The Skorina Letter

News, Interviews, Research for Institutional and Family Office Investors

● Retained Executive Search ●

We recruit chief investment officers and senior asset managers for
endowments, foundations, family offices and institutional investment firms

skorina@charlesskorina.com http://www.charlesskorina.com/
Office: 415-391-3431

Cambridge Associates: Leading the charge into OCIO battlespace

Two Harvardians invent an industry

In 1973, two former Harvard roommates and budding entrepreneurs – Jim Bailey and Hunter Lewis – took on an assignment to review the investments held in their school's endowment.

Things were very different back then. A treasurer of the Harvard Corporation with the wonderfully Bostonian name of Paul Codman Cabot had managed the endowment from 1948 to 1965 as an account at his own firm, State Street Research & Management; charging the school $20,000 per annum for his services.

Mr. Cabot, one of the inventors of the modern mutual fund, had daringly shifted the Harvard portfolio from ultra-safe bonds into a more balanced stock-and-bond mix, catching the equities boom of the 50s and early 60s. And in 1973, with the fund having risen to a then-colossal $1 billion, Treasurer George Putnam and President Derek Bok created the Harvard Management Company.

When Messrs. Bailey and Lewis began their consulting relationship with the Harvard endowment in 1973 and formally established Cambridge Associates, Mr. Bailey was still on campus, finishing his joint MBA/JD program, while Mr. Lewis was working at The Boston Company, an old-line merchant banking firm. Forty-four years later, CA continues to count Harvard as a client.

A decade later, a young woman named Sandra Urie wangled a one-on-one job interview with Jim Bailey. She was a product of Stanford and Yale (and development office head at Phillips Andover Academy, a CA client). The scheduled 30-minute interview lasted 3 hours, and Mr. Bailey hired her.

As a divorced single mother, she was not the typical junior consultant of that era. Yet, fifteen years later she was named CEO of Cambridge Associates, and subsequently chairman, stepping back to become Chairman emeritus in 2016 after thirty-two years with the firm.

Consulting and asset management: the rapidly blurring boundaries

Traditionally, institutional investment consulting – which Cambridge virtually invented – and asset management were distinct businesses run by different kinds of people, and the twain seldom met.

The barrier was as much cultural as institutional. Consultants were seen (and saw themselves) as operating in a more disinterested, academic, and research-related environment. Asset managers were closer to the Street: faster-paced, more competitive. They were increasingly publicly-traded, and therefore relentlessly profit-driven.

An individual consultant who wanted a more hands-on job could always become an institutional CIO (and many CA alumni did just that). Or, they could move over to a Wall Street asset manager. CA consultants tend to have good contacts in both worlds.

[See our appendix: CA's CIO Alumni, down below.]

Over recent decades, traditional asset managers found that their institutional clients demanded more help dealing with increasingly complex and sophisticated multi-asset portfolios. They responded by building "multi-asset" units staffed by "multi-asset" people who were often recruited from the consultants.

The consultants responded by launching their own discretionary investment businesses, calling them outsourced chief investment officers (OCIOs).

As far back as 2011, co-founder Jim Bailey said: We've been doing outsourced investing for almost 20 years, now."

And, CEO Sandy Urie said: “Outsourcing is an evolution of what we’ve been doing for 36 years.”

I recently met the new CEO and chairman, David Druley (both of whose degrees are from University of Texas, if you please!). And, he doubled down on the same strategic point.

“Portfolio management is the growth engine for Cambridge Associates, Charles; and I, like many of my colleagues, ran money before coming to Cambridge. The better we do for our clients, the bigger the impact they can have on the world as they pursue their specific missions. Knowing that is what gets me up every morning.

By owning investment strategy and execution, and being able to pull the trigger on manager hiring and firing decisions, we become fully accountable for maximizing that impact.”

Today, over forty percent of CA’s 1,200 employees work on institutional and high-net-worth investment accounts. And, about eighty percent of the firm’s revenue now comes from asset-based fees, a huge shift from its early days as a retainer-based consultant.

As CA edged into this niche, so did many of their direct consulting competitors, including Russell, SEI, Wilshire, Mercer, RogersCasey, NEPC, et al.

This shift to a high-touch, full-service portfolio management model allowed for assets-based fees and it also gave the consulting firms a way to offer a more remunerative career path for talented recruits who might otherwise have headed directly to an investment bank.

The battlespace and the challenges

Here’s a Top 25 list (based on the most recent version of the canonical and widely-admired Skorina’s Ultimate Outsourcer List).

We've omitted the big banks and traditional asset managers (e.g., BlackRock, Goldman Sachs, State Street, JP Morgan, etc.) and used an arbitrary $5 billion AUM cutoff. We include only bonafide OCIO assets based on our own survey as of September, 2016.

Top 25 Investment Advisors in the OCIO Battlespace

Ranked by AUM from Skorina OCIO List as of September 2016

-	Firm	HQ	OCIO $bn
-	-	-	-
1	Mercer	Boston, MA	$140.0
2	Russell Investments	New York, NY	$112.0
3	AON Hewitt	Chicago, IL	$88.0
4	Willis Towers Watson	Chicago, IL	$80.0
5	Alan Biller and Associates	Menlo Park, CA	$41.5
6	Strategic Investment Group	Arlington, VA	$25.1
7	Hirtle Callaghan	W. Conshohocken, PA	$23.8
8	Callan Associates	San Francisco, CA	$21.0
9	**Cambridge Associates**	**Boston, MA**	**$20.0**
10	Makena	Menlo Park, CA	$20.0
11	Verus Investments	Seattle, WA	$20.0
12	Investure	Charlottesville, VA	$12.0
13	CornerStone Partners	Charlottesville, VA	$10.0
14	Pentegra Retirement Services	White Plains, NY	$10.0
15	Investment Performance Services	Newtown, PA	$9.6
16	The Investment Fund for Foundations (TIFF)	Radnor, PA	$9.5
17	Highland Associates	Birmingham, AL	$9.2
18	Rocaton Investment Advisors	Norwalk, CT	$8.2
19	Commonfund	Wilton, CT	$7.7
20	Global Endowment Mgmt	Charlotte, NC	$7.6
21	Wilshire Consulting	Pittsburgh, PA	$7.3
22	NEPC	Boston, MA	$7.2
23	Agility (Perella Weinberg)	Denver, CO	$7.0
24	Marquette Associates	Chicago, IL	$6.1
25	Athena Capital Advisors	Lincoln, MA	$5.2

(See full OCIO list here: http://www.charlesskorina.com/?s=ocio)

Cambridge clients hold several trillion dollars in assets. CA advises on about $142 billion of that and directly manages about $20 billion on a discretionary OCIO basis, as we see on the above chart.

But the goal is clearly to build out the full-engagement portfolio management relationships that charge asset-based fees.

The consulting industry has evolved over the years and with maturity comes challenges. Cambridge Associates, like many closely-held companies of a certain age, faces transition issues, which are always tricky and troublesome.

Mr. Bailey and Mr. Lewis (who are now ages 70 and 69, respectively) still own most of the company. But Mr. Bailey, at least (who still works with clients in the Boston office) is reportedly interested in reducing his shares as part of his estate planning.

The Wall Street Journal has reported that Mr. Druley is working with 50 recently-named partners (a new title at CA) to help them buy into the firm.

Succession, competition, talent management, and adapting to new conditions are all standard-issue challenges that face any firm in any field at any time (although it can be bruising when they all arrive at once!).

But CA's edge has always been its reputation for the quality of its people and their work, built over 42 years.

As a recruiter, I'm chiefly interested in people, and I recently travelled to Boston to meet some of CA's best and brightest.

Boards versus CIOs: Allies or frenemies?

Despite the name on the letterhead, Cambridge Associates is located in Boston, where their shiny new headquarters occupies seven floors of the 125 High Street building in the financial district. When I arrived on a rainy spring day, I had three missions in mind.

First: get their take on how relationships between boards and CIOs can help and/or hinder the quest for alpha. That's a topic that has interested me and my clients for a long time.

Second: to learn more about how they run their OCIO business.

Third: to hear more about how they develop minority and female professionals, directly from the source.

Not-so-coincidentally, Deirdre Nectow (a fellow Chicago MBA!) who oversees the firm's business development and client service, arranged for me to meet a group of senior OCIO leaders who could also talk knowledgably about diversity issues. They were:

Margaret Chen, managing director and head of CA OCIO business, CA Capital Management

Sona Menon, managing director, CIO, and head of pensions North America

Kyle Johnson, managing director and CIO

Skorina: Let's talk about board governance at institutional investors.

I'm on the phone with chief investment officers and board members every day, and it's often pretty frank and off-the-record. The org charts and official pronouncements all say they're working in close cooperation toward a common goal. But I often hear about tensions and frictions which could hamstring the process if they get out of hand.

It seems intuitive that when great trustees get in sync and stay in sync with great CIOs, the result will be superior investment performance. Look at a couple of the obvious suspects: David Swensen at Yale and Scott Malpass at Notre Dame. Those CIOs bat .400 plus year after year and are always careful to give credit to the stability and wisdom of their boards and long-time chairmen.

I know Cambridge has written and spoken extensively about this and you three personally have years of up-close experience. You come in as respected, neutral experts and don't have to take sides in intra-institutional food-fights. What do you see?

Chen: Governance can be a very unsexy topic, Charles, but I think it's a "secret sauce" to solid performance over time.

The decision-load on investment committees has grown dramatically since I started in this business. And we have to remember that these are unpaid volunteers for whom it's not their day job.

At the same time, asset-categories become more numerous, more complex, more specialized. This seems to be a natural, inevitable evolution. But it means there also has to be more specialization and division of labor among the people managing the portfolio.

This is one reason why we are seeing such growth in our OCIO business. We assume the responsibilities and headaches of managing a complex endowment and let boards focus on the broad, long-term goals of the institution.

Another big problem is that nonprofits tend to have a fundamental mismatch between the tenure of board members and their CIOs; and also between the tenure of board members and the time horizon of the endowment. These mismatches can be a drag on decision-making and performance.

Generally, board member terms are staggered, and they have three to six year terms with the ability to renew for another term. You computed average CIO tenure in one of your newsletters at about five years. That means that even if a CIO has the backing of every member on the board when they were hired, almost immediately the board personnel start to change.

By the time they're half way through their average tenure, there's been considerable turnover, with new trustees who don't know the CIO or the portfolio. New people can feel compelled to challenge the perceived status quo, and some aren't shy about sharing their own ideas.

That's when things can start to come apart: when the philosophy and strategy shift too often and too abruptly. Then, institutions aren't leveraging their most valuable asset -- their long time horizon -- to their maximum advantage.

Menon: Also, let's look at it from the CIO's standpoint. It takes a new CIO months to understand the legacy investments he or she inherited and it can take a year or more to develop and implement a new asset allocation strategy. This is assuming there is agreement from the board on strategy and allocations. And while the CIO is setting up his or her process for manager research and selection, new board members are coming in with their own ideas about risk, desired returns, preferred managers, etc.

And even more crucially, maybe a new board chairperson or chair of the investment committee is about to take over. In addition to putting the right investment strategy in place, a strong CIO should be able to navigate the various perspectives on the Investment Committee or Board. Part of a CIO's job is to educate the new members and develop a strong relationship with them.

Johnson: Investment Committee turnover can certainly present some challenges, but it's an understandable fact of life for most institutions given the voluntary nature of Committee members' service. So, for better or worse, we've got to embrace that reality.

One way I'm handling that as an OCIO is by creating a series of educational modules that we can share with new Committee members proactively to give them a strong sense of our philosophy and strategy. Of course, the new members have every right to disagree with our approach, but at least they'll know where we're coming from at the get-go.

Skorina: We have two studies coming out in the next few weeks on endowment performance and compensation; one will show five-year performance numbers for the top one hundred CIOs, and the second will analyze compensation for those same people.

As we crunched the stats, we also noted the turnover on the boards – the longevity of the board chair and investment committee chairs for many of these institutions.

We hope to gather enough longitudinal data to draw some valid conclusions about these relationships. We all have a lot of anecdotal evidence, but it will be good to have some harder numbers to support our observations and intuitions.

Chen: Again, maybe that's one of the reasons the OCIO business and CA's discretionary business are growing, since OCIO firms like ours provide continuity and significant resources to an institution.

The investment pools with the worst performance are often the ones with high turnover of board members and staff. If an investment office is always rebuilding, it's hard to establish a process and follow through with the plan, no matter how well thought through the plan is.

If new personalities are regularly added to the board and there is not an established process to incorporate them into the norms and best practices for that particular institution, you can end up with a very messy situation.

We've seen institutions with a long-term commitment to active management shift to 100% index management within a three-year period because of board turnover.

Menon: It can take up to a year, and in some cases more, to set up a new investment strategy and portfolio. More importantly, it takes several years to see whether it's working.

This is not only true for illiquid investments like private equity and venture capital but also liquid investments in public markets. We have done work that shows that even the very best managers will go through a bad period of performance. In fact, one of the most dangerous behavioral mistakes can be to hire or fire a manager based on three-year performance figures because it may very well be a misleading indicator.

A CIO may have patience for tolerating short-term underperformance, but a specific Board member may not. That's another potential disconnect due to different time horizons.

Then you have to consider what happens to the portfolio if the CIO leaves in two or three years. We've seen that at a number of institutions lately. A new CIO comes in with new preferences and a new plan and the cycle starts all over again. This is not good for the institution or investment performance.

Skorina: Let's shift topics and talk about how you all found your way into the wonderful world of institutional investing. Women and minorities, especially, usually tell me they never expected to wind up in asset management.

Are any of you exceptions to that?

Chen: Investment management was never on my radar until after graduate school. My parents were immigrants from Taiwan in the early 1960s. They came as poor graduate school students and met on a blind date in Kansas. At home, we talked about earning money and saving money, so my sisters and I didn't grow up talking about investing money.

In college, I studied political science and I loved it. I was the head of student government at Yale and went on to the Kennedy School at Harvard. I thought I would end up working in Washington in a public policy role, but I realized business was something that interested me even more.

So I did management consulting instead and focused on airlines and the transportation industry, which meant I had to learn about debt, capital budgeting, project finance, structured finance, and other topics which led me to look at finance and asset management. Over time I realized I loved investing, and that changed the direction of my career.

Looking back, my parents were not your stereotypical Asian-American parents. They were entrepreneurial and they each started their own small businesses. They were open-minded and progressive, which I didn't appreciate until I was in college. They taught me there's nothing wrong with risk-taking as long as you're aiming at something worthwhile and doing the best you can.

I did study hard, but I didn't always follow the rules. My parents encouraged me to be an independent thinker, and with my parents behind me I always felt confident I would succeed at something.   I just didn't know what it would be! So I pursued things that interested me until I found something I loved.

If I can add one more thing on women and people of color in investment management: I do think there are expectations, challenges, and hurdles even today that require some forethought. I'm a big believer in role models and the "it takes a village" concept when it comes to career planning.

Menon: I think I'm your exception, Charles. Picking a job in investing was not accidental for me.

My mother and father immigrated from Mumbai when I was 2 years old and I was raised by my grandparents in India until the age of 8 when I joined my parents in the US. My mother is a dentist and dad is an insurance underwriter, and they both worked very hard to provide for our family. Mom was an important family breadwinner, so I grew up assuming I would be too.

When I finished my degree at Cornell, I methodically surveyed various industries and talked to campus recruiters, then decided to take a trainee position with JP Morgan.

It was the training program that clinched the deal for me. The big New York banks had some of the best training programs in corporate America. And it made sense to me. Money-center banks are global operations, and I had studied international relations at Cornell and spoke several Indian languages, plus English, Spanish, and French.

I loved my four years at JPM. There was literally something new every day. I moved through sales and FX trading, research, sales, then took a research job covering Latin America and worked on country credit ratings.

Johnson: I guess I'm another guy who took a very oblique path to investing, Charles. While both my parents were in the corporate world – my dad as an accountant and my mom as a human resources executive – I was instead a real science nerd; I loved math and physics.

I grew up in Teaneck, New Jersey and went to the Governors School of Sciences, an intensive summer program for high-schoolers interested in STEM fields. When I got to Harvard for undergrad I started out as an astronomy and astrophysics major, but I ended up majoring in comparative religion of all things. And I loved it! I'm not sure my parents did – but they were supportive. That's maybe because I didn't end up following my other passion, which was playing guitar in a rock band!

I then got my Masters of Theological Studies at Harvard, thinking I'd become a chaplain of some sort. But I also took courses in political economic theory, international diplomacy, and corporate social responsibility. And it was that coursework that put me on the road to this job.

Out of divinity school I was hired by a firm called KLD that specialized in researching the social and environmental impacts of corporations, selling those studies to investors. One of their key products was a socially-screened index called the Domini 400 Social Index, and I eventually became its chair.

I found that investing was a great marriage of the quantitative and social-science sides of my brain.

Skorina: And how did each of you wind up at Cambridge?

Chen: After about six years of management consulting, I had what I would call a career crisis. At age 29, I was not enjoying my work anymore. I was at a boutique consulting firm called Harbridge House that had been sold to Coopers & Lybrand Consulting, a much bigger firm, and it just wasn't the same. It took me a while to figure out, but in addition to institutional investing, I realized I wanted to work at a firm that was growing, that had fantastic clients, and smart, interesting colleagues.

So, I started interviewing and I liked everyone I met at CA. They told me I was a "high risk hire" when I started in 1997 but CA has been a great fit for me. Because I spent a lot of time at libraries, museums, and free music concerts as a kid, I also feel working at CA is my way of giving back.

Menon: In my case, CA was the logical next step after business school. I joined the firm after I graduated from Harvard Business School in 2001. I tend to be deliberate and methodical about career choices.

When I started interviewing for a job after HBS, I liked the people I met at CA. I met a lot of smart women who had good jobs and responsible positions and I thought that this would be a good place for me.

Johnson: Well, it was a chance meeting really. At the time I was working at Domini Social Investments, and CA called my firm to say it needed someone to give a presentation on socially responsible investing to one of CA's clients. I took that assignment and I was really impressed with the CA investment team's sheer breadth of capital markets knowledge.

I basically realized then and there that I wanted to be on THAT side of the table because it seemed intellectually fascinating. I also thought working with CA might give me more opportunity to explore socially-responsible investing in a more impartial way, which, given my fascination with political economic theory, was very academically interesting to me. So, I applied for a position and here I am!

Skorina: When I think about what makes great chief investment officers, I keep coming back to a conundrum. Superior returns require doing things that diverge from crowd behavior. But most institutional boards and trustees resist the unconventional. There doesn't seem to be any simple solution. What do you all think?

Chen: I sometimes compare nonprofit boards to middle-school students. Of course, they all want to be different and think of themselves as different. But, somehow, they all end up looking different in exactly the same way!

Skorina: You've all dealt, implicitly, with the challenges of being females or minorities in this business. I look at CA compared to the other firms and CA looks like an outlier. A third of your professional-level employees are women, and that's trending up. How did this come about?

Chen: CA is a great place for women, Charles. We can always do better, but it always has been a place that purposefully hired women. I think it's partly the founders. They made a point of recruiting women from the very beginning, in 1973, in part because few firms wanted to hire these smart women who wanted to get into investing. And the career of Sandy Urie, as the Chairman and CEO for years, set a tone. This gave us an early-mover advantage, so to speak.

Menon: I think we need to separate "diversity" as a means to better investment returns from "diversity" to achieve social goals.

We're in the investment business. And our objective is to produce good returns. So how does diversity help produce better returns for our clients? For me, diversity means diversity of perspectives with regards to investment ideas, process, managing risk, and managing teams.

People from diverse backgrounds and genders bring some unique ideas to the table. Women have their own views on investing and managing teams, and that enriches the discussion and improves returns. That's the bottom line for me, and that's how the firm looks at it.

Chen: The whole point of investing is to have a better idea than the next person, and to execute it well. This requires resources, but it also means you have to generate well-founded ideas, and not be afraid to take a different point of view. If ethnic and gender diversity helps to break down groupthink and foster more non-standard ideas, then it is way to get an edge.

Johnson: Let me say something about opportunity for African-Americans.

The civil-rights movement expanded the possibilities. It was essential; but it wasn't enough. I was super fortunate to grow up in a middle-class household with two Ivy-educated parents who were huge role models for me. They showed me not just that education is important in an abstract way; but more importantly, how much fun learning could be. And I wish that other African-American kids – really, ALL kids – could have access to the kind of nurturing environment that I had. So many simply don't have that access.

Do I have the answer? No. It's a complex issue. But it's tragic to lose all that untapped talent. We need every bit of it reach our country's potential.

Turning back to investing: in your interview with Kim Lew at the Carnegie Corporation she mentions African-Americans and the money factor and the fact that hard-driving, ambitious African-Americans often head for Wall Street and look for jobs with a big performance bonus upside.

(See: Foundation Chief Investment Officers and the American dream. http://www.charlesskorina.com/?p=4645)

I'm glad I can make a good living, but money never drove me. I'm here at CA because of the people and the chance to do work that I like to do. From an investment perspective, it's pretty difficult to match the resources we've got here at CA, and I work with fantastic people.

One last comment about bringing African-Americans into the financial world: you asked about role models and there's no question role models sure help. But the people who I admired growing up probably didn't realize that anyone was looking at them that way. They were just living their own lives, doing whatever they did for their own reasons.

So, are there people looking at us and finding something that can help them focus on what is possible for them? Well, we would probably never know. But it's nice to imagine.

Appendix:

CA's CIO Alumni

Partial list of current CIOs, does not include former CIOs

Name	Current Organization	Tenure
John Barker	Partners Healthcare	2012 - pres
Michael Barry	Georgetown University	2011 - pres
Aoifinn Devitt	Chicago Police Pension Fund	2016 - pres
Andrew Eberhart	Heinz Family Office	2012 - pres
Clarissa (Lila) C. Hunnewell	Boston University	2011 - pres
Meredith Jenkins	Trinity Wall Street	2016 – pres
Brad Johnson	U Oklahoma Fdn	2015 - pres
Jane Moncreiff	CareGroup/Combined Jewish Philanthropies	2009 - pres

Catherine A. Piez	The Brookings Institution	2006 - pres
Nicholas Warren	Brandeis University	2011 - pres
K.C. Krieger	Eli and Edythe Broad Fdn	2017 - (2001)

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.

Prior issues can be found in "archives" on our website, www.charlesskorina.com