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Profile/**William H. Gross**

Playing for Keeps With $45 Billion

By KATHLEEN MURRAY

NEWPORT BEACH, Calif.

IN the early 1970's, when the focus for traders was on stocks, William H. Gross, whose qualifications included a master's degree in finance and success at the Las Vegas blackjack tables, felt the lure. But in a bear market, the only job he could land was clipping bond coupons for the Pacific Mutual Life Insurance Company in Los Angeles.

Undeterred, he plotted his move into equities from the dusty vault. Along the way, a funny thing happened. He got interested in bonds. "Lucky me," he said. "Little did I know where the opportunity was." When bonds began a long-term rally in 1981, Mr. Gross was along for the ride.

It has taken him further than he ever imagined. Today, Mr. Gross, 49 years old, manages from offices here a total of $45 billion in bond funds for the Pacific Investment Management Company, or Pimco, a unit of Pacific Mutual Life that he was instrumental in turning into a separate subsidiary more than a decade ago. Nearly $40 billion of that is institutional money, such as pension funds for the likes of New York City, A.T.&T. and Philip Morris Inc.

The remaining $5 billion is in 11 mutual funds. Over the past five years, the flagship Pimco Total Return Fund has earned an average annual return, 13.62 percent, well above the 10.93 percent of the Shearson Lehman Bond Index, according to Morningstar Inc., Chicago-based mutual fund researchers. No manager of a competing fund has done better. Morningstar recently named his Harbor Bond fund one of five "forgotten funds" offering outstanding value. [Page 16.]

"In terms of performance, no one is really in their league," said Kurt Brouwer, a San Francisco-based money manager.

Don Phillips, publisher of Morningstar Mutual Funds, who calls Mr. Gross "kind of like the Peter Lynch of bond funds," points to Mr. Gross's creativity and his long-term view.

Pimco profited by analyzing and taking advantage of new bond-like substitutes and derivatives in the late 70's and 80's, and its funds were the first to look at bond futures as a viable option for conservative investors.

"It seemed clear to me that if you could be conservative from an investing standpoint, but innovative from a new products standpoint, you could beat everyone to the starting line," Mr. Gross said. "And that turned out to be the case."

Pimco still relishes a trading coup in 1983-84 involving Ginnie Mae collateralized depository receipts, a new kind of futures contract. After analyzing the securities, company managers realized there could be a healthy return with almost no downside risk.

"It was the kind of investment you dream about," Mr. Gross said. Pimco quickly bought up contracts before other traders caught on. In the end, Mr. Gross said, Chicago bond pit traders were waving handkerchiefs at Pimco's brokers in mock surrender. The company made millions for its clients.

Photographs by Jim Wilson/The New York Times

Bill Gross, the Peter Lynch of bond funds, in Newport Beach, Calif.

at Stake

Mr. Gross and his fellow managers also take a global view, investing abroad, and a long-term view, taking economic forces like corporate downsizing into account. In recent weeks, as uncertainty over President Clinton's economic package has mounted, bond traders have grown bearish. Mr. Gross has been among the most vocal critics and has been selling long-term bonds.

The long view enables the firm to "avoid the psychological whipsaws" faced by short-term investors, he said. The strategy isn't fail-safe. In 1981, for example, Mr. Gross was too early in anticipating a bond bull market. In 1984, Pimco underestimated a drop in interest rates, hurting results. Still, he's been right more than he's been wrong.

Pimco won its first client in 1974, when Southern California Edison opened a $25 million account, and got its big break a year and a half later, when A.T.&T. hired it to manage $100 million. "That was like getting the President's seal of approval," Mr. Gross said.

By 1981, the portfolio was doing well enough that Mr. Gross and two other Pimco principals, William Podlich, an administrator, and James Muzzy, who handled marketing and client services, felt they ought to be getting a piece of the profits, not just salaries. So they approached Pacific Mutual about getting more control.

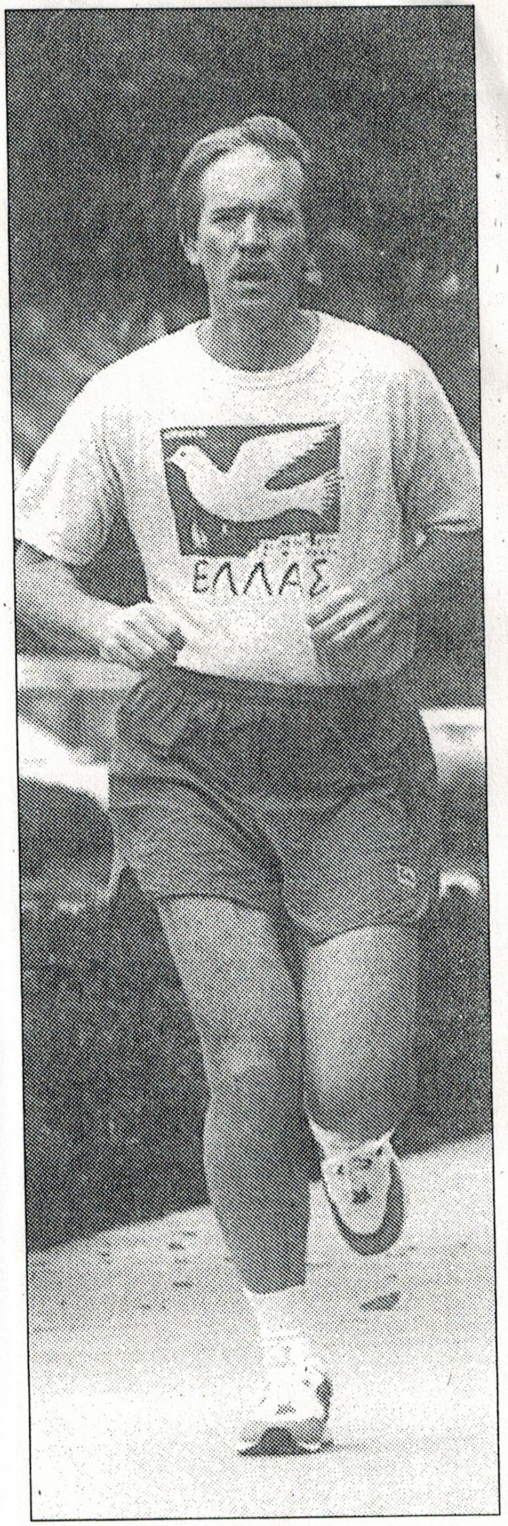
"In retrospect, it was a gutsy move," Mr. Gross said. "They could have thrown us out of there." Instead, the company set up Pimco as an independent subsidiary. Today, Pimco is still run by the three executives. "We're all very competitive," said Mr. Muzzy, who is building a house down the road from Mr. Gross's oceanfront property in an exclusive gated community in Laguna Beach, Calif. "But we all have different strengths," he added.

Mr. Gross takes special pride that Pimco has continued to grow rapidly and has never lost a client for service or performance reasons. "It's my obsessive tendency," he said.

From blackjack to bond trading, Bill Gross makes his bets pay off.

Following graduation from Duke University with a degree in psychology, Mr. Gross took $200 and headed to Las Vegas in 1966 to try out a card-counting theory. For the next three months, he slept in fleabag motels or his car and played blackjack 16 hours a day. He was soon wearing disguises so he wouldn't be thrown out of the casinos. By the time he left to join the Navy, he had $10,000.

"The point wasn't to win money, but to prove I could beat the system," he said. Aboard ship, he pondered mathematical methods and flirted briefly with becoming a professional gambler, but decided investing was a more socially acceptable way to use his mathematical skill and desire to win. So after the Navy he studied finance at U.C.L.A.



Jogging near his office.

THOSE closest to Mr. Gross point to his vigor and determination. An avid runner, he once decided to do a marathon a day for five days. Eventually, his kidneys started bleeding, but he still finished. His stamp collection has him wheeling and dealing at auctions by phone. "It's the deal," says his wife, Sue, whom he met through a dating service after his first marriage failed.

Unexpectedly perhaps, Mr. Gross is soft-spoken, self-deprecating and accommodating. "My time is your time," he says to an interviewer. Still, he is calculating in what he reveals. To be a good bond manager, he says, one has to be part mathematician, part economist and part horse trader. "When you're trading, you become this riverboat gambler, and you sort of put on your riverboat gambling hat," he said. "You have to be able to take on several different personas."

Sometimes this means schmoozing and cajoling. Other times it means having to "yell and scream and pretend you're a little schizoid. That way the seller is never really sure if you're going to accept his offer," Mr. Gross said. "I learned in the first four or five years that you could never let them see your face," he added. "You always have to be sort of a one-eyed jack."

But he offers brief glimpses. One recent day, as Mr. Gross awaited an announcement by President Clinton on the long-term bond supply, his eyes flickered back and forth between the Telerate and computer screens. Suddenly the news came across a screen. His neck muscles tensed and his face reddened. The supply was lower than he expected, but the market — perversely — was going down, too quickly to lock in a price. He pounded the table in frustration. By the time he put in his order, the market had moved up.

Later he said the market had misread the announcement. "I knew it, but I didn't act on it quick enough," said Mr. Gross, who still made $50,000 or so on the trade. But that was a short-term play, and not the essence of Pimco. Mr. Gross and 13 other portfolio managers, sitting in a corner trading room overlooking the Pacific, have built the firm by hatching longer-term strategies.

In 1982, Mr. Gross, to help with mathematical analysis, hired Frank Rabinovitch, a self-described computer nerd from Stanford University, who designed a system that can "slice and dice a bond like a Veg-o-matic."

But the investment decisions are still made by people. At a U-shaped trading desk, Mr. Gross has surrounded himself with some of the smartest. One trader, David Edington, a former aerospace engineer with an M.B.A. from M.I.T., acknowledges this is not a place for the insecure. "Sometimes," he said, "you've done all this research, and everyone tears your idea apart, but that's what keeps you from falling asleep."

For Mr. Gross there seems to be little danger of that, although he does try to go home by 4 P.M. to play with his 5-year-old son, Nick. His children from the previous marriage — Jeff, 21, and Jennifer, 17 — live with him part time. His home office and refuge has books and a collection of his press clippings but computers are noticeably absent. The Telerate is jammed in a closet off a small gym downstairs.

"He didn't want to see it," Mrs. Gross said. "He made a decision that he had to scale back because he wants to last."

Pimco wants to last as well. "Our nightmare is that we wake up and pension funds will have lost their tax exemption or something like that," said Mr. Muzzy. "So we're constantly doing reality checks."

MR. GROSS'S take on reality is that with interest rates lower, bond investors will have to settle for returns of 5 percent or 6 percent instead of 15 percent. As baby boomers age, pensions will be paid out, and fund balances will be lower.

An emotive writer, he opened a recent newsletter with an A.E. Housman poem about an athlete past his prime and mused about how to stay in the race. But he concluded he's a long-term player, no matter how the game changes.

"You've got to take what the pitcher gives you," he said. "The big challenge will always be to beat the competition."

Kathleen Murray is a business writer based in Los Angeles.