CHAPTER 20
DONALDSON CAPITAL MANAGEMENT IS BORN

From 1988 through 1993, our investment management firm grew rapidly. For our Blue-Chip Growth accounts, we continued to use our B.I.G. Trend stock selection process with a few twists from the Value Line ratings. Our investment results outperformed the benchmarks for the period. Based on my work in dividends and Dr. Begley's continuous encouragement, our high-dividend-yield investing style also continued to gain new clients. As Dr. Begley had promised, Indianapolis investors finally became adherents of the High-Dividend-Yield strategy after I started describing it as conservative and capable of offering rising income in a falling interest rate environment.

The Blue-Chip Growth strategy continued to be much more popular with our clients for three reasons: (1) the other portfolio managers in our firm were committed to it; (2) the many investment brokers and investment consultants who referred clients to us liked its solid performance versus the markets; and (3) this was an era when the major indexes were producing double-digit annual returns, which drew most investors to growth stocks. It was true though, on a total return basis, the High-Dividend-Yield strategy's return was not far behind.

We had developed a series of DDMs that could work with almost any stock, from those that paid no dividend to the high-dividend-yield, high-payout-ratio utilities, telecoms, and energy stocks. As Tim Roe had originally advised, we used the DDMs as a ballpark indicator of which stocks were overvalued and which were undervalued. We never used the models as a black box stock picker. Our investment policy committee always made the final decisions on which stocks to buy or sell.

Our rapid growth finally caught the eye of the large insurance holding company that owned our parent company. In 1993, they spun our investment management division out of our parent firm to become a direct subsidiary of the insurance holding company. Our company was renamed Anthem Capital Management and merged with the insurance company's in-house investment staff. In a matter of months, we went from being a small investment management firm with eight employees and $160 million in assets under management to a large institutional asset management firm with over $2 billion in assets and 80 employees. The new firm sought and was granted trust powers, and it introduced a family of mutual funds, including a dividend-style fund I managed.

In the early days of the merger, I was excited by all the activity and the notion that we were building a firm that could serve a wide range of clients. I had long believed that trust services, mutual funds, and investment management were natural partners. With these three service offerings, we could provide financial advice and investment management to almost anyone. We were one of the first nonbank companies in the Midwest to put these three investment services under one roof.

I have always said that the insurance company got the "head" part of the business right but not the "heart." That deficiency became increasingly apparent, and soon I realized the new organization was not for me. One of the first indications of "heart trouble" came when top management changed our motto. Our previous motto, "Discipline, Patience, and Humility," was discarded as too corny. Then, the first line of our mission statement changed from "Our ultimate business is trust" to "We will earn a return on equity consistent with the leading firms in the industry." Next, a brochure appeared on my desk with a long quote attributed to me. It was not my quote and something I would never say. From the very beginning of the new firm, top management had a bad habit of asking for advice, then ignoring it, or telling me how things were going to be done and then doing something else entirely.

The final straw came in October 1994 after our investment policy meeting. My primary role with the firm was as senior vice president of economic strategy. In that role, I had the responsibility to set our investment strategy for managing our bonds and other interest-sensitive securities, such as corporate and municipal securities and collateralized mortgage obligations. I was also manager or co-manager of four mutual funds. These roles were all in addition to being the firm's top new asset gatherer.

I had heard rumors the CEO wanted to make some role changes in our executive investment team. I did not know what that meant and being one of two senior vice presidents and not having been consulted, I was concerned I might not like the changes. When the CEO announced his decision, I instantly knew this would likely be the last investment policy meeting I attended. The CEO said he wanted all his top investment strategists to be located in Indianapolis. To him, I am sure that was not an unusual request. It was the way 99 percent of large investment managers and insurance companies did business. This being the case, all the investment decision makers were in the home office so they could rub shoulders and swap ideas on a daily basis. As it was, my partner, Tom, and I still lived in Evansville, and we came to Indianapolis about every two weeks for regular meetings and more often to visit clients.

The CEO said that if Tom or I did not want to move to Indianapolis, then we would not continue to lead the firm's investment strategy for stocks, bonds, and the economy. We would focus our efforts on marketing the multiple products and services the company offered by building a large regional marketing office in Evansville. When I heard the CEO's decision, I struggled to understand his logic. It was true that the investment leadership of most large asset managers was located in the home office, but his announcement affected only my partner and me. Then it hit me so hard I felt like the air had suddenly left the room.

This action affected only Tom and me, and even though we were the senior executives in the investment advisory division, its insurance division had many equity and debt asset managers who could replace us. In addition, the CEO knew Tom and I would not move to Indianapolis because we had said as much to one of our colleagues who had moved to Indianapolis to help with marketing.

"Hello, three-times-an-insurance-company-loser," I heard shriek through my head. Yep, it was happening for the third time. I was being let go from the great little firm I had helped build nine months after the large insurance company had bragged to high heaven about our growth and where were going from here.

That was not literally true because the CEO assured me I would be handsomely compensated to lead the regional marketing role that would continue to be headquartered in Evansville. As I sat in the CEO's office, I wondered why my partner was not also hearing his pronouncement at the same time I was. I found out later that Tom had already told the executive vice president he was not leaving Evansville. I mentioned to the CEO that the timing was not good for me, and I would like some time to think the matter over. The truth was I wanted to buy time to chat with Tom and find out what he knew that I did not. We could do that on the drive back to Evansville. Yet, I already knew I would not stay with the company if my investment duties were removed or if my client contact roles were eliminated. That was the choice I was being given, and I knew it was a nonstarter.

That meant I had no choice but to resign. I felt immediate relief. After the meeting, I headed for the elevator to begin a walk around downtown. This was a regular part of my routine when I visited Indianapolis. My walks usually took me past many of the office towers of Indianapolis-based corporations and the State of Indiana government buildings. That day I had only one spot in mind, the chapel on the Circle.

The chapel had held a prominent place on what is known as Monument Circle since 1857. Its doors were always open, and I had often visited it through the years, delighting in its wonderful silence and beauty, which invited prayer and meditation. Its multicolored stained-glass windows gave its interior a numinous aura that spoke both of its long history as a place of worship and as a venue that invited everyone to experience its mystical peace in the middle of a bustling city. I sat in the back row and soaked in all the beauty and holiness that the chapel evoked. I began to pray, asking for direction and help. I wanted to be guided to a good firm with good people who shared my vision that without trust and humility, there could be no common good that served everyone's interests.

My prayer was fervent and expectant, and I genuinely looked forward to contacting some people in the investment business whom I trusted and had known for many years. I had already worked for four different investment firms and was confident I would not have any trouble landing another spot, but I was also serious that I wanted to work for a company that cared more about its clients than its bottom line. As I exited the chapel, I heard a voice that was not mine or anybody else's I knew. Though it came and went in a moment, I heard exactly what it said: "You have all you need."

In the next instant, I also knew I had heard the words before.

Twenty years earlier, I had been offered a job in the investment business by a friend of mine, Mark English. He and I had worked together for a division of AT&T before he left the company to join the investment firm. The change had been good for him personally and financially. As a result, every time we went to a college or professional football game, he would try to recruit me to join him at the investment firm.

In the spring of that year, 1975, I was taking a lunchtime stroll around the Circle when I walked past the chapel and heard the words, "You have all you need." At the time, I had no idea what they meant, but as I walked on, I passed the offices where Mark's firm was headquartered and realized I had been thinking about his offer for days about leaving AT&T and joining him.

I decided to accept Mark's offer, and his recruiting me into the investment business was good for me. It gave me the freedom to try my own ideas and be compensated based on my success in attracting clients and choosing investments wisely, rather than on the subjective job appraisal of a single manager. Moreover, the investment industry constantly sought to discern the future of everything, not hang on to a hundred years of providing a dial tone in the cheapest way possible.

Now I was amazed that those words had come again as I was thinking about a career change. Yet, what did "You have all you need" mean in this case? I continued to walk around downtown with no destination in mind, hoping the message would make sense to me. As I approached the chapel again, it was as though it explained itself. It was telling me I did not need to look for another investment firm. I had enough experience and capital to start my own firm and run it the way I wanted.

Moving to another firm made a lot more financial sense than going off on my own. The legal, accounting, and start-up costs of creating a new firm would be a financial drain for the first few years. But starting my own firm would bring the satisfaction of following my own head and heart. The only problem with that argument was it would take a lot more than capital to get a firm up and rolling. Attracting a high-quality support staff would be essential, and I knew how difficult it was to find the right kind of people. Yet, the message seemed clear that I should start my own firm and do the best I could to run it by trying to do right by others as much as I did in trying to do right for myself. Three weeks later, I resigned and began the process of starting Donaldson Capital Management, LLC.