Mutual Admiration

Investors love Houston’s AIM Management Group, whose mutual funds have made them rich. AIM’s founders love them back: They’ve gotten rich too.

by Claire Poole

Here’s a photograph Ted Bauer likes to show people who ask about the humble beginnings of his investment company, AIM Management Group. It’s a blurry snapshot of him and co-founder Gary Crum sitting in an empty office in the Marathon Building in downtown Houston in 1976. “The telephone didn’t work,” 78-year-old Bauer recalls. “Those are Gary’s chairs, and that’s my card table. That was about it. And not one dollar under management.”

These days Bauer and 49-year-old Crum can afford better furniture—a whole skyscraper, even. After two decades of explosive growth, AIM is the twelfth-largest mutual fund company in the United States, with almost $70 billion in assets and 1,400 people in Houston and Austin on its payroll. The company manages $66 billion for some 3.5 million shareholders, with 39 kinds of stock, bond, and money market funds to choose from; last year investors poured nearly $14 billion into its mutual funds. AIM’s top performer is its $2.1 billion Aggressive Growth Fund, which invests in fast-growing stocks like the Landry’s restaurant chain, computer retailer CompUSA, and PetCo pet supply stores; it has one of the best five-year annual returns—20.7 percent—of any diversified fund in the business. It has been so successful, in fact, that AIM closed it to new investors in 1994, fearing that too much money was chasing too few quality investments. When it was briefly reopened in 1995, $1 billion came flooding in; after only two days, the company had to close it again.

How did chairman of the board Bauer, director of investments Crum, and a third partner, fifty-year-old president and CEO Bob Graham, turn their tiny start-up into an investment powerhouse? Like all entrepreneurs, they saw an opportunity—in mutual funds—and exploited it; today, thanks to companies like theirs, such funds are as common as stocks and bonds and are a favorite vehicle for retirement savings. And over time, they developed a strategy: Unlike their counterparts at other fund firms, who bought stocks when they were cheap or overlooked by Wall Street or when they emerged as takeover targets, AIM’s principals were early devotees of the “earnings momentum” theory of investing: You buy stock when a company’s earnings are growing faster than the rest of the economy—regardless of the price—and sell at the slightest hint of bad news. AIM’s portfolio managers don’t bother to grill corporate executives or do rigorous critiques of financial statements to pick the fastest-growing stocks. Rather, they scan the wire services, talk on the phone with Wall Street analysts, and re-
AIM’s mantra: Spend less time worrying about where the market is headed and more time picking stocks whose earnings are growing faster than Wall Street predicted.

view earnings projections in an almost robotic fashion. “I don’t like them to travel,” says chief equity officer Scott Lucas, who manages AIM’s stock pickers. “If they’re on the road, they’re not sitting in front of their computer screens.”

If it sounds like a simple approach to a complex business, it is—too simple, some say. Following the earnings momentum theory means AIM’s fortunes are tied to the health of the stock market at any given time. When the market is good, AIM’s funds are very good; when the market is off, they’re horrid. In its annual mutual fund review, for instance, Forbes gave AIM’s Constellation Fund—which invests in growth companies like software giant Microsoft and hospital chain Columbia/HCA Healthcare—an A+ in up markets but an F in down markets. And, in fact, after the Dow Jones Industrial Average slid 157 points on March 31, growth funds like AIM’s lost $1 billion in a week’s time. “The problem with earnings momentum is when it doesn’t work, it can really, really fail,” says Don Phillips, the president of Morningstar, a Chicago-based mutual fund tracking firm.

By and large, though, the market has been robust over the past two years, so earnings momentum has worked; when the Dow rebounded in late April, gaining 179 points in a single day, AIM’s funds recovered nicely (though how nicely won’t be known until quarterly figures are tallied at the end of this month). “Our objective is not to outperform the market in every part of the cycle,” Graham says. “We tend to outperform the market over the complete cycle.”

That consistent record has led other mutual fund companies such as PBHG, Stein Roe, and Van Wagoner to jump on the earnings momentum bandwagon. And it has brought a handsome reward for Bauer, Crum, and Graham: In November they pocketed $880 million when they sold AIM to the London investment firm Invesco for $2.2 billion—the largest takeover of a fund company in history. All three have kept their jobs with AIM, which is now a division of one of the world’s largest
independent money managers, a firm with $160 billion in assets.

Twenty years ago AIM's founders must have seemed crazy to leave their secure jobs managing money at the Houston insurance company American General Capital Management Corporation. But they were determined to go out on their own, so they scraped together $430,000 of their own money, solicited another $20,000 from private investors, and lined up $2.25 million in letters of credit, then created three funds from scratch: a high-yield bond fund that invested in risky corporate debt, a balanced fund that invested in both stocks and bonds, and a money market fund that invested in low-risk, low-return securities like Treasury bills and bank certificates of deposit. Yet despite their reputations as smart money men, they couldn't get investors to bite. It was so slow at first that they found themselves sitting around "looking at each other," Bauer recalls.

The turning point came in 1980, when they launched a money market fund that charged lower fees than those of big-time rivals like Fidelity and Shearson—and thus provided a better return to investors (AIM could do this because of its lower overhead). By the end of its first year, the fund had pulled in $2.5 billion, giving AIM a foundation on which to grow its reputation. Then, in the mid-eighties, AIM began acquiring well-established funds from other companies—funds that invested primarily in stocks rather than bonds or Treasury bills to ride the ever-rising bull market. In 1986 it paid $12 million for the Charter Fund, run by Julian Lerner in Dallas, and the Weingarten and Constellation funds, run by Harry Hutzler in New York, two pioneers in the mutual fund business who were advocates of the earnings momentum theory. It was Hutzler, in particular, who turned AIM's founders on to earnings momentum.

After the acquisition, Bauer shipped his brightest star, 25-year-old Jonathan Schoolar, to New York to learn Hutzler's theory about picking hot stocks. Schoolar, a former equity trader at American General, was ready to learn. "I had come from the mid-eighties: Wall Street suspenders, slicked back hair, all that stuff. I was getting real burned out on the business," he says. "I was tired of the ends justifying the means. Everything was an ego play; everybody was master of the universe. It was a great deal of fun, but intellectually, it was not very interesting." Hutzler, who toiled for thirteen years as an economist at the corporate research firm Value Line, taught him his three-pronged method. First, he explained, spend less time worrying about where the market is headed and more time picking stocks whose earnings are growing faster than Wall Street had predicted. Second, pack your fund with a lot of different stocks—even as many as two hundred to three hundred—so any one dud won't destroy you. And third, fully invest your fund; don't sit on your cash until you think the market is turning.

Hutzler's musings became AIM's mantra. The company now tracks 14,000 stocks broken down by their market capitalization—that is, their value according to Wall Street—and splits them into three groups: small cap, large cap, and blue chip. The ones that aren't meeting their earnings projections are dumped, leaving an average of around five hundred companies for each portfolio manager to consider. Schoolar says that's where the real art is—in managers talking to analysts, reading research reports, and trying to pin down a consensus on how fast the companies are expected to grow. In that stage of the process, the list is whittled down to two hundred.

After acquiring Charter, Weingarten, and Constellation, AIM continued to buy funds, applying Hutzler's method to all of them. In 1992 it picked up fourteen funds—including its Aggressive Growth Fund—from Philadelphia insurance giant Cigna for $36 million. Last year it acquired three more funds from Milwaukee's Robert W. Baird and Company—including its Blue Chip Fund—for $2.7 million. Why buy an existing fund instead of creat-
ing one yourself? "We get instant investors," Bauer says, "and we're able to put them directly into our machinery."

And what a machine it is. Unlike its rivals, AIM doesn't sell its own funds; instead, it offers them through a network of 2,300 banks, brokerage firms, and financial planners, such as Citicorp, Smith Barney, and Chemical/Chase. Overseeing this aspect of AIM's business is Michael Cemo, the president of AIM Distributors, whom Bauer hired away from American General in 1988. An old-school marketer who uses his charm to win clients, Cemo studiously promoted AIM's funds, one segment of the industry at a time, from the day he joined the company. First, he sent eight of his associates into the field to approach the big brokerage houses individually and preach the earnings momentum gospel. Three years later, he hit the banks; thanks to his efforts, AIM is the nation's second-most popular fund family among bankers. In 1993 he went after thousands of financial planners, who account for 24 percent of AIM's sales. Today he's pitching investment advisers—buoyed, no doubt, by the fact that an industry newsletter, Fund Marketing Alert, named him marketer of the year in 1996.

The one hitch in AIM's strategy is the size of its fees. Overhead is no longer low—in Houston alone, the company leases most of the space on fifteen floors of a 31-story downtown office tower in Greenway Plaza and a 40,000-square-foot warehouse on the north side of town. And because its funds are sold through brokers and dealers, AIM has to charge a 5.5 percent sales commission, with an additional 1.07 percent annual charge for the Aggressive Growth Fund. Even though the rest of the industry seems to be moving toward low-fee or "no load" mutual funds, AIM adheres to its you-get-what-you-pay-for approach. "We really believe most people need the help of a consultant to choose a fund," Graham says. Clearly the fee hasn't deterred millions of clients worldwide, but just to be on the safe side, the company is about to launch a $12 million ad campaign designed to make investors aware of AIM's name, management style, and investment discipline.

Also on the horizon, of course, is even greater expansion. With $100 million in liquid investments, AIM hopes to buy more funds—although the list of possible targets is getting shorter and shorter. "There are four hundred or five hundred fund management companies, and one hundred of them have ninety percent of the business," says Bauer. "I don't know what the other guys are doing." By now, everyone knows what AIM is doing.

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