group.

To make things worse, in 2003 Minnesota Life inked a deal with Waddell & Reed in which Waddell gained all of Advantus’s equity portfolios, in return for distributing Minnesota Life’s annuity products and its bond and mortgage mutual funds. Although the bond and mortgage funds would continue to be managed by Advantus, they became part of Waddell’s Ivy Funds family. The ensuing layoffs and bitterness hit the portfolio managers hard.

“You’d read about terminations and firings and downsizings in the newspaper, and this was my first experience of it first hand,” says Schmidt. “These were friends I had worked with for 15, 20 years and finding out that these people were being terminated, it was a sad event to see.”

Although the fixed-income side was not directly affected, the dismantling of the equities desk sent ripples through the organisation. So when Navon put in his first call to Schmidt last March, the timing was perfect.

The Axa IM high-grade team in Minneapolis now has just $200 million of assets under management, most of it for the Workers Compensation Reinsurance Association (WCRA) of Minnesota, which was also their biggest client at Advantus. Carl Cummins, CEO of WCRA, says the decision to move the assets when the team switched employers was simple.

“We had hired this team because of their professional skills and with the team departing we thought it was prudent to move our money,” he says. “They represent the best of solid, stable, clear-thinking Midwestern common sense.”

The crew also has a mandate to manage about $1.5 billion of assets for a variety of Axa Group institutional clients which are currently being served out of Europe, although it might be months before the funds change hands. Axa IM’s long-term goal for the Minneapolis group is to build a mix of assets worth up to $15 billion from international Axa Group clients and US institutional accounts.

For the portfolio managers, the main job this year will be to generate returns worthy of their reputations. While the bond rally of the past two years may be over, Schmidt and Weber are not ready to throw in the towel. Schmidt says that the portfolio is close to a maximum long position while mortgages are close to a neutral position. “I think we’re getting closer to the end of the capital appreciation piece of corporate bonds outperforming due to spread tightening,” he says.

Most of the value in 2004, he predicts, will come from incremental yields on corporate bonds. Some of the top holdings in the fund include GMAC 6.875% bonds due in 2011, Altria 7% due in 2013 and Southern California Edison 30-year paper.

On the mortgage side, Weber says pickings may be slim but value is there if one knows where to look. “There’s more spread tightening to be had in select markets, but you’ve got to be very careful,” he says. “The low-hanging fruit has been picked. Now it’s going to be hand-to-hand combat to generate a lot of excess returns from those other areas.”

Weber says he is overweight in asset-backed securities and commercial mortgage-backed securities and slightly underweight in the agency mortgage market, with three- to six-year maturities looking particularly attractive.

Although the team says it has settled in and business is proceeding as usual, one complication remains to be taken care of. After the team defected to Axa, Advantus filed a lawsuit charging Axa, Feuerherm and Schmidt with nine counts, including deceptive trade practices, breach of fiduciary duty and misappropriation of trade secrets. The suit came as a surprise, since lift-outs are becoming more popular in the investment community and rarely result in legal action, particularly when no employment contracts are in place.

This case was different however, because the crew had tried to soften the blow at Advantus by proposing a friendly deal to their old bosses and offering to continue managing Advantus’s assets from Axa, much like Waddell & Reed was now running Advantus’s equity portfolios. But Advantus rejected the deal.

“It saddens me that they are being accused of being disloyal,” says one source. Advantus has declined comment on the story, and Axa executives would only acknowledge that the lawsuit is ongoing.

Schmidt and Feuerherm have filed countercharges, and although Advantus hasn’t made any demands so far, the suit has been damaging.

Until the case is settled, Axa IM’s new high-grade team is doing the best it can to generate the kind of returns it prided itself on at Advantus. In the changing market landscape, this is no small task; but this group feels up to the challenge.

**Please email** [**Matthew Attwood**](mailto:matthew.attwood@incisivemedia.com)**, Editor, to comment on this article**.

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