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INSIDE BET

OppenheimerFunds gambles on its first CEO from investment ranks

By Jeff Benjamin

WHEN Arthur P. Steinmetz talks about his new role as chief executive of OppenheimerFunds Inc., you can't help but imagine him slipping into the captain's chair on a big, freshly restored ship.

There he sits, proud and excited, looking beyond the shiny instrument panel toward the distant horizon.

Mr. Steinmetz, 55, has spent more than half of his life working at the $245 billion money management subsidiary of Massachusetts Mutual Life Insurance Co., and he definitely knows both the company and the asset management business.

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>
> **Bridget Hughes**
> Associate director
> Morningstar Inc.

From most perspectives, he is well-qualified for the CEO position he took over July 1. But it must be noted that Mr. Steinmetz's appointment is in some ways an experiment — perhaps even a risky one.

Both the fund company and the parent company are touting Mr. Steinmetz as the first investment manager to lead OppenheimerFunds,

Continued on Page 34

Arthur P. Steinmetz: "We swept the decks pretty clean and made the changes necessary," he says of missteps at the company in the 2008 crisis.

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OppenheimerFunds' inside man

Continued from Page 1
whose history dates back to 1960.

"My goal was to find a successor, and I think Art felt an obligation to step up in these various roles over the past five years," said William F. Glavin Jr., who immediately preceded Mr. Steinmetz as CEO and will remain as chairman until that title is passed to Mr. Steinmetz sometime next year.

To say Mr. Steinmetz was groomed for the job of heading the entire fund complex might be an overstatement. More accurately, he fit neatly into the void.

If there was a point at which Mr. Steinmetz's fate started to move toward the top rung of the company, it was the 2008 financial crisis, which exposed some risky bets made by some of OppenheimerFunds' domestic bond fund managers.

The portfolio management missteps, which were vividly illustrated by a 37.6% decline in 2008 for the $1.1 billion Oppenheimer Core Bond Fund (OPIXG), put a lot of heads on the chopping block and brought in Mr. Glavin from MassMutual, the self-described "fix-it man," to clean up the mess.

"Bill parachuted in as an unknown quantity to us, and we were unknown to him," said Mr. Steinmetz, who was managing global debt funds at the time and "was one step removed from the folks responsible for the performance problem.

"I was bruised and bloodied, but not blown up," he recalls. "But I was still a legacy at the company, and I could have been one of those guys that Bill decided was part of the old guard and needed to be out of here."

The $7 billion Oppenheimer Global Strategic Income Fund (OPSIX) Mr. Steinmetz had managed since 1989 lost 16.5% in 2008, which compared to a 15.4% decline for the multisector bond fund category, according to Morningstar Inc.

The ultimate fallout from the financial crisis, which company executives don't enjoy talking about but also don't shy away from, included a $35 million fine to settle Securities and Exchange Commission charges that OppenheimerFunds made misleading statements to investors.

DIVERSE BACKGROUND

Mr. Steinmetz, who grew up in Cleveland, graduated from Denison University in 1980 with a degree in Russian language and Slavic studies.

"It seemed weird and I was interested in it," he said of his college studies.

From there he joined the U.S. Air Force and "washed out" of flight school after one year. "I think the instructors were a little afraid of my flying abilities," he confessed.

Then it was off to Columbia University, where he earned an MBA.

After a couple years cutting his teeth at Paine Webber, he was hired as an analyst at OppenheimerFunds. And he's been there ever since, building a reputation as a solid fixed-income manager and a sometimes colorful observer of financial market trends.

"TIPS are for chumps" has become one of his popular retorts to questions about Treasury Inflation-Protected Securities, which he insists offer investors negative yield.

MAKING CHANGES

But now Mr. Steinmetz, who has been brewing beer in his home basement since 1986, is the big cheese, advancing from the chief investment officer role he took over in 2010, and his fingerprints on the company are already evident, if one looks closely.

Krishna Memani, who was hired by Mr. Steinmetz in 2009 after Mr. Glavin's general housecleaning, has moved into Mr. Steinmetz's former position as CIO.

"I was hired by Art to rebuild a set of strategies that we had run into trouble with," said Mr. Memani, who took over management of the aforementioned Oppenheimer Core Bond Fund that took a nose dive in 2008.

"We decided everyone in investments here is going to be an investor, including the CIO," he added. "That's something that Art instituted and the reason is it gives everyone an anchor into the market, which is critical for a CIO because if you're too far removed you will become just an administrative person."

In his capacity, Mr. Memani said he has hired an "entirely new investment team," and has required some of the exiting money managers to essentially reapply for their jobs.

But whatever changes have taken place over the past few years, the foundation of OppenheimerFunds remains: active and sometimes aggressive money management.

That point was illustrated near the end of last year when some big bets on Puerto Rico debt came back to haunt some of the company's popular municipal bond funds, leading analysts to start drawing parallels between them and the breakdowns of 2008.

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Art Steinmetz: "The challenge for us going forward will be to continue to show investors that we're worth active-management fees."

The Puerto Rico debt exposure contributed to a jarring 15.5% decline in 2013 by the Oppenheimer Rochester Virginia Municipal Bond Fund (ORVAX).

"Short of a North Korean invasion of Virginia, losing 15% in a Virginia-specific bond fund is probably going to make people very upset," Lee Munson, principal at Portfolio Wealth Advisors, said at the time.

Just last week, Bloomberg News reported that assets in the Oppenheimer Rochester Maryland Municipal Fund (ORMDX), which directed about 35% of holdings to Puerto Rico as of June 30, fell to $64.9 million as of Aug. 4, down from $96.1 million a year ago.

More generally speaking, Mr. Memani said the company is constantly striving to step up its risk controls.

"We know that bond funds have to act as a ballast for investors, otherwise the entire allocation goes haywire," he said. "But it doesn't mean we won't be taking risks."

Putting an investment manager into the chairman and CEO chair (though Mr. Steinmetz will be stepping away from money management in his new role) and also requiring all investment executives to manage portfolios is not necessarily revolutionary, but it is a first for OppenheimerFunds.

"I think they feel that having an investment person at the head of the company gives him credibility with the management team, and it will also move [Mr. Steinmetz] into a more public role," said Bridget Hughes, associate director at Morningstar Inc.

GOOD MOMENTUM

If nothing else, OppenheimerFunds and its brand-new CEO have momentum on their side.

Investors seem to have looked past the missteps of 2008 that cost the company $10.9 billion in net outflows.

Last year marked a company record of $17.3 billion in net inflows, and the funds have had net inflows of $6.1 billion in the first half of this year.

"They appear to have weathered the storm," said Todd Rosenbluth, director of mutual fund research at S&P Capital IQ.

With regard to the kind of risk apparent just last year in some of the company's muni bond funds, Mr. Rosenbluth added that "if some situations worsen, and they stick to their guns, they could see bad performance that leads to outflows."

Mr. Steinmetz recognizes that it will take a long time to shed associations with some of the system failures of 2008, but he doesn't apologize for the company's commitment to active management.

"It pains me when 2008 is brought up, because we swept the decks pretty clean and made the changes necessary," he said. "The company isn't so much different from 2008, but the conditions are different. We are an active-management firm and will continue to be so, because that's where we've planted our flag."

In other words, don't expect to see OppenheimerFunds following the path of other fund companies into the fast-growing exchange-trade-fund space.

But where you will see the company expand, according to Mr. Steinmetz, is deeper into areas he describes as "white space," including alternative investments and certain asset allocation strategies.

"The challenge for us going forward will be to continue to show investors that we're worth active-management fees," he said. "My personal passion is to come up with alternative solutions that are truly alternative because there is a lot of expensive beta masking as alternative in the marketplace today."

On the topic of taking charge in the wake of Mr. Glavin's restoration project and at a time when markets are high and assets are flowing into the funds, Mr. Steinmetz admits to some mixed emotions.

"The position I'm in now is good and bad, because the market is obviously at our backs and I'm coming in taking over at a great time, but that also makes me just a little bit superstitious," he said. "I just really want people to feel that this is a place where investment people can come to do their best work."

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