

Virtual Earthquake in LA's Bond World

TCW fires Jeffrey Gundlach and replaces him by purchasing MetWest.

Fund Spy | 12-04-09 | by Eric Jacobson

In hindsight the signs should not have been hard to miss.

On the heels of public statements from TCW's interim-chief Marc Stern about strategic alternatives for the firm—wholly owned by France's Societe Generale—rumors began to swirl that numerous parties were in talks with chief investment officer Jeffrey Gundlach, some suggesting that he and his team might even jump ship. The thinking was that a private equity firm might want to do a leveraged buyout of TCW, for example, or that Gundlach would take his team to a rival asset management firm. Gundlach made denials, telling Pensions and Investments that "People are in a dark room, looking for a black cat that isn't there and finding it." But it was his statement in a September Reuters story that may have held the most telling clue. "No private equity firm has spoken to me with definitive interest and it is very unlikely to me that any buyer advancing beyond a preliminary stage would do so without talking to me, since I manage 70 percent of the assets."

It seems that Stern and TCW viewed the latter as a threat to the franchise. Whether they had given it serious consideration before or not, the risk that Gundlach might actually walk out the door must have seemed much less remote. With more than \$100 billion under management, a sudden Gundlach departure would have left TCW in the lurch, and an asset exodus would have been disastrous. Investors have fled for the exits in the past when other firms have experienced major changes to their businesses. When Vanguard pulled its business from Lincoln Capital Management nearly 10 years ago, for example, it didn't even involve a management change. But the lack of confidence it telegraphed to investors led to a "run" that effectively wiped out the firm. Clearly, Stern and his team didn't want to risk such a scenario and felt they had to act.

And act they have. In an audacious move unrivaled by any in recent memory, TCW has agreed to purchase Metropolitan West Asset Management, not so much for its nearly \$30 billion in assets under

management, but for the talent and breadth of its investment team, headed by CIO Tad Rivelle. That group, which recently became the sole owner of MetWest, will be transplanted into TCW and take over managing all of its traditional high-grade bond assets, including everything currently under Gundlach's control. Rivelle will become TCW's fixed-income CIO, and for now the team will continue to operate its own funds while managing all of TCW's investment mandates in the same styles under which they were run by Gundlach.

One can only imagine the calculus that went into TCW's choice. It would have been difficult to envision many other managers or groups that would or could have credibly stepped into Gundlach's shoes. Morningstar's 2006 choice for Fixed-Income Manager of the Year, Gundlach built his share of the business around picking apart the government mortgage market, more recently plunging roughly half the assets of TCW Total Return (TGLMX) into the non-agency space after it was so badly decimated in 2008.

Yet MetWest has itself built a talented mortgage team led by Mitch Flack and Bryan Whalen, and has plied very similar non-agency mortgage territory. Meanwhile, the firm has really built its reputation with core bond strategies like those plied in Metropolitan West Total Return (MWTRX). Rivelle and his team won Morningstar's Manager of the Year honors in 2005 for those efforts. He and generalist colleagues Laird Landmann and Steve Kane have been together for years, cutting their teeth together at PIMCO and then further honing their skills at Hotchkis and Wiley before founding MetWest in the mid-1990s. That should be reassuring to investors across TCW's lineup.

MetWest will bring more than 100 employees to TCW by Monday, but the future of Gundlach's current staff is a bigger question mark. Although Rivelle's team brings numerous capabilities, there's been no indication that the firm is interested in cutting its current roster. It's likely there will be a few casualties among those perceived as too close to Gundlach, but a bigger question may be whether many in his

crew will be inclined to follow him. Unless Gundlach has already solidified future plans, sticking around TCW will likely be seen as a much safer option for his staff. Meanwhile, Gundlach has been the center of attention at that firm for some years, and it seems plausible that some will see his departure as an opportunity for more visibility.

Assuming their worries were well founded, it's difficult to think of many better ways that TCW could have handled this situation. With one savvy move, the firm has eliminated tremendous "key man risk" and increased the depth of its investment team exponentially, all while solving major issues of succession. Only time will tell whether the firm can successfully blend two cultures and handle the challenges of maintaining personnel and executing a significant merger. From a strategic perspective, however, it appears to be a shrewd and daring move.

Eric Jacobson is Morningstar's director of fixed income research and an editorial director for mutual fund content.

MetWest offers fixed income investment management services for institutions, financial advisors, and individual mutual fund investors. MetWest has no editorial control over the content, subject matter, and timing of this article; and is independent of **Morningstar, Inc.** and its publisher. The views and forecasts expressed by MetWest personnel in this publication are as of December 2009, are for information purposes only, and subject to change without notice. The comments do not represent a recommendation or offer of any particular security, strategy, or investments and should not be considered investment advice. This article is reprinted for educational purposes only. The information presented has been gathered from sources believed to be reliable, but MetWest does not provide any guarantees regarding this information. MetWest makes no warranties and bears no liability for your use of this information. Additional information can be provided upon request.

Reprinted with permission from **Morningstar, Inc.** December 2009.