The Skorina Letter

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Harvard throws in the towel

In our piece on Harvard last July titled "The Harvard Endowment: Time for some Creative Destruction?" we wrote the following...

It's been ten years now since Jack Meyer stepped down as head of the Harvard Management Company, while David Swensen - now in his 31st year - has carried on at the Yale Investment Office.

Each endowment has pursued its own distinctive management model: HMC with its "hybrid" internal/external approach, versus YIO's exclusive reliance on cherry-picked external managers.

We can now call the winner: It's Yale.

See: "The Harvard Endowment: Time for some Creative Destruction"
It's here: http://www.charlesskorina.com/?p=3631

Well, the creative destruction has arrived in the person of Narv Narvekar.

Yesterday, reporters Dawn Lim and Juliet Chung broke the big news in the Wall Street Journal that Harvard will adopt a new model of endowment management.

Maybe we should call it the "Columbia model" rather than the Yale Model, but it amounts to the same thing.

In brief, Harvard Management Company will cut its staff by 50 percent, outsource internally-managed assets, and hire a CIO which, technically, HMC has never had. The new CIO will be Richard Slocum, an old colleague of Mr. Narvekar's from JPMorgan.

With separate CEO and CIO, and a much smaller staff, HMC will look a lot like Columbia under Mr. Narvekar.

We all knew changes were coming, but we didn't foresee such rapid and dramatic restructuring. Obviously this happened with the full support of Chairman Paul Finnegan and the HMC board and was probably in the works since Mr. Narvekar was offered the job.

See: http://www.wsj.com/articles/harvard-to-outsource-management-of-its-35-7-billion-endowment-1485363650

Texas Turmoil

UTIMCO picks a new path through a political minefield

Endowment returns took a beating last year and the turnover in chief investment officers tells the tale.

Among the big names to make an exit in 2016 was **Bruce Zimmerman**, longtime CEO of The University of Texas Investment Management Company (UTIMCO).

We wrote about endowment turnover in our last newsletter.

See: http://www.charlesskorina.com/?p=4488

Texas is the home of big money, bigger egos, and bare-knuckled politics and the last few years have been uneasy ones for the UT system and, collaterally, for UTIMCO.

Here's what happened:

Prologue: An Admiral comes aboard

Five years ago I, and many others who don't much follow naval affairs, became aware of **Admiral William H. McRaven**.

The short version of his bio is: He's the guy who got Bin Laden. To be sure, it was a SEAL operator who put a bullet through OBL's black heart in 2011; but it was Adm. McRaven, as commander of JSOC (Joint Special Operations Command), who planned and executed the op.

In May, 2014 he made another big impression. He showed up to give the commencement address at the University of Texas in Austin, his alma mater, refulgent in his dress whites instead of a drab academic gown. And, his talk, as the kids say, went viral, with over 4 million views on YouTube. It was widely remarked upon all over the country.

The admiral's "If you want to change the world, start off by making your bed" speech is worth a watch.

See: https://www.youtube.com/watch?v=pxBQLFLei70

Apparently Texans took particular notice.

Dr. Francisco G. Cigarroa, Chancellor of the UT System had announced just four months earlier that he was ready to step down and would leave at year-end.

Dr. Cigarroa had been touched, but mostly untainted by a rancorous, multi-year admissions scandal and a governance struggle at the flagship campus in Austin, which caused the Regents to force out campus president **Bill Powers**.

It's a long, tangled story, but here's the short version:

https://www.insidehighered.com/news/2015/02/13/investigation-finds-ut-austin-president-influenced-admissions-decisions

Following Adm. McRaven's star turn it was clear that the Regents had found their new Chancellor. He was named sole finalist for the job in July, 2014, two months after his speech. He got the formal nod in August, and took office five months later in January, 2015.

It's a pretty nice job. As a federal employee, Adm. McRaven made about $200K. As UT Chancellor, McRaven makes $1.2 million take-home. He negotiated a 60 percent increase over the $750K his predecessor made. That doesn't include some $400K in deferred comp he will collect in subsequent years.

What's important for our story, however, is that the UT chancellor also automatically takes a seat on the governing board of UTIMCO. In fact, he becomes UTIMCO's Vice Chairman for Policy.

So, starting in 2015, Mr. Mc Raven was also one of the nine men who govern UTIMCO and the $35 billion dollar endowment pool it manages for UT and, in part, for Texas A&M University.

A sudden departure

Another big Texas job turned over in October, 2016. Bruce Zimmerman, CEO and chief investment officer at University of Texas Investment Management Company (UTIMCO), departed after 9 years in office.

Mr. Zimmerman's departure was uncommonly sudden. A press release on October 10th announced a resignation effective that same day, which is not how things are usually done.

Per his separation agreement, he got a total of about $1.3 million in severance payments, and that was that.

Writing in UT's hometown paper, the Austin Statesman, reporter **Ralph Haurwitz** asked Mr. Zimmerman the delicate but unavoidable question: whether he decided to resign or was nudged?

Mr. Zimmerman responded: "I would say it's mutual. I've been thinking about it for a year or two. I really am ready to do something different. We have a relatively new board. I think they have an interest in kind of putting on their print. So it works out for everybody. I'm very happy."

A conservative consensus?

In our review of the big Public Ivy endowments two years ago, Mr. Zimmerman got a very honorable mention.

We noted that the UT System is by far the largest public university, with twice the assets of its next-biggest rival, the University of California System. But their 5-year returns both then and now were only in the middle of the pack for the publics.

We noticed something interesting, however, when we computed Sharpe ratios over five years: UT/UTIMCO moved up to first place. They clearly had the best risk-adjusted returns in this pack of 15 big publics.

That risk/reward tradeoff appears to have been a deliberate policy, one which had been duly approved by the board and constituents.

A 2013 report contained this language:

"Over the past few years, the Endowment's investment returns have lagged other large endowments primarily due to the Endowment's lower risk profile...While it is the case that risk has been rewarded over the past few years, there is agreement [among staff, Board, and Regents] that the necessity to protect principal supersedes the desire for higher investment returns."

And, Mr. Zimmerman told a reporter:

"...It is not surprising that UT's returns have been a bit lower than the other endowments.

"We have been increasing our portfolio's risk profile - very prudently and gradually - over the past six years and plan to continue to do so.

"When equity markets are strong, as they have been since the financial crisis in 2008, our portfolio will lag riskier peers, but in tougher times our returns should look attractive on a relative basis."

Language like this has continued to appear in official UTIMCO reports over the last few years.

In addition, UTIMCO's performance reports always emphasize their out-performance relative to their internal benchmarks. This out-performance is significant and persistent and something Mr. Zimmerman frequently alludes to.

Shifting goalposts

By 2016 there were a lot of new faces on the UTIMCO board.

There had been a 100 percent turnover since Mr. Zimmerman was hired in 2007, and six new members just in 2014-2015, most conspicuously Regents Vice President **Jeffery Hildebrand and Mr. McRaven, who were chairman and vice-chairman, respectively.**

We surmise that the new crew had re-evaluated the longstanding risk-return regime under which Mr. Zimmerman had been working.

There is a boiling resentment among voters around the country over rising tuition at public universities and public officials, elected or appointed, feel that burn.

And, the crisis of 2008-2009 is rapidly receding in memory. UTIMCO's relatively conservative portfolio weathered those years with smaller losses than most major schools, and everyone was pleased. But that was then and this is now. And the new crew seems to be more interested in what that policy has done for them lately.

PUF: the best little sovereign-wealth fund in Texas

There's another, peculiarly Texan piece to this puzzle. Without delving deep into UTIMCO bookkeeping, we should at least mention that the endowment funds managed by UTIMCO are kept in two separate pockets: PUF and GEF.

These may sound like Saturday-morning cartoon characters, but they denote the Permanent University Fund and General Endowment Fund, respectively. Their investment returns are similar, but they are differently funded.

PUF, now worth over $17 billion, is essentially a sovereign-wealth fund and is much older than UTIMCO, dating back to the 19th century. It was set up to receive the income from the state's 2.1 million acres of public lands, mostly in sparsely-settled West Texas. The fruits weren't much at first, consisting mostly of fees from cattle-grazing. But that all changed in 1923 when drillers struck oil on PUF land in Reagan County.

By law, two-thirds of PUF income goes to the UT System and one-third to the Texas A&M System. Those oil and gas revenues have made UTIMCO and, therefore, UT and TAM rich, but it puts them in somewhat the same position as any commodity-rich country. Gyrations in world prices and changes in technology make annual revenues volatile.

As of February 2016, eight months before Mr. Zimmerman's departure, oil prices had plummeted, with West Texas Intermediate trading at less than $27 a barrel, down more than 70% from its 2014 high.

Annual oil money flowing into PUF peaked at $1.1 billion in 2014, driven up by advances in hydraulic fracturing and horizontal drilling which increased production volume. But by FY 2016 revenues had fallen to just $512.3 million, a 60 percent drop as prices fell and some drillers gave up.

This was not a huge hit relative to UTIMCO's total assets and returns, and the oil market has roller-coastered before, but the UTIMCO board contains many people close to the oil industry, including Chairman Hildebrand. They are acutely sensitive to the ebb and flow of oil and gas revenues and these trends probably affect their views on UTIMCO's investment policies.

Show us the money

What the triggering event was in changing CIOs, we can't say. FY 2016 returns were slightly negative (see top 25 chart below) but they were still quite good in a bad year when compared to peer endowments. At some point, however, there was clearly a consensual shift.

In August the UTIMCO board decided they needed an official, designated back-up to the CIO, and **Mark J. Warner**, a senior managing director was, in effect, made deputy CIO, although he wasn't given that title. That permitted Mr. Zimmerman to take a rare two-week vacation in September with Mr. Warner in charge.

A few weeks later, just back from vacation, he was suddenly gone and Mr. Warner was named interim CEO and CIO.

We can get a hint about how the wind was blowing from an interview Mr. McRaven gave to Bloomberg reporter **Michael McDonald** just a few days later.

"For whatever reason, we just couldn't get the returns we were looking for. We're always looking for more money."..."We need UTIMCO to deliver the amount of money we need to fund higher education."

He also noted that "Bruce did a great job for us." But his priorities were pretty clear.

Whoever interviews for this position shouldn't have to wonder about his mandate. Higher returns are required and that will probably require higher risk.

And speaking of endowment returns, as you can see from our top 25 endowment chart below, fiscal 2016 was not an easy year for any endowment chief investment officer.

Among these big funds, both private and public, UT/UTIMCO did quite well in FY2016, ranked 9th out of 25. They had the highest returns among the publics, except for Texas Permanent School Fund, and surpassed several Private Ivys, including Columbia, Penn, Dartmouth, Harvard and Cornell.

Largest 25 Endowments: Returns FY 2016

Ranking by **FY2016** returns for **1, 3, 5, and 10 years**

-	Endowment	CEO/CIO	1yr Rtn %	3yr Rtn %	5yr Rtn %	10yr Rtn %	AUM FY16 $bn
1	**Texas Permanent School Fund ***	Timmins, Holland	**7.6***	6.4	7.8	5.7	30.2
2	Yale	Swensen, David F.	**3.4**	11.5	10.3	8.1	25.4
3	**Emory U ***	Cahill, Mary	**1.9***	6.2	7.3	NA	6.5
4	MIT (MITMC)	Alexander, Seth	**0.8**	10.8	10.3	8.3	13.2
5	**Princeton** (PRINCO)	Golden, Andrew	**0.8**	10.8	9.4	8.2	22.2
6	Rice U	Thacker, Allison K.	**0.2**	7.3	7.8	7.1	5.3
7	**U of Notre Dame**	Malpass, Scott C.	**-0.3**	9.1	8.4	7.9	10.4
8	Stanford (SMC)	Wallace, Robert	**-0.4**	7.6	7.1	6.7	22.4
9	**U of Texas Sys (UTIMCO)**	**x Zimmerman, Bruce**	**-0.7**	**6.2**	**5.3**	**5.4**	**24.1**
10	Penn State U	Pomeroy, John C.	**-0.8**	6.4	6.8	6.4	3.6
11	**Columbia** (CIMC)	Holland, Peter	**-0.9**	7.8	7.4	8.1	9.0
12	U of Michigan	Lundberg, Erik L.	**-1.4**	6.6	6.0	6.7	9.7
13	**U of Pennsylvania**	Ammon, Peter H.	**-1.4**	7.6	7.7	6.5	10.7
14	U of Virginia (UVIMCO)	Kochard, Larry	**-1.5**	8.1	8.5	8.5	7.6
15	**Dartmouth College**	x Peedin, Pamela L.	**-1.9**	8.7	8.5	6.9	4.5
16	U of Chicago	Schmid, Mark	**-1.9**	5.0	5.7	6.3	7.1
17	**Harvard** (HMC)	Narvekar, Nirmal	**-2.0**	6.2	5.9	5.7	35.7
18	U of So. California	Mazzocco, Lisa	**-2.1**	6.6	6.3	5.5	4.6
19	Duke University (DUMAC)	Triplett, Neal F.	**-2.6**	6.9	7.0	7.1	6.8
20	**Northwestern**	McLean, William H.	**-2.7**	6.5	6.5	6.6	10.2
21	**Washington U**	x Walker, Kimberly G.	**-3.2**	5.4	5.6	5.3	6.8
22	Cornell U	Miranda, Ken	**-3.3**	5.0	5.2	5.2	6.1
23	**U of Calif. Regents**	Bachher, Jagdeep S.	**-3.4**	7.1	6.5	5.8	9.1
24	Ohio State U	Lane, John C.	**-3.4**	4.7	5.0	3.7	3.6
25	**Vanderbilt**	Hall, Anders W.	**-4.3**	4.0	4.5	4.8	3.8

NB: numbers by Charles Skorina & Co. and Bloomberg News
NB: **Texas Permanent**, **Emory**, **Northwestern**, and **UTIMCO** have a FY of Aug 31st
*All endowment returns are for FY Jun 30th except for **Emory** and **Texas Permanent**.
Returns for **UTIMCO** and **Northwestern** are trailing 12 months ending Jun 30th as reported to NACUBO.

A conversation with Bruce Zimmerman

Bruce Zimmerman joined UTIMCO as Chief Executive Officer and chief investment officer in June of 2007, six months before the official start of the "great recession" in December 2007 (US National Bureau of Economic Research).

But despite a 13% drop in the endowment in UTIMCO's 2009 fiscal year (Sep 1, 08 - Aug 31, 09), half the fall of some notable east coast Ivy endowments, performance has been, for the most part, solid and steady during Mr. Zimmerman's tenure.

With billions in oil and gas royalties flowing into the school's endowment coffers, the UT Regents and UTIMCO board historically has not felt the need to push the investment boundaries. Their mantra was make a decent return and don't lose the money.

Mr. Zimmerman joined UTIMCO after seven years at Citigroup, leaving as head of Citi's global pensions. With a Harvard MBA, an undergraduate degree from Duke and a few years at Bain and Texas Commerce Bank/JPMorgan Chase, the post at UTIMCO brought Bruce back home to Texas

When he resigned this October, the school's press releases were laudable.

According to UT Regent and chairman of UTIMCO's board Jeffery Hildebrand, Mr. Zimmerman has done "a masterful job in maximizing" resources. "Bruce built an organization and a business model that truly reflects what Chancellor (Bill) McRaven calls a 'team of teams' approach, capitalizing on the creativity and intellect of many external partners and internal colleagues, and making smart, calculated decisions that benefit and advance public higher education."

Mr. Zimmerman certainly deserves credit for managing endowment funds not much smaller than Harvard's, but with a quarter of the staff. And for hiring a lot of very good people for a fraction of what HMC pays their senior staffers. Down below we have a partial list of senior staffers at UTIMCO, with their latest available comps.

I spoke recently with Mr. Zimmerman about the challenges of managing a large public endowment and I asked him what his takeaways were from his nine years at UTIMCO.

Skorina: how would you characterize the challenge of a CIO position at a major endowment?

Zimmerman: it's important to remember that the CIO and investment staff all work for a client, in my case the UTIMCO and Regents board members. They set the objectives. But the objectives often change as the people change, and part of the job as CIO is to continually explain and educate. Often we become the institutional memory because people on the board with very different backgrounds come and go.

I don't know that I fully appreciated the realities of this ever-changing environment when I first signed up for the job; our board changed a lot over my nine years, six board chairs and thirty board members. And the university regents change often, as well. This turnover does present challenges.

That said, I loved being at UTIMCO and have nothing but praise for those that serve, as volunteers, as Regents, and UTIMCO Board members.

Skorina: What is it about the job that's so appealing?

Zimmerman: A lot of reasons. First: the mission. Providing resources for public education and health is a noble cause. Second: the privilege of working with such talented colleagues and external partners. Third: the challenge presented by global capital markets and the opportunity to continue to learn.

Skorina: how did you approach the job? What was your process like?

Zimmerman: From the beginning, I wanted to take advantage of our size. We did this by building deep expertise in various industries and regions and capital structures; health care, for example, Latin America, lower middle market private equity, credit, agriculture.

All of these areas of expertise served to complement the skill the organization already had in investment styles such as hedge funds and long only fixed income and public equity. We encouraged innovation, entrepreneurship, we also spent a lot of time trying to establish processes that created collaboration and shared learning.

It's hard work, Charles. We hire maybe fifteen managers max out of about 1,200 presentations a year. We see a lot of opportunities, but invest in very few.

When I joined in 2007 we had 12% in private investments. When I left we had 36% in privates, composed of a very diversified portfolio of very focused strategies. When I arrived, we had 30% in hedge funds and it was without a doubt the "crown jewel" of the portfolio. It remains a top quartile if not top decile portfolio although we have gradually reduced the exposure to closer to 25% as we moved the overall portfolio to be more in the middle of large US endowments from a risk perspective. And now, almost the entire book produces above average and often top quartile returns for their respective strategies.

From a risk perspective, at the direction of the client and the board we aim toward the middle of the fairway, you could say. Our long term target is to earn 5% plus inflation of about 1.5% on the AUM.

So we came pretty close. Over my nine years, UTIMCO earned approximately 4.5% and we distributed 4.5% to 5% of endowment funds. Inflation was low but it did exist, so we fell a bit short of our long-term objective due to the Great Financial Recession. The seven years after 2009, saw about an 8.5% annual return in performance.

We added 170 basis points of excess returns above our benchmark, or $4.5 extra billion during my career at UTIMCO. I'm proud of that. That's what chief investment officers are supposed to do. That's why we are hired

Skorina: I see a lot of resumes from guys out of top MBA schools who were recruited directly into a consultant firm; you put in five years as a consultant for Bain before moving JPM and Citi.

I'm curious about how that consultant training and mindset affected your approach to later jobs, including UTIMCO.

Zimmerman: I found my consulting background, as well as my work at JPM and Citi where I had responsibilities across many functions, very helpful for an investor as well as a CEO of an investment management firm. As an investor, when buying a security, I very strongly subscribe to the notion that one owns a piece of a company, not just a piece of paper. Being able to analyze a business as more than just a black box is often quite valuable.

Skorina: What are your key takeaways from leading UTIMCO?

Zimmerman: A great team, or as we looked to build, a "team of teams" is an incredibly powerful force. A CEO/CIO cannot overinvest in their organization.

Skorina: Of the top twenty endowments, about three quarters reported loses for the latest fiscal year and the top performers earned just a few percent. UTIMCO came very close to breaking even, landing just at the top quartile among large US endowments. It's been tough for CIOs to make a buck. Yet some do. Why? Where?

Zimmerman: One key is to maintain a long-term focus. This requires the support of the client and the board. Another key is to assemble and maintain a great team. This requires a concerted, consistent effort.

A third key is the willingness to be different based on non-conventional views derived from hard work and data-driven insights. Some of the key risk areas we spent a good deal of time analyzing included illiquidity risk and concentration risk. These are two areas that, if done right, can contribute to favorable returns.

Skorina: What do you see on the horizon? Where are the opportunities to make money?

Zimmerman: First, I think, in general, asset prices are high due to seven years of easy money. That makes me cautious. Second, I think we are in for a period of enhanced volatility. Those investors that embrace volatility, trim gains, keep cash, invest when assets are out of favor, I think will all do well. Third, I continue to believe that skill matters when it comes to investing. Therefore, the hard work to identify and partner with folks that are the best at what they do remains a formula for success in my mind.

Skorina: You have had a stellar career so far. What's next do you think?

Zimmerman: well I'm not ready to retire Charles. And although we like Austin, I would certainly look consider a move that made sense. A family office or multi-family office, an OCIO business, a niche asset management initiative. Who knows? We'll see what comes along. You're in the business. Call me.

Skorina: Thanks, Bruce, I will, and best of luck to you.

Here are some compensation filings for senior UTIMCO investment staff.

Top six UTIMCO staff compensation

(partial list from 990s for 2014)

Name	Title (2014)	Title (2016)	Base	Bonus	Total W2
Warner, Mark J.	**Sr MD**	**Interim CEO/CIO**	**$305,473**	**$605,357**	**$913,868**
Ruebsham, Ryan	MD	MD HFs & Credit	$239,862	$367,099	$609,700
Chen, Susan	**MD**	**MD Public Equity**	**$237,790**	**$355,000**	**$595,829**
Kampfe, James Russell	Sr PM	MD Fixed Income	$216,529	$561,060	$777,589
Doak, Harland	**PM**	**Sr Dir Fixed Income**	**$176,529**	**$236,688**	**$415,355**
Powers, Courtney	Dir	Sr Dir HFs	$164,395	$218,179	$384,713
Lewis, Edward	**Dir**	**Sr Dir Real Estate**	**$162,942**	**$190,498**	**$355,574**
Hopper, Amanda	Dir	Sr Dir Public Equity	$148,505	$170,196	$321,139

NB: source: UTIMCO Form 990 - FY 2015 ending 31Aug2015 - filed Jul2016
NB: comp is for calendar year **2014**
NB: Total headcount for investment professionals at UTIMCO is about 55. This list of senior staffers is limited to those for whom comp numbers are available.

A look ahead for endowment returns

As we mentioned in the beginning of our UTIMCO review, the last year has been a rough one for endowment performance.

Looking at our largest 25 endowments chart above, only six of the top 25 endowments in AUM earned positive returns. We should note the Texas Permanent School Fund and Emory look especially good because the reported numbers are for their fiscal year end of August 31st.

As one chief investment officer said to me recently "The one year returns ending Aug 31st show how fast things can change when two negative months - July and August 2015 - roll off and are replaced by two good months - July and August 2016."

But don't walk away feeling too cheerful about the future. In Grantham, Mayo, Van Otterloo's (GMO) third quarter investor letter, **Ben Inker** ponders whether this investment climate could be considered "Purgatory or Hell".

We leave you with Mr. Inker's observation about future endowment, foundation, and pension returns.

One point that becomes immediately clear from these forecasts is that earning the 5% real return that endowments and foundations and savers are counting on, or the approximately 7.3% nominal return that defined benefit pension funds are assuming on average, is going to be extremely difficult.

While a few institutions have been able to generate the kind of outperformance that it would take to turn these forecasts into an acceptable outcome, it would be impossible for institutions as a whole to do so.

Alpha of that kind is predominantly a zero sum game. It is certainly possible for a well-resourced, talented, and hard-working investment staff to field a group of active managers to outperform their respective asset classes, as evidenced by Yale University's endowment returns over the last 30 years. But active managers in aggregate have not, will not, and cannot meaningfully outperform their asset classes in the long run.

This means that whether we are in Purgatory or Hell, institutions have a very big problem today.

See: **Hellish Choices: What's An Asset Owner To Do?** By Ben Inker.
GMO Quarterly Letter by Ben Inker, Jeremy Grantham, 11/8/16
https://www.advisorperspectives.com/commentaries/2016/11/08/gmo-quarterly-letter

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The Skorina Letter

Each issue explores how the world's most accomplished asset managers think and invest. Original content includes profiles and interviews with industry veterans and research on compensation and investment performance.

Our insights and commentary come from our clients - board members, CEOs, chief investment officers - and the global investment community within which we work as executive search professionals.

Institutional investors operate at the crossroads of capital, talent, and ideas, shepherding over seventy trillion dollars in global assets. It's a constantly evolving spectacle and The Skorina Letter gives readers a ringside seat.

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