In Conversation with Karen Karniol-Tambour, Co-CIO of Bridgewater Associates

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Introduction

On the sidelines of GIC Insights 2023, GIC's annual thought leadership event, Karen Karniol-Tambour, Co-CIO of Bridgewater Associates, shared her views on today's key macroeconomic and investment trends and about her time with the firm.

Transcript

The following is an adapted transcript of Karen's full interview, and has been edited for clarity and brevity.

How does Bridgewater anticipate and prepare for unexpected crises? How has the team maintained its all-weather investment strategy over the decades?

KAREN: To build a great portfolio that will be resilient over time, the most important tool at your disposal is to ask what you do not know, what could transpire in the future, and then stress-test your holdings against how different things might affect it. Don't be too caught up in the recent environment, but ask yourself what could happen, what might happen, and then how do I stress-test against that and pick the most resilient portfolio. That was Ray Dalio's original idea when he set up the all-weather portfolio many years ago. Over the years we have maintained that portfolio and built on it by adding to our scale of tools to stress-test this portfolio over time and look at the many different options that might occur. We stress-test them in different geographies, thinking about what if we could only run a portfolio in one geography or another, and expanding the range of assets and ideas we have to create that resilience over time.

In Bridgewater's view, who are the winners and losers of global supply chain realignment, and what are the implications for investors?

KAREN: I don't think deglobalisation is happening. It's just a rewiring of the globalisation we do have. It's about companies looking around, realising they don't want to be overly reliant on any one place, and are especially nervous about being overly reliant on China because of the political pressure to diversify away from it. They have to think about what geopolitical risks might arise. The big winners are going to be countries that can basically replace what was offered by China previously. These are likely the places that weren't the top destination to go to before, but are now considered as alternative options.

China is so massive that no one place is going to be able to replace everything that China has done for global supply chains. Different countries are now competing to try to take on some of those roles. Mexico geographically is in a great place to meet a lot of those roles and India is probably the best candidate to take over some of the scale of what China has done. For years, India has not had a great policy backdrop to enable that and it is certainly trying to take advantage of the current opportunities. It's still early days and we don't know which of these countries will really be able to capitalise on this potential. However, the size of the opportunity and the scope of the financial and investment flows that might move is massive, as seen in the early FDI flows soaring into those countries.

As co-lead of the firm's sustainable investing efforts, how do you manage the impact of climate change and climate policies on markets?

KAREN: If we think about what it takes to move from where we are today to a net-zero world, what we really need to do is discourage people from creating emissions or using carbon, and encourage them to do other things instead. We can either take the stuff we don't want and make it expensive, or we can take stuff we do like and make it more attractive. The classic economist favourite is definitely to make the bad stuff expensive by taxing it and the market will then find the most efficient way to get around those emissions.

The problem with that is it's extremely unpopular politically to take things that we use like oil and make them more expensive. It also became a lot more politically unpalatable as inflation rose the last few years, and especially as Russia invaded Ukraine, which increased energy prices in places like Europe. As a result, there is a massive shift in the world to move to incentivising the good stuff instead.

I think geopolitical competition with China was probably what catapulted the US most in this direction. The US realised that China has spent a lot of government effort trying to be leaders in areas like solar and EVs, and so the US and now Europe are trying to follow suit by shifting direction in terms of giving lots of incentives to encourage all the things we want to see in a transition world. The implications for investors are massive.

I like to think of the stock market as a Venn diagram: one circle being the climate problem and one circle being the stock markets. There are things in the climate problem that don't really affect stock market investors because their exposure is minimal at best, and there are parts of the stock market that don't have a lot to do with the climate problem. In the middle you have this sweet spot of companies that are really important to how the climate problem is tackled. What these companies do is really going to make a difference to whether or not we have impact.

From the perspective of those running one of these companies, the policy landscape is quickly shifting to either disincentivise emissions or - more often now - offer incentives to move towards different, more sustainable business models. For investors, that's a landscape with a significant influence over which companies can take advantage of the transition and who the winners and losers are going to be.

How should investors navigate artificial intelligence (AI) – where are the most investable opportunities?

KAREN: We are definitely studying it deeply and we see a lot of potential for AI to upend a lot of different industries. To make one comparison, the biggest shift we have witnessed from the 1980s till today is in manufacturing in the developed world. We saw probably 10% of the developed world workforce shift out of manufacturing either because those jobs were moved abroad, or because there was a lot of automation. Today we will see fewer workers on a factory floor in the US, but those workers are highly productive, working alongside machines to do incredible things. And that made up maybe 10% or 15% of the economy, which feels small, but, gradually over the years, had enormous consequences. It had huge consequences for politics, inequality, and corporate profitability. Therefore, it mattered to investors hugely over a multi-decade timescale.

When I look at AI in comparison, it has the potential for that impact, but at an at least two- or three-times greater scale. When we look at different studies which examine the likelihood of different jobs being augmented in some way by AI, we aren't looking at 10% of the workforce, but 40% or 50% instead; multiple magnitudes bigger.

While the potential is huge, it's so far progressed with baby steps. Not only does the technology have to be ready, but we also need to have the right business processes. Today, we are starting to see green shoots of it in small industries, but not enough to affect the broader macro backdrop. For example, call centres and customer services are going through something as transformational as what we saw during the early phase of globalisation. The number of jobs lost is just as large as before, but instead of moving to different countries, they are shifting to machines.

However, the wages of those who are still doing those jobs are continuing to go up rapidly because they are competing with hotel workers, restaurant workers and all the other places with persistent upward pressure on wages. In other words, if the industry expands in small amounts, the broader inflationary backdrop is going to have a bigger influence than the small deflationary impact of the one place which integrated AI.

My best bet is that over the next year or two, the inflationary impacts are going to be significantly greater and drown out the more deflationary impacts and productivity enhancements coming from AI. But as you look towards a longer time scale of 10, 20, 30 years, I wouldn't be surprised if we look back and say, this is the biggest event that occurred, just like how automation and globalisation in manufacturing were one of the most important events that happened in the last 40 years.

Can you explain Bridgewater's co-CIO model briefly and why it's worked for the firm?

KAREN: Bridgewater has always had a co-CIO model because we had a profound belief that the most important ingredient to good decision-making is to get multiple people around the table who are deeply informed but have independent perspectives. Ray Dalio, our founder, often talked about playing jazz together. What he meant was, when you listen to jazz, every instrument adds something different to the composition and together the music is something one instrument on its own could never make. We want to create that in investing. We want at least three smart people, that are deeply knowledgeable about the topic, with really independent perspectives, so that what comes out is greater than what any one person can accomplish. So, we set up our structure and our investment committee based on these beliefs. We have built these very long-lasting relationships between myself, the other chief investment officers and our senior investors to foster that kind of dialogue, including a space for disagreements, and ultimately, a way of working together to create something any one of us couldn't do on our own.

How has Ray Dalio's stepping down impacted Bridgewater and what's next in store for the firm?

KAREN: Ray Dalio has succeeded in doing what very, very few people in the industry have ever succeeded doing, which is actually building a firm that could transition to the next generation without him. A lot of people have built iconic firms, but very few of them have managed to make them outlast that first iconic person that put it together. I think that Ray switching officially into a mentor role is an incredible accomplishment for all of us, like myself, that Ray has been such a personal and incredible mentor to. It's a moment of celebration in some sense because it's on us now. This incredible founder and visionary created this company and at the end has actually managed to transition it to us. And so, while I have loved working at Bridgewater all the time, we are now at that moment of really taking full responsibility and being able to say, we are going to be the people that move this company into the next generation, beyond that first founder, beyond that first person that set it up. It's really exciting and I think it was empowering and energising to the whole group of people who took over from Ray. We are really excited to work together for the next few decades.

You have been with the firm for your entire career. How has it changed since you first joined?

KAREN: When I joined Bridgewater in 2006, the world was very different. As an example, emerging markets had a smaller footprint in global financial markets. We were pre-financial crisis, so it was still the heyday of leveraging up and talking about debt seemed strange to people.

And in the years since I have been there, we have massively expanded our research footprint and have been able to keep up with incredible developments in the world and accelerate beyond them in order to keep our investment process humming. We have invested tremendously into machine learning and AI to keep up with the technology needed to invest better. We have invested massively into studying new emerging markets which grew and became a much larger share of what's available to investors, compared to when I first joined the firm. In the last 15 years, we have also done incredible work to map out the buyers and sellers of every asset globally and predict what they are going to do next. We have studied and honed in on 10 years of quantitative easing and the big financial flows that affected every market, in a way that didn't exist as a real-life case since the Great Depression.

How has your experience been as co-CIO so far and any reflections on the journey that's led you to become the firm's first female CIO?

KAREN: I have had an incredible journey at Bridgewater, and I think that I never would have had that journey without the deeply embedded firm culture that it's everyone's job to give feedback and teach the people around them. Everyone I encountered, no matter what their depth of expertise was, starting with the co-CIOs all the way to people I worked with on very specific things, took the time to teach, to explain, to ask tough questions, and to give real feedback. This is critical because you can’t really move ahead in your career if someone is not pointing out to you the things you need to do to get to the next level.

The most incredible mentors I had often saw things in me before I saw them myself, and could point me in a direction that lay out a path that didn’t come to me on my own. And to me, the most important thing is to do that for others. I have mentored a lot of people during my time at Bridgewater, but the most meaningful to me have probably been the women I have mentored because of seeing fewer senior women in the industry. In many ways it might not matter as I have had incredible mentorship from people from every background, but there are certain things that stood out. As a mother myself, I know I have struck a chord with people by making it crystal clear that enjoying being a parent and enjoying your job are two things that can go hand in hand. It can be two parts of a whole that make a life and aren't in any way in conflict. That's meant a lot to me.

What would be your top predictions for the investment environment in the year ahead?

KAREN: A prediction for the next year or two that's not that commonly talked about is that currencies have been a totally ignored part of the investment landscape for a long time. This is because for quite a few years, it just didn't matter what you denominated your investments in.

However, that’s not always true. When you look at past cases where there is volatile inflation and higher rates that are moving between countries, it can matter a tremendous amount whether or not you have currency exposure.

My prediction is that we are moving back into that world where you are going to have much bigger differences between countries, more volatile inflation rates and interest rates, and bigger current account shifts. It's not going to be possible to be an investor that completely ignores the currency exposure question, as it will be too big of a driver of your actual ultimate returns.

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