The Skorina Letter

News, Interviews, Research for Institutional and Family Office Investors

● Retained Executive Search ●

Our Clients: board members, families, and institutional asset managers

Our Services: recruit chief investment officers, advise on performance & pay

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Trustees: Are you holding your investment office accountable?

We have worked over three decades recruiting chief investment officers and advising boards on investment performance and our research on investment leaders goes back years. No one has been a stronger supporter of building internal investment management teams than us.

But lately we've been wondering if non-profit boards and trustees are holding their investment offices accountable for performance.

Here is what's bothering us: Many tax-exempt institutional investors have underperformed public markets for ten years and more and, according to board members we have spoken with, failed to meet the needs of their stakeholders.

In some cases, as we have highlighted in past newsletters, it's the board's fault. Dissension or timidity tied the hands of highly skilled staff. In others, the chief investment officer just didn't have what it takes.

So, here's the way some of our trustee clients see it: If the current investment team at an endowment, foundation, pension fund, or family office can't out-perform the market over a reasonable period, say five to ten years, then the trustees or principals should replace them with those who can...or get out of the investment business.

In our latest study of large endowment performance, not one investment office out of the hundred we ranked beat the S&P over five years and only a third managed to out-perform a traditional sixty-forty stocks and bonds portfolio.

We tend to focus on foundations, endowments, and family offices but, in the larger universe of pension investors the story is mostly the same.

The annual report of the $150-billion Texas TRS fund (seventh-largest tax-exempt fund in the country) just became available, and Scott Burns at the Dallas Morning News gave it a hard look this week.

Over ten years (ending August 2018) they earned an annualized 7.1 percent with a portfolio that's more than 40-percent invested in alternatives.

By comparison, the one-stop Vanguard Balanced Index Fund, invested entirely in marketable U.S. stocks and bonds, earned 9.95 percent. The Vanguard fund also beat them over one, three, and five years.

He concludes:

The comprehensive annual report provides thoughtful reasons for this, laying out its sophisticated case for global equity, stable value, real return and risk parity investments.

But simplicity and low cost would have been worth $46.2 billion more [over the same ten-year period].

Using a full market cycle or two to judge a CIO's performance would have been better - our recent studies exclude the 55% decline in the S&P 500 from September 2007 to March 2009 and earlier ups and downs - but, unfortunately the median tenure of CIOs happens to be exactly 5 years. (The mean is higher, tipped by a handful of very senior CIOs.)

For our recruiting purposes, five-year returns give us a good - albeit imperfect - picture of how CIOs are doing their jobs. A longer timeframe would blur the responsibility for results as CIOs come and go.

Based on our research, a highly diversified "endowment" style portfolio, often referred to as the Yale model, has not and will not deliver the performance most tax-exempt institutions require.

Chief investment officers supposedly know what they are doing but, we can find no evidence to support the proposition that the Yale model is replicable for most institutions and we doubt that even Yale and the redoubtable David Swensen could duplicate his model if he started from scratch today.

We're not saying throw out the baby with the bathwater, (after all, we make our living recruiting investment talent) but we are saying you need the right baby.

There are only a handful of endowment and foundation CIOs that can keep pace with Mr. Swensen, and most are happy where they are.

Nonprofits - endowments, foundations, pension funds - and taxable family offices supposedly have only one innate edge, the ability to invest over a longer time horizon than Wall Street money.

That sounds great in theory, but most board members serve three-year terms with one or two renewals and the average tenure of a chief investment officer is, as we mentioned above, less than six years.

John Maynard Keynes wrote a hundred years ago that "in the long-run we're all dead" and most stakeholders - pensioners, students, faculty, foundation beneficiaries, charity recipients, and board members - care a great deal more about today's headlines and the next budget or grant cycle than what happens fifty years down the road.

Superior performance depends on recruiting and investing with exceptional talent. But there's a catch.

Exceptional is not conventional and most boards and CIOs are risk adverse, preferring to place money with conventional and safe second-tier managers found on every consultant's list.

The top-performing one percent of outside asset managers are open to at most five percent of all institutional funds. And the established super-stars don't need new money.

Furthermore, as Howard Marks notes, "what's clear to the broad consensus of investors is almost always wrong." (Howard Marks, *It's Not Easy*)

Only an exceptional board of directors or family office head gives their chief investment officer the time and space to be "different" and better.

Larry Ellison, the hard-nosed founder and chairman of software giant Oracle, during a period of frustratingly poor company performance, reportedly sat down one-on-one with every senior manager in the company and asked each one, roughly, "if you can't meet and exceed the targets I set, explain to me very carefully why I should continue to employ you?"

It's time for every boardroom with responsibility for an investment portfolio to have a similar frank discussion about performance and expectations and their role in meeting them.

Professor Nelson, my legendary finance and accounting instructor in the Chemical Bank training program (now JPMorgan) use to say to us trainees, "as analysts, you'll hear a thousand excuses for why a corporate client under-performed. But, in the end, they either make money for us or they don't. And, if they don't, invite them to go elsewhere."

Investment management is a complicated business with a simple objective, deliver the returns the client needs. Hire the right people and give them the opportunity to succeed or, outsource the portfolio to those who can.

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.