Meet Farris Shuggi: Co-portfolio Manager of the Capital Appreciation and Income Fund

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Farris Shuggi

Farris earned a B.S. in financial economics and an M.A. in economic policy analysis from the University of Maryland Baltimore County and an M.A. in economics and an M.S. in finance from Washington University in St. Louis.

15
years of investment experience

15
years with T. Rowe Price

Baltimore office location

2023–Present
Co-portfolio Manager, Capital Appreciation and Income Fund

2022–Present
Head of Quantitative Equity, T. Rowe Price Investment Management

2016–2021
Portfolio Manager, Integrated U.S. Large-Cap Value Equity Fund

2012–2016
Quantitative Analyst, Equity Quantitative Research Group

2008–2012
Quantitative Analyst, Multi-Asset Division

The launch of the Capital Appreciation and Income Fund in late November came more than 15 years after Co-portfolio Managers David Giroux, CIO of T. Rowe Price Investment Management, Inc. (TRPIM), and Farris Shuggi, TRPIM's head of quantitative equity, began their professional collaboration. In this Q&A, Farris discusses the genesis of this income-oriented fund, how he and David work together to blend quantitative and fundamental analysis, and what makes him tick as a portfolio manager.

Q: Tell us about your background and how you started your investment career.

I studied economics, finance, and applied statistics in college. My goal, at one point, was to become an economist.

But I fell in love with investing and found that it dovetailed nicely with my skills and interests. Trying to generate alpha—or excess returns—for clients is like solving a math problem that's fighting against you. The market is always changing, so you need to keep learning and refining your process.

After building my chops as a quantitative analyst, I managed the Integrated U.S. Large-Cap Value Equity Fund[1] for six years and then assumed a leadership role to help build the firm's quant capabilities at TRPIM.

David Giroux and I have been close collaborators for more than a decade and a half. We're also good friends. His humbleness, discipline, and even-keeled thinking about what drives long-term value in stock and bond markets have profoundly influenced how I approach quantitative investing.

When David and I work together, each of us brings unique knowledge and expertise to the table. My team's quantitative approach and his team's strength in fundamental analysis feed back into one another in an iterative process.

A lot of this collaborative, "quantamental" research has evolved into models and analytics that David has used extensively as a portfolio manager. These tools are built on the premise that there is a durable and repeatable statistical advantage to investing in companies with certain fundamental attributes. The fruits of these labors are also foundational to the Capital Appreciation and Income Fund.

Q: What are the goals of the Capital Appreciation and Income Fund?

The fund seeks to generate attractive income and long-term capital appreciation while limiting losses in a market downturn. We take a different approach than portfolios whose primary goal is to generate stable income or to maximize potential yields.

In equities, we focus more on high-quality businesses than high dividend yields.

- We gravitate toward dividend payers that we believe offer the prospect of steady earnings growth at a reasonable price (GARP).

- The GARP companies that we favor typically generate significant cash flow and exhibit lower earnings variability, qualities that may make the stocks less volatile and can provide support for share buybacks and/or dividend increases.

> Rigorous quantitative analysis provides a useful outside view that can give us the conviction to be contrarian.

In fixed income, we're looking for securities that we believe offer the potential for high current income with minimal default risk.

- Our emphasis is on higher-quality high yield bonds—predominantly those that are BB rated[2]—and leveraged loans where the rates periodically adjust higher or lower with interest rates.

- U.S. Treasuries also provide income and, along with our approach to equity investing, can help to balance the higher credit risk associated with the high yield market.

Taken all together, this strategy should lead to a diversified, income-oriented fund that aims to generate strong returns in a risk-efficient manner.

Q: How does your fund and your style of investment differ from your competitors?

Relative to other quantitative approaches, I'd say that the models we use place less weight on price momentum. We focus on fundamentals and business quality, as well as valuation—factors that tend to create value over extended holding periods.

The fund itself is unique because David and I can pull three different levers as we seek to add value for clients. Having this flexibility can be helpful in a variety of investing environments.

1. Strategic Asset Allocation: We want meaningful exposure to parts of the market where structural inefficiencies tend to create greater potential for outperformance. In other words, we are attracted to areas that are likely to contain more of the kinds of opportunities that we favor.

BB rated bonds, for example, historically have generated strong risk-adjusted returns relative to the other tranches on the credit-quality spectrum. The BB rating is one step below investment grade, which creates recurring dislocations that can be exploited.

Think about the fallen angel effect. When a credit rating agency lowers a company's credit rating from BBB to BB, many of the strategies that focus on investment-grade credits are forced to sell these bonds, regardless of the reason for the downgrade. We are on the lookout for instances where the downward pressure on a bond's price does not appear to reflect what might be only a marginal increase in perceived default risk.

[1] On April 5, 2023, the QM U.S. Value Equity Fund changed its name to the Integrated U.S. Large-Cap Value Equity Fund. Farris Shuggi was portfolio manager of the fund from its inception on February 26, 2016, through December 31, 2021.
[2] Credit ratings are provided by Moody's Investors Service, Standard & Poor's, and Fitch Ratings. A bond is considered non-investment grade (or high yield) if it has a rating of BB+ or lower from Standard & Poor's and Fitch Ratings or Ba1 or below from Moody's Investors Service. A bond is considered investment grade if it has a rating of BBB- or higher from Standard & Poor's and Fitch Ratings or BAA3 or above from Moody's Investors Service.

Sources of potential outperformance

(Fig. 1) Three levers to pull in the Capital Appreciation and Income Fund

1	2	3
Strategic Asset Allocation	**Tactical Asset Allocation**	**Security Selection**
Quality GARP in equities	Rigorous quantitative process that works to identify significant opportunities for outperformance relative to our strategic asset allocation	Equity
High yield BB bonds and leveraged loans in fixed income		Fixed income

GARP is growth at a reasonable price. Leveraged loans have floating interest rates that reset periodically (typically, quarterly or monthly) and represent amounts borrowed by companies or other entities from banks and other lenders.
For illustrative purposes only. This is not to be construed as investment advice or a recommendation to buy or sell any security. Investments involve risks, including possible loss of principal.
Source: T. Rowe Price.

Within equities, GARP stocks exhibit many of the attributes that we believe create long-term value. Nevertheless, these companies tend to trade at reasonable prices. Why? GARP stocks fall between the cracks. Growth-oriented investors usually prefer outsized revenue growth, while the quality of these businesses means that the valuations aren't necessarily attractive to value investors.

2. Tactical Asset Allocation: We have the flexibility to tilt the portfolio toward one asset class or another when dislocations in the market create opportunities that we regard as statistically attractive.

Rigorous quantitative analysis provides a useful outside view that can give us the conviction to be contrarian. I talked about this potential advantage with my team over coffee when we were building some of our models. Knowing that we worked on these tools together when we were in a relaxed state of mind can help us to stick to our process and to avoid succumbing to behavioral biases that might seem more comfortable but could be costly in the long run.

3. Security Selection: Our collaboration is another source of edge. My team and David's team are in constant discussion, both with one another and with TRPIM's equity and fixed income analysts. Working with our in-house equity and fixed income analysts helps us to enhance our models with their deep knowledge of industries and companies. In turn, we can provide statistical analysis on the analysts' coverage areas that can inform their research. These partnerships are critical as we look for individual securities with potentially compelling risk/reward profiles.

Q: What's next in equity and fixed income markets?

The only certainty in investing is that there will be uncertainty. Last year, the market was focused on interest rates, artificial intelligence, and elevated geopolitical tensions, but 2024 could be very different.

Within equities, we are seeing the greatest opportunities in higher-quality names that historically have exhibited lower volatility. These types of stocks underperformed last year and are generally being overlooked by the market. In fixed income, attractive yields can still be found in high yield bonds and leveraged loans.

Q: What's one thing that people don't know about you?

In my mind, managing human relationships is just as important as managing financial capital. Teamwork is critical to doing our best for clients. I'm fortunate to manage a great team of quantitative analysts, and I think a lot about making sure we have the right culture and environment to develop and retain talent.

My hobbies outside of work may come as a bit of a surprise. On weekends or evenings, you might find me in the garage, working on my pickup truck. I also enjoy baking for my family. Breads are a favorite, but I have a bit of a sweet tooth, so cookies and pastries are also in the mix.

Investment risks:

The value approach to investing carries the risk that the market will not recognize a security's intrinsic value for a long time or that a stock judged to be undervalued may actually be appropriately priced.
Fixed income securities are subject to credit risk, liquidity risk, call risk, and interest rate risk. As interest rates rise, bond prices generally fall.
Investments in **high yield bonds** involve greater risk of price volatility, illiquidity, and default than higher-rated debt securities.
Investments in **bank loans** may, at times, become highly illiquid and difficult to value; they are subject to credit risk, such as nonpayment of principal or interest, and risks of bankruptcy and insolvency.
There is no assurance that any investment objective will be achieved. Because of the fund's fixed income holdings or cash position, it may not keep pace in a rapidly rising market.

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