Travelling through time: The history of asset management

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Asset management company T. Rowe Price has opened its extensive archive. By roaming through letters and historic documents, we gain an entirely new way of looking at the history of asset management in the twentieth century. At the same time, the documents also tell the fascinating story of T. Rowe Price itself since its founding in 1937. While the first part of the story starts with the Great Depression, this trip back through time looks at the 1950s, 60s, 70s, 80s and 90s and finally the industry's current situation.

A pioneer in Baltimore

It was 1929. On 29 October – known as Black Tuesday – the US stock market collapsed. This had a domino effect across the globe, with GDP falling by approximately 15 percent between 1929 and 1932. Some countries' national economies took until the start of the Second World War to recover. It affected both poor countries and rich countries like the USA equally: personal incomes, prices, taxes and profits fell, while unemployment in the US rose to around 25 percent. As a result, people were suspicious of anything to do with finance. If they had money, they were reluctant to let it go. The idea of investing, particularly in equities, was almost inconceivable for many.

Great Depression: Unemployed people queuing at a soup kitchen

In the years that followed, the US returned to growth as it became the main driving force in the arms industry. However, it experienced an economic recession in 1937 and 1938,

A man named Thomas Rowe Price Jr. was not discouraged by hard times. In 1937, he founded a firm focusing solely on portfolio management on a fee basis – something that was new at the time. The entrepreneur named the firm after himself: T. Rowe Price. Initially, other companies and individual asset managers viewed Price's new firm with amusement and did not take it seriously.

A diverse industry with little regulation

Price had worked as head of the investment management department at Baltimore-based brokerage house Mackubin, Legg before he decided to go it alone. Alongside Mackubin, Legg, companies like Alex Brown and offices of Merrill Lynch also looked after assets for clients. However, exclusive asset management, as we know it today, was not yet a thing. In general, it was a highly mixed industry with banks, brokers and individual advisors trying to increase their clients' assets by investing in ways that they thought best.

Marie Walper was Thomas Rowe Price Jr.'s first employee

Source: T. Rowe Price

Until SEC regulations were adopted in 1940, financial services companies were able to operate within a legal grey area without having to disclose conflicts or bad practices. After 1940, the sector underwent a major overhaul. More stringent procedures relating to asset management were put in place to the benefit of clients.

A few years earlier, pioneer Thomas Rowe Price Jr. knew that he wanted to pursue his policy without compromise. He soon hired Marie Walper, who had also previously worked for Mackubin, Legg. She later became the company's treasurer.

Price believed that there was "an inherent possibility of conflict of interest where the same firm both advised clients and handled their brokerage," says a memo from the T. Rowe Price archive. "Generally, Mr. Price did not like the way customers were treated in the industry," explains Emily Davidson, archivist and Brand Historian at T. Rowe Price. For this reason, he developed his own new and untested concept, combining ethical principles, transparency and a good relationship with the customer. In addition, his emphasised long-term profit rather than the 'quick wins' sought by most other companies.

While other firms maintained classic forms of investment advice, T. Rowe Price developed its own 'growth stock' theory. According to Davidson, Thomas Rowe Price Jr. is regarded as the pioneer of this theory and became known widely for it.

Distance from Wall Street

Price founded his firm in Baltimore. At the time, the city between New York City and Washington D.C. was still a thriving financial hub. One of the leading banks in the financial district was the Bank of Baltimore, which later became National Bank of Baltimore.

However, after several years the population fell significantly, and most asset managers moved to New York in order to be close to Wall Street. Price, however, decided to keep his distance and stay in Baltimore. "Mr. Price had a deep suspicion of Wall Street and brokers. He thought that if they really had something worth saying or selling, they'd come down on the train," states a former analyst who joined the firm in 1961.

The industry grows up

Before 1940, asset management had little structure and some participants operated in grey areas. The SEC's Investment Company Act of 1940 helped bring order to a once rather opaque sector. It is now time to continue with the story and look at the flourishing industry in the 1950s and 60s.

Jobs and growing prosperity in the 1950s and 60s

The 1950s and 60s were regarded as the boom years for the US economy. The United States was the world's strongest military power. The economy was growing and the fruits of this prosperity – new cars, suburban houses and other consumer goods – were available to more people than ever before. While the 1950s were also a time of major conflicts, unemployment was low. New jobs were created primarily in the flourishing manufacturing and construction sector.

A small asset management company grows

1950 was also the first profitable year for a small asset management firm in Baltimore that had been founded in 1937: T. Rowe Price. Compared with other asset managers of the period, Thomas Rowe Price Jr. spent longer developing his business's foundations and principles. His cautious approach meant growth took longer but resulted in a more solid firm that was able to withstand financial upheavals better than many competitors.

Thomas Rowe Price Jr., founder of T. Rowe Price, in his car in the 1960s

Source: T. Rowe Price

The US economy made a quick recovery in the 1950s and T. Rowe Price grew its number of clients. Its first investment fund was launched in 1950, and a year later, the firm won its first institutional clients. While it had operated with four employees in the 1940s, T. Rowe Price now employed fifteen people. To keep up with its growing client base, in the 1960s, T. Rowe Price hired an unparalleled new group of research analysts and client advisors. Many of these associates remained with the company into the 1990s.

Modern portfolio theory, diversification and growth stocks

In 1952, Harry Markowitz developed his Modern Portfolio Theory. The main focus of his theory is the concept of diversification. "Markowitz was the first to formalize the measurement of portfolio risk and return in a mathematically consistent framework, which he subsequently expanded. Acknowledging that measuring portfolio risk and portfolio return was only the first step, Markowitz introduced a methodology for assembling portfolios that considers the expected returns and risk characteristics of the underlying assets as well as the investor's appetite for risk. The result, usually referred to as the modern portfolio theory, pushed portfolio construction toward a science and away from being an art," explains François-Serge Lhabitant[1]. Harry Markowitz and his colleagues William Sharpe and Merton Miller won the Nobel prize for economics in 1990.

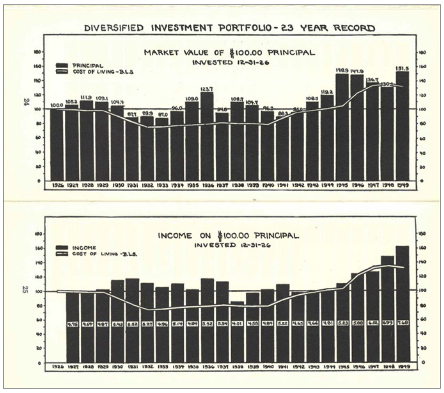
Diversification is now used by analysts at asset management companies to achieve the best return for a particular risk. This risk is defined as yield volatility. While some asset managers have evolved regarding their processes, others – like T. Rowe Price and JP Morgan Chase – still apply this theory and use the concept of diversification as their most important financial management instrument.

In the mid-1930s, Thomas Rowe Price Jr. developed his Growth Stock Theory. A growth stock is defined as one "anticipated to grow at a rate significantly above the average for the market." Such stocks "generally do not pay dividends, as the companies usually want to reinvest any earnings in order to accelerate growth."[2] This theory made Price famous throughout the industry, explains Emily Davidson, Brand Historian at T. Rowe Price.

International expansion? Not yet

Between 1950 and 1960, T. Rowe Price continued to grow at a slower pace than competitors like Alex Brown and JP Morgan Chase. However, this approach was intentional from T. Rowe Price's leadership. Their focus was on long-term growth, rather than short-term gains. In 1960, they saw the right opportunity to launch a second fund, ten years after the first. Although T. Rowe Price had a five-person office New York City, the company's leadership decided to leave the firm's head office in Baltimore. They saw no need for further expansion at that time. As with the ten-year gap between the launch of the first and second fund, it would take another decade before T. Rowe Price looked to grow abroad.

In 1950, Thomas Rowe Price Jr. explained his investment strategy and research processes



Source: T. Rowe Price

Foreign expansion

Although the US economy boomed in the 1950s and 60s, the 1970s and 1980s experienced periods of rising inflation and unemployment. Despite this, asset management and the finance industry continued to develop, and firms looked to grow internationally.

Before 1971, the annual inflation rate in the USA had never exceeded 1.6%. However, the latter half of the 1970s was completely different. Influenced by the oil price shock of 1973, economic growth in almost all parts of the world

[1] https://seekingalpha.com/article/4025094-emergence-contemporary-portfolio-theory
[2] Investopedia

suddenly slowed down. This trend continued well into the first half of the 1980s. In the USA, the annual inflation rate continued to rise, exceeding 10% in 1974. The annual inflation rate reached a similar level again in 1979, 1980 and 1981 and even more people lost their jobs. By 1982, the unemployment rate in the USA was 10%.[3]

Back in 1970, Thomas Rowe Price Jr. predicted in an interview with the Baltimore Sun that in his opinion “accelerated inflation will be the biggest problem for both the nation and investors in the 1970s.”

Discovering new markets

“It is hard to imagine today [but] in the early 1980s, US clients imagined investing overseas as a highly risky and unusual, if not outright dangerous, notion” explains now-retired David Testa, former Vice President at T. Rowe Price, “yet it was clear to us that the merits were compelling.” In 1979, with USD$6bn of assets under management, T. Rowe Price expanded internationally, founding a joint venture with British bank Robert Fleming Holdings. The joint venture was named Rowe Price-Fleming International (RFPI).

While the total number of associates at the company rose from 160 in the 1970s to over 1,000 by the end of the 1980s, the number of associates outside the United States remained low. The entirety of RPFI (London, Singapore, Tokyo, Hong Kong) had about 20 investment professionals at its highest and was dedicated to collaborative international investment research. According to Davidson, “all the investment professionals of RPFI remained with the company through its buyout in 2000 and conversion to T. Rowe Price International.”

Other asset managers also saw the potential of investing internationally. For example, JP Morgan founded a joint venture in Asia in 1970, and in 1973, HSBC began managing assets in Hong Kong, Singapore, Sydney, Tokyo and London. David Testa notes that “many early competitors tried out the joint venture approach, but Rowe Price-Fleming was the only one to achieve meaningful and lasting success.” Funds developed at the Baltimore-based asset manager’s London office included the International Bond fund and the International Discovery fund.

Important political changes

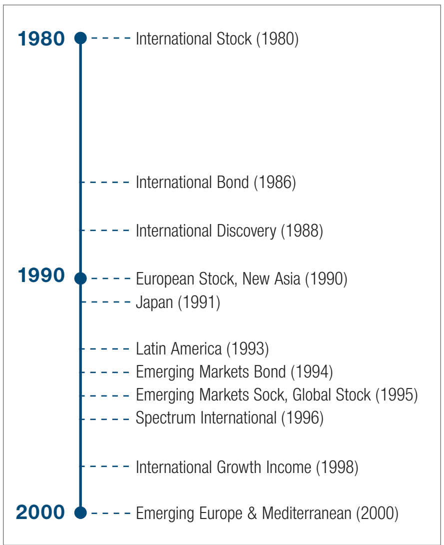
With the Cold War forming part of the backdrop, the 1980s was a decade of change. On 4th January 1980, President Jimmy Carter announced an embargo on the sale of grain and high technology to the Soviet Union. The embargo was a reaction to the Soviet Union’s invasion of Afghanistan. One year later, President Ronald Reagan took office and the biggest ever tax cut– part of the so-called ‘Reagan revolution’ – was passed by both houses. As a result, taxes fell over the next five years by more than USD$750 bn.

The political situation created opportunities for asset managers to grow their client bases and develop their businesses at home and abroad. Countries in Africa and South America whose economies had suffered under the recessions of the late 1970s and early 1980s began to recover. The economies of large Asian countries that had shown themselves to be resilient during this time saw a return to stronger growth. In Europe, the Berlin Wall separating East Germany from West Germany finally came down. New markets opened all over the world, bringing investors more opportunities than ever before.

T. Rowe Price’s head office in Baltimore, taken in 1986

Source: T. Rowe Price

Funds launched during the joint venture with Robert Fleming Holdings



Source: T. Rowe Price

[3] http://www.dollarsandsense.org/archives/2009/1109reuss.html

Turbulent times

"While the 1970s and 1980s witnessed important events and changes, the financial market experienced turbulence during the 1990s and 2000s that continues to influence legislation and proceedings today. Some companies were rocked by the fallout, while for others, it demonstrated the value of prudent risk management and fundamental research.

The structure of asset management in the 1990s

The 1990s was a good decade for investors. Bonds, equities, as well as private equity and hedge funds achieved consistent total returns.[4] CAPM (Capital Asset Price Model) and Harry Markowitz's Modern Portfolio Theory dominated investment strategic thinking and in 1990, Markowitz received the Nobel Prize in Economic Science (even though he developed his theory in 1952). In terms of trading, the 1990s experienced one of 'the greatest' bull markets and in February 1997, the Dow Jones Industrial average was pushed above 7000 points.[5] The industry's structure, however, remained focused on traditional asset classes with equities and bonds at the forefront and little attention paid to alternatives.

Asset management and digitalization

During the 1990s, technology came to the fore, not only in operations but also for the client experience. Corporations changed their procedures from paper based to 'virtual' and asset management firms started to build up their online presence as more and more clients gained access to the internet. In 1996, for example, T. Rowe Price launched its corporate website. Almost at the same time, the firm surpassed USD$100bn in assets under management (AUM).

An industry faces its downfall

While the 1990s were a decade of excitement, the new millennium brought widespread change to the financial industry as excitement turned to greed. Many firms chased momentum and turned to unethical practices for easy profit. Others, such as T. Rowe Price, rejected this approach to what seemed like their detriment.

In 2000 and 2001, excessive speculation around the internet sphere came to an abrupt halt with the so-called dot-com crash – or the bursting of the New Economy bubble. Despite widespread mockery from investment peers and the media for its contrarian stance, T. Rowe Price had refused to follow what it saw as a dangerously overpriced fad. This belief was vindicated when the market crashed. The firm's Science and Technology Equity Strategy shrank from USD$12bn to USD$3.2bn[6] but this strategy, and many of the firm's other products, were better protected[7] because they had avoided the dot-com hype.

In 2008, Lehmann Brothers, a global bank, collapsed. This event almost brought down the world's financial system. Economies around the globe were faced with the worst recession in 80 years. It was only because of massive monetary and fiscal stimulus that another 'Great Depression' like that of 1929 was prevented.[8]

But how did the financial crisis effect the asset management industry?

The global value of professionally managed assets declined by 18% during the financial crisis to USD$48.6trn.[9] Investors fled asset classes they considered too risky, illiquid or nontransparent – a major example were hedge funds. Instead, investors focused on asset classes they perceived to be safer, such as ETFs

The heads of T. Rowe Price in the late 1980s

Source: T. Rowe Price

The 1990s witnessed one of the strongest bull markets in history

The financial crisis of 2008 made headlines around the world

[4] https://www.ubs.com/content/dam/static/asset_management/global/Evolution-of-the-asset-manager.pdf
[5] https://www.nytimes.com/1997/03/31/business/analysts-say-1990-s-bull-market-faces-its-toughest-test.html
[6] BusinessWeek
[7] **Past Performance is not a reliable indicator of future performance**
[8] https://www.economist.com/schools-brief/2013/09/07/crash-course
[9] Boston Consulting Group

(ETFs were one of the products that benefitted from the financial crisis). On top of shrinking assets under management, confidence in the asset management industry was hurt badly. Investors were concerned about dubious advice, poor risk management and even fraud in some cases.

The situation was different for T. Rowe Price. Once again, its investment professionals had refused to follow the pack and the company was ahead of market conditions when the crisis broke. Nevertheless T. Rowe Price's AUM was reduced from USD$400bn in 2007 to USD$276.3bn in 2008 due to battered markets around the world. Despite its drop in AUM, the company maintained its strong balance sheet and had no liquidity issues. They even hired people during the crisis, while others pulled back.

Susan Troll foresaw the 2008 financial crisis in 2006

Source: T. Rowe Price

T. Rowe Price saw a potential crisis brewing as early as 2006, thanks to Susan Troll, a fixed income credit analyst still with the company. Her rigorous research helped the firm to distance itself from the subprime credit market and take measures to reduce exposure to other risks as well. In a 2008 interview with Kiplinger, Troll stated that she recognized a lot of 'red flags' with regards to the subprime market.

"The subprime market was so irrational that a huge correction was absolutely necessary," Troll said. What surprised her however "was the speed and severity of the downturn." When asked why others found it so hard to see the risks, Troll explained: "some people saw it coming. But it's hard to pull back from a market that's booming."

A look ahead: The renaissance of active investment strategies

Growth of passive investing

Since the financial crisis, one of the most striking developments has been the increasing popularity of passive investment strategies. "This is easy to understand" says Yoram Lustig, T. Rowe Price's Head of Solutions, EMEA. "Passive investment strategies are relatively simple to handle, since they do not require the same effort as the search, selection and monitoring of good portfolio managers. In addition, their costs are generally lower than for active funds. Perhaps most importantly, passive strategies have delivered strong performance over the past decade as asset prices have rallied since the financial crisis." However, one should bear in mind that the high returns of passive strategies were primarily fueled by the quantitative easing of central banks. Ultra-low interest rates combined with trillions of dollars of fresh money have led to a valuation increase since 2008.

The return of volatility and dispersion

In Lustig's view, this phase is "almost certainly over. Volatility and performance differences between different sectors and securities is likely to reappear as soon as the impact of quantitative easing recedes, taking away markets' artificial support." This environment should offer good asset managers the opportunity to select investments with above-average performance - especially as active strategies can benefit from rotation within and between asset classes.

The future role of active and passive strategies

It is often suggested that passive strategies form the core of a portfolio and that active investments are used as satellites. In the future, the opposite may be the case: Active approaches allow the core area of the portfolio to be used optimally, whereas passive approaches could be used for thematic satellite investments. These developments will become clearer over the next few years.

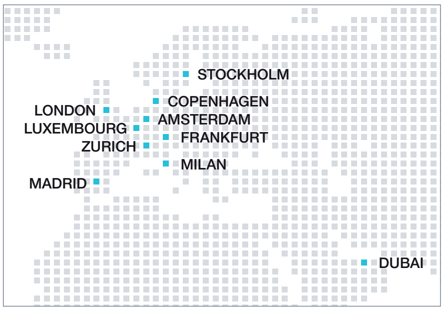
T. Rowe Price today in EMEA

T. Rowe Price began in 1937 as a small public limited company with just a handful of employees and by 1970 had around USD$6 billion in AUM. Beginning in 2000, T. Rowe Price committed to steady expansion in Europe despite the volatility and fallout of the dot-com crash later that year. It opened a Copenhagen office 2001, then Amsterdam in 2004, Luxembourg in 2005, Zurich in 2008, Stockholm in 2010, Milan in 2014, and Madrid and Frankfurt in 2015. Today T. Rowe Price manages more than USD$1.1 trillion for clients in 47 countries around the globe.

Guided by the same principle for over 80 years

But why do European clients continue to trust a Baltimore-based asset manager? "The principle on which Thomas Rowe Price, Jr., founded the firm in 1937—that his company's success should follow from the success it achieves for its clients—continues to guide us today." Says Brand Historian Emily Davidson. "Our disciplined investment approach is rooted in proprietary research carried out by experienced professionals around the globe. To this approach, we bring a deep understanding of client needs and a long-term view that balances risk and reward, and we nurture a culture that encourages collaboration and diverse thinking."

T. Rowe Price's European offices



Source: T. Rowe Price

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