Interview with Mebane Faber

Mebane Faber,
Chief Investment Officer, CEO,
Cambria Investment
Management

This summer, AIAR Content Director Barbara J. Mack had a chance to speak with serial entrepreneur and CAIA Member Mebane Faber about his career in alternative investments.

BJM: Tell us a little bit about your background and how you wound up running Cambria Investments.

MF: In college, I studied engineering and biology and after graduation I started out as a biotech equity analyst. My plan was to take a year off working before going back to get my PhD in biotech, that year quickly became a career. I never went back for the PhD, but gravitated away from biotech and towards the quant side of the investment management business, co-founding Cambria in 2006. We were managing money by 2007 through separate accounts and two hedge funds and things developed from there. The biggest initiative in the past few years has been to launch public funds through ETFs and we now have five ETFs trading and four more have been filed and are on the way. They cover a broad spectrum, from equities to global macro to fund of funds, with both tactical and buy and hold approaches. The goal is to launch low-cost, strategy-based ETFs that everyone can access, many of which are seen as hedge fund or alternative-like strategies, but are much more tax efficient and cost effective due to the ETF structure

BJM: How did you choose the partner who launched the business with you?

MF: My partner Eric Richardson and I have complementary backgrounds – he is a lawyer and has experience in investment banking and venture capital and I was in research, so it's nice to have his skill set, especially when we are dealing with public funds and there are a lot of regulations. You learn quickly that the business of money management is very different from managing money and you have to handle both sides effectively.

Like many entrepreneurs, we bootstrapped the business and it took a few years to gain traction. We are known mostly for our research and publishing; I just put out our fourth book in March and have written over 1,500 articles on my blog and produced some academic articles as well. For a small company this kind of productivity has been beneficial in getting the word out and sharing our research, enabling steady growth with a small headcount.

BM: Can you give us an example from some recent research?

We try to publish research so that investors can understand our process, and hopefully, be more informed investors in our funds. As an example, in the recent book, *Global Asset Allocation*, we looked at about 15 of the most famous asset allocation models, including the classic 60/40 model, the permanent portfolio, and risk parity. One of the main issues that is discussed in the media and investing circles involves determining what the best allocation may be: is it the endowment model, for example? We looked at the allocations that were proposed by some of the most prominent asset managers, Rob Arnott, Ray Dalio, David Swensen, Mohammed El-Erian, and showed the results all the way back to the 1970s.

A pretty interesting take away is that a lot of the asset allocations ended up quite close to the same place, as long as you have some global stock, some global bonds, and some real assets, and the actual percentages to each category did not matter that much. What did matter a great deal were the fees paid, including the manager fees of the funds and the adviser costs. So we did a thought experiment, saying "What if you could go back to 1972 and predict the absolute best performing asset allocations in this case?" It turned out to be the endowment style portfolio, but if you executed that portfolio through an average adviser with average fees, the process would have taken the best performing "crystal ball" portfolio and transformed it into the worst one.

That is a pretty stunning revelation and so if you are working with buy and hold allocations, you should be paying as little as possible. Our research on this issue culminated in the formation of the ETF that we launched in December. We are the first company to launch an ETF with a permanent 0% management fee and it holds 29 other underlying ETFs, so all-in it only costs 0.29%, which was and may still be the lowest cost asset allocation ETF.

It comes back to the notion that investors focus so much on the allocation and particular strategies, when a lot of the "boring" parts like fees and taxes, can have a much greater impact that the actual allocation choices.

BJM: What role do the foreign markets play in your allocations?

MF: We love the foreign markets and one of the biggest mistakes that investors make is not allocating enough to foreign asset classes. If you look at the world market cap portfolio for equities, it is roughly half foreign, yet most people in the U.S. allocate around 70% to U.S. equities – this is far too much and is called home country bias.

Everything we do at Cambria is quant based, and we screen countries or foreign equities for certain characteristics that have worked well historically. These are often the same factors that work well in the U.S.: value, momentum, trend, and quality.

So we are huge believers in the international markets, especially right now, when the U.S. is one of the most expensive stock markets in the world. The good news is that the markets in most countries are attractively priced and some are really cheap, particularly in Europe, and also Russia and Brazil.

The funny thing about global market valuations is that the best places to invest are often the ones where things look the worst, geopolitically and economically. The famous Templeton quote says, Don't ask me where things are best, that is the wrong question, ask where things are most miserable. The perfect example is Russia, last year it was in the news every day, with Putin invading Ukraine, and yet they have the best performing stock market in the world this year.

Now Greece is in the news every day – but there will be opportunities for strong returns in that market too. Their stock market is much smaller, of course, but it is a good example of a country that is very cheap now and could perform better in the future. There is another Templeton quote that might be appropriate for this situation – "Invest at the point of maximum pessimism."

BJM: Do you think that many funds will always tend to move towards the same broad selection of assets?

MF: There is a herding effect – one of the greatest examples of this at the moment is in dividend stocks. In the late 1990s, no one wanted them in the U.S., but in looking at the factor, it was clear that dividend stocks have worked because historically they have traded at a roughly 20% discount to the overall market, based on valuation. However, in the late 1990s, that discount hit almost 50%. So that was a fat pitch – it was a great time to be investing in dividend stocks, but it was also a time when no one wanted them.

Over the next 15 years or so, the picture has changed completely. Everyone is searching for yield, and a lot of money flowed in to dividend stocks. Partly, this was the quest for yield in an environment of low interest rates; and partly this was managers and investors chasing performance. These inflows have changed the valuations of a historically attractive asset class. Not only do they not trade at a discount, they are now trading at a premium to the market. It's not surprising that they are underperforming – because investors are choosing stocks that have yields that are comparable to the market, but with higher valuations!

You don't have to believe me, just look at the ticker of the largest three dividend ETFs and look at their valuation metrics and it is clear that a lot of investors will be surprised by the results. There are other examples of this – low volatility strategies were a great way to invest historically, but so much money has piled in it has changed the nature of that type of investment too. In any cognitive approach, there are certain times when it works very well and certain times when it does not make sense to be investing in that strategy, at least until things change again.

BJM: The game keeps moving anyway…

MF: That's what makes it fun and keeps it interesting!

BJM: What do you see for the near future at Cambria?

MF: We have five funds out, four funds filed and probably another six on the way. We have a number of criteria for a fund to launch. First, it has to be something I want to put my own money into – I have 100% of my net worth in these funds. Second, it has to be something that doesn't exist, or a situation where we think we can do much better than what is out there already. Managed futures is one area that we may enter eventually, because we think the opportunities are there.

BJM: Let's turn to CAIA – how did you discover it and what advice might you have for current candidates or members, especially those who might want to start their own firms some day?

MF: I went through the program in the early days – I must have been in one of the first few classes of the program. At that time, the curriculum was math and stats-heavy; it was focused on alternatives and also included things like insurance-dedicated funds - not what you would see in traditional financial education offerings. The designation should become even more important in the future, as we are in the seventh year of a bull market in the U.S. and stocks are expensive. This will not last forever and we will go through another cycle of recession and bear market, then alternatives will receive a lot of attention again.

For people who want to start a company, I would say, "Go for it!" I have been involved in launching three different companies – Cambria and the investment management company, Idea Farm, which is a research business, and Alpha Clone, which is a software company that also manages money and has ETFs. It is a lot of work - it can be very rewarding and very trying over time. It took three to four years to gain traction in our space; we literally started it from scratch – friends and family – and there may be easier ways to start a business and not everyone has the make-up for it. But it's a wonderful journey and adventure and we have plenty more ideas for the future.

Author's Bio

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Mr. Faber is a co-founder and the Chief Investment Officer of Cambria Investment Management. Faber is the manager of Cambria's ETFs, separate accounts and private investment funds. Mr. Faber has authored numerous white papers and three books: Shareholder Yield, The Ivy Portfolio, and Global Value. He is a frequent speaker and writer on investment strategies and has been featured in Barron's, The New York Times, and The New Yorker. Mr. Faber graduated from the University of Virginia with a double major in Engineering Science and Biology.