



FRANK K. MARTIN

Frank (MSBA '78, MBA '92) has built Martin Capital Management, one of the most trusted and respected investment management firms in the United States. It was ranked by Barron's in 2008 in 57th place among more than 10,000 financial advisory firms in the nation. Recognized twice by the School of Business and Economics for his accomplishments and contributions, Martin won the IU South Bend Distinguished Alumni Award in 1983 and the Lewis S. Armstrong Award in 1998.

As a Crowe Horwath executive-in-residence, he visited with student and faculty groups and shared his thoughtful and deeply reasoned views about business, economics, and the capital markets. His passion for examining the "why" behind all outward events and for sharing his wisdom with students has been a constant. Dean Rob Ducoffe interviewed Martin at his home in Elkhart on November 6, 2008.

Rob Ducoffe: Can you tell us a little bit about yourself, your family, and your background?

Frank Martin: I was an early World War II baby, June of '42, the first of six boys, no sisters, son of a commonsensical father who was then a major in the Army Corps of Engineers, and a mother who was intellectually and artistically gifted yet gladly gave up “her” life for a career as the house mother to a home full of boys. My parents were a beautifully complementary match. I am the product of that genetic union and the environment of love in which it thrived. I can lay no claim to being self-made.

RD: Where did you grow up?

FM: Here in Elkhart County. This has always been the place I've called home, even though my actual and vicarious travels have taken me around the world.

My undergraduate experience at Northwestern University and my tour of duty as an officer in the U.S. Navy opened my eyes to a bigger world. But when all is said and done, home is where your heart is, and many of the people I love are close by.

I remember a potentially lucrative job offer I received in 1987 that stipulated I move to a large metropolitan area more than four hours from Elkhart. I responded by saying: “Before you make your offer, no matter how grand it might be, please know in advance that I will respectfully decline.” Some things simply cannot be bought with money.

RD: Can you explain what Martin Capital Management does?

FM: That question would be better answered by our clients. One wag in our profession as investment managers once lightheartedly confessed, “I invest other people’s money until they have no more.” The irony of that statement, in light of what’s happening in the capital markets today, is not lost on any of us. We have discretionary authority as investment managers over the financial assets of some 120 wealthy individual clients who have entrusted to our care something in excess of \$700 million. Our mandate is as simple in concept as it is difficult to implement in the real world, and it is patterned after parts of the Hippocratic Oath: Always put our clients’ interest above our own and never engage in those activities that could permanently jeopardize their capital. Living by the adage “To win, first you must not lose,” we have managed thus far in this time of great turmoil to stay, for the most part, out of harm’s way. In this particular cycle it’s important to remember that our job is only half done. Like the biblical “Parable of the Talents,” if we are to be diligent in carrying out our responsibilities, we cannot simply bury the assets entrusted to our

care in the ground like the last servant. We must exercise wisdom and prudence in multiplying the talents given to us. While resisting the cries to join the bull market crowd was difficult, stepping up to the plate in what will likely be an empty ballpark will be even more difficult.

RD: Can you explain the roles that you play and have played with the firm?

FM: I was the founder in mid-1987 and, at the time, being somewhat of a contrarian and confident beyond what was warranted, I nonetheless sought the counsel of others for encouragement. The first 10 people I asked said it was the craziest idea they had ever heard. “Who would ever be so foolish as to start an investment management company in Elkhart, Indiana?” they enjoined. Admittedly, there had never been one here before, which I guess was reason enough for some to believe that there never could be one. Fortunately, I’ve always been intrigued by the improbable if not the impossible. I love to turn conventional wisdom on its ear. (I like to say I don’t so much defy conventional wisdom as ignore it.) So, the declarations that it could not be done served as my inspiration. Strangely, that streak of independence has served me well professionally, particularly of late.

I waited to hang out my shingle until I had earned an MBA from a fine institution known by the acronym IUSB. I also felt that before I opened my doors that I wanted to be professionally accredited at the highest level, so I studied for three years to become a Chartered Financial Analyst (CFA). Ironically, my timing could not have been better, depending on your point of view. I started doing business in September of 1987, as soon as my charter arrived in the mail. Within a month, the Crash of '87 rocked the financial world. Since the modest amount of money I managed was invested in the highest-quality tax-exempt bonds and U.S. Treasury securities, client portfolios actually appreciated during that maelstrom. As to why the money was safe-harbored, let’s just call it serendipity! That’s a thumbnail sketch of Martin Capital’s humble beginnings.

RD: My next question is about your investment philosophy, but before we talk about that, as the firm grew how much of a managerial role did you play? How is the firm actually run? What is it like to work there?

FM: Culturally, if you read our business and investment principles in any annual report [all the firm’s communiqués, including annual reports, fireside chats, among other items can be found on its Web site by Googling “Martin Capital Management,” we are uncompromisingly client-focused and, because we are independent, we are accountable only to our clients. Our firm is operated to optimize the experience of our clients. If we perform that responsibility adequately, the firm and its employees will do just fine. We don’t need external capital and so, ethically, we have no conflicts of interest that might compromise the objectivity in our service

to our clients. Our unique performance-based fee schedule complements our objective of aligning our interests with those of our clients.

Looking inside the firm, no organization is without challenges. We have a generation-gap challenge. I'm 66. My next oldest partner is 43, and the others are in their late 30s and early 40s; that creates its own dynamic tension, not unlike Methuselah attending a meeting of the Young Presidents Organization (YPO)! Nonetheless, our culture is collegial.

In the early years, I wore most of the hats and worked prodigious hours. A watershed event took place effective January 1, 2007, when I turned over daily management to my son, Todd, who became managing partner, and I "ascended" to the position of senior partner, sort of like the relationship between the chairman of the board and the CEO, and that has worked out spectacularly well for a couple of reasons: First, Todd has done a great job in the daily management of the firm, and he has earned my implicit trust and, equally important, he has earned the trust of clients, peers, and employees. As a father, it is a joy to watch him grow and earn the respect of everyone, not because he is my son, but because, by acclamation, he was chosen as the best man for the job.

I now have more freedom. Some people who don't know me might call me a workaholic. If reading, thinking, and writing are work, then I plead guilty as charged. If DreamsWork [www.dreamswork.org] is work, then I am doubly guilty. Everyone who seeks to understand the connection between one's labors and the soul should read the short chapter on work from Kahlil Gibran's *The Prophet*. I do labor 60 hours or more a week—starting at 4:30 a.m. daily—but it's a labor of love.

Some people view me as physically challenged, though I see myself as cerebrally liberated—and have observed a few things about life as a result. First, money doesn't buy you anything of importance. Second, the aphorism "If you have your health, you have everything" is overrated. I believe one's attitude is more important and, without faith, no positive attitude is sustainable. The absence of robust health actually opens up a whole new world. For me, it has been a blessing in disguise. I might have become a self-indulgent guy if it weren't for MS redirecting and refining my focus. And, if it weren't for MS, I wouldn't have met my wife, Marsha. I believe God speaks through people, and he speaks to me 100 times every day through her.

RD: You worked for your dad, and now your son works for you...

FM: I actually worked with my dad. We were competitors; each of us had his own practice.

RD: Is there something unique about having two family members in the

business together? Are there challenges you think about, things you handle or make an effort to handle, a bit differently?

FM: One must be a bit more guarded. I have always been a vocal opponent of nepotism and still am. In fact, when Todd graduated from DePauw he made it clear that of all the professions he didn't want to consider, investment management was at the top of his list. He then took a job with First Chicago and ended up in the investment area. A couple years later, he called and said, "Dad, this profession is really fascinating; might you have an opening?" I countered, disguising my glee, "Only for someone with a CFA," which he knew was three long years away. He went on to earn his charter and called me again. That time we talked turkey!

Todd is my only son and oldest child. I have two daughters as well. The relationship between Todd and me has been very good, and I have such admiration for him. There's always risk, of course, particularly for people who bring their kids into their businesses, that their visions may not coincide. I made every effort to discourage Todd from entering this profession ill-advisedly. That he discovered it on his own is pleasing to me, but I'd have been just as happy if he had followed his heart somewhere else.

RD: Could you give us a brief sense of the investment philosophy of your firm and, in talking a bit about that, explain whether or not it has evolved over time?

FM: Before I get into the philosophy, the answer is "no" to the second question. It has not evolved over time. We adhere to the investment philosophy of Warren Buffett, only modified as necessary to fit our particular circumstances (like the flexibility that comes from being much smaller in terms of assets). We reconcile some of our disputes by asking, "What would Warren do?" I have read everything I could on Buffett. He is our business/investment role model. We don't try to directly mimic or "ape" him, but we try to think like he does, and we try to employ the investment principles that have served Berkshire shareholders so well for almost half a century. Warren and I are in more frequent contact as time has passed, and we communicate on interests we have in common. An op-ed piece I wrote in early October, "Privatizing Rube Goldberg for the Common Good" (in opposition to Treasury Secretary Paulson's government-administered program), precipitated some fascinating exchanges between us. Buffett was kind enough to provide the lead blurb for my book *Speculative Contagion*, published in 2006. Nobody seemed to understand the title then but, sadly, they do now.

RD: How do you characterize your investment philosophy? What are the main aspects of it?

FM: Nearly 80 percent of our clients have entrusted us with all their money, and they are our friends. Our mandate is to keep them wealthy under all circumstances. Buffett, in his 2006 annual report, outlined the attributes he was looking for in a successor and makes abundantly clear the truly awesome responsibility behind that moral commitment.

What happened this year is an example of Nassim Taleb's Black Swan-type of event. We are self-mandated to protect even against these kinds of unpredictable occurrences, which means we have to be largely out of the game when temptation is strongest. For the most part we were. You lose clients who want more action during such times, but our belief that we'd rather lose 50 percent of our clients than 50 percent of our clients' assets is not subject to compromise. We impose the principle on ourselves by "eating our own cooking," that is, by investing our own assets in the same securities as we invest for our clients. When somebody comes to me and wants to do something I consider irrationally aggressive, I simply reply, "I'm not going to be foolish with my own money, and therefore I won't be foolish with yours. If that is unacceptable, then I think you should find somebody who has a different attitude toward risk." As I stated earlier, we know that to win, first you must not lose. Since we haven't lost much, we may now have the opportunity to win by filling out portfolios with really great companies that can withstand any storm and will almost certainly prevail.

RD: How many companies?

FM: A maximum of 15 core holdings.

RD: What is the significance of that number?

FM: You provided me with a nice segue into my IUSB experience. A project I was given as a graduate student was to determine just how much diversification is necessary to reduce what we call "random risk," the chance of a single event wreaking havoc with a portfolio's aggregate return. It could be a bankruptcy, fraud (e.g., Enron), or the unprecedented meltdown in the financial services industry. How much diversification do we need to reduce that random risk by, say, 90–95 percent? Random risk cannot be reduced to zero but, if the diversification is truly broad—geographically, by industry, and so on—about 12 stocks in a portfolio will do the trick. Most institutions managers have hundreds of companies in their portfolios. While this is mathematically and practically absurd, it is the conventional wisdom. In such portfolios, it's easier to bury mistakes because they're less conspicuous. But there is a downside to extensive diversification. As the market goes, so goes your portfolio. Investors with broadly diversified portfolios participated fully in the market crash of 2008. More importantly, can you ever hope to accomplish great things if you do what everyone is doing?

RD: What kind of student were you?

FM: I think I was the top student in my class. That was less a tribute to my aptitude than it was to my attitude. I was also quite committed. (I'm single-mindedly driven by return on investment; my friend, Professor Wayne Bartholomew, was incredibly demanding in his macroeconomics course, but I figured it was worth the price. In effect, I received 6 credit hours of education for 3 credit hours of tuition!) Finally, I had the desire to "get it right" after not reaching my potential as an undergraduate student at Northwestern. At IUSB I was intent on seeing what I could do if I actually applied myself, and I had excellent rapport with my professors, many of whom became friends. It was a delightful, though admittedly arduous, experience.

RD: Can you reflect back a bit more on where you were in your career when you started at IU South Bend?

FM: I was 33, I think, when I started the Master of Science in Business Administration program. I was 10–11 years out of undergraduate school and actually apprehensive about returning to the classroom, even though I had scored very high on the GMAT. I didn't know if I would be accepted, so I scrambled to get letters of recommendation from Art Decio and Jon Armstrong (son of Lewis Armstrong, after whom the IUSB award is named), hoping they would carry the day. John Peck, then dean of the business school, smiled when I gave them to him. As it turned out, once I was accepted, I discovered I hadn't forgotten everything I'd learned. The experience was a great refresher, a confidence booster. The experience left me convinced that education is a lifelong experience. Ever since, I've tried to read about one good book a week.

RD: Could you pinpoint when you realized you wanted a business career?

FM: I defaulted into it. My father was in the securities brokerage business. What I really wanted to be, if I may confess, was a Navy fighter pilot. That's what I dreamed about as a kid. I had an academic scholarship to Indiana University, but they didn't have a Navy ROTC program, and my dad was goading me into taking on a bit more of a challenge. He suggested I check into Northwestern (which did have Navy ROTC). So, if truth be told, I really went to Northwestern to be a fighter pilot. As it turned out, I flunked three flight physicals consecutively because of astigmatism. So all I walked away with (yes, walked, not flew) was a great education! I really did have an epiphany. In my senior year, I took a course by Corliss Anderson, who was the "Anderson" of Duff, Anderson & Clark, the great research firm. Anderson was an adjunct faculty member, and he used Ben Graham's *Security Analysis*, the bible of our industry, as his text. I was so smitten by both Anderson and Graham that the ideology stuck like glue. I knew then exactly the career I wanted.

RD: Was there a setback or a challenge you had to deal with that, looking back, was critical in the success you enjoyed?

FM: Today I wouldn't call it a setback, but the onset of MS at the age of 36 forced a re-evaluation of my priorities in my personal life, work, and how I was going to ensure that my family was taken care of in case I was destined to depart this mortal coil earlier than I had planned. With an MS diagnosis, your future becomes a giant unknown. So that really forced the issue, and that is when I decided that I should begin preparing for managing money. At age 45, nine years later, I started my firm and, in the meantime, I finished my MBA degree and became a CFA.

RD: That seems like a significant amount of retraining for a middle-aged person. Would you agree?

FM: Not really. I had been investing for a long time—and with some measure of success. Moreover, my values have remained the same. More importantly, at the beginning I was a solo practitioner, and as our organization evolved it managed to survive my ineptitude. I was not a natural-born leader, which is quite evident even today. I defaulted into the role in spite of the mistakes I made. Somehow, we managed to pull it off.

RD: With the kind of success you have had in your career, when people ask you as I am asking you now, are there any hints you could share with the rest of us?

FM: Absolutely. I am looking over your shoulder at Viktor Frankl's book on my library shelf, *Man's Search for Meaning*, which I have read countless times. I have lectured on it at Goshen College and other places. Frankl has been one of my mentors in absentia. I think he was, despite his existentialism, full of remarkable insights about human behavior. On success, he said joy or happiness cannot be pursued directly, but they must ensue from the devotion of one's life to a cause greater than oneself—or as the result of the unconditional love of a person other than oneself. So I never aim directly at success any more than, as a sailor, I would aim at the shoals along the shoreline, as I would likely get the same results. While I frequently fail, I try to be other-directed. I try to get beyond myself. I believe that the measure of a man is not what he gets, but what he gives back. The verdict on my life will only be learned when it's too late for me to make any changes. When I meet my Maker, anything worldly that happens between now and then will pale by comparison.

RD: Many readers of this interview will be students. Is there anything beyond what you have already said, sort of pieces of advice that you would like to offer?

FM: I think, first of all, you must reconcile your heart and your head. To

disregard one or the other is likely to be a mistake. Strenuously avoid being driven by the pursuit of money in and of itself. You know the old adage, "A man who loves his work never works a day in his life." At the age of 66 I'm signing on for another 10 years, not because I have to, but because I want to. So as long as I enjoy what I'm doing, I will pursue that which brings me great personal satisfaction and a sense of contribution to my community, something greater than my own needs. I do think one should give some thought about the kind of business he chooses if he elects a career in business. Some businesses are intrinsically better than others, with more pricing power, more sustainable competitive advantages, and so on. If money is important to you—not as a direct object but as a by-product of what you do—so that you can, in time, use it to make a difference in this world, all the better. If you use it to live extravagantly and self-indulgently, then I'm not sure that is a worthy goal.

If you want to create an organization, to build a business that adds to the greater good, and if you can avoid being corrupted by money, then you look for those careers and businesses that will reward you accordingly. If you want to be a teacher, there are going to be limitations on how much money you can earn. If you go into business and it's a business that can be very profitable, such as ours (and if you execute your responsibilities with character and integrity), then you will have a lot of money flowing through your coffers that you can recycle, ideally, in a meaningful way. To reiterate: I believe that the measure of a man is not what he gets, but what he gives back.

RD: Do you have any thoughts on what business schools ought to be doing to improve their programs?

FM: In theory I do; in practice I think it will be very difficult. Testing is best suited for left-brain-dominant students. It's much easier to test for sequential thinking and problem solving, recall, etc., than for right-brain attributes. For example, how do you test for intuition or artistry? So economics has become largely quantitative. Of course, modern portfolio theory (MPT) is the ultimate in the application of mathematics to what really is a soft science. So even though MPT is an important part of the CFA program and the curriculum in most graduate business schools, Buffett and I consider it almost laughable. Yet it continues as core curriculum because that's what teachers have been taught to teach, and it's hard for this battleship to change direction. In a recent *New York Times* edition, Bob Schiller, with whom I've had communications, wrote that behavioral economics is the new frontier. Even though it's gaining currency at Harvard, Yale, and a number of other leading schools, it's going to be difficult to institutionalize because it's so intuitive. So I would love for schools to teach right-brain thinking and applications as well, but it won't be easy to quantifiably integrate it into the curriculum.

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One other thing I might teach is discussed in Steven Levitt's book *Freakonomics: The Importance of Incentives*. Incentives make the world work, according to Levitt, and I agree. In business, discerning others' motives and incentives is critically important if you want to avoid being the patsy. Just because this is soft science doesn't mean it should be neglected any more than medical students should avoid learning about the effects of "bedside manner."

I do think it's hard to teach ethics. You can use case studies, but ethics is based on a strong moral foundation, and most colleges and universities are more likely to teach Adam Smith's *An Inquiry into the Nature and Causes of the Wealth of Nations* than they are to teach his equally important book, the *Theory of Moral Sentiments*. Many so-called business leaders who have brought shame to the name of capitalism were educated in the very schools that teach ethics. Were they not listening—or is ethics, like morality, something not easily taught in the classroom?

The first of Mahatma Gandhi's "Seven Deadly Sins" that can bring ruin to a society is "money without labor," which is one reason why I philosophically struggle with family dynasties. Another, "commerce without morality" (also what Adam Smith conveyed in *Theory of Moral Sentiments*), may help schools teach the importance of living life ethically so that you can look back on what you've accomplished without regret and with self-respect. I think it's critical for young people, out trying to make their first buck and climb up Maslow's hierarchy of needs, to consider the long-term consequences of their actions. It's pretty academic, but if you look at what happened in this whole financial fiasco, you can see there was a major problem undergirding everything—moral drift.

RD: Well, I think that's a good place to stop. Thank you.