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Building the World's Best Investment Management

The Endowment Model: If everyone thinks alike, who's doing the thinking?

Groupthink is a phenomenon that occurs when a group of well-intentioned people makes irrational or non-optimal decisions spurred by the urge to conform or the belief that dissent is impossible.
– Psychology Today

It's hard to find an independent thinker among university endowments these days. Every board member wants to hire a Swensen clone and every CIO wants to partner with Sequoia. Group-think and safety-in-numbers has become the new endowment-model-norm.

David Swensen was one of a kind, a different thinker, a pioneer. Swensen blazed a trail thirty years ago and his first book was called *Pioneering* Portfolio Management for good reason. It was all new stuff. Forget public markets. Spend your time on private opportunities with less visibility and more upside.

Today that trail he blazed has become a freeway and the endowment model is one very crowded trade.

Richard Ennis, co-founder of EnnisKnupp (AON), points out that in 1994 large endowments with AUM over one billion dollars held on average less than twenty managers in their portfolio.

Twenty-five years later the average was well over one hundred, with some holding close to three-hundred funds (asset managers, commingled funds, and partnership interests, NACUBO Study 2019).

The strategy du jour on campus is mostly about appeasing the VC and PE gods, doubling down with existing managers and anteing up to the spin-offs. No one wants to be excluded from a new manager or the next flagship fund.

Proliferation drives up costs of course. With management fees of two percent of AUM plus a twenty percent carry, plus broken-deal fees and every conceivable expense charged back to the fund, the load can run six to ten percent.

As an aside, we hear that Swensen was cutting back on managers and growing more conservative in his final years. We'll see what course Matthew Mendelsohn and staff chart going forward, but we suspect there will be headwinds.

Mr. Mendelsohn has the smarts and the will but he does not yet have Swensen's clout.

Groupthink Happens

A recent paper in the Journal of Risk and Financial Management suggests (as do countless others) that it all begins with the boards. They set the tone and lead by example, for better or worse.

"The author argues that selecting investment committee members with expertise in diverse asset classes, promoting an open-minded and learning environment, and employing the principles of portfolio theory" leads to higher risk-adjusted returns.

That all sounds fine, but we wonder about the "open-minded learning environment" part. With a few notable exceptions, the biggest, scrappiest, contrarian carnivores on Wall Street turn into risk-adverse consensus-huggers when they take a seat on college boards.

Most board members accept the position because they love the institution and its mission, but the reputational risks of sitting on a nonprofit board outweighs the rewards.

Board members never get credit for good performance but always take the heat for any blowup. As a consequence they seek consensus and institutional cover.

The first question most board members ask when presented with something new and different – a candidate or investment opportunity – is, "who did the other school hire? Or "who else is doing this?"

They all hire the same recruiter, interview the same ten candidates, and ask for the same set of referrals from their buddies on other boards.

Let's be honest here. If the David Swenson of 1985 had applied for the CIO position at Yale today he would not have made it past the first round of interviews. A young untested Wall Street banker with a knack for interest rate swaps? Not a chance.

Recruiting investment executives is our business so here's some news for boards with searches on the docket.

There are about seven-hundred CIOs at tax-exempt institutions in the US and fifteen-hundred fully-baked up-and-comers ready to step into a CIO role in the nonprofit space.

And we have yet to list all the sell-side superstars and family office gems that would love the opportunity to serve their school.

But many of these individuals look different, think different, and they don't like wearing choke-collars so they seldom get a chance to interview, let alone an offer.

Those Consultants

Let's talk about consultants.

If your investment advisor with two-hundred clients, has the inside skinny on your impressive under-the-radar new manager, or catches wind of that special fee you privately negotiated, or uncovers your plans to redeem from a certain fund, how soon do you suppose before their co-workers and other clients know?

There's a reason why family offices seldom use consultants. They don't want others knowing their business.

When it comes to money there are very few saints.

Fashion and Funding

As for the endowment investment staffs? They try their best, but most go to the same conferences, use the same consultants, follow the same trends, and invest with the same managers.

It's hard to break from the herd. Career risk is too great to be different and the reward for being like everyone else is a comfortable year-end bonus.

The early Swensen diaspora had help from the master when they needed an introduction to an unconventional manager or cover for radical thinking. They could follow his lead in real time. That door closed for good this year.

Outliers

Who are the outliers today? Of the veterans, probably Stuart Mason, a former sell-side investment banker who runs the University of Minnesota endowment like a venture capital firm.

Or Sam Gallo, ex trader, hedge fund and risk consultant now CIO at the University of Maryland system who assembled strategic partnerships long before they were fashionable.

Looking farther afield into foundation land we find an impressive pool of nonconformists.

Joseph Boateng at the Casey Family Programs in Seattle and Rukaiyah Adams at the Meyer Memorial Trust in Portland are both little-known top decile performers and original thinkers. But few hear of them because they are based in the Pacific Northwest, far from the New York media bubble.

And let's not forget Jeffrey Heil at the Doris Duke Foundation or Ed Grefenstette at the Dietrich Foundation. Both wave politely as the herd thunders by then head down those trails less traveled.

And there's Michael Larson at Cascade, in a league of his own.

By the way, Mr. Boateng from Ghana and Ms. Adams from Portland are African-Americans, two of only sixteen African-American chief investment officers in our nonprofit database.

Diversity works.

Group-Think Apocalypse

Too often a new member, or worse a new investment committee chair, comes crashing in with a big ego and bad ideas and a carefully crafted investment strategy comes unglued.

When boards and investment strategies blur there are at least three options for change.

Board chairs and college presidents can work with what they have, change the structure, or outsource.

Boards

Princeton has an interesting board arrangement designed to mitigate groupthink. There are two classes of board members, regular and charter. Regular serve four-year terms and charter member eight-year terms renewable by invitation. (Ten years until recently, a controversial change).

By first seating new members to a four-year term there is time to judge their performance and fit. The eight-year terms preserve institutional memory and long-term focus and the mix allows new blood to contribute but not disrupt.

Canadian Model

A second option, as Robin Wigglesworth described in the Financial Times, is to spin off the investment office into a Canadian style independent investment structure with more direct investment capability and a professional corporate-like board with broad expertise.

The problem with the Canadian model, as the Harvard Management Company under Jack Meyer found to its detriment, is that Wall Street talent requires a Wall Street payroll, anathema to aggrieved professors and alums and click-bait for the media.

Outsourcing

The outsourced chief investment officer model offers the proven performance of the best endowment and foundation investment managers and takes group-think and politics off the table, a compelling reason why OCIO has gained so many converts.

OCIOs don't use consultants, so your neighbors don't know what you're doing ten minutes after you do it, and they offer a variety of investment styles to choose from.

Each of the 104 firms on our OCIO list – from JPMorgan and Blackrock to Hirtle Callaghan and Alan Biller and Associates – has a distinctive investment and service model.

Go ahead and call a few if you're in the market for discretionary asset-management help. They will be happy to hear from you.

Wrapping It Up

We all know what good board governance is supposed to look like: establish roles and responsibilities, set the objectives, put up some guard rails around concentration, illiquidity, geography, thematic, one-off trades, etc., and lay down some clear metrics to judge performance.

Then step back and let the staff do their work.

In practice, we're not sure much will change until another market crash shakes things up again.

But there's always someone out there who's building the next big thing. Maybe an investment model for the next thirty years. Maybe someone who's reading this newsletter. Stay tuned.

-- Charles Skorina

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.

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