StarTribune

AUGUST 13, 2017 • STARTRIBUNE.COM • MINNESOTA'S TOP NEWS CHOICE • MINNEAPOLIS • ST. PAUL

Staying the same has made Minneapolis investment firm new

By LEE SCHAFER
Star Tribune

The Minneapolis money manager Compass Capital Management seems like exactly the kind of traditional firm that could soon be in the buggy whip business.

Assets continue to flow into passive investment funds like those that mirror a stock index and away from traditional active managers staffed by people picking stocks. There hasn't been a net increase of money going into actively managed, U.S. stock mutual funds since 2005, and the net flow out of them last year was a flood.

Yet traditional, even old-fashioned, precisely describes Compass.

It's picking individual stocks for its clients with a buy-and-hold style that hasn't changed a bit since it opened for business 29 years ago. It charges fees the traditional way, too, based on the assets it manages.

Yet Compass is also growing. With a marketing program that consists primarily of accepting referrals, the firm this summer broke through $1 billion in assets, up about 90 percent in the last five years. While some of that growth can be attributed to a bull market for stocks, about 75 of its 250 or so clients came aboard in the last few years.

What's happened to founder Charlie Kelley and Compass Capital Management in 29 years of doing exactly the same thing presents a very interesting case study in a dynamic market — what was once a me-too provider is becoming a differentiated one. In 1988 it was one of many options just in Minnesota for clients interested in having someone pick their stocks and bonds for them.

"I remember clients asking, 'So where is the sizzle? You're just like everybody else,'" Kelley said. "Well, now we're not."

Kelley declined to provide investment performance figures, but the growth in assets can be independently confirmed. It's probably safe to conclude that returns must at least be matching the common performance benchmarks. And one interesting aspect of a conversation last week with Kelley and Chief Operating Officer Phil Stern is that they choose to talk so little about markets or stocks.

Most of a pleasant hour went by with Kelley discussing all the ways to put clients at risk that he and his colleagues try to avoid.

A case in point is the position of chief investment officer, the main decisionmaker at many asset management firms. Compass doesn't have one.

It was one of the lessons Kelley learned early in his career in the trust department of what is now Wells Fargo & Co. His department had an investment boss who had to approve investment decisions. So it wasn't really a team of skilled pros working together to safeguard the client's wealth. It turned out to be a single guy.

When Compass opened its doors it had three portfolio managers who had to all agree before they bought a single share. Now with six portfolio managers, the Compass process hasn't changed.

No Compass client has to fret about having to rely on a superstar investment manager who someday could walk into the path of a bus, Kelley said.

How risk conscious is this firm? Well, the portfolio managers don't even use laptop computers. Sure, there may not be much risk of confidential data going missing if a Compass laptop gets forgotten in an airport lounge. But there's no chance anyone unplugs and carries out a desktop computer and then accidentally leaves that behind at the airport.

Of all the risks Kelley talked about, though, the biggest is letting human emotions come into play when managing money.

One way Compass keeps emotion out of decisionmaking is by fixing the portfolio at 25 stocks, with each getting about 4 percent of the money. As Kelley described it, their jobs as portfolio managers are a little like being parents with 25 children, with an obligation to love all 25 kids equally.

Stock prices, of course, don't increase or decrease across the board. There may be a stock in the portfolio of a company that hits a rough patch, and as the share price declines its percentage of the portfolio value might slip to 3 percent. Then the portfolio managers have to decide if they want to keep money invested in that company. If they do, they buy more shares.

What Compass is doing here, of course, is just another form of buying low and selling high.

Compass brings that same approach to balancing portfolios between stocks and bonds, Kelley said. In a poor market for stocks, like the terrible slump associated with the Great Recession nearly a decade ago, they were selling bonds and buying stocks.

The firm has the same no-nonsense approach to its portfolio of bonds, with the same amount of money invested in one-year bonds, two-year bonds, three-year bonds and so on out through 10 years.

Changes in interest rates affect bond prices differently based on how long it takes for the bond to mature, of course, but another thing Kelley said he learned at the bank trust department is that no one can consistently make the right call on interest rates. It's best to not even try.

Compass buys individual bonds for clients, too, not bond funds. A bond fund is another "product" created by a financial company, and Kelley sees risks in many financial products, including the now-popular exchange-traded funds.

To him even the most popular stock benchmark, the S&P 500 index, looks a little like a big virtual growth stock fund with its recent performance largely shaped by a relative handful of currently hot stocks.

Of course Kelley has noted the growth of passive investing like index funds, although he said clients never seem to raise the topic with him. When asked if he thought Compass had many good years ahead given these changes in the market, he didn't hesitate.

"Yes," he said. "Because it's been here forever."

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