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Gwin Myerberg: 00:00:00 Hello and welcome to the Price-to-Value podcast with Southeastern Asset Management, where our global investment team discuss the topics that are most top of mind for our clients, from a Business, People, Price point of view. We at Southeastern are long-term, concentrated, engaged value investors and we seek to own high quality businesses, run by capable people, at a discounted price to intrinsic value or P/V. I'm Gwin Myerberg, Global Head of Client Relations and Communications. On today's podcast, Southeastern's Vice-Chairman, Staley Cates interviews Jonathon Jacobson, co-founder, chief investment officer and CEO of Highfields Capital, and a long-term friend and highly respected peer of Southeastern and client of the Longleaf Partners Funds. They discuss Jonathon's decision to close Highfields in 2018, share war stories and talk about the current environment and their

		outlook for value investing. We hope you enjoy the conversation.
Staley Cates:	00:01:00	Hello everybody, and thanks for joining us. Today it's both an honor and a lot of fun to welcome Jonathon Jacobson as our guest. It's an honor because he's a Hall of Famer in the investment world with an incredible track record over several decades at both Harvard and then at Highfields, which we'll talk about more later. But it's also a lot of fun because he's a long-term close personal friend and he's been a great ally to Southeastern and Longleaf over the years.
Staley Cates:	00:01:27	As far as the more official bio, Jon who goes by, sometimes Jonathon, some call him Jon, his great friends call him Jake. I've heard him called a lot worse than any of that, but for this G-rated family podcast, I'm not going to say those names. But he was the co-founder, chief investment officer and CEO of Highfields Capital from 1998 until 2018, when they returned their outside capital to investors, which at the time was about $10 billion.
Staley Cates:	00:01:57	Prior to founding Highfields, Jon spent eight years as senior portfolio manager at Harvard Management Company, which is responsible for investing Harvard's endowment. He's been on a whole bunch of big shot boards. Do I have to name all your big shot boards?
Jonathon Jacobson:	00:02:12	Nope.
Staley Cates:	00:02:13	Okay. Probably most importantly though, Jon and his wife, Joanna, are co-trustees of the One8 Foundation and are involved in numerous philanthropic causes, which he will talk about some, hopefully, coming up. He got his MBA from Harvard in '87, and he got his BS from Wharton in '83. And then as far as, on the more personal part of this bio, as far as how far we go back, we were talking about this earlier today, but I'm going to age myself as old as dirt when I convey that.
Staley Cates:	00:02:44	When I started 35 years ago, we had these William O'Neil red books, pre-computer, which you would go

through to check out the shareholder registry of who else owned the stocks we were in. And the biggest overlap that we had was the Harvard Management Company. And I did not know Jon at that time. And I think he was seeing the same thing in terms of overlap from his side. And so we were both asking about each other and a point of overlap with Seth Klarman. Seth was on a couple of boards that were clients of ours, and he's a very good friend of Jon's.

Staley Cates: 00:03:18 And so he introduced us and we hit it off, stayed in touch, and that level of overlap remained over ensuing decades. I think it's been great for our clients and for his clients as we would compare notes on things, and we had some great overlap, happy stories that Longleaf holders may remember like De Beers, Horsham, Cable One. And then we had some that were not so great where we worked together on stuff like Money Group and Dell. Money Group was interesting because Southeastern and Highfields filed a group 13D, which was very rare for all of us and something we're not wild about but thought was necessary at the time.

Staley Cates: 00:04:01 But anyway, all those years also gave me great therapy through the friendship and sanity checks through comparing notes. So thank you for being here.

Jonathon Jacobson: 00:04:12 Staley, it's an honor to do this and to be here with you. And thank you very much for that really nice and lengthy introduction, which my only takeaway from it or my two takeaways from it are number one, it just makes me feel really old.

Staley Cates: 00:04:26 Well, you are.

Jonathon Jacobson: 00:04:27 And number two, the mention of Money Group and Dell amongst other things, it just gives, I feel like I've got PTSD. I hadn’t thought about those in a long time.

Staley Cates: 00:04:39 Well, sorry I brought them up. So I guess place to start is when you closed Highfields there was an article in the Wall Street Journal titled, ‘Twilight of the Stock Pickers’. Value was already kind of on the ropes, there was a lot

about that stuff. Within that article, your quote, and this was a front page thing with your mug on it. But one of your quotes was, "I wasn't having fun." So tell us about the closing of Highfields and then tell us, are you having fun and how are you spending the time, and will you touch on personal and philanthropic and business?

Jonathon Jacobson: 00:05:15

Well, first of all the article ... Since I don't talk to the press and really never have. The article, somehow they got ahold of the letter that we sent out to our LPs, and that was one of the quotes in the letter. So it was accurate. It was a really hard decision. I mean, I had been in the investment business for 35 years at that point. So having spent 30 years managing other people's money. And as you and Mason and the entire Southeastern team knows better than anybody else, I mean managing, being a fiduciary for others is a 24/7, 365 day a year job. And it's a great honor. And it certainly was for me to have the roster of clients that we had over a very long period of time, but I was just really tired.

Jonathon Jacobson: 00:06:07

And I think two of the quotes I had in that letter was that number one, I wasn't having fun anymore. And number two, I had sat in front of a screen for 35 years and I didn't want to spend the next five or 10 or 20 years doing the same thing. Our mutual friend, David Abrams, when I had a conversation with him about it after this when I told him exactly what I was feeling. He said, "Look, I totally get it. If you can't make a commitment for five years, I think it's hard to make a commitment for five minutes." And at the time I made the decision, I had a handful of key personnel decisions I had to make. It was something that I had been thinking about for a long time in terms of stepping back.

Jonathon Jacobson: 00:06:52

And I ultimately just came to the conclusion that the succession plan that I had carefully worked on for when the day was going to come, where I was going to try to ease out of the business, just wasn't going to succeed for a variety of reasons that we can talk about or not. I don't think it's that important. And at the end of the day, I just thought it was better for everybody to do

		what we did. I thought it was in the best interest to the clients, and I actually thought it was in the best interest of the employees to do that. Now, you mentioned value investing and was the fact that growth had outperformed value and value investing been out of favor seemingly forever. Was that a factor? I mean, it's hard to say it wasn't, but that wasn't really the reason I made the decision that I did.
Staley Cates:	00:07:39	How about on a decision that big, did you have regret coming after that or either shortly after or later, or was it more like opposite immediate peace or what were the feelings in the wake of it?
Jonathon Jacobson:	00:07:56	Well, I made the investment in October ... I made the announcement in October, sorry. And at that point we had ... It's a really tough thing to do. We had close to a $12 billion portfolio. Wall Street is a tough place and there's lots of sharks in the water, and it's very hard to keep a decision like that secret. And it's very hard to do it internally, also, because there's all sorts of compliance issues. And it was tricky for me because with 100 people in the firm, if employees generally get wind of it, that means other people are going to get wind of it, and people will shoot against us, which is ultimately bad for the clients. Because we had to sell a lot of stocks and ...
Staley Cates:	00:08:52	That would be a terrifying factor.
Jonathon Jacobson:	00:08:54	And so I was trying to thread this needle of putting a plan in place that was going to do the best job as a fiduciary for the clients. And what we did was we raised, I don't know, 25 or 30% cash prior to me making the announcement, which was reasonably easy to do in the marketplace, it was less easy to do, to not signal to banks and our counterparties and all that, that it was anything other than normal course of business. And then once we made the announcement in October, I made it clear that we didn't have a gun to our head and that we were going to sell stuff judiciously over the next nine months. And we'd raised a lot of cash so that we weren't ... I didn't think we were going to be that

vulnerable to essentially people attacking our public holdings.

Jonathon Jacobson: 00:10:03 And then I spent the ensuing nine months both working on that liquidation plan, creating transition plans, helping people find jobs to other things. So, to answer your question in a very long-winded way I was sort of all in the next nine months after I made the announcement, I was probably working harder than I was working before. And I really didn't have a chance to sit back and think about, "Did I make a mistake, am I relieved?" I don't know, I was just very myopically focused on doing the best job I could for both the employees and more importantly for our clients.

Staley Cates: 00:10:45 How about the use of time now, how are you dividing between personal and philanthropy?

Jonathon Jacobson: 00:10:51 As part of this whole process, when I made the decision I really didn't know what plan B was or what the next act was going to be. But what I did know was I wanted there to be a next act. And some of my mentors and my role models, essentially, frankly the happiest and healthiest people I know, and we were talking about this earlier at lunch, are people in their 70s and 80s that are still working in some way, shape or form. They have a reason to get up in the morning, being in the game is better than being out of the game. And I didn't want to be another "rich retired guy," who would play golf five days a week. I thought that would get boring very quickly. And at 58, which is what I was when I made the decision, I felt like I was young enough that I could do something for 20 years or 25 years.

Jonathon Jacobson: 00:11:43 And I wasn't quite sure what that was. I didn't know if it was going to be non-profit, I didn't know if it was going to start a business. But I didn't want to sit in front of a screen. It was literally that. And the other issue that I had, which is certainly a high class problem, is that for the prior 30 years, my net worth, my family's net worth and a big chunk of our foundations net worth was invested in Highfields funds. And so my day job, I didn't have to worry about sort of financial planning or as a

fiduciary investment returns because it was homegrown. As a result of the funds being liquidated, I had the high class problem of now having a pile of cash because I got back cash just like everybody else when we sent the money back.

Jonathon Jacobson: 00:12:38 And so I had to set up a family office and figure out what I was going to do. And I didn't quite know exactly how involved I wanted to be because it was somewhat path dependent on what I decided to do otherwise on a full-time job. But I'd seen a whole bunch of family office models and certainly liked some better than others. And so I needed to figure that part of it out. I guess the silver lining of COVID is that for the better part of the last year I've spent a fair amount of time or close to 100% of my time actually getting that money invested which, both because there was nothing else to do and also because there was a lot of opportunity in March and April and even May of last year, it became incredibly interesting and somewhat fun again. Just from an investment standpoint, COVID obviously has been no fun and the lockdowns have been no fun and not being able to travel has been no fun.

Jonathon Jacobson: 00:13:40 These again are high class problems and don't even begin to reflect the difficulties that most people in society have had as a result of this.

Staley Cates: 00:13:50 Can you talk about y’all’s Foundation work? I think our listeners would like to hear, and it's incredibly interesting to me.

Jonathon Jacobson: 00:13:55 Yeah. We have a family foundation called the One8 Foundation, which is run by Joanna, my wife, and we've got 22 incredibly dedicated staff people. And philosophically, I mean, Joanna and I agree that it's easier to make money than it is to give it away effectively. And that so much of philanthropic dollars, not for lack of good intentions, ultimately are wasted because the outcomes are just not worth the investment. And so our philosophy has been, and we have a whole bunch of former management consultants. So our foundation is both a grant maker,

		but it's also a sort of pro bono consulting firm where we work closely with our grantees on the strategic planning and measurement outcome to try to effect change that is systemic essentially in the areas that we're interested in.
Jonathon Jacobson:	00:14:56	Roughly half the money we give away on an annual basis goes broadly speaking to Jewish causes and the other half to secular things, but primarily focus in the education space. And we were talking at lunch earlier and I think across the board, in terms of everything that we're doing, I felt really good a year ago about some of the programs that we were doing, some of the results of the things that we're doing, changes that were being implemented particularly in the education space in Massachusetts. And I'm so disheartened because I feel like COVID has really overwhelmed our ability to make a difference. That the long lasting problems of remote learning and kids not being in school for a year is not something that is going to take a year to repair.
Jonathon Jacobson:	00:15:53	I mean, I think these kids are going to be impaired for a long time and yeah, at the margin is a good to be putting in math and science programs in middle schools across the state of Massachusetts, particularly in areas where the school systems aren't good. Yeah. It is. But is that being overwhelmed by some of the other issues? Yeah, I think it is too. And it's actually quite tragic.
Staley Cates:	00:16:20	Now that you've had some time away from closing the fund down, going back to the investment side, what are your insights or thoughts or reflections as you look back, and there is some distance between being at the screen every day, what are some of your takeaways or thoughts?
Jonathon Jacobson:	00:16:42	It's amazing how, when you're out of the day-to-day, how much clarity you have. The things that seem so obvious in hindsight that aren't really obvious when they're right in front of you. If I look back on the investment mistakes that we made and we made a lot of them both in Highfields and in Harvard over a long period of time.

Staley Cates:	00:17:09	That's weird. We've never had any mistakes.
Jonathon Jacobson:	00:17:11	They were almost uniquely characterized by errors of omission rather than commission. And in every case ... Well, not in every case, the biggest mistakes we made was selling something too soon. And I actually never forget when I first met you and Mason, and this is again close to 25 years ago. Something that Mason told me in that conversation or our conversation shortly after we met stuck with me for a long time. When he was explaining the Southeastern philosophy about, "We want to buy 50 or 56 cent dollars and sell them at 100 cents, and then go take that money and find the next 50 or 60 cent dollar."
Jonathon Jacobson:	00:18:02	The problem with that as Mason articulated is, is that you don't ... It's not glaringly obvious that when you sell something that there's another 50 or 60 cent dollar at the time to redeploy the money. And for better, for worse, I think that's what we tried to do at Highfields for 20 years. And our track record was good. But had we not sold those 100 cent dollars and hung onto the good companies that we were really fortunate enough to have bought for 50 or 60 cents, because there was some disconnect in the marketplace versus what the consensus was, or they had some legal issue or some structural issue, or made some bad capital allocation decision, these good businesses compounded equity at whatever 10, 15% a year over time. And the power of compounding is just enormous.
Jonathon Jacobson:	00:18:55	And so, I mean, a perfect example is ... I mean, we bought Microsoft almost near the lows right before Ballmer got fired. And I think we bought stock in the high 30s and a year later it was at 60 and there was all this speculation of who they were going to hire for the CEO. And a bunch of the activist, shareholders didn't want Satya who turned out might be one of the best CEOs in our lifetime. And anyway, well, we saw the stock in the mid to high 50s and took a victory lap because we thought we were geniuses in that it was a 100 cent dollar. I mean, Microsoft today is a four bagger, they're, they basically have a monopoly or near monopoly in

their two biggest businesses. And they're going to compound earnings for 15 or 20% for as far as the eye can see. And that's just a perfect example of that.

Jonathon Jacobson: 00:19:55 And so I think had we just focused on buying good companies at a discount and been disciplined enough to wait because you do get those opportunities and you named a bunch of them earlier. But we've had overlap on lots of other ones too. And just let them compound, we just make it way too complicated. There's a really famous guy that if I mentioned his name, everybody who's listening to this podcast would know, he's an American icon who's a really wealthy guy, who's a friend of mine I'm happy to say. Who some 40 years ago sold a small device company to Eli Lilly for stock. And this guy I'm talking about has never sold a share of Eli Lilly stock in 40 years. And he gets up at 4:00 in the morning every day, but particularly every quarter they report earnings and he listens to the earnings calls, and he could tell you chapter and verse about everything that's going on in Eli's business. And they've been through good managements and bad managements, and they've been through good parts of their R&D cycle and droughts in the R&D cycle.

Jonathon Jacobson: 00:21:17 And the pharma stocks have been in favor and out of favor, but for 40 years, he's never sold a share. And he's the largest single shareholder of Eli Lilly. And he's a super-rich guy and people know where he's made his money, but people don't even know he owns this stock and this stock is probably worth more than all the money he's made put together in his life. And that in and of itself is sort of my big takeaway of what would I have done differently if I could have. Now, the bottom line is, is that, look, we've been in a 35 year bull market for stocks and interest rates have gone from 15% to two and we can talk about that later.

Jonathon Jacobson: 00:22:07 So that's obviously been a huge tailwind. So clearly there are some sort of backward looking aspect to this that you never should have sold something because everything went up. But if I think about all the mistakes that we made, where we lost money, we sold what we

thought were 100 cent dollars to redeploy in what turned out to be cigar butt businesses, which were structurally challenged. And so that's my big takeaway.

Staley Cates: 00:22:41 That rings so true with our own retrospectives or postmortems or whatever, in that as we try to spend time looking back on names and the mistakes and all that, it's so consistent and that we think we've done overall a good job on the buying side. But as we graded ourselves on selling, not so great. And I'd give Ross credit, Ross was a breath of fresh air on, "Let's be more careful as we sell, let's do more work about it." Because there's so much intensive work on buying anything at all of our shops. And then if it hits a target, you're inclined to say, "Oh, it hit it." Instead of the same kind of rigor on, "Should we sell it?" Anyway, long winded way to agree. Morphing to big themes of the day. Talk about, you mentioned it a second ago, but value versus growth. How do you see that? If there are such labels.

Jonathon Jacobson: 00:23:36 I'm not sure I'm going to have any sort of unique insights into this. I think even the great value investors, our sort of role models in that world, would acknowledge that traditional measures of value versus traditional measures of growth have morphed. And if you separate the world into companies that trade at sort of low price earnings multiples or low book value multiples versus things that have no book value and less in intangible assets. I think what you're really identifying is businesses that are capital intensive versus ones that aren't. And I think Buffett sort of alluded to all of this actually in his most recent annual letter.

Jonathon Jacobson: 00:24:36 And I don't think that you can look at a valuation of a company based upon earnings multiples or EBITDA multiples or whatever, and say, "This one's value, and this is growth" necessarily because lots of companies have intangible assets and they also have durable cash flows. I mean, if you think about the whole concept of trying to buy businesses that have a moat where ... Essentially what you're saying is that they're going to be able to have an enduring cash flow profile for as far as

the eye can see and actually grow that. And historically the companies that Berkshire Hathaway is invested in with those moats have been consumer facing companies. You think about Coca Cola, you think about Gillette, you think about Procter & Gamble, those things that Buffet could understand. But the reality is they were essentially bonds that grew.

Jonathon Jacobson: 00:25:35

They had predictable cash flows that grow. Now there's lots of companies that aren't necessarily characterized as value companies that have the same cash flow characteristics. And I think one of the biggest mistakes we made, we, Highfields, and I think some of the biggest mistakes that people of our generation, who are considered like the best value investors and friends of ours, have made is that we essentially decided that technology was too hard. And we completely missed, we, Highfields, completely missed the durability and the intractability of these vertical market software businesses. And people have made a fortune figuring out, and Larry Ellison is essentially the original guy that figured out that once the software gets embedded in an enterprise, it becomes very difficult to take out.

Jonathon Jacobson: 00:26:39

And that you have enormous pricing power because it's a relatively low cost and the disruption risk of substituting something else is relatively hard. I'm sort of jumping around a bit, but I think about a big investment and a very successful investment that Southeastern has had over the years, probably a couple of different times is FedEx, right? If you look at FedEx and think about how much money they've invested, both in terms of technology and also in terms of building both their ground network and their air network, it's almost irreplicable. And that's an intangible asset that partially shows up in book value, but not necessarily. So the question is does that make FedEx a value stock or not, and how do you think about that in tangible assets they have in terms of valuing it? Is it a technology company?

Jonathon Jacobson: 00:27:51

I just think there's been so much convergence that I think that class ... And if you look at whatever the sub-indices, the S&P value and the S&P growth, it's

somewhat arbitrary. Someone's making a decision that this one should go in this column and the other one should go in this column. I'm just not sure it's so obvious anymore that there's differentiation.

Staley Cates: 00:28:11 How about another raging theme would be active versus passive?

Jonathon Jacobson: 00:28:16 What's the question?

Staley Cates: 00:28:18 What do you see happening? Do you see ... I have one question within the normal, which is, I feel like passive is further along than usually acknowledged when you do the numbers on here's what index penetration is. I think sometimes that misses shadow indexing and ETFs, and some other stuff. I feel like indexing has a way higher penetration than is typically advertised. But that would be a sub question within the ... Will that movement continue to ... Will passive keep chewing up active?

Jonathon Jacobson: 00:28:48 Yeah, that's a tough one. I've actually thought about this a lot. I think it goes in cycles. I mean, intellectually, you can look at data and say, "Active managers underperform. And so why try." It's a lot cheaper to index. And so if you replicate the market, you know passively that over time, you're going to pay less fees, and you're also less likely to ... I mean, you're not going to underperform, but if you pick only active managers, you're more likely to perform. It's a little bit like playing Blackjack, right? If you go to a casino, you play Blackjack for three hours, you can win, but the longer you play, there's no question that no matter how good you play, that you have an edge. And so if you look at the active managers as a euphemism for trying to play Blackjack against the house, the data would suggest that you're better off indexing.

Jonathon Jacobson: 00:29:44 Now, the paradox is that the more money that's indexed, which has no fundamental approach to analyzing companies, then the more inefficiency there is out there, right? And so it seemed to me that when you get into these hyper trends of money going one way or the other, going into active versus going to passive, it

should almost be mean reverting. And there will be a period of time after when people give up on trying to pick stocks or short stocks and do whatever that there's market inefficiencies. And then over time, you're going to get paid for doing fundamental research. And then once people give up on active management again, and then the competition becomes more intense to do fundamental research, then it becomes a tougher game and the managers as a whole are going to underperform.

Jonathon Jacobson: 00:30:41 I mean, I sit on a whole bunch of investment committees and we have these debates all the time is, if we know that picking active managers is generally a fool's errand, like in what asset classes do we try to do that? And how do we figure out which? Where we're willing to say, "We really think that this manager can exploit these inefficiencies, and this is what their edge is and why." This was a big institutional focus when I worked at Harvard Management and my boss, Jack Meyer, who's a famous guy and a wonderful investor was really skeptical when he came to Harvard about active management, fortunately we converted him.

Staley Cates: 00:31:22 Don't you think that committee mindset has kind of given up, especially on US large cap? I feel like the plan sponsor in endowment world, if they are going to pick a spot where they're going to try to be active, I think the last place that it is, is US mid to large cap. Would you agree with that?

Jonathon Jacobson: 00:31:38 I think that's right. I think the only other place where they've given up more is maybe in vanilla fixed income, but I think the more liquid the markets, the more the willingness of committees to give up. And if you think about the committees they generally try to focus ... By the way, and I'm not sure they've done so well on a relative basis. But they focused on venture and private equity and real estate used to be commodities, but that was out of favor and look how they've done. They've done so well in the last year and a half because nobody wants to own commodities anymore. But it's just how it goes, as you know.

Staley Cates:	00:32:18	So we all grew up with Buffet and Graham and other kind of patron saints of investing and it's well known, how Buffett's philosophy kind of morphed from buying the Ben Graham, net net junkie, quant bargains, to caring more about the business and the characteristics more than maybe the going in price per se. Just evolutionary thought in his philosophy. When you look back on your 20 years, did you have any ... I don't mean of that specific example, but did you have parts of your investment philosophy where you said, "This really morphed over the 20 years, and this looked really different in year 20 than what I thought in year one?"
Jonathon Jacobson:	00:33:01	Yeah. I mean, I talked about a little bit earlier. When we just talked about trying to buy ... Paying a little more, but willing to stay with better companies which is not that dissimilar to the analogy. Not that I'm comparing myself to Buffet. But when I started out in the business, I mean, I was an arbitrage guy. And I really cut my teeth on, before I went to Harvard, at Lehman Brothers, as a trader focusing on option arbitrage and merger arbitrage. And trying to create a portfolio of essentially cheap options. And if you think about investing in a net-net, I mean, isn't that the ultimate cheap call option, right? You're buying something where you've got limited downside, because you know what it's worth worst case. And you've got the opportunity for the business to be worth more than the market's value.
Jonathon Jacobson:	00:34:01	I mean, in a way this SPAC meeting, which we can talk about, it's a similar analogy, right? If you're investing in a SPAC where worst case in two years, you can have your money back, your option, and you've got some warrants to compensate you for giving your money for two years in a zero interest rate environment. Like what's the opportunity cost of that? As long as you're disciplined and have the ability to evaluate whatever businesses they decide to buy and vote against the deal. So, we morphed away from that. And I think into buying better companies and looking for what I would call it is sort of value in catalyst.

Jonathon Jacobson: 00:34:51

But to a point I made earlier, we just didn't spend enough time on technology and technology broadly speaking has become such a large part of the market that if you're going to be an active manager, I mean you can't just say, it's too hard. Because essentially if you're not going to invest in technology stocks whether you underperform or outperform is going to be purely a function of how they do. I mean, there's no way to overcome what the FAANG stocks have done, the five FAANG stocks or whatever, 24% of the S&P if they do well and you don't own them, there's no way you're going to outperform. And if you don't own them and they do poorly, you're going to outperform almost no matter what you do. And I'm not sure that most active managers of our generation actually really think about it that way.

Staley Cates: 00:35:48

Well, let's do segue into SPACs. I bet you're buying tons of SPACs, I bet you're trading a lot of GameStop back and forth. Now, can you talk about SPACs, retail craziness, GameStop, all that stuff, how you see that and related actually, is the concept of shorting? And especially in the GameStop scenario that was a big, hot topic. I personally feel like, lost in the shuffle, was proper shorting to me is the best regulator a market can have. And one of the greatest stories ever was you guys on Enron, and I wish you would tell that quickly, but talk about the real role of shorting versus when it's abused. And then talk about a GameStop world and a SPAC world.

Jonathon Jacobson: 00:36:40

Let's start with GameStop and Robinhood broadly speaking and retail, which I think is a mania, which in many ways is more excessive than what we saw in 1998, '99. My late great partner, Richard Grubman used to always say that, "You're entitled to your own opinion, but you're not entitled to your own facts." And that used to be true. It's not anymore. I mean, if you look at the proliferation of social media and the divisiveness of the country in general, everybody's got their own facts. And I think that Robinhood is an extension of that. I mean, when David Portnoy and Chamath, whatever his last name is and Elon Musk can tweet or get on TV and

essentially rig these retail stocks to valuations that are completely unsustainable and nonsensical.

Jonathon Jacobson: 00:37:40 I mean, it's really people are creating them and people that are buying these stocks actually believe it. I mean, they're creating their own facts. It's a revenge of the little guy against sort of the big bad institutionalized Wall Street, investment guys, and the latter need their comeuppance and this is their opportunity to do that. Well, yeah, it could last for a few months, but it's just not sustainable. And to your point about shorting and to your point about market manipulation, there was a story in the Wall Street Journal two weeks ago, or three weeks ago that the SEC was going after two guys from AT&T's IR department about ... In 2016, a week prior to them announcing earnings that they called three analysts and guided the revenues of an unimportant part of AT&T's business lower than what their models were.

Jonathon Jacobson: 00:38:37 And this is what the SEC is choosing to enforce. When right in front of everyone's clear eyes, you have these essentially two-bit carnival barkers on TV promoting and encouraging people to manipulate these stocks that are worthless to stratospheric valuations. I mean, it's so obvious that this is going to end really badly, and then you're going to have all sorts of congressional hearings and the ... I mean, where are the regulators in all this? So this idea that shorting is bad, and so it's okay to go after short sellers and then we can get into a whole discussion as to why it is people have to disclose shorts and short interests being disclosed and all that. And this goes back to obviously the bear rates, back to the depression, but it's totally antiquated.

Jonathon Jacobson: 00:39:28 And shorts provide a rudder and a valuable price discovery process in the marketplace, and theoretically prevent companies from A, outright fraud and B, distorting their capital structure, such that they actually raise money at unfair prices from unsuspecting individual investors. So, I mean, listen, I want to get off my soap box, but I mean, it's going to end the same way it's ended every other time. And the people that can

least afford it are going to end up losing a lot of money. I mean, that's what's going to happen.

Jonathon Jacobson: 00:40:00 We got onto Enron as a short in, I would say, either late '99 or early 2000, it was sort of the Tesla of that era. It was heavily promoted stock. It went from being a sleepy utility essentially to the internet era poster child for a capital light business that they were literally trading derivatives and everything you could think of and that they were printing money and they had whatever 20 consecutive quarters of record earnings.

Jonathon Jacobson: 00:40:35 Anyway, the way we got onto it was a mutual friend of ours, yours and mine Staley, who used to work for me, who was in the energy business. We were having a conversation and he was saying that Goldman Sachs and Morgan Stanley were consistently losing by a lot to Enron for long-term essentially hedging contracts on commodities. The oil companies or airlines or whomever we're trying to hedge your long-term exposure. And Enron was being way too aggressive. I've got a lot of enormous respect for the quants at Goldman Sachs and Morgan Stanley. And if they were losing by a lot, it meant that there was something fishy and we got onto it. And then we started looking through the financials and the earnings that they reported versus the cashflow that showed up in their accusing case.

Staley Cates: 00:41:20 Those were epic, those should be training material for every class ever. The difference between those P&Ls and those funds flows were...

Jonathon Jacobson: 00:41:26 Yeah. Weren't even close. So anyway, the story, I'm going to get into this part of the story where you want me to tell, which is, so we had been shorted for a lot and like every short we had lost a bunch of money because they kept promoting it. And on the first quarter earnings call of 2000 for the first quarter of 2000, which was April something in 2000, Jeff Skilling, who was the CEO at the time everyone's on hold and there's music playing and he starts the call with, "Sorry for the delay. Sorry we’re two or three minutes late." And we were all

just dancing to the music here in the conference room before the comment we didn't realize what time it was. That's how he started the call.

Jonathon Jacobson: 00:42:12

And anyway, so they get to the Q&A, and this was shortly before most companies ended the policy of taking questions from real investors, as opposed to Wall Street, shill analysts, only on their earnings call. My partner Richard asked to call and they went through the whole release was peppered with record earnings, record revenues, record earnings, and they went through their prepared remarks and talked about how on a daily basis they had the best risk management systems and they could tell you to the penny kind of what their exposures were. So Richard asked him a question saying, "If you're so good at risk management and you can tell to the penny, why is it impossible for you to produce a cashflow statement 45 days after the quarter ended?" Because there was no cashflow statement with their earnings release. So anyway, Skilling gave him a snippy answer and he thought the mic was off and he called Richard an asshole. Am I allowed to say that on the podcast?

Staley Cates: 00:43:30

I think you can say asshole.

Jonathon Jacobson: 00:43:33

So he said, "Thanks for your question, and then asshole." There was no Twitter back then, but all of a sudden Bloomberg was like abuzz with the story and this, that and the other thing and that was sort of like the beginning of the end. So just to finish this story, which is really the best part of the story, which most people don't know. So, Skilling gets fired shortly thereafter. I mean, the stock had gone from like a high of 110, and it was probably in the 30s a month after the call. It was probably in the 50s before the call started. And Ken Lay, who was the founder and the chairman, they bring him back to be the CEO.

Jonathon Jacobson: 00:44:15

So he goes on a roadshow, like a non-deal roadshow to go around, to talk to other institutional investors and placate them about, "We've got a steady hand on the wheel and sorry that Jeff's gone, but everything's going

to be fine." And Ken, in my opinion, literally had no idea what these guys were doing. And so they come to Boston and there's a lunch at the Four Seasons Hotel. So Richard and I sign up for the lunch and we get to the lunch. We're coming from different places. He was at a meeting or I was at a meeting. So, we meet at the Four Seasons Hotel.

Jonathon Jacobson: 00:44:47 And we kind of walk in at the same time. And there's a little table in the lobby. And somebody from investor relations is sitting there and they've got all the name tags on the table. So, Richard goes up to the table and he says, "Hi, I'm Richard Grubman." And the woman says to him, "Oh, Mr. Grubman, Mr. Lay has been waiting for you. He wants you to sit with him at your table." Now most CEOs actually wouldn't do that. So, to his credit, and then Ken comes up shakes Richard's hand and I'm standing there watching this. And he goes, "I need you to sit with me." He says, "Because you guys are making a lot of money and I'm losing a lot of money." So, he went there, and I went and sat with somebody else on a different table.

Staley Cates: 00:45:34 Well, hopping to something I wanted to ask you about, which is the setup of a money management organization. You've had your own, you've seen a bunch of others. You've been on the sponsor side. You've been on the endowment side. I think about the two variables of how one hires talent and keeps them and all that on the talent front, and then the process part of guardrails around the talent, as well as ways to take the psychological traps out of investing. Any particular things you feel strongly about on talent and process?

Jonathon Jacobson: 00:46:18 Yeah, it's a really good question. It's something I've thought about a lot. I would say that whatever Southeastern Asset Management does, that's what you should do.

Staley Cates: 00:46:27 That's a great podcast. I like this.

Jonathon Jacobson: 00:46:31 I think this is a really hard one. I think that in general, most founders of investments shops are founders

because they're investment people and the skillset to being a really good investor and the personality traits of being a really good investor, generally don't also lend themselves to being a good manager or running an organization. I mean, they can, but not always. And if you think about to be a good investor, you have to be cynical and independent minded. And in some cases stubborn and thoughtful and patient in certain ways and the people that are good at that or drawn to being in the investment game because they want to make the investments usually aren't drawn to organization building, HR, compliance, client relations, all the things that you need to build a successful brand at any company, but certainly in the investment business.

Jonathon Jacobson: 00:48:05

And so I think as investment firms are successful and they grow in terms of people, they have to morph. And I think it's just some firms and some people have done a better job of that than others. And when I started at Highfields, if I looked at who we would consider our peer group was in the hedge fund world. And these are if you took the top 20 brand names of hedge funds in 1998, 80% of them at that time the founder, the chief investment officer and the CEO are all the same person. If you took the top 20 today you'd be hard pressed to find one or two where that's still the case. And so to build an organization and by definition, you're going to have to delegate a lot of responsibility and you're going to get further removed from either the investment process or from managing the firm process, because everybody's only got so much time. And it's hard. I mean, any growing business is hard.

Staley Cates: 00:49:27

Hopping to interest rates and inflation. Inflation is the raging debate. Is it coming back or not? Fed, blah, blah, blah. The interest rate question of what you're using discount rates, if you're valuing something, how do you approach today's level of rates and inflation and how do you look forward?

Jonathon Jacobson: 00:49:47

Well, the short answer to the inflation and interest rate question is nobody knows, right? Everybody's got an opinion, and nobody knows. It's by far, in my opinion,

the single biggest risk to the equity markets and equity market valuations. And when we started the business interest rates were 10. Long-term rates were 10 down from 16 on their way to two or three. People that have been in the investment business for the last 20 years have never seen 30-year rates above four, four and a half or five. And so when people talk about, "There's not going to be inflation. It's unimaginable.” I just don't see that. I mean, to me, it seems more likely than not that the long-term risk is really of inflation and serious inflation, not 2% inflation like you're talking about versus deflation. If you think about all the money that's been printed in the last year, all the deficits that we have, the fact that we're approaching full employment.

Jonathon Jacobson: 00:51:06

The fact that they're talking about doing another $2 trillion of infrastructure. The process of electrifying everything and going to clean energy means that there's going to be a shortage of raw materials and metals for as far as the eye can see. That there's no new mines being built anywhere around the world and the places with the most reliable mines are in third world countries with confiscatory tax regimes. All the signs to me, and just anecdotally, if you think of the things in your life. I mean, we've gone through a protracted period of deflation because of technology. But I think, is it going to continue at that pace in terms of efficiencies? It seems to me that there's real risk, that you can have 3 or 4% inflation on a sustained basis and nominal rates five, six, seven, eight, and then you get into the issue of if rates go that high, then servicing the debt becomes a real issue in terms of budget deficits, which we've been the huge beneficiary of to have all these irresponsible deficits.

Jonathon Jacobson: 00:52:23

And the Fed's I don't know, buying whatever the trillion for of securities a year just continuing to print money. There's got to be some long-term repercussions of it. And so that's the risk. The risk of buying stocks, instead of the 30 year being 230, whatever it is today, that's 6or 7%. So I am actively buying swaptions, I mean, it's good to get into the details, but three-year options on the 30 year treasury bond for 30 year swap, which is effectively

close to the same thing where if rates go to five we'll make 10 times the money. And that 10 times our money will hopefully provide a fair amount of protection on the amount of money we're going to lose on stocks if multiples rerate lower, even in good companies.

Staley Cates: 00:53:29 You mentioned Microsoft in this vein earlier, but as you think back on greatest partners you've ever had, and therefore you'd still be looking at them, maybe again, at some point, if price cooperated as well as great companies, you'd love to own if they got in the right zone of pricing, what jumps out at you?

Jonathon Jacobson: 00:53:48 All right. To answer the first part of your question because you gave me a little preview of this. So, I gave it some thought in terms of best investee CEOs that we invested with in the last 25 years, two of them were actually at the same company with Chase Carey and Mike White at DirecTV that was a happily overlap with Southeast.

Staley Cates: 00:54:09 Man, totally agree on both.

Jonathon Jacobson: 00:54:10 And it kind of makes you wonder when you see what has happened to the DirecTV business under AT&T's ownership and would it have happened anyway. And was it a house of cards, and did we get lucky or is it they just mismanaged it, or does it highlight back to the earlier discussion we had about technology, like the technology risk of investing in something where obviously the terminal value was worth way less because the cash flows weren't enduring. But those guys were both terrific. And when I think about what you want an investee partner or somebody you want to partner with as an investor I mean, there's three real characteristics. One is you want somebody who's an owner actually is an owner, but certainly thinks like an owner.

Jonathon Jacobson: 00:55:02 Secondly, you want somebody who's a good operator. And the third thing is you want someone that understands capital allocation and cost of capital. And

both those guys check all three of those boxes. The other two people I would put in there in that category would be Larry Fink who has just built a phenomenal, phenomenal company at BlackRock. And we've invested in BlackRock on a couple of different occasions. He's been a great partner. And then Stan Kurland, who's somebody I actually met through Larry who started a company called PennyMac Financial Services in the heart of the mortgage crisis in 2007, and we backed him. Stan was the number two guy at Countrywide and essentially quit in a huff when Angelo Mozilo sort of stepped on the gas in terms of into subprime and Stan thought it was the wrong thing to do in 2005, and obviously he turned out to be vindicated. And then put his team back together. Or some of his band got back together and started PennyMac from scratch.

Jonathon Jacobson: 00:56:16 And today it's a $4 billion company. And the number two mortgage bank beyond Rocket and they've just built a great mousetrap and Stan has been a great, he just passed away actually tragically in the last six months but was a great partner for 13 years and his successor, David Specter, it's early days, but I put him in the same category. He's been there since the beginning. He was one of Stan's inner circle from day one.

Jonathon Jacobson: 00:56:56 In terms of companies that I'd like to buy at the right price. I think Microsoft is the top of the list, as I mentioned earlier, it's incredibly well run. They have tailwinds and certainly in their cloud business and they have monopolies and their two biggest businesses. And the one thing that this COVID has done is it just accelerated every trend towards digital and embedded technology. I mean, it's a phenomenal company.

Jonathon Jacobson: 00:57:35 Others, we own a bunch of stocks. We haven't bought very many in the last three or four months. United Health Care is a company that's on my wish list which every so often when there's some threat of single payer system or something that is going to impact large carriers, you get a pullback or a scare and that's something, one that you can own, and it will compound for as long as the eye can see. I think we have a little bit

of an overlap in a company called MGM which I think is really poised, positioned well for the next decade. I don't know, it's a good list.

Staley Cates: 00:58:25 That was a good list. Another random question is, can you talk about the evolution of the client side of things from when you started Highfields to when it closed. Just any evolution of the type of client or the mentality or the time horizon? Just any thoughts on that.

Jonathon Jacobson: 00:58:48 Look, we were really fortunate when we started. I mean, when I left Harvard Management, Jack and I had a bit of a Kabuki dance about this was something I always wanted to do. And, clearly, he didn't want me to leave. And he knew that if he told me he was going to give me money, Harvard money, that would make it easy for me to leave. And then also set a precedent for others to do, which unfortunately it did. And in the ensuing five or six years virtually all my partners left and have started very successful investment firms. It wasn't so good for Harvard in the long-term. But anyway, when we started, we started with a billion and a half dollars or a billion and six, of which $500 million was from Harvard and for me, my ability to go around and meet with potential clients and tell them that, "Yeah, I'd worked for Harvard for eight years." And then they're giving me $500 million. I mean, $500 million is a lot of money now. It was really a lot of money in 1998.

Staley Cates: 00:59:52 Especially from that source.

Jonathon Jacobson: 00:59:57 I mean, most of our initial clients were other university endowments and foundations. We had no pension money. We had no fund of funds ‘cause I didn't want them. And we had some, either family offices or high net worth families, but three quarters of the money was non-taxable. And it was mostly endowments and foundations. At the time, that was considered the holy grail of clients. They were long-term, they were thoughtful, they were good partners. They weren't second guessers. And I would say that for the first decade or so, that was universally true.

Jonathon Jacobson: 01:00:47 I'm sure you guys see this in your world, around the time of the crisis, two things really changed. I think the behavior of LPs for understandable reasons. One was the crisis itself, the other was Madoff. And again, in the mid and late '90s the nature of the LPs certainly in the endowment and foundation world is that they were almost completely committee driven, that the internal staffs of everybody but Harvard and Yale were actually frankly really small, and they really relied on their investment committees to make decisions. And there was very much a personal aspect to who they entrusted money with. They're really trying to assess whether or not potential investees were honorable, trustworthy people that they wanted to partner with for a long period of time. And they weren't so much focused on quarterly performance.

Jonathon Jacobson: 01:01:56 And it's obviously morphed a lot over time and changed a lot in the last 10 or 15 years for the reasons that I cited. My own personal view is that ... And look, the other thing is that there's a hugely understandable personal incentive dynamic that contributes to why it has changed. Because if you're the public markets allocator, marketable equities allocator at XYZ university, and you get hired to be the deputy CIO or the public markets allocator at ABC university. When you start your job, the last thing you're going to do is basically tell ABC university, "Yeah, your portfolio is great. You don't have to do anything, just keep doing what you're doing." Because number one, if they were going to keep doing what they're doing, they wouldn't have hired you in the first place.

Jonathon Jacobson: 01:03:05 And number two is, that for your own personal advancement to come in and take a new job, and basically say like, "I don't have nothing to add. We should just ..." So there's this incentive to change managers just by a function of personnel changes at the LPs. And so in addition to the fact that people become much more short-term oriented, and everybody's comparing to benchmarks and trying to compare with a peer group and that the periods by which they're trying to measure performance are becoming shorter and

shorter. There's this other dynamic, which we've seen consistently over a long period of time. My personal view is that if you give money to a manager, it really is going to take five or 10 years to figure out if they're any good, because if you're a large cap value manager, for example, if large cap value underperforms, it's hard to judge the manager, things that you do are going to go in and out of style.

Jonathon Jacobson: 01:04:08 Most allocators or most clients aren't paying managers for style drift to try to get in front of the next investment fat, or try to figure out what's going to be hot and morph into something else, because that's a short recipe for disaster. I mean, I don't know if I'm allowed to say this, but I've been an LP of Longleaf for, I don't know, 15 years. And I don't even look at my statements. Now sometimes it's better than others to do that, but I literally ... I have money in international and I have money in the big fund, and I think a little money in small ... I don't even look, so I trust what you guys are doing, and I know your performance is going to be really streaky, but I knew that when I signed up for it and I wasn't making any other like a market timing bet when I did that.

Staley Cates: 01:05:11 Everybody on the call, myself included would be interested. What are your must reads, whether that's regular investment material or a book or movie, podcast, other... If you're coaching someone, an investor, what they should be reading right now, or what would you say?

Jonathon Jacobson: 01:05:29 Yeah, I mean, the best investment books I read are really more books on human psychology and human behavior as opposed to you know necessarily sort of how to books and not necessarily related to investing per se. I mean, Moneyball and Blindside, and obviously you're very familiar with both, but particularly the Blindside part of it, were great books in understanding human psychology. Anything to do with sports and understanding the NFL, the vagaries of the salary cap and trying to compete on a level playing field or in a

game where there's a level playing field because that's essentially what investing is, is really helpful.

Staley Cates: 01:06:26 Mercifully last question, mercifully for you, it's been good for us. What's next for you? What do you see yourself doing for the next 5 or 10?

Jonathon Jacobson: 01:06:36 I was going to ask you what I should do.

Staley Cates: 01:06:42 You should give us a bunch of ideas in-

Jonathon Jacobson: 01:06:45 Listen. I think that as I alluded to earlier, I want to do something full-time other than management of money and foundation. And in terms of the grant making of the foundation, I just get in the way my wife and her team do such a good job. So, they just bring me in to say no when they need someone to say no. I think COVID has really set me back a year in terms of kind of thinking or exploring something full-time. And I have a handful of ideas, I have an idea about buying a failing college or the physical plant of a failing college and trying to start a new one without the legacy cost associated with the flawed business model of the university system in this country, and not have tenure and not have sports and maybe provide an education for something that's affordable for most Americans there's a value proposition there and that's a heavy lift.

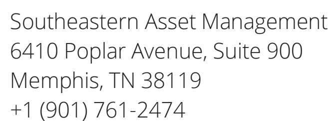
Jonathon Jacobson: 01:07:48 But that's something that I'm noodling over. Lots of people tell me I should teach and coach and maybe I'll end up doing that. I'm not sure. But I'm having right now, as I said, the silver lining of having to spend time with my small team in terms of the family office has been great.

Staley Cates: 01:08:08 It's been great of you to do this. Thanks a ton for the time and for doing it.

Jonathon Jacobson: 01:08:13 Thanks for having me. I hope you guys are happy with the results.

Staley Cates: 01:08:16 We are and will be.

Gwin Myerberg:	01:08:21	Many thanks to Staley and to Jonathon for joining us today and for the fascinating discussion. Thank you as always to all our listeners, for tuning into the Price-to-Value podcast with Southeastern Asset Management. If you have any questions or would like to share topics, you'd like to see us cover in future episodes, please feel free to send us an email at podcast@SEasset.com.



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