Family Office Exchange | 30 YEARS

FOX GLOBAL INVESTMENT FORUM™

# Insights & Takeaways

**MARCH 13-14, 2019 | THE METROPOLITAN CLUB | NEW YORK, NY**

The **2019 FOX Global Investment Forum** brought together the most sophisticated investors of private capital across the FOX community, as family offices forge a distinct approach to their investing in the midst of market uncertainty.

At our recent sold-out 2019 FOX Global Investment Forum, more than 125 investment leaders came together from family offices and wealth management firms. A survey of attendees identified their top three concerns to be: 1. Downside protection in global downturn; 2. Frothy markets/valuations (public markets, venture and private equity) 3. Correlations of asset classes in diversified portfolios in next downturn.

**HOW TO USE THIS RECAP**

Select sessions from the **2019 Global Investment Forum** are summarized here. Use this recap to:

- Confirm what you heard in the sessions you attended
- Learn about sessions you didn't attend
- Access the presentation slides, videos, or audio recordings, where available

**If you weren't there**, read through for a thorough update on the leading ideas in our world of rapid change.

***Please feel free to share this with colleagues who were not able to attend.***

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## HOW TO NAVIGATE THIS DOCUMENT

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*"A great mix of content, speakers, and points of view. It's hard to find this level of broad participation in most other forums."*

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# Crashed: How a Decade of Financial Crises Changed the World

**PRESENTER**

**Adam Tooze, PhD**
Author, Professor of History and Director of the European Institute, Columbia University

View Presentation Slides

## SESSION DESCRIPTION

The financial crisis of 2007-2008 was perhaps the most dangerous moment, not just in the history of the U.S. economy, but in the history of the Western world. Ten years later we can still feel its reverberations. Historian Adam Tooze discussed the causes of the crisis and the political, economic, and financial implications for the present and the future of the U.S. and world economy.

## KEY TAKEAWAYS FROM THE SESSION

The narrative of the financial markets broke during the 2008 crisis, and according to Tooze, there has been no clear replacement for that narrative. Indeed, over the past 10+ years, the world has been living with "radical uncertainty." Adam Tooze set forth three questions to the audience during his talk and provided comments in response to each:

- **Why didn't the world see the 2008 crisis coming?** Prior to the 2008 crisis all eyes were on the large U.S. debt levels held by China, but instead, the private economy crashed. The piercing of the real estate bubble and the impact on financial institutions was the most prominent manifestation of the crash.

- **Does the world understand how much worse the crisis could have been?** After the financial implosion of the trans-Atlantic banking system, it was the leadership by the United States Federal Reserve, acting as the lender of last resort for the global financial community, that avoided a much greater meltdown, (Tooze made a comparison to the Cuban missile crisis of 1962, as another moment that could have been utterly disastrous.)

- **What are the consequences of the 2008 crisis and the "broken narrative?"** There has been a divergence as the U.S. has made a more robust recovery while Europe continues to struggle. Uncertainty is the rule as Europe is caught between Russia and the U.S. and it is not clear if China will converge economically with the West. As such, the threat of further financial disruption is real.

# Family Office Panel: Forging a New Path

### PANELISTS

**Ashvin Chhabra**
President, Euclidian Capital

**Peter Pauley, CFA**
Founder and Chief Executive Officer, (qp) global family offices

**Juan Fernando Valdivieso**
Managing Director, OLS Capital

### MODERATOR

**Kristi Kuechler**
Managing Director, Investor Market, Family Office Exchange

*"Just because you have the checkbook doesn't mean you know anything."*

*"If you don't have a process that leads to 'No' 95% of the time, you have the wrong process."*

### SESSION DESCRIPTION

A panel of sophisticated family office leaders shared their differentiated approaches to investing private capital in uncertain markets. These family offices are pursuing unconventional approaches with conviction. They shared actionable takeaways with other family offices facing similar challenges.

### KEY TAKEAWAYS FROM THE SESSION

- Regarding managers and strategies, if you don't say no 95% of the time, you are doing something wrong. Think about how to create a default process of saying no, and then invest only in those managers or strategies that are truly exceptional.
- If you do this right, you are often looking in places that are contrary to the norm. It's important to help families understand why they want to invest—what is the purpose of the investment?
- To be a long-term investor you need to be prepared to go through the full cycle, which means you will participate in a downside at least 50% of the time. It's important to lower the correlation to economic conditions.
- We're close to a tipping point in a very divergent world. Think about protecting capital and consider what are likely to be the main destroyers of wealth.
- Liquidity in the market is something of great worry. The coupling of central banks and public markets is concerning. The economy is very politically driven and investors need enough liquidity to sustain a correction.
- The China trade war is concerning because there will be significant winners/losers. There are a lot of volatile aspects that need to be handled delicately and the State Department is not providing the stabilizing role it needs to. China is an emerging superpower taking on an established superpower—a situation that can lead to significant risks.
- Tech is a very exciting area and there are amazing things happening with artificial intelligence, robotics, 3D printing, etc. Find areas you like and understand where the industry is likely to be disrupted.
- Allocate capital to strategies that create stable capital, but avoid the subtle mistake of overdiversification.

# The Direct Investing Divide: How Family Offices and Institutional Investors Approach Direct Investing

**PRESENTERS**

**Andrew Eberhart**
Former Chief Investment Officer, Single Family Office

**Kristi Hanson, CFA**
Partner, NEPC, LLC

## SESSION DESCRIPTION

As family offices move aggressively into the realm of direct investing, they are diverging from the traditional investment approach taken by most institutional investors. Two highly experienced investors—who have sat on both sides of the advisor table—explored how families are building successful direct investing programs and explained why institutions are wary to follow suit. They discussed internal and external resources needed for families to pursue direct investments in a sophisticated way and explained how the trend for direct investing is forcing many traditional investment advisors to evolve their current practices to meet new client demands.

*"In the next downturn, family offices are likely to 'double down' on direct investments in operating businesses. The public markets are rife with volatility and feel severed from economic fundamentals. Having an asset that the family can see and understand—and in some cases, contribute to operating—will be an important way to avoid the uncertainty of the overall investment markets."*

## KEY TAKEAWAYS FROM THE SESSION

- In the past, institutional investors have been considered "the smart money," often leading the way in sophisticated investing. Most institutions today pursue a "managers of managers" approach (often called the endowment model).
- Family offices are actively pursuing—and increasing their appetite for—investing directly in real estate and operating businesses, bypassing managers. Family offices are leading this path in direct investing in operating companies while large institutional investors continue to invest through private equity managers—although some may pursue co-investing alongside the GPs.
- While the average allocation to direct investments in operating companies for family investors is 8% (per FOX research), the average allocation to direct investments in private companies among institutional investors (per industry data) is closer to 1%.
- Approximately 30% of institutional investors enhance their private investment fund exposure with allocations to co-investments offered alongside the general partner. Thus, close to 70% of institutional investors do not hold direct investments at all.
- As a general rule, families engaged in direct investing tend to focus on sectors in which they have expertise. Families agreed that building a team in a family office can be challenging.
- There were varying opinions on what will happen during the next economic downturn and if families will retreat from direct private investments. The counter argument is that those families that are "all in" may increase their allocations as they see more attractive valuations.

# Investing in Opportunity Zones

**PRESENTERS**

**Steven M. Kennedy**
Director, PwC

**Jeff Schaffart**
Shareholder, Koley Jessen

View Presentation Slides

*"The Qualified Opportunity Fund program has generated a lot of hype and excitement—it is a new gold rush."*

*-Stephen M. Kennedy*

*"The back-end exclusion is the strongest benefit over the life of the holding, even more than the step-up in basis which has a shortened time window. Families should not feel pressured to rush into a program to try to meet that timeline."*

*-Jeff Schaffart*

## SESSION DESCRIPTION

This session explored Opportunity Zones, a tool designed to stimulate economic development and job creation in economically disadvantaged communities throughout the U.S. Taxable investors have shown strong interest in the potential for preferential treatment of capital gains that are reinvested in qualified opportunity investments, but many questions remain as the regulation continues to take shape. The discussion focused on the evolving rules of Opportunity Zones—from both a tax and legal perspective—and explored the potential benefits of investing in Opportunity Zones to provide clarity for family offices considering the strategy.

## KEY TAKEAWAYS FROM THE SESSION

- The Qualified Opportunity Fund (QOF) program, part of the Tax Cut and Jobs Act of 2017, is a nationwide economic development initiative targeting the most impoverished communities in the United States. "Opportunity Zones" are low-income census tracts designated by state and federal governments, and include both rural and urban communities with an average poverty rate of nearly 31% and an average median family income of only 59% of its area median.
- Benefits of a QOF include: temporary deferral of inclusion in taxable income for capital gains re-invested into a QOF, step-up in basis for capital gains reinvested into QOF, and permanent exclusion of capital gains from sale or exchange of a QOF interest if interest is held for at least 10 years. Guidelines were released in October 2018, with an IRS hearing held on Feb. 14 of this year. Additional clarifications are forthcoming.
- The provision allows investors to put money into any type of project so long as it is in an Opportunity Zone—a business, infrastructure, etc.—it is especially well suited for real estate developers. The largest tax benefits go to those who stay invested in an Opportunity Zone for at least 10 years.
- It is important to consider details of investment opportunities, including single-asset QOF or diversified QOF, geography, asset-type, developer expertise/proven track record, confidence in manager's ability to comply with QOF requirements, project's life cycle, ability to structure exit as sale of interest in a QOF, and investment by general/ operating partner. Understand the fee arrangements, capital calls, and tax filings as well as the uncertainty and evolving tax guidance.
- The regulations for investing in operating businesses in QOZs is still unclear—the rules around real estate investing are further along. But an interesting opportunity may exist for operating businesses in QOZs, depending on the evolution of the regulations.

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# Real Estate Investing Late in the Cycle: Opportunities, Risks, and Threats

## PRESENTER

**Douglas Poutasse**
Head of Strategy and Research,
Bentall Kennedy (U.S.) LP

## SESSION DESCRIPTION

Investing late in the cycle in any asset class is a challenge but investing in real estate has additional risks. Commercial real estate investors face disruption from e-commerce, work force automation, and co-working trends, among many others. Broader macroeconomic, capital market, and policy risks must be understood to successfully invest in property. Looking back over the last century through the prism of other famous and infamous "Niner" years (1919, 1929, 1969, 1989, and 2009 to name a few), this session used history to suggest some major opportunities available to investors while providing insight into potential major threats.

View Presentation Slides

## KEY TAKEAWAYS FROM THE SESSION

- Outlook for 2019: healthy U.S. economic growth coming under pressure, with more dovish Fed stance calming markets. Economic fundamentals are strong, but risks remain due to global slowdown, trade war, and other factors.
- GDP is coming down. Most economists are projecting a recession by the end of 2020. What we are really watching is the labor shortage—a significant labor supply mismatch.
- Mobility in the U.S. is at an all-time low. People don't move away from unemployment, they move toward employment opportunities. The 18 to35 year-olds are moving much less than previous generations.
- Investment activity is robust even as returns moderate. NCREIF total return came in slightly below consensus expectation and industrial is outperforming dramatically while retail lags.
- U.S. interest rates are high, not low (relative to other countries). It is cheaper to borrow money for a real estate project in Portugal than in the U.S. Economic trends remain supportive of apartment demand, but urban development focus is weighing on recent performance.
- Office properties see downtowns hosting an increased share of supply and tech markets are driving office rent growth. Coworking spaces are emerging as an office-demand growth driver. Not all retail spaces are created equal and smart tenant selection is more important than ever. We overbuilt office space in the 1980s and are still paying for that. The office sector has been the weakest and there is still too much supply.
- 2018 was third-highest year for real estate transaction volume but returns have dropped from recent highs with expectations low. The cap-rate spread has eroded but yield still attracts investors.

*"The real estate market is quite fully valued at this stage in the cycle, so don't think you will enter it at this point and see significant gains."*

# Impact of Policy and Politics on Global Investment Markets

## PRESENTER

**Libby Cantrill, CFA**
Managing Director and Head of Public Policy, PIMCO

View Presentation Slides

*"The President delivered on a number of pro-growth and pro-market policies in the last two years. But is the fiscal stimulus a sugar high?"*

*"The deficit may be the largest casualty, potentially limiting future counter-cyclical stimulus."*

## SESSION DESCRIPTION

In this session, Libby Cantrill, the head of public policy at PIMCO, discussed global challenges, including the rise of populist movements (i.e. Brexit) and challenges to democratic institutions around the globe. She addressed these challenges from both a policy and political lens—and discussed the ensuing potential effects on markets and their investment implications.

## KEY TAKEAWAYS FROM THE SESSION

- Despite some initial missteps, President Trump was ultimately able to deliver on many of his growth-positive policies, including:
  - The Tax Cuts and Jobs Act
  - The 2018-2019 spending bill
  - The beginnings of deregulation
  - Continuity at the Federal Reserve Board
- Growth-negative actions include: the ongoing trade war, geo-political tensions, immigration policies, and manufactured crises (debt ceiling, government shutdown).
- The fiscal stimulus may be a sugar high, expect a boost of .6% of GDP in 2018 and .4% in 2019 to growth, but then a fade after that. The tax bill has been a boon to share buybacks but we have seen only marginal pick-up in CAPEX. The deficit may be the largest casualty, potentially limiting future counter-cyclical stimulus.
- Partisanship remains near a multi-decade high in Washington D.C. but started before the current administration. And the president's trade policies, which represent his long-held philosophy, will continue to challenge growth as the executive branch of U.S. government has unprecedented authority over trade. This will lead to higher uncertainty due to an aggressive trade policy that may translate into a headwind for growth.
- Globally, the rise of populism has important implications around the world where we could see weaker growth and higher inflation if radical populism takes hold. Brexit outcomes also create uncertainty and instability in the global market. Weakening growth metrics and political upheaval suggest a fragile outlook in the Eurozone.
- As a result of the U.S. and global outlook, an overall cautious approach to portfolio construction is recommended with focus on broad, diversified sources of carry amidst heightened political uncertainty and global growth "synching lower."

BREAKOUT 1

# Models for Family Direct Investing and Key Governance Considerations

## PRESENTER

**Nate Hamilton, CFA**
Advisory Board Member,
Family Office Exchange

View Presentation Slides

*"Leading direct investing families follow 'best practices'—invest in deals where your capital gives you a demonstrable edge."*

*"I like being able to see what others are working on and being able to pick and choose the best deals."*

*"Who is in the deal can be as important as what the deal is."*

## SESSION DESCRIPTION

Families have a history of building successful operating businesses, and many seek to re-energize the wealth creation engine for later generations through direct investments in operating businesses. In recent years, there has been increasing interest among families to build out direct investment programs with meaningful resources and expertise—as they seek strong returns, more control of assets, and longer investment time horizons—often through co-investing with other families. This session provided a framework for families getting started with direct investments and discussed key governance considerations.

## KEY TAKEAWAYS FROM THE SESSION

- There are fewer public companies than at any time in the last 20 years, and today there are over 30,000 successful private businesses in the U.S. that are owned and operated by people over 60 years old. Average private equity acquisition multiple has gone from ~6x in 2001 to ~10x in 2018, with banks driving prices higher. However, private equity is still an attractive investment vehicle for long duration assets and compound, tax-deferred returns.
- According to recent Family Office Exchange research, direct investing families appear to be quickening the pace of their investment, with over three-fourths expecting to maintain or increase their current pace of investment over next two years.
- Co-investing with other families creates complexity in governance and risk which should be thoughtfully considered. Building a direct investing business is time consuming and complex and families should consider the following:
    - Roles/functions to outsource vs. manage in-house.
    - The amount and duration of capital to commit as well as the holding period and target return and the timing in the market cycle.
    - Compensation targets for investment team. It is also advisable to have a sound and clear investment process for direct investment opportunities in place, given the need to move quickly.
- Co-investing with other families allows a family to leverage the power of their network, share expertise, and spread capital across a broader base of deals. Having shared values and common views on risk-taking allows for sustained trust in your investing partners.

## BREAKOUT 2

# A Private Investment Action Plan

### PRESENTERS

**Tim Wray**
Co-Founder and Principal,
V3Limited

**Todd Kellerman**
Co-Founder and Principal,
V3Limited

View Presentation Slides

*"Given where we are in the cycle, allocate your focus related to your private investments as follows:"*

- *Current and legacy investments: 70%*
- *Deal flow: 20%*
- *Acquisitions: 10%*

*"The management team is the best driver and protector of value, so provide the best structure for governance, transparency, alignment, and accountability."*

### SESSION DESCRIPTION

Given where we are in the private equity cycle, family office investors need to take a hard look at their private equity portfolios, both funds and direct investments. With the illiquid nature of this high-risk and high-return asset class, major decisions made in today's still healthy, mature environment will drive success and minimize challenges that will inevitably unfold over the coming years. This session used real-world case studies to help identify key challenges in a portfolio, including capital structure risk mitigation, management team assessment, and co-investor terms.

### KEY TAKEAWAYS FROM THE SESSION

- Key investment principles to remember—cash is king, be careful with leverage, and always stay focused on liquidity. The key driver of value is management.
- Globally, there is over $1.6 trillion of "dry powder" among private equity GPs. There is robust M&A activity with U.S. private equity-backed companies at 2x-5x historic highs, with the last four years above 10x EV/EBITDA. This is the very definition of investing late in the cycle—be cautious.
- Great investors do great work. Performing funds generated real value despite the '08 crises and they generated liquidity, so investors could participate in the "up" vintages. For non-performing funds, the damage is double: not only are returns weak (IRR and TVPI), but investors missed the "up" years, stuck in investments for 5,10, or more years.
- Your private investment plan should prepare for the headwinds. Focus on and invest your resources in current and legacy investments (increase discipline for Deal Flow and Acquisitions). Have a 100-day portfolio plan that assesses the 12 key issues in each investment. Prioritize your plan based on value drivers for the portfolio, time to completion, and establishing clear gates. The plan should be supported by investor-management governance, transparency, alignment, and accountability.
- The best investors are top-to-bottom (boardroom to shop floor), ahead of the game (stress tests and scenario analyses), and active throughout (execute, execute, execute). The management team is the best driver and protector of value, so provide the best structure for governance, transparency, alignment, and accountability. A private investor is not a passive investor, ever.

BREAKOUT 3

# Navigating the Landscape of Investment Advice

## PRESENTERS

**Paulina Cromwell, CFA**
Product Manager, Family Office Exchange

**Charles B. Grace, III**
Managing Director, Family Office Exchange

View Presentation Slides

*"One of the big challenges for families is finding advisors who will help the family navigate a diverse set of investment approaches while still aligning to the family's core values and strategic intent."*

## SESSION DESCRIPTION

This session explored the landscape of strategic investment advisors and explained how families and family offices utilize different advisory models. The session compared business models (levels of discretion, open architecture and proprietary product utilization, inclusion of other ancillary services, and explored key selection criteria to establish the best fit between advisor and client. A case-study approach highlighted various challenges and success factors for families working effectively with external advisors.

## KEY TAKEAWAYS FROM THE SESSION

- Families utilize different advisory models across investing, including: a team of in-house experts, in-house led with help from advisors, advisor-led with family approval, or fully outsourced investment management. A fully internal investment team requires strong talent but provides the family with privacy and full control over decisions. A hybrid model of a leaner in-house team supported by external advisors can provide access to diversified investment thought leadership but can delay decision-making and create questions around accountability. A fully outsourced approach frees up staff to focus on other activities and provides access to "best thinking" but can lead to limited family engagement.
- Strategic investment advisors were laid out in various categories, grouped by common characteristics, and included traditional investment consultants, multi-family offices / RIAs, OCIO/multi-manager firms, and asset managers and trust banks. These firms cover the spectrum from non-discretionary to discretionary, and from open-architecture to offering proprietary products. There are pros and cons to each type of advisor and each family will prioritize these characteristics differently.
- It is important to answer questions around several key topics prior to engaging with an investment advisor, including: purpose for the investment pool, depth of investment resources, desired service model, level of discretion, and investment philosophy. These criteria will guide the type of advisor a family should engage with and will allow for the best "apples to apples" comparison in the selection process. The process is not clean-cut from there, however. Selecting the "best" investment advisor is actually about finding the "best fit." Families should consider the following in their selection criteria: quality of proposed solution, team, transparency, client profile, performance, fees, and specific expertise. Other important factors to find the right fit include: alignment of interests & values, advisor ownership structure, access to managers, receptivity to input/humility, compatibility, team stability, and succession planning.

BREAKOUT 4

# Hiring and Firing Investment Managers—Lessons from the Field

## PRESENTER

**Matthew Litwin**
Managing Director, Head of Manager Research, Greycourt & Co

View Presentation Slides

*"Know precisely what you are solving for, document your thesis before hiring, and constantly underwrite the opportunity set."*

## SESSION DESCRIPTION

Selecting good investment managers is challenging but knowing when and why to fire a manager is equally as important. This session explored a disciplined approach to ongoing manager-evaluation that can be used to increase the odds of making good decisions and decrease the risk of backward-looking, overly reactive firing. Using real-world examples, participants were provided a useful, approachable, and durable framework for evaluating investment managers.

## KEY TAKEAWAYS FROM THE SESSION

The Litmus Test in Action includes:

- Does the strategy make sense? Know precisely what you are solving for, document your thesis before hiring, and constantly underwrite the opportunity set. Do not become a fund collector (less really is more).
- Does the manager benefit the portfolio?
- Do: read every doc revision, not just the original LPA, consider how exposures and risks line up with other positions and use a robust and durable opportunity cost benchmark. Do not: get complacent or depend entirely on outside operational due dilligence, forget about taxes and liquidity—even if a fund doesn't change, these can. Do not be vague about your cost of capital for every position.

Important to understand what you are seeing in manager behavior:

- If performance is strong (or weak), the root cause may be that opportunity set is a headwind or tailwind, not the manager.
- If positions make sense (or don't), the root cause may be acts of research/risk control omission or commission.
- If teams are changing, there may be a fundamental (mis)alignment.

Things to remember when hiring and firing a manager:

- Hiring and firing managers are active investment decisions, but global alpha is zero.
- Putting in the work during and after initial due diligence will improve your hit rate if you're not a genius or super lucky.
- Outperformance is episodic for the best manager. Patience is an absolute requirement.
- Understanding what the potential recovery is when things are not going well is also required. Your time is extremely important.

BREAKOUT A

# Managing Legal and Structural Issues of Co-Investing

## PRESENTER

**M. Machua Millett, Esq.**
Managing Director, General Partner Liability Product Leader, Marsh USA, Inc.

View Presentation Slides

*"Current Trends in Alternative Investment Claims Activity—Top 5 Claim Types"*

- *Portfolio Company Related Litigation*
- *Frictional Litigation*
- *Regulatory Investigations and Proceedings*
- *Employment Practices Liability*
- *Social Engineering*

## SESSION DESCRIPTION

Co-Investing can be a great way to maximize investment leverage and return, but it can also exacerbate risk exposures when things do not work out as planned for all co-investors. As family offices increasingly create syndicates and enter into co-investments, it is important that they understand the potential benefits and risks, as well as best practices around structure, legal arrangements, risk management, and insurance. Experienced legal and risk management practitioners shared real-life successes and horror stories, as well as lessons learned, and trends seen in the area of family office co-investment.

## KEY TAKEAWAYS FROM THE SESSION

- **Shareholder Rights:** The Co-investor rights should be negotiated/taken into consideration in a Shareholder´s agreement between the Co-investment vehicle and the Lead Investor/Sponsor´s main fund. This agreement should include tag-along rights (allowing minority investors to participate on a pro-rata basis in any sale of securities by the controlling shareholder), drag along rights (requiring minority shareholders to sell their interest at the same time and on the same terms as controlling shareholder), pre-emptive rights on future sales (both at the co-investment vehicle level, operating company level, and subsidiary level). In essence, it is key to clarify what will happen when any shareholder sells.
- **Management Fees and Carried Interest:** The larger PE deals have no carry, while the smaller PE and most RE deals do have them.
- **Expenses:** It is critical to clarify beforehand if the deal expenses are included in the investor´s aggregate commitment, if expenses are capped and how will the expenses will take care of if the deal is broken.
- **Closing Conditions:** Typical closing conditions involve a Material Adverse Effects (MAE) Clause that leads to a fundamental change in the economics of the target (even though Courts are very tough on what constitutes MAE) add opt-out clauses if there are changes in Debt-Equity ratios, credit arrangements, or the deal does not close by a certain date.
- **Sponsor Concerns:** These typically include the need for sponsors to know if the commitment is there (as speed is critical), the allocation of investment opportunities, and who will pick up the deal expenses if the deal is broken (the typical way is to use the expected equity commitments.)
- **Family Office as Sponsor:** This is a growing trend, and there are additional complications/issues to consider in this case, including information sharing, expenses, and fiduciary duties.

BREAKOUT B

# The Three L's of Portfolio Construction: Liquidity, Liquidity, Liquidity

## PRESENTER

**Patrick Parisi, CIMA®**
Director, Investment Advisory Services, BMO Family Office

View Presentation Slides

## SESSION DESCRIPTION

Understanding the role of liquidity is critical to effective portfolio management. This session provided guidance on how to build investment portfolios that incorporate liquidity needs and manage through market downturns. Participants learned how to manage "capital-in-waiting," as they build out a private markets portfolio, among other considerations for liquidity management.

## KEY TAKEAWAYS FROM THE SESSION

- To optimize liquidity management: comprehensively identify sources and uses of cash, analyzing how they behave during periods of market stress, reviewing the relationship between liquidity and market volatility and creating a framework that combines cash flow and investment portfolio analysis.
- Liquidity and volatility: If the portfolio is not required to make any liquidity distributions, then theoretically, portfolio volatility, should not be a consideration. If a portfolio is required to make significant distributions, volatility will impact its ability to grow over the long term. This is especially true if the distributions are dollar-based rather than percentage-based, and there is little or no flexibility to adjust the distribution level during economic and financial market stress.
- Liquidity planning is the process of understanding the sources and uses of portfolio liquidity and how they could be impacted during various types of market environments. Uses of liquidity should include, but are not limited to:
  - Personal spending
  - Operating company cash requirements
  - Real estate development and capital requirements
  - Private market capital calls (private equity, venture capital, distressed etc.)
  - Taxes (State and Federal)—not just income
  - Family office and professional expenses
  - Philanthropy
  - Loan repayments
  - Investment opportunities (dry powder).
- Families with high allocations to illiquid investments should understand the impact to portfolio and liquidity management of increasing their allocations to private market funds and direct investments.

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BREAKOUT C

# The Blurred Lines Between Active and Passive

## PRESENTER

**Daniel Berkowitz, CFA**
Investment Analyst, Vanguard

View Presentation Slides

*"Given clients' range of risks and needs, the case for using both active and passive probably makes the most sense."*

*- Daniel Berkowitz*

## SESSION DESCRIPTION

Building on a recently published framework for combining active and passive investments in a portfolio, this session highlighted the case for indexing and utilization of active managers in portfolio construction. Participants also explored the common myths and misperceptions around the active versus passive decision and explained factors that can help investors determine an appropriate mix between them.

## KEY TAKEAWAYS FROM THE SESSION

- Active vs. passive is not a binary decision. Note that any decision to deviate from a broad market cap-weighted index is an active one. Investors are increasingly using passive vehicles to express active views (like geography-specific ETFs).
- The case for traditional active involves three elements for improving the odds of success: talent, cost, and patience. Identifying talent has not been easy, and growing skill in the industry is making the identification of best talent more difficult. Cost is a powerful indicator of future alpha. Those with patience to endure lengthy underperformance can find success.
- Time and willingness to pick managers should drive whether investors engage in active. Time is the biggest opportunity cost.
- Active outperformance depends on market leadership. Active manager universe tends to do better when their style box is "out of favor".
- Combining active and passive can mitigate relative downside risk.
- Index out-performance over active is largely a function of cost.
- Both structural and cyclical factors play a role in the difficulty of active managers outperforming the index.

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