Interview Series

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INVESTMENT COUNSEL
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AN INTERVIEW WITH DOUG ASIELLO, CFA®

SMID CAP PORTFOLIO MANAGER

SENIOR ANALYST - CONSUMER DISCRETIONARY

JOINED CRAWFORD IN 2017

Interviewer: How did you become Crawford's SMID Strategy Director?

Doug Asiello, CFA®: I've been with Crawford since 2017, and prior to my joining, I worked on a mid-cap product at another firm for 16 years. Honestly, it was a pretty easy transition in terms of the shift that I had to make from focusing on mid-caps in my old position to focusing on SMID caps at Crawford. The product that I previously co-managed was benchmarked against the Russell Midcap Index, so its reach was a bit broader, with a slightly higher average market capitalization. With that being said, there is a lot of philosophical consistency and overlap between the two strategies. Both mid-caps and SMID caps tend to have slightly lower, but more stable growth rates as compared to small caps that are earlier in their life cycles. These more stable SMID caps also generally exhibit lower volatility. The SMID cap arbitrage is a higher growth opportunity (versus mid- or large caps) coupled with lower volatility (versus small or microcaps). Over time, I believe that this will afford Crawford SMID investors better risk-adjusted returns.

I: Will you elaborate on Crawford's SMID cap investable universe? It seems to be slightly more mechanical than that of other strategies.

DA: When you think about winnowing the SMID universe, there are plenty of companies in tech, particularly in software, that have recently proven to be so-called growth rockets which we won't own because they don't pay dividends. This is also true across biotech. Biotech is an example of a sector which has shown strong recent returns, but it is a subsector largely void of dividend payers. A central tenet of the firm's investment philosophy is that consistent, growing dividends are one of the best indicators of quality, be that the quality of the business assets or management's capital allocation prowess, or both. Crawford's SMID strategy, and our Small Cap strategy too, for that matter, have disproportionate underexposure to those two sectors, because, in short, those are two ponds wherein we can't fish. When we reduce the Russell 2500 or 2500 Value to companies with three-year dividend-paying histories, we are left with roughly 800 companies. So off the bat, we reduce our addressable universe to about a third of the broader index. We spend a lot of time thinking about and analyzing what has happened with dividend payers and non-dividend payers over time. More recently, over the past two or three years, we have seen a stark trend in non-dividend payers outperforming dividend payers. We do not think that this non-dividend payer outperformance is sustainable, so we believe that the Crawford SMID strategy is well set up for both the near and longer term.

I: Will you speak about Crawford's team-based approach to research?

DA: The first thing that I'll point to is that we really have an outstanding set of long-tenured, thoughtful business analysts on the team with vast industry experience. I was in the Army, and I'm also a competitive soccer player, so I've been on a lot of different teams. With that being said, I can confidently say I believe this to be an exceptionally strong team that Crawford management has thoughtfully assembled. This is a group of people that are well-schooled in the discipline—both in the art and science of investing—and the experience that each of us brings to Crawford is unmatched. In short, we have all been around the block, working at different, well-respected firms, and we have all seen best and worst practices at those various firms. We are bringing what each of us has learned elsewhere into a collaborative learning process. We get better every day, as we continue to create layers of sediment around industries, in terms of sector research, but also around best practices. We seek to embrace best practices and ensure that our processes are not eroded by worst practices. A lot of this is cultural, and it comes from leadership, too. The thoughtful building of this team over a long period of time was not an accident at all. This team was designed with intention and purpose, and I believe that we have a very bright future ahead of us, for all Crawford strategies and our clients.

I: How does the team-orientation approach play a role in your stock-selection process?

DA: As it relates specifically to research, we focus on the longer term, and we look at everything we can find, overturning all the rocks. We use the resources available to us and do some “shoe leather sleuthing” as well. One thing I believe that we’re particularly effective at is cross-pollinating ideas. A lot of times, when we’re analyzing a business, lines bleed over from one sector or subsector to another, and while companies may be classified in a specific sector, they may touch multiple other sectors. The degree of sector knowledge that we have here at Crawford seeks to ensure that each of our ideas is well vetted and fully understood. Finally, I believe that one of our explicit strengths is that we do a particularly good job at identifying risks upfront. Our strategies are designed to compound consistently over time in a thoughtful, gradual, consistent fashion, with risks properly vetted ex-ante, before investment decisions are executed. Consequently, we feel that Crawford’s SMID strategy exhibits lower volatility than its markets, benchmarks, and most of its peers.

I: How would you describe your investment philosophy?

DA: In broad strokes, an underlying theme and a key part of my individual investment philosophy is that management teams have two principal functions. One is to allocate financial capital, and the second is to maintain, attract, and retain human capital. We’re talking about capital in both cases, but that second piece, as it relates to human capital, I believe is probably the most important. It is critical that businesses create “flywheels” where good people want to come, stay, and prosper, creating a long-term culture of sustainability. This piece is difficult to quantify, but it is clear when you see it. The former, however, as it relates to capital allocation, involves companies investing incremental capital to ensure the growth of Return on Invested Capital (ROIC) over time. To some extent, I believe that stocks follow the path of earnings, but even more so, I believe that stocks follow the rate of change and path of a company’s ROIC. If a business can continually reinvest at very high rates, its ROIC will expand and its stock price will follow. We are always on the hunt for those “ROIC flywheel” kinds of businesses for inclusion in the SMID portfolio.

I: Will you talk about the role of quality in Crawford’s SMID strategy and discuss metrics you like to use to quantify this?

DA: If I reduce my hunt for quality to the lowest common denominator, I am looking for management quality, asset quality, balance sheet quality, and overall business quality. Business quality is most singularly measured by gradual, upward-sloping, consistent returns. More specifically, business quality can be measured by ROIC over time and change in ROIC over time. Return on Equity (ROE) also plays a role in my assessment of quality, but the problem with ROE is that it can more easily be manipulated within a company’s capital structure. We’re always suspect of companies who have too much debt or are engaging in “financial engineering” of their balance sheets. With that being said, when we analyze ROIC, we look at any and every source of capital that management chooses to employ. I will add that there are exceptional businesses where ROIC over time is practically a straight line. In cases such as these, we have to look at where these companies place excess capital.

I: How do you keep the ideas in the Crawford SMID strategy fresh?

DA: Charlie Munger likes to say that every year you should destroy one of your best ideas. I believe he means that one should always be on the lookout for unknown unknowns, testing investment theses to see where you might be wrong. I am always asking myself how and where we could be wrong. Broadly speaking, we constantly seek to manage volatility in SMID while delivering competitive returns. Part of our strategy is working with and coaching our investors, letting them know that investing in Crawford's SMID strategy will come with peaks and valleys over time. We believe it will prove successful and deliver competitive returns over time for those who are in it for the long term, as we seek to manage SMID volatility-adjusted returns with a portfolio populated with superior, "ROIC flywheel" businesses managed by enlightened management teams.