TRANSCRIPT | Milken Institute Global Conference panel: Asset management: Don't stop me now (event replay)

MODERATOR: Please welcome the panel on: "Asset Management: Don't Stop Me Now," moderated by Bloomberg News TV Anchor Sonali Basak.

SONALI BASAK: Hi everybody, thrilled to be with you today. We have a really amazing panel for you here. I have Catherine Keating of BNY Mellon. We have Steve Klar, Wellington Management. We have Matthias Kristol at Jefferies, Carter Lyons at Two Sigma, and Neal Wilson at EJF. And so, you know, we have a lot of questions in this volatile environment about where to go. And I'm wondering if you'll get us started on how you think about investing through the volatility that's ahead of you?

STEVE KLAR: So, we are big believers that active management's going to be really important in this next regime, which is likely to be more measured market returns and much higher volatility. We're focused on making sure that we deliver on active, and if you think about the returns that the alpha is going to deliver relative to the returns of the markets, we think it's going to be very important to our clients and objectives. We also are seeing that our clients are expecting more of us, above and beyond the alpha we deliver. So, some things we're working on would be the intersection and the blurring of lines between privates and publics.

So, if you go back over the last 20 years, PE-backed companies, there were 2000, now there are 8,000 public companies, 7,000, now there's 4,000. And so there's a lot of alpha in making sure you're working at the intersection of the two. And we have some privates-only funds, some public-only funds, and some that are mixing. The second is

blending art and science. And the third is integrating sustainability authentically into all the portfolios.

SONALI BASAK: You know, this would look very different for you with a high-net-worth client base. And so I'm wondering when people talk to you about active management, how are they changing course in this environment?

CATHERINE KEATING: Yes, so I would start with just the individual client generally, and the fact that over our careers we've really seen a sea change in financial markets. And, you know individual investors, if you add the 401(k)s and personal savings, are now almost two-thirds of financial markets. And we talk about the fact that the consumer's two-thirds of the economy, but we don't often talk about that. They are also very, very important to financial markets, and their financial performance and retirement security is important to all of us. And so, the way we think about it is, the individual investor today now being responsible for their own financial future, their own retirement, typically without the security of a defined benefit plan, has to have access to all of the same investment thinking and capabilities that any institution has, including active management, where it can add value.

SONALI BASAK: You see this from a strategic perspective over at Jefferies. You have a lot of clients that are grappling with just these problems. And so I'm wondering, what are they doing to pivot to the needs of what clients want right now?

MATTHIAS KRISTOL: Yes, thank you, so we spent time strategically with clients. And I would put the discussion and the activities in four broad buckets. For alternative asset management, it's really getting access to strategic growth capital. And so that comes in two forms: IPOs, which is very visible, and there have been about a handful in the last 18 months. There's going to be others, as markets normalize. It also is minority capital, and

so there's been over 80 of those minority stakes sales, again for growth capital. The second bucket is really adding adjacencies. And so, we see it about at a clip of one to two a month, where larger asset managers add what we would call hypergrowth areas. So these are private asset, private credit, private real estate, private infrastructure, private equity, ESG, and also access to insurance balance sheet. The third bucket is getting closer to your client. So accessing wealth management through wealth solutions, separate accounts, technology, other think-tech technology. And then the last bucket is really a bit more opportunistic. So there's been areas in asset management that have been more challenged, and so it's acquiring books of businesses that are maybe running off, that are maybe in outflows, to amortize your platform on the bigger asset base. And so, on those four areas, we're very active.

SONALI BASAK: Now Carter, you know, those are some things that I know you work on at Two Sigma; I know that they've really expanded into things like private credit and other areas. So how are you thinking about this in terms of what are going to be the big places to invest over the next 12 months or so?

CARTER LYONS: I think when you're talking about expanding into privates, you probably should look out a little bit further than 12 months, but our view has been for 20 years that the best way to make investment decisions is to incorporate as much data as you possibly can. So, when Steve was talking about the role of alpha in a portfolio, and Catherine talking about her client base, which is different than ours — ours is primarily institutional — I think over the last couple of years, if you rode beta, you had a pretty good result. And we saw a lot of active managers and hedge fund managers that we more directly compete with, really leaning into tech, into growth, into beta, and putting up fantastic results. I think as we look at this year, and maybe the next 12 months,

equities have obviously sold off; rates, I think, in general are going up, so the core asset classes are probably not going to deliver the type of returns that our investors need. So they're going to look increasingly for real alpha solutions, things like market-neutral, etcetera, where we've been building out for 20 years. On the private side, we're quite excited about just disrupting, if we can, the way that private markets have been invested for many, many years. So Steve said art and science, that's very similar to our view, how can we take the data science capabilities that we've successfully deployed in liquid markets, match those up with real investors — you still need a lot more human involvement on the private side certainly than you do on the systematic side in the liquid markets — how can we combine those two to try to differentiate outcomes, not just for 12 months, but for 10 or 12 years?

SONALI BASAK: You know, Neal, I think that drives the question of, how much do you go into publics, and how much do you go into privates, right? What does this look like for you?

NEAL WILSON: So at EJF Capital, we're a sector-focused shop, so we focus on financials, you know, it's a broad area, but financials in general. So, we have hedge funds that are in the public markets. We've got private credit, and we do fintech. But I think, in this environment, it's a rising interest-rate environment, so it's actually kind of, for us, it's coming into a great zone for banks. And insurance companies. So on the public side, you want to be in insurance companies. On the private side, you want to be in banks. We have floating-rate paper. If you can get securitized, or securitized floating-rate paper of a bank, it's even better. And then on the public side, you want to focus on things like disruptor banks, where you can take advantage of kind of the regulatory change, because that's not really tied to the volatility of the markets. That's tied to governmental

themes, so disruptor banks are banks that are, like, banking to the crypto community — the digital asset community, for example, the on-ramp, off-ramp, and kind of we can see where the stable coin, you know, kind of regulation's going to happen, so that's where we want to move into those type of areas.

SONALI BASAK: We will definitely get back to additional assets. But before we get there, I'm wondering, over at Wellington, we've been talking so much now about private versus public. How are you now seeing it, and what role is private credit playing, given that, you know, people don't really love what the bond market looks like right now?

STEVE KLAR: Yes, so, we've been doing late-stage private equity since 2014, and we are now in the midst of building out our private credit capabilities. Our approach is always to focus on where we have an edge, where our capabilities bring something rather than what happens to be the biggest area. So we're going to be building out IG private credit for insurance companies, and then there are some areas in the structured space where we have some capabilities that we want to add there, so that's how we're thinking about it.

SONALI BASAK: You know, a lot of people don't realize this, but so much of the money recently raised in the private credit space, is in high net worth.

CATHERINE KEATING: Yes it is.

SONALI BASAK: Everyone from Blackstone to Blue Owl to Apollo have all been expanding their high-net-worth channels, and I'm wondering, when you're looking at that, what are clients looking for in managers? What are clients looking for from the products?

CATHERINE KEATING: So the first thing clients are looking for is the returns that are going to accomplish their objectives in the future. And if you think of that 60/40 portfolio that reliably generated high single-digit returns for them over the last 40 years, that's just

not the case anymore, right? Our outlook is a portfolio like that will generate about 4% a year, right? And if you start to add in inflation expectations, you know you need to have an institutional portfolio. And so, our clients look at their portfolios the same way any institution does. If I need more growth, where should I go? I should go to private equity. If I need more yield, I should probably consider private credit. If I need to protect myself from inflation, I should consider more real assets. So we approach it the same way any institution does, because they need to get the same returns an institution does.

SONALI BASAK: What are maybe some of the struggles? You're seeing so many new asset managers get into spaces that are more private, you know, we've been talking about this a little bit. But what are some of the struggles perhaps that they face, as they're making the pivot?

MATTHIAS KRISTOL: Yes, and I think the journey is long. So I think for the last five years, every larger alternative private asset manager has tried to really penetrate into retail channels, into more liquid areas, into wealth management, and we are now starting to see this really at the tipping point. I think the market has found these managers — is expecting it. You can see transactions, you can see AUM growing, you can see funds being raised, but it does feel like we're at the very beginning, and that this is going to be one of the big pressure points for the industry. And interestingly, you see the traditionals really moving into that alternative space to serve their retail clients, and the alternatives getting into the retail space to get closer to wealth management, and ultimately they will meet, and it's open who will win that fight.

SONALI BASAK: You mentioned something earlier in the context of this conversation, market-neutral. And, by the way, my education is in quant finance too, so I am with you on this; the quants have had very interesting performance over the last couple of years.

Many are coming back, right? So what is the value of market-neutral in this environment?

CARTER LYONS: I think if you had asked that question when we were here in October, people would be really skeptical.

SONALI BASAK: Yes.

CARTER LYONS: But after the last four months, and some of these fairly violent moves down in equities, we've had a much better set of conversations with our clients during this conference than we did the last conference. So, when markets are going up and you can get beta for a basis point, and you easily meet your return objectives, it's sometimes more difficult to explain the benefits of market-neutral, and certainly, the higher fees that come with hedge funds, but when we do have those dislocations and they do happen with some frequency, people then tend to realize, okay, that's what you're here for in my portfolio, and thank you for being there. But, quants have not performed as well, and I certainly think, your first question when you kicked off the panel was, we're in a higher-volatility environment, and we always say, and I think this is true of others too, we don't mind a low-volatility environment, we don't mind a high-volatility environment. It's the inflection points that we tend to be 50/50, and we don't like being 50/50. So, COVID, the meme stocks, some of those things over 2020 and 2021, and they certainly made things more difficult, because those types of events were nowhere in the historical data. So, I've been joking with many people over the last couple days that, you know, inflation's here, you have to take it into consideration regardless of your investment style, but very few of us were actually managing risk 40 years ago when we actually had inflation, and some of our datasets don't go back that far, so how do you incorporate today's environment, using history where you might not

have it? So all of that has to go into consideration, but I still believe there's a very solid role for market-neutral, as long as you're producing positive results.

SONALI BASAK: There's the point you made about how so many people have not seen this environment, especially a lot of newer money managers that have raised money more recently. And I'm wondering, when you're looking across the field, Neal, what do you see in terms of the ability of people to weather the storm here?

NEAL WILSON: Well I think they have to look at themes that are event-driven, and that is one area where you want to focus. Again, I talked about, you want to be in floating-rate paper, that's kind of an obvious thing. But you also want to be in opportunistic areas where, for example, we have an MSR, they call it mortgage servicing rights; when rates go up, the asset becomes more valuable, because people do not pre-pay their mortgages, right? So you have the servicing fee that goes longer than if rates were coming down, so it's a way to hedge portfolios. So that's how we talk to people, is like, look at your portfolio, look at things you can do to essentially hedge against that. So MSRs are one way. Another way is to go into areas, like, we call it regulatory event-driven, so we like investing actually in minority depository institutions and CDFIs. Why, because the government just implemented in one of the last COVID relief bills, a huge US$12 billion program, which is a small number but it's a big number for this cohort of banks, so you want to be invested in them, because they're going to be getting US$12 billion of permanent capital, and that's going to make those banks incredibly competitive. So that's an area where you can invest, and you're not worried about the volatility or interest rates going up; those are all tailwinds.

SONALI BASAK: Yes, and there's an ESG aspect to it, too. And so I'm wondering from your perspective here, seeing the market through so many cycles, what are you most

concerned about moving forward given that we still have a war in Ukraine, we still have inflation, we still have to see the greater effects of the Federal Reserve doing something we've never seen. And so I'm wondering, from your perspective, what do you think is going to be the most rippling effect to the markets?

STEVE KLAR: Well, I don't know if we know exactly what will be the most rippling effect, but I think this heightened uncertainty and the heightened volatility of outcomes is going to stay for a while, and I think if you connect sort of the governments around the world, and the deglobalization trend, the central banks catching up, and frankly, just a lot of division, divisiveness around the world, all these things are going to be factors that impact the underlying look at a company and its potential. And so I kind of want to just go back to what Carter said is, I think our clients need to just continue to think about a holistic asset allocation with absolute return market-neutral and uncorrelated returns being very important in this environment.

SONALI BASAK: Well, speaking of investing, I'm wondering, Catherine, how many of your clients want to hold on to cash given all that uncertainty?

CATHERINE KEATING: So, I'm going to tie into two words you used, which is uncertainty and volatility, and link them to your question, because the truth of the matter is, for institutional investors, investing is, to a certain extent, math. It's quantitative. I have a goal, what do I think is the diversified portfolio that's going to get me there, I'm going to have an investment policy statement and a committee and I'm going to follow it and I'm going to stay disciplined, and ultimately, I'm countercyclical, because when the market goes down, I rebalance. There's nothing that requires an individual investor to do that. And in fact, for most individuals, I would say probably all of us, money's very emotional. It's not math, it's how I feel, and guess what, we know the pain of the market going

down, we feel much more than the euphoria of it going up. And so, you know, one of the biggest things that we have to do for our clients is guide them through a much more uncertain and volatile environment where, if left to our own devices, we do the wrong thing at the wrong time. And we can see that as recently as the last two years. So if you look at fund flows, ETFs, and mutual funds as kind of a proxy for what the individual has done, if you start at the beginning of 2020, so right before COVID, and you stop right around February of this year, when the Russian invasion happened, what you see is the S&P 500 was up 40%, bond markets delivered 3% whether you were in taxable bonds or munis, and you saw over a trillion dollars flow into the bond market, and almost nothing into equities. So left to our own devices, we tend to do the wrong thing at the wrong time, and our job is to help clients not only have institutional portfolios, but institutional behavior, and be countercyclical.

SONALI BASAK: It's interesting, I was in a meeting earlier and there was a joke made about how everyone wants to invest in oil when it's over a hundred. And so, you had made this comment before the panel about how different investors have different risk appetites. How does that play out generationally, and how do you encourage investors to take on risk at the right time?

CATHERINE KEATING: So it's very interesting as we now think about the large size of the individual investor market and the generations, you know, the boomers and above, the millennials, Generation X. And they *are* different. They share some similarities; it doesn't matter what generation you're in, everybody would prefer to have an advisor than do it alone, which is a really good thing, right, because it helps take the emotion out. But you see some disconcerting differences. For example, risk tolerance actually rises by generation. The boomers say they have the highest risk tolerance, which you — when

you really think about it — they have shorter time horizons, they probably ought to be thinking about reducing — you know, just like LDI, right, when you're fully funded, maybe you reduce your risk a little bit. As you go down the generations, risk tolerance is much less, so to your point, much more skepticism about markets. Much less willing to take long-term risk, which is of course the thing that creates capital and wealth over time. So those are all things that we have to work on.

SONALI BASAK: I apologize, I left out a few risks. There's also supply-chain issues, and there's also still COVID around the world, and I'm wondering, when you're talking to your clients, what are they preparing for? Is it a recession? Is it stagflation? Is it something else?

MATTHIAS KRISTOL: Yes, I think that when you look at the strategic direction of the firms and how they are thinking, they have put the pause button on two types of activities. I think that the two things that really are taking a back seat now, is one, new IPOs. And they are preparing, they're getting ready. But people that usually want to IPO as an asset management firm are very high quality, and they don't need to IPO in a market like this. So that's the first activity that's in a pause. The second one is really marginal firms that are trying to get to a transaction, really can't transact in this volatile environment. Everything else we feel is very much active in planning forward. And why is that, despite the volatility? The mega-trends in the industry are clear. And strategically, these firms need to move forward, they need to fill in the gaps that they have, they need to raise capital, usually in private markets now. And they're moving forward. I don't think that, hopefully, short-term volatility has really changed the big strategic plans that the firms have had.

SONALI BASAK: And Neal, I'm wondering what we really see here in terms of the opportunity set moving forward. I mean, there's also a lot of people raising money in preparation for valuations to come down. So, if that is happening, to the extent that's happening, what is it happening for?

NEAL WILSON: I'm sorry, what it's happening for?

SONALI BASAK: Yes, what are people preparing to invest in?

NEAL WILSON: Oh, well, look, I think people are really focused on, you know, you're into a rising rate environment, potentially a recession coming, or recession will come. And so, the question is, where can I protect myself? And so again, I would go back to the interest-rate hedging is I think the question you asked Matthias for his clients on the banking side, but I think our individual and our corporate clients and institutional clients are really worried about interest rates. And again, we're in the financials area, so that's core to what we're doing. But people have to think about different ways to take advantage of that. So I talked about the disruptor banks, for example. So disruptor banks are different than most banks. They're not focused on mortgages or car loans. What they're focused on is depositors and providing a technology service, an on-ramp, off-ramp, for example, like [*inaudible* are used to?] digital currencies. They pay their depositors zero percent interest. So if interest rates move up, guess what, guess who wins? That bank, and so you want to be invested in those kinds of areas. The other thing is you look at when you have kind of a revaluation in high growth, like fintech, for example, or any high-growth area, it's not a bad time to think about lending *into* that space through private credit, floating-rate instruments with equity kickers, right? And if you're a tech company, you don't want to be doing an equity round necessarily right now unless you can [*inaudible*] it, A round, B round, yes you do. But if you're in that

C/D round, that's where in that later stage of the fintech life cycle, they're not going to be able to IPO. So take on some debt, don't dilute yourself, and you're happy to give the equivalent of, like a convertible that has that upside kicker with equity, if everything turns out, you know, that's perfect.

SONALI BASAK: Matthias, I'll have to get back to you about structured products in a minute. Actually, I want to move over to Carter again on the quant, that aspect of this, because what do the signals tell you when the environment is so uncertain?

CARTER LYONS: I think, maybe I'll just go back to one point about, maybe I'm being a little cynical here, of people going out to fundraise cause valuations have come in, a lot of those firms were fundraising six months ago as well when valuations were sky-high. And I think, maybe the cynicism, and I'm guilty of this myself at times, people fundraise because they can, so they want to go out and take advantage of things, and on the private side, we've certainly seen larger fundraises, firms coming back to market more quickly, so the vintage diversification isn't the same as it once was, so I think investors are going to be asking more questions about, well what do you actually see? Cause you were here a year ago and you told me you saw something that's not actually played out the way that you have. So I think there would be greater degrees of skepticism for the remaining part of this year.

MATTHIAS KRISTOL: Well, so you're pointing out something really interesting, which is, if you look at the fundraising, the private markets are in a big advantage because they have fundraised and continue to fundraise. And so the private market, for example, for growth companies, is likely to stabilize much earlier, because there are supplies of capital that can pick up the assets, at a certain price. In the public markets, because of the outflows, that is not the case. And so, we do think that the private markets, and we

see this every day, are going to stabilize a bit earlier, and so these private funding rounds for fintechs, etcetera, are likely to continue at a new price point.

CARTER LYONS: They don't have to worry nearly as much about the current volatility environment.

MATTHIAS KRISTOL: Correct.

CARTER LYONS: So, they don't have to worry about outflows, they don't have to worry about, they have to sell eventually, but it's very different than a higher turnover strategy like the core of Two Sigma's investment management, and we're turning our portfolios over in weeks and months, certainly not in years. So, when you asked earlier, what do we see, well we see something now and we're going to see something slightly different a minute from now, and a minute from then, and, you know, I think we're running our computers, and, you know, Catherine's point about the emotions of the individual investor, and I started smiling, because that's one of the things that we talk about: computers don't get emotional, they don't get tired, they don't take breaks. They work 24 hours a day, so we're constantly reincorporating information to try to make the best prediction we can with as much data that we can possibly incorporate.

SONALI BASAK: Let's use this example in one sector. Let's use it in finance for a second, because the banks are down this year, even with the prospect of higher interest rates. PayPal is down way more.

NEAL WILSON: Well wait, if I may, the big money center banks are down. Small banks are down slightly, relatively speaking, because they are not tied into the geopolitical risk from the invasion by Russia into Ukraine, and the energy markets being in turmoil. You know, US small banks are actually not affected as much.

SONALI BASAK: Well, what does this mean then? Does it mean then, fintechs and smaller banks, because they have that growth opportunity, is a better investment? Or to what extent do you worry about those public market valuations floating over into the private space?

NEAL WILSON: I guess on the public market valuations right now, we think that it's an interesting time actually to be thinking about going back in, in the smaller banks. On the fintech side, look, it's going to take a little while till valuations — look — it's going to creep into private markets, I mean that's how things are valued, right? You look to the public markets, and you apply your discount. So, I just think what you're going to see is people not wanting to necessarily raise equity capital unless they absolutely need to, and that's where that lending opportunity with floating-rate paper is, to us, a screaming opportunity, and we've been trying to focus on that.

CATHERINE KEATING: And I think you're raising a really good point about differentiation, right? You talked about that, large banks versus the small banks. And you know, when you really think about the last 40 years, what's really defined them? You know, low and dropping interest rates and inflation. And what happened? Business cycles extended, right? We have the longest business cycle ever, coming into the pandemic. And that's all starting to change, and I think of the Tolstoy quote from *Anna Karenina*, you know, every happy family is the same, but every unhappy family is unhappy in its own way. Well I think every company has gotten used to low interest rates, low inflation in its own way, and now everybody's going to be unhappy in their own way as we go forward, figuring out how to deal with this, because it does impact different companies even in the same sector very differently, and arguably would be a very good environment, therefore, for good old-fashioned active management.

STEVE KLAR: Active management (in chorus).

SONALI BASAK: Back to active management, because we've talked so much about publics versus privates. But you know, companies have not gone public at the same rate. And there's this volatility to contend with. How attractive are the public markets anymore?

STEVE KLAR: Well, I think, you know, if you take top line this year, market's down 15%, but it's very different across sectors. So I think there are attractive opportunities in public markets, but you have to choose wisely, take a long-term view, and, you know, again, some of the tech stocks are down to pre-pandemic levels. So I think there is opportunity in tech, there's clearly opportunity in real assets, there's opportunity in a lot of areas, and this is where security selection comes in, and really understanding the companies, and putting together a portfolio that can win over a horizon, and I think what we're all saying also is that there's a temptation to say, what will win tomorrow? But that's not really what the clients care about. What they want to know is, what's a portfolio that's going to achieve their objectives, as Catherine said, over the long run, and how do you combine the different portfolios. So obviously I'm biased, but I really do think that there's a lot of opportunity in active — in publics right now as well as privates.

SONALI BASAK: I want to spend a little more time on the markets here because they're so interesting before moving to some of the business perspectives here, what you folks are thinking as business leaders here. But for you, you know, Catherine, we were talking a little bit about valuations and sectors. What does a higher interest rate mean, for so many sectors like technology? And you're already seeing the wind out of the sails to a large degree. So, what now, what next?

CATHERINE KEATING: So one thing we know is that interest rates are quite relevant to different investing styles, right? Growth versus value, for example. And what you see is,

value-type investing, you know, good companies with moats around their businesses, and good cash flows, have tended to do much better in higher inflation environments, and higher rate environments, than growth companies, and in fact, we're seeing that right now. So I think the point for our clients, the bigger issue for our clients, believe it or not, is really inflation and volatility. It's really inflation and volatility, and you know the market is down, 14%, 15%, year to date, that's actually the *average* intra-year correction for the S&P 500, it's just they haven't felt it very often over the last 10 or 12 years. And yet, even with that average correction of 14/15%, 70% of the time, the market ends up rebounding and ending in positive territory for the year. Now that may or may not happen this year, but it has tended to happen over time, and so again, the biggest issue for our clients is how do you deal with that volatility and stay with your long-term plan so that you've got the security for your retirement and your future that you need.

SONALI BASAK: You know, it's interesting, you folks wanted to talk about passive versus active, right? And when you're looking at a market that is facing this volatility, what role does passive have?

MATTHIAS KRISTOL: Yes, so from a strategic perspective, I think passive is actually not that important. In terms of the revenue pool, that game has played. And so, I think where passive comes back into play, is how to create individualized passive. So what I mean by that is, that you can create your own index, that you can create your own exposure. And so all of the strategic focus right now is to acquire technologies that allow you to translate that passive exposure into your own individual exposure, and then overlay that with ESG, overlay that with tax, overlay that with your own personal risk

appetite, and do that multiple times over hundreds of thousands of portfolios, rather than have one index fund that you invest in.

SONALI BASAK: I want to remind the audience also; we do take questions for our panelists. So if you want to ask a question, if you scan the QR code, we can start taking them for you. And we actually already have one, so, open question: Given the risk of a potential nuclear event in Ukraine, what's the right allocation to cash in this environment? Anybody have a thought?

CATHERINE KEATING: Look, I think that all investors have modest allocations to cash at a minimum right now simply because of the interest-rate environment. Cash is basically, however, being short every asset class; that's what it means. And so, you don't want to have extraordinarily large cash allocations over a long time.

CARTER LYONS: It's particularly hard to have a large cash allocation when inflation's so high, you're just looking at the purchasing power of that allocation losing money. It doesn't feel like it, you might feel safe to certain investors, but I think our answer would be, just be as diversified as possible for an event like that. There's really nothing that you can do; hopefully, nothing like that happens.

NEAL WILSON: Yes, I mean that would be a 2008, you know, March 2020-type event if that happened. I mean there's nowhere to hide, you just have to, like Catherine said, go to cash if you can, and be diversified. That would be a brutal kind of situation.

SONALI BASAK: We have a lot more. What investment, private or public, do you folks see in emerging markets? That's a very hot topic for us over at Bloomberg also given so many challenges that so many nations are seeing.

MATTHIAS KRISTOL: So, if I can weigh in on this one, I think this is one of the biggest strategic decisions, actually, asset managers need to make. And I'm not sure there's a

right answer, because you can play both sides here. So on one hand, I think for decades-plus, emerging markets has been the great promise for the industry, so investing in joint ventures abroad, investing in local-to-local markets, bringing exposure, including passive exposure, to portfolios here, and now you have, clearly a political trend of deglobalization. And so the big decision is, do you double down, you build for the next 50 years, and you invest, you continue to stay the course. But I would not be surprised if some actors decide that actually they will get out of these markets and try to divest of the local joint ventures and activities, and in fact, you know, investors have been voting with their feet, and are ahead of that curve, but business leaders don't have that luxury and still need to make a decision, whether they want to be in those local markets or not.

SONALI BASAK: Anybody else?

CARTER LYONS: I think, from our perspective, China still presents an interesting alpha opportunity. We've been training on short China A-shares for almost 10 years, and you know, Steve mentioned earlier, the number of publicly listed companies in the US goes down, the number of private companies is going up. China actually is on its way to being the second-largest number of public companies, it's the second largest in terms of liquidity, it's a very massive market in terms of data. So for our type of approaches, and also the market itself, is highly retail-oriented, so 80-some-odd percent of the flows are driven by retail investors, so, whether you want the beta of China, and there's the geopolitical risk — that's obvious with an investment like that — or you just want to farm that field for potential alpha opportunities, we've been focusing a lot there, and it's been quite lucrative.

NEAL WILSON: So, I'm not going to ask this directly, because we're regulatory event-driven, so we focus on highly regulated, developed legal systems and markets, so that's

not going to be the emerging markets. But I would submit to you that there is an emerging market in the United States, and I talked about that Emerging Capital Investment Program, the ECIP program. Our minority depository institutions, or CDFIs, these are underserved banks that basically have not had access to capital, and I forgot to mention that the FDIC has also promoted a mission-driven bank fund, and there's going to be a billion dollars put in on top of that. So this is an area where there's not a securitization loan market, for example. It has not developed. We think that that capital can help develop with having access to areas underserved by capital through MDIs and CDFIs. So again, that's not an emerging market, but it is in the United States, and it's going to be immune. When you have that much capital coming into an area, it's going to be immune to some of these — not completely immune — but it's going to be largely immune to some of these geopolitical risks, volatility, recession. And so, you know if you have enough capital, you can do anything, and that would just be an area to think about for the audience.

STEVE KLAR: Sonali, I was just going to add, EM markets have underperformed the US for a very long time. Six months ago, if we asked who's interested in real assets, capitulation, no one. Now there's great interest. I think if you believe that emerging markets *do* have an emerging middle class, *are* going to improve health care, *are* going to develop more consumers over time, we think there are opportunities there. Again, these are long-term investments, but I think the opportunity in emerging markets remains attractive.

CATHERINE KEATING: And we would agree with that. If we're looking at a future with lower returns and lower real returns than we've seen over the last decades, you've got to eke out those excess returns in your portfolio wherever you can. And, you know, emerging

markets are roughly a third of the global economy, but only sort of 10% of global market cap right, they're a really underinvested asset, in parts of the world that are growing more quickly, so we would agree with that. But every investor has to have a view not just of that, I think there are roughly 150 emerging markets, so not all the stories are the same, you've got to be very tailored, in discerning a new strategy. And the other thing in particular for an individual investor is every time you invest outside the United States, you also have to have an eye and a view to the dollar, because individuals don't tend to hedge the dollar the way institutions would. So, we have a very strong dollar at the moment, it's obviously kind of helping our economy. But you have to have a view of the dollar as well when [inaudible].

SONALI BASAK: Now to Carter's point, how do both of you feel about China, and investing in China given the geopolitical, and, frankly, the economic headwinds?

CATHERINE KEATING: So China's the second-largest economy in the world, and one of the things about China is they tell you what's important to them — both in their five-year plans, and then, you know, the government's announcements. And so, if you know what the priorities are for China, then you kind of have a bit of a guide to what the priorities should be for investors.

STEVE KLAR: I think there are risks investing in every country, and clearly, if you think about the education sector and the implications of that. But I think again if you step back, are there opportunities to add value in China? Yes. Does it require a lot of focus? Do you need to spend time with the companies? Do you need to understand the policy environment? Yes.

SONALI BASAK: We should talk now about digital assets a little bit. We are definitely getting questions about — actually interestingly — the effect of inflation that had recently been

created by crypto, meta, and digital currency NFT. But the market is being flooded with liquidity, and are the effects starting to be seen? How do you folks approach this area, and do you worry about it?

NEAL WILSON: Well again, we look at it from the convergence between the regulated world and the currency digital asset world and payment systems that are going to be based upon those. And I know it's not necessarily popular with folks in the crypto crowd that that's going be the inevitable outcome, but it will be, and in so, the US has been behind, there's a little bit of a regulatory arbitrage you can play. You know, Europe, the EU, has come through with [indistinct: "a meek"?) proposal of regulation for stable coins and other things. And the UK is trying to catch up, and the US president put out an executive order recently. And that was really not a lot of specificity, but it was a call to action. And I think that when we look at the digital currency area, we look at it — there was first experimentation for years, then there was proliferation. I think 20% of Americans who are of an age where they can invest have some digital currency exposure. Then you get adoption, which is where we are now. And now we're going to get regulation. That's the gradation, that's how it goes, and that's happened in many other industries. So, I think we're at such an interesting area, because you're getting from widespread adoption, institutional adoption, to regulation. And so, there's a way to play it. I'm not here to say buy Bitcoin, or buy this first layer, you know, kind of, you know, technology that the [indistinct: "DeFi's being built on"?]. You want to look at how, or at least from our perspective, the safe way to play it is to get that exposure indirectly through institutions that are thinking ahead. They know that this is the — you know, the banks, are for example, in the horse-and-buggy business, and that this is what they have to think forward on. And so, we think that's where the opportunity set really lies in — in the

digital currency and payment system area. Because – look — the financial services system has been technologically way behind, and you're just seeing massive changes in adoption, and it's really an exciting time for that area; I hope you can sense it in my voice.

CARTER LYONS: We look at it, not too dissimilar to that — the 20% active, I'd think probably 90% of Two Sigma employees have some sort of digital asset exposure. We are just starting to dip our toe in the water. I mean we look at it, similar to what I was saying about China, it's a large and growing asset class with volatility and liquidity that is actually ripe for quantitative modeling. Now there's a whole bunch of other things that you have to take into consideration, the lack of regulation, how do you get comfortable with certain security ramifications, so we're starting to trade, very small, onshore and offshore, this year, and then we're really going to think about what do we do here, and I'd say, from an investor perspective, we get questions, but they're more sort of curiosity questions. We've seen some institutions who are perhaps just a little bit more front-footed, making allocations and working more actively in the space, but we've been happy to be a bit more of a fast follower here and try to play a bit more of a catch-up game, but I think if you were asking earlier about 12 months, five years, 10 years, I don't think the fad is going to go away by any means. I do think it'll probably be more regulated, and that might force even more people offshore. And those are just the types of specifics that organizations like all of ours are going to have to deal with.

NEAL WILSON: Yes, and keep in mind that if the Republicans take the House and the Senate — but if they take the House, which is probably more likely — Patrick McHenry from North Carolina will be the head of financial services, and he has been one of the proselytizers for digital currencies and for regulating it. And those are two separate

concepts, but he's one person who actually has a plan and has been thoughtful about it, and he's a very middle-of-the-road, bipartisan person, politically and individually. And so I think that's something to watch out for.

STEVE KLAR: Sonali, I would just add that we break it into two pieces. One is blockchain technology, so that in and of itself has a potential implication for our industry and our business, and we're thinking through where can it actually potentially disrupt — in a helpful way — our business. And then secondly, we think of it as digital assets, of which digital currencies could be one form. You have tokens, you have lots of different areas. So, right now it's investing in our privates portfolios, in companies that themselves are pursuing business plans around this where we have conviction that they can be successful, and as Carter said, we're in a heavy experimentation phase internally, just making sure we can get adjusted to investing in different types of these assets so that we're ready, as things evolve. But there's a lot of ideas out there, and I think, if you think about other analogies in the past, there will be some big successes, and potentially some failures, and it's all understanding, and watching, and making sure you keep pace with it.

SONALI BASAK: So there's a day soon, someday soon, that you will be investing in cryptocurrencies and tokens.

STEVE KLAR: We're going to evaluate that, and we're experimenting, we're going to see where we go.

NEAL WILSON: Sonali, if I may interject, there's exciting things that can be done with the technology that are also ESG-focused, right? So one idea that we've proposed to the government is, basically, if a loan is issued by a CRA-eligible (Community Reinvestment Act) so if you're, a minority depository institution, or you're CDFI, and you issue a loan,

the way it works today, let's say Carter's, you know, JP Morgan, not to pick on JP Morgan, but I issued a loan at a hundred, and JP Morgan has to meet their requirements to get CRA-qualifying credit. So he buys the loan from me, the issuing bank, and the minority bank at 102, and then Bank of America, or Jefferies, because Matthias is actually Jefferies, they need to qualify, so they buy it at 104, right, and on and on, it goes to 110; everyone's just buying it to meet their qualifications. Well what if you could tokenize that loan, that CRA-eligible loan? Then I, the issuing bank who's serving the community, I could get a piece of that upward float; instead of just making two dollars, I could make, as it goes up to 120, and that would lower my cost of capital. So tokenization in a technology using blockchain can have some really interesting applications.

MATTHIAS KRISTOL: Yes, so I think Steve and Neal actually summarized very much where I think the industry leadership is. I think everybody agrees on the direction. I don't think people know exactly the destination. And what that means in practice is that business leaders will invest for optionality. So they will invest and put money in some of the things [indistinct: that? they?] could be very big. I think personally, the two big game changers for the asset management industry is one, what you described, which is creating liquidity in things that today are not liquid, tag them through tokens. I don't know if it has to be decentralized, by the way. And the second one, I think this is more in your world, is actually the ability to put something like that in a retail portfolio. And to market infrastructure that's been built over the last three years is extraordinary.

SONALI BASAK: Yes.

MATTHIAS KRISTOL: So that today, we could tokenize anything in this room and put it into a retail portfolio. Now clearly, everybody understands that there needs to be a legal

and a regulatory overlay to that, but the reduction of friction cost and transaction cost in that will create value and lower the cost of capital for a lot of great things in the future.

CATHERINE KEATING: Well you just think of the mortgage market and mortgage securities, right?

MATTHIAS KRISTOL: Correct.

CATHERINE KEATING: Three-and-a-half trillion-dollar market, very difficult for any individual investor to access on their own. But if you can tokenize it, break it up into pieces, all of a sudden, you've got a whole new set of investors who can access it.

SONALI BASAK: It's pretty amazing how much, when you start talking about money management, it goes to crypto; that's where the conversation naturally goes. I do want to shift gears a little bit, because there's a really interesting question that we had all also talked about before which is as rates rise, what's the risk of having a lot of leverage? A lot of money managers these days have been buying a lot of leverage, you're seeing that [indistinct: in?] exacerbated moves on the way down, and so the question is, is there a bubble caused by clients borrowing against their portfolios or concentrated equity positions?

CATHERINE KEATING: So look, I think one of the lessons of the financial crisis, and I always say careers can be long as long as you don't make the same mistake twice, right? So one of the lessons of the financial crisis was that concentration, plus leverage, plus a lack of liquidity is very hard to survive, right? So we need to remember that, and we need to always guide our clients around that, and, you know, individual clients, and actually every survey will tell you this, don't just think of their assets, they intuitively also think of their liabilities, what am I borrowing? And actually you saw exactly what they thought about borrowing in the pandemic crisis, because what did individuals do with

the pandemic money? They paid down debt, that's the first thing they did, was pay down debt. So, if we're going to guide our clients to have secure financial futures and secure retirements, we have to bring the same institutional disciplines that a CFO would bring, to how you manage your assets and liabilities. And the truth of the matter is, most of the time, you should probably borrow a little less money than a bank will lend you. *Most of the time,* you should probably borrow a little less than a bank will lend you.

SONALI BASAK: This side of the room?

NEAL WILSON: You do have to look at the investing market now where the consumer is. We're seeing signs right now that, with kind of the subprime-type borrower, the one who's buying on the edge of their last paycheck, cracks are starting to appear. I'm not calling 2007, going into 2008. But you're seeing that, and that should, again, make you think in your portfolios of how you should adjust towards that. So again, that's why we would say, look at a disruptor bank, don't look at a community or consumer-focused bank. Don't focus on buy-now-pay-later type companies, those are going to be a little bit tough now, right? Maybe you could short them, yes. Things like that are going to happen, and then, it's going to get worse, right? We've seen this movie before. Interest rates are going up, inflation is brutal — we haven't seen inflation like this for 40 years — so this is going to affect the consumer, and there's going to be, sadly, investment opportunities or things that you should avoid, both because when you hit that inevitable recession, whether it be end of this year, next year, you're going to have some of the repeat ugliness because the leverage was so high in the consumer, and in the system.

CATHERINE KEATING: And I also think your question points to maybe a bit of a humbling moment for all of us in the asset management industry because the truth of the matter is, again, for institutions, reaching your goals is largely math and policy and staying

disciplined. But for individuals, beating the market isn't enough. You can beat the market, but to *your* question, you could borrow too much. You could spend too much. You could fail to take into account the impact of taxes on returns, and that is something we haven't talked about, the changes in the individual market, you pay taxes every year and every generation. Or you may fail to protect what you have. Maybe you don't have insurance when you need it. Maybe you don't have good estate planning when you need it. We can't solve it all in the asset management industry alone. It takes a lot of these other disciplines that we have to bring to the individual client.

SONALI BASAK: It's so interesting that everyone has answered this in the vein of the consumer, mostly. But what does this look like for the investors that are also borrowing a lot, and the corporations as well?

MATTHIAS KRISTOL: I think I heard it in a separate panel. You know, one thing about the current stress is that the market seems to be working, right? And I think, a lot of things that we've talked about on this panel, are the answer, which is investors are looking for yield, and a way to get yield is floating rate and credit, and there is plenty of private capital that's been raised last year that is still on the sideline. And so when you play that through, it's just a matter of price, and there isn't a stress in the market for leveraged loans, for companies to refinance. It's just, at what price can they refinance, and what covenants. But right now, the market is working, and the capital is there, especially capital looking for yield.

CATHERINE KEATING: But I think it's a good question, Sonali, because if you really think about what causes the market to go down in a sustained way, and maybe cause some collateral damage, it's really two things. The first is, recessions are actually caused by human behavior — and we actually see a little inkling of that right now. When confidence

goes down, of CEOs, small businesses, consumers, they tend to become more conservative, and they tend to make decisions that could lead to recession; this is how it happens. But the other thing that you have to be alert for, because if you have a recession, you can expect, you know, a 30-plus percent decline in the market. But the other thing you have to be *really* alert for is what you're alluding to, which is something that's much worse, right? Leverage in the system that becomes contagious. We saw it in the financial crisis. We actually saw it in a more limited way in 1998 with the ruble, and long-term capital management. And to your point, we don't see that kind of contagious leverage in the system today, but we have to be very alert to it, because if it is ever there, it's very damaging.

SONALI BASAK: Something embedded in what you said, is that there could be a bigger crash in the market ahead. So, how do you kind of get a sense of what the low is? How do you get a sense of when the bleeding stops?

CATHERINE KEATING: So I don't want to suggest by any means that we forecast a crash in the market in the future; we don't. In fact, we actually think that it's very unlikely that we have a recession this year in the United States. We went into this period in an unbelievable, strong position, because you know, we've never had a recession before where no one's income went down and went up. And that's what happened here, so we went into this period with incredibly strong consumers, incredibly strong companies, profit margins at all-time highs, and we actually think we're going to weather this, this year; we don't forecast a recession this year, and, you know, there's a path where you could say maybe we don't even have one next year, but obviously we are dealing probably with more uncertainty at one time than almost any of us have in our careers, and so we're very humble about it and very careful.

SONALI BASAK: How do you see the R word, the recession risk?

STEVE KLAR: Definitely, recession risk is meaningful at this point and it's something we're watching, and I think this stagflation risk is the one to really watch, and that is, it's on the probability sheet, but it's not the highest, but it's one we need to watch for; so, you know, cycles happen. It would be great if you could always avoid some parts of the cycle, but cycles happen, and I think the idea is to focus on how to invest successfully through it.

CATHERINE KEATING: We think that inflation is transitional, which means it's not transitory, it's transitioning, and it's going to go from being very, very high to something more moderate, maybe 3 to 4%, and it turns out that markets generally do okay with inflation in that zone. It can't get much above that, you know, bad things can happen, but in that zone, it's generally okay. If we transition to that, there's a there's a reasonably good path forward.

SONALI BASAK: Now how are you folks seeing this issue on the recession, what the markets might look like in the face of it?

CARTER LYONS: I think it's similar to what both my co-panelists said, that, you have to look at it from a probability perspective; I think stagflation — you start to read headlines about that, to Catherine's point, it almost becomes a self-fulfilling prophecy. If people think bad news is coming, if the storm clouds are gathering, they're going to entrench, or retrench. And then, to Steve's point as well, okay, the environment is what it is. Very few of us can just sit that one out. You have to figure out what companies are going to perform better, what sectors are going to perform better, what asset classes; should you be more international, more US? What's the differentiation between inflation? So right now the US is high, Europe is closer to what Catherine was saying is a more

acceptable level. So, I think you have to look at it from as much of a global perspective as you can, just knowing that it's not going to last forever, but it's likely going to be a little bit painful in the short term. I mean, this year so far from a capital markets perspective has certainly been painful. But I do think it's different in that we have grown very accustomed since 2008, whenever the market sells off, the Fed tends to cut rates. Well they can't do that, that arrow's not in their quiver this time, so it's going to be interesting to see how much pain can market participants actually take. I mean we saw that in '08, we certainly saw it at the beginning of COVID, they learned how to deal with it from '08 and applied some of those same techniques in 2020, if we were to have a substantial sell-off from here, they wouldn't be able to respond to it in a similar way.

NEAL WILSON: Everyone has, I think, covered the topic quite well. I just think that, what's the unknown is dealing with the level of inflation, and the speed that it's had, and that's not something that people who've grown up in the last 30 years have experienced at all, and I think that's kind of an interesting dynamic, and it really does hit the poorest among us on inflation, and I think that's where, you know, you have to worry about, where the problems are going to start always, is going to be where the people are under the most duress. And I think the geopolitical kind of energy, what we're seeing in Europe, the impact, in the US anyway, one out of every five dollars has been printed in the last two years, right? So, it's not a surprise why we have inflation, but it's certainly very hard to bring that in, and I think just focusing on the person who's living on the margins, that's where you're going to see the first cracks, and where there's going to be things to avoid, and things to to invest in.

CATHERINE KEATING: And I think you're pointing out, Neal, a very good point, which it's not just the *fact* of inflation that matters, it's the *pace* of it. It is much harder for

individuals, economies, companies to deal with spiky, spiky, fast inflation, than it is, with more gentle rising inflation, and we're in a spike right now.

STEVE KLAR: Sonali, maybe I would just try to think positively for a second, which is, we've been in an environment where it's been very optimistic, lower for longer, risk assets are going up, let's find new and interesting risk assts, and now we're in an environment where for the first time we're hearing words of caution, concern, and I think there's opportunity in that. It's hard, but that's what we're all here for, that's why we all love markets, and we love our clients, is we want to invest in a way that helps the clients through these events, and I think that's what we're all here to do. I have an esteemed group of competitors and colleagues here, and that's what we do, is we seize the opportunity in the moments of concern, fear, and caution.

CATHERINE KEATING: And it's how we show our value, right, when times are tough.

SONALI BASAK: Steady hands. Well thank you folks so much for taking my questions. Thank you all for being here, it's been a great time. Thank you.

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