Junk-Bond Firm Turmoil Shows People Trump Market-Beating Profit

Tuesday, December 16, 2014 08:00 AM

By Zachary Tracer

(Bloomberg) -- Market-beating returns aren't always enough to keep investors, as Principal Financial Group Inc. has found.

The main high-yield debt fund at Principal's Post Advisory Group outperformed junk bonds since the start of 2013. Post Advisory also lost clients such as government pension funds in Vermont and Texas, cutting assets to $9.8 billion at the end of November, a decline of 17 percent in less than two years.

The reason: The departure of managers including founder Larry Post, which led to a legal spat. Santa Monica, California-based Post Advisory sued the executives, alleging they violated confidentiality and non-compete agreements by working for a new fund business. The executives said a "hostile" work environment forced them out.

"The decision to terminate Post Advisory was driven by the ongoing personnel and leadership turnover at the firm, and concerns this raised about the stability and focus of the investment team," Stephen Rauh, chairman of the Vermont Pension Investment Committee, said by e-mail.

The turmoil at Post Advisory, owned by Des Moines, Iowa-based Principal for more than a decade, echoes the dramas surrounding star bond-fund managers Bill Gross, who exited Pacific Investment Management Co. this year, and Jeffrey Gundlach, who left TCW Group Inc. in 2009. All three companies lost clients and assets after disputes with talented -- and sometimes controversial -- money managers.

High Emotions

"Emotions do run high in the markets, and especially among bond people," Ellen Shumway, Principal's senior executive director for strategy and boutique operations, said in an interview, when asked about the environment at Post Advisory. "These things happen. But it's not anything that we would say is out of the usual for Post, out of the usual for the industry."

Still, Principal, which bought Post Advisory to help expand beyond life insurance and retirement products, is taking action. It sent a corporate psychologist to work with staff and is changing compensation to help retain talent. The company is also weighing the risks of counting on iconic founders in future fund acquisitions, Shumway said.

"We tend to favor firms, I think, that are less reliant on one key founder," she said. "Partnerships are more stable and stronger."

Principal said Post Advisory had about $250 million of net inflows in the fourth quarter as of Dec. 11. That narrowed outflows for the year to $2.3 billion.

Larry Post started the firm in 1992 and expanded it to manage $3.4 billion by 2003 when Principal agreed to pay about $100 million for 68 percent of the money manager. Employees lost the opportunity to hold equity in Post after Principal took full ownership in 2008, limiting the staff's incentives to stay, said a person familiar with the situation who asked not to be identified discussing internal matters.

Hedge Fund

Employees Carl Goldsmith and Scott Klein struck a deal to buy Post Advisory's hedge fund business from Principal, and added asset management contracts in early 2009. Their business, renamed Beach Point Capital Management, lists 26 investing team members on its website. Eleven previously worked at Post Advisory, including Allan Schweitzer, who was CIO there.

After Schweitzer left in 2011, Larry Post took the CIO role with the aim of finding a successor. That set off jockeying for power among employees, helping to create an opening for Henry Chyung, who rejoined Post Advisory that year after working at Canyon Capital Advisors, people familiar with the matter said.

In August 2013 Principal named Chyung and Jeremy Sagi to fill Larry Post's duties at the end of the year, and said that after four decades in the industry he would be retiring and taking the title of vice chairman. At the time, Post Advisory managed $11.8 billion.

"The transition was not handled in a very delicate or respectful manner," Post said by e-mail. "That's all I would like to say."

'Punched Walls'

Larry Post left at the end of 2013 in what Principal said was a planned retirement. Post later said he was forced out, as did former Chief Operating Officer Sanije Perrett. Sagi, one of two successors picked to run the business, left in March. Sagi and Perrett are among the founding partners at a new junk-bond firm, Arena Capital Advisors, where Post is a partner.

Post Advisory sued Larry Post and Perrett in state court in Los Angeles in May, saying that they violated non-competition or confidentiality agreements through their roles at Arena, and Sagi was later added to the case. Post and Perrett said in a letter in the court case that they were forced out by the work environment.

A person at Post Advisory, whose name was redacted, "punched walls, broke phones, threw pens and slammed doors in employees' faces," an attorney for the former employees said in the document.

“Employees repeatedly expressed concerns about his conduct, including the fear that his violence would escalate,” the lawyer wrote. Principal’s asset management business “did nothing to address it.”

‘Wild Rumors’

The passage refers to Chyung, the chief investment officer at Post Advisory, said two people with knowledge of the matter who requested anonymity to discuss details that weren’t public.

Chyung said in an interview that he didn’t punch walls. He said the environment at Post has improved and that he’s friends with many of the employees. He was also asked about his temper and whether he yelled at employees.

“Do I have an intensity about me?” he asked in response. “Yes. But it’s because I care about doing what’s right for the clients.”

Principal said in a statement that legal clashes can include documents that “have no requirement for truth.”

“Wild rumors can be turned into serious sounding allegations before the legal system has a chance to verify the facts,” the company said.

‘Tough Culture’

Jim McCaughan, chief executive officer of Principal Global Investors, said that while Chyung has been a “divisive” leader, the company’s human resources department reviewed claims by employees at Post Advisory and found there was “no clear offender” in some staff disputes.

“The high performance of this organization kind of doesn’t come for free,” McCaughan said in a phone interview. “It comes with, in this particular case, quite a combative, quite a tough culture. And I can understand it doesn’t appeal to everyone, but it does produce the results.”

Post Advisory’s traditional high-yield fund gained 14.7 percent from the start of 2013 through Sept. 30, according to data provided by the company. High yield, or junk bonds, gained 11.3 percent in the period.

‘Different Personalities’

For some clients, employee departures trumped performance. Texas County & District Retirement System decided in September 2013 to withdraw funds due to personnel turnover, according to a spokesman. Vermont withdrew in October of last year.

Principal now plans to give top employees including Chyung a 10 percent stake in Post Advisory, leaving the parent with 70 percent, said George Jamgochian, an executive director at Principal who was sent to help with the transition as Post retired. Nippon Life Insurance Co., which agreed last year to take an equity stake in the firm, owns 20 percent. Jamgochian said the company is trying to draw up contracts by the end of the year.

Sagi said he left Post Advisory in part because of “different personalities and different thoughts about how to move Post forward.” He said he couldn’t elaborate because of the legal case.

Chris Tayback, an attorney at Quinn Emanuel Urquhart & Sullivan LLP who represents Larry Post, Sagi and Perrett, said the suit against his clients has no merit. The dispute has been sent to arbitration.

Jamgochian said Post wasn’t forced out and that the atmosphere at the firm has improved. He said the Post Advisory team bonded at a Los Angeles Dodgers baseball game and at a Mexican restaurant.

Some of the departures helped, according to Jamgochian, who said, “It’s sort of addition by subtraction.”

For Related News and Information:
Principal’s Post Steps Down From Running $11.8 Billion Group
NSN MR6I3G1A1I4H<GO>
Principal Targets Junk, CMBS for More Fees Than Stocks
NSN MT2YJP1A74E9<GO>
Gross Exit Spurs $27.5 Billion Withdrawal From Pimco Fund
NSN NEL3G66KLVRE<GO>
Principal management: PFG US <Equity> MGMT <GO>
Principal earnings: PFG US <Equity> ERN <GO>
Top financial stories: FTOP <GO>

--With assistance from Kelly Bit and Caroline Salas Gage in New York.

To contact the reporter on this story:
Zachary Tracer in New York at +1-212-617-1673 or
ztracer1@bloomberg.net
To contact the editors responsible for this story:
Dan Kraut at +1-212-617-2432 or
dkraut2@bloomberg.net
Pierre Paulden