The Greenwich Roundtable Quarterly™
2014
EXPLORING NEW FRONTIERS OF INVESTING

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Best Practices for Investment Committee Governance

"Good governance is about having the right people making the right decisions about the right issues."

– Myra Drucker

Historically the subject matter of our Best Practices series has always been original. The topics we chose had never been written about. Before Best Practices not much had been written from the limited partners' point of view. Due diligence, portfolio construction, complexity and pathology were largely orally transmitted but never codified, until we published them. Today our Education Committee is tackling a topic that's been documented for decades.

Investment Committee Governance has been examined and published by the best and brightest in our field. But the governance of the investment process still needs improvement. We keep hearing stories of difficult and dysfunctional investment committees. To be fair we hear of a great many committees that truly make a difference when good governance takes hold. But we felt we could make a difference by taking a different tack. What could we say that would raise the bar? What could we write that would improve the process? The published material over the decades seemed to focus on principles and concepts.

After we published *Avoiding Mistakes* the feedback we got was overwhelmingly positive primarily due to the case study approach. Our anonymous treatment of each case discouraged the sensationalist and greatly benefited the serious reader. (Or at least that's what they told us.) *Investment Committee Governance* is taking an anonymously written case study approach to help Boards and Investment Committees see themselves and improve their governance. It's being written to help those who govern see what highly effective Boards are doing and how they do it. It's being written to encompass all of the best principles as well as the controversial. *Investment Committee Governance* is informed by the leading thinkers and practitioners of our time. We hope you'll enjoy reading it as much as we enjoy writing it. Please let me know if you have any contributions.

Steve McMenamin
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Education Committee Brings Best Practices to Tomorrow's Practitioners

Over the past year, Education Committee members have taken our Best Practices in Alternative Investments series on the road, making visits to the top universities in the Tri-State area. Education committee members have brought their years of experience and wisdom to the students of Columbia, Fordham, and NYU.

Mark Silverstein, Chairman of the Education Committee and Trustee, noted that "This has been a great opportunity to lend the knowledge and expertise of our committee members to those who are just beginning their careers in the industry." Past and present committee members including Benjamin Alimansky, Brian Feurtado, Ray Gustin, Mark Silverstein, and Steve McMenamin, have given a series of presentations on Due Diligence, Portfolio Construction, Avoiding Mistakes, and Managing Complexity.

This series of presentations has been part of a push to reach the wider investment community and the next generation of investors. As part of its mission to educate the broader investment universe, the education committee is bringing the Best Practices series to life through personal experiences and anecdotes. The Education Committee looks forward to continuing these series of presentations, and expanding the breadth of outreach this fall. If you are interested in lecturing or in organizing a series of lectures at your alma mater, please contact Mark Silverstein at msilverstein@enduranceservices.com

The Doctor is In: Has Biotech Investing Arrived?

January 24, 2014 • UNDERWRITTEN BY HedgeServ

Greetings from the Greenwich Roundtable. Our topic *The Doctor is In: Has Biotech Investing Arrived?* is a continuation of our series on life science investing that started in 2000 when Craig Venter told us how mapping the genome would unlock a lot of discovery. Biotech had a nice run last year which caught us by surprise. Biotech indexes rose 65%. Venture-backed healthcare IPOs dominated the market. Before there was hope and hype and now there seems to be real drugs making real money. Is this rally sustainable? On the other hand, funding for healthcare venture capital teams was cut in half. Raising money for healthcare venture capital was difficult. Building a biotech company is capital intensive and fraught with risk. Our speakers, a hedge fund, a venture capitalist and an operator, were selected for their skill and their diversity. Peter Lawrence organized and moderated this session with a seasoned allocator's eye for talent and money-making prowess. peter@flagcapital.com

Bihua Chen

Bihua Chen
Cormorant Asset Management

Healthcare investing is not gambling despite what my parents think. There's concrete evidence to analyze. Markets are semi-efficient with available information. What's inefficient is projecting out. Biotech has milestones. Starting with a concept you get lab data progressing from molecular to cellular to animal models. Then you go to human phase one, two, and three. Then you get a sense for efficacy, side-effects, and then FDA approval if you clear these milestones. What makes money is taking available information to predict what happens next. That is driven by science and logic. Valuations go up and down with sentiment. What's helpful in valuing a company is to think about peak sales and its M&A price. What would a new drug be worth to a large pharma company? What are their gross margins? Most are over 90 percent. What are their R&D costs? Sales and marketing costs are highly variable. It's not practical to model EPS for these little companies. It's more helpful to model price to peak sales and discount it back to your probability or the time value of money. Are we in a biotech bubble? Has it arrived? No, it's always been here… for the last 20 years. There's alpha in biotech. Odds of success are still low. With individual companies you're faced with a binary event. You've got to make the call. But valuations are already reflecting success. Just because there are more new companies doesn't make (public) investing easier. These new companies have real products and real profits. The first wave of large biotech drugs in the 1980 -90s were simple protein replacements. This was low hanging fruit. The next wave was in cancer and autoimmune diseases because monoclonal antibody technology had matured. This technology was highly predictive. The next wave was targeted therapies for cancer. The final wave was the orphan diseases. They have high pricing to manage a few thousand patients worldwide. These business models were benefitting. Cancer drugs went from $30 thousand to $100 thousand per year. That drove the expansion of multiples. You need to watch pricing. If there's a problem then there's leverage. Going forward cancer immunotherapy technology is awesome. Breakthroughs are happening. There will be multiple molecules to treat a cancer. Monoclonal antibody technology is still a mainstay. Whether the era of gene therapy has arrived is hotly debated. We're approaching an era of curing the disease rather than managing the symptom. The pharma model of managing 5 symptoms is additive, not competitive. In 5 years biotech will be competitive, not additive. Eventually there will be cannibalization. This is creating volatility because investor's timeframes are different. Ultimately it's a binary event. You either die or thrive. We create value by embracing this binary element. Incremental thinking in biotech is bad. You need to think big and outside-the-box. Shorting a stock because it has doubled may be dangerous because it depends on its potential and its previous perception. The devil is in the detail. Biotech companies all tell the most amazing stories. What's important is what they didn't tell you. If you don't know the field you won't know the right question. chen@cormorant-asset.com

Amir Nashat

Amir Nashat
Polaris Partners

My journalist friends are talking the industry up. That's not a good sign. Are we in a bubble? Is this fundamental or is it a moment in time? I look at how people react to discontinuous events, a news event. Bad news was disproportionately punished relative to good news. Today the good news is disproportionately rewarded. There's enthusiasm and positive energy built into people's reactions. Prices rise because people are anticipating good news. Optimism is an occupational hazard of venture capital. We're optimistic for three reasons. The US healthcare system spends $3 trillion. We consume the same amount of drugs and procedures as Europeans but we pay twice as much. This is unsustainable. We'll go bankrupt. Costs must come down. Eighty percent is spent on human labor. Drugs keep you out of the hospital or help you prevent disease. Information technology makes healthcare operations more efficient. And diagnosis can catch you before you get sick. All three can help us save money. Drugs play a critical role. Cancer deaths have been dropping because of early diagnosis and drugs. Productivity gains from drugs have been significant. This industry will be transformed by the medicines we create. There will be winners and losers. Hospitals are being forced to take-on risk. Accountable care forces doctors to be more efficient. A lot of technology is coming-in to revolutionize this industry. It took 20 years to tackle HIV. It took only 3 months to tackle SARS because of genome sequencing. Building a company is getting more predictable much quicker. The ability to go from concept to clinical trials is incredibly fast. It's unlike anything I've seen. We won't see fruit for another 5-10 years because it takes that long for business processes to reorganize. Our business is backing great people. But the amount of money in the system has shrunk in half. Before there were 30-40 early-stage biotech VC firms in Boston. Today there are 4 left. The deals and entrepreneurs are incredibly high quality. Because there's less money the survivors are more entrepreneurial, more capital efficient and they're building better businesses. The same is true for companies going public. The scarcity of capital and trends in healthcare are driving dramatic developments in technology and innovation. We're seeing the benefits of it all. We make very small initial investments to get the entrepreneur into a capital efficient mindset. But people are still over optimistic. Prices will go up and down. Over 5-10 years there will be more good announcements. anashat@polarispartners.com

Tim Shannon

Tim Shannon
Canaan Partners

I'm an operator and a venture capitalist. What is biotech? It started as a manufacturing process that uses living organisms. Companies want to be viewed as biotech companies rather than pharmaceutical companies. Some hedge by calling themselves biopharmaceutical. All biotech is not the same. You need to get granular to understand what you're looking at. The power of healthcare technology reveals itself in life expectancy. For the first 8000 generations of humanity life expectancy was 30-40 years. From the 1900's to 2000 it doubled in Westernized countries. First we took on infectious diseases with vaccines, antibiotics, and antiviral drugs. Second, cardio vascular disease, the leading cause of mortality has decreased over the last decade due to great hypertension and lipid drugs. Then the industry shifted its focus towards oncology. Cancer mortality is falling. I don't expect life expectancy to double but we'll be taking on things that provide a better quality of life. We'll work on things that create more productivity. As chief medical officer at Bayer our bread and butter were drugs for infectious, respiratory and metabolic diseases. We had a huge sales force to call on general practitioners. We were dabbling in rare disease drugs but they were lost on the general practitioner. They didn't fit strategically. Then I led Bayer into oncology because there was an unmet need, no competition, and cost effective development. Bayer was shifting from mass market products into more specialized sales forces and products. Then as head of research for Curagen our advantage over the big guys was R&D and speed. Our thesis was good but our timing was bad. Capital was scarce and we were a single product company. We merged with another company to build critical mass and become a cancer immunotherapy company. This was not popular in 2009 during the great recession. But you need to believe in what you're doing. You need to be a long investor or a hedge fund manager who's able to interpret the ups and downs. Today I'm a venture partner who starts companies. One of our portfolio companies creates a small molecule drug that can degrade a pathogenic (cancer) protein you want to eliminate with great specificity. Small, private companies can feed the big guys with novel products very quickly. Another portfolio company creates a next generation antibody. Antibody drugs are not done, they're just beginning. Antibody drugs will constantly get improved so there will be some cannibalization. Overall there's a strong foundation of fundamentals. Big pharma survived the patent cliffs. They're realigning their business models to buy innovation. This is healthy (for exits). The gorilla in the room is pricing. These novel drugs will command higher prices but there will be downward pressure. New cures won't eliminate the need for drugs so I don't see cannibalization as a binary outcome. tshannon@canaan.com

Richard Cheung, Brian Lasher

Clouds Over the Emerging Markets: Silver Linings South of the Border

February 20, 2014 • UNDERWRITTEN BY BOARD OF THE GREENWICH ROUNDTABLE

Greetings from the Greenwich Roundtable. Our topic *Clouds Over the Emerging Markets: Silver Linings South of the Border* is a continuation of our series on developing economies. Inefficient pricing is our grail. Finding it inside the big, liquid markets is getting more and more difficult. Crowded trades, 24 hour news cycles and the too big to grow economies compel the alternative investor to press-on to the roads less travelled despite the heartache and disappointment. Investors are tired, spooked, underperforming and envious. After the recent barrage of bad news coming out of Argentina, Turkey, Thailand and Ukraine, they're asking themselves 'is there no end to these insults?' But exhaustion is our signal for investigation and we're hearing about dislocations. Our speakers are all practitioners, all experienced hands in these wild and woolly markets. They're considered to be the best athletes in their event, not household names and that's why we like 'em. Rian Dartnell continues to lead the conversation on how we make money and avoid getting hurt on the frontier. These emerging market sessions have become a members-only tutorial on portfolio construction and manager selection from a leading connoisseur of talent. Rdartnell@shlcap.com

Curtis Mewbourne

Curtis Mewbourne
PIMCO

What's the 30,000 feet view on the emerging markets? We see a decoupling story unfolding. We see evidence in fixed income, currencies and economic activity. Rising out of the Crisis, growth in the US and Japan has gained traction. Japan had its reforms. And the US had its accommodative monetary policy as well as traction in the auto, housing and energy sectors. Europe is seeing positive developments out of its recession and markets are pricing that in. In contrast there is no traction in the emerging markets. Latin America is expected to grow only .5 percent down from 2 percent. Brazil and Mexico economies, at only 1 percent, can't continue at such low rates. Although inflation is low by historical levels it's still higher than the developed world. Interest rates are being raised by LatAm governments. Slower growth is leading to currency weakness which leads to financial market outflows which leads to a lack of investment which leads to inflationary pressures which leads to even slower growth and a vicious cycle begins again. Politics are a factor too. Elections are coming up in the Fragile Five; Indonesia, Turkey, South Africa, Brazil and India. Incumbents are expected to win which creates vulnerability, political risk and disruption. After Bernanke's tapering speech we saw heavy retail outflows in our emerging market strategies but inflows and interest from institutions. Yet the net effect is still an outflow. In LatAm valuations are compelling in equities, 10-12 price-to-earnings ratios. Real interest rates are 2-6 percent. Historically these have been attractive levels. Tactically we expect to experience continued outflows and slow growth. Brazil and Mexico may grow a bit faster. And their debt levels are lower which helps the financial sector stabilize faster. But traction in the developed economies will lead to more demand and more traction in the emerging markets at some point. We think the interest rates cycles will continue to see hikes. Tactically we're still playing defense. We continue to underweight emerging market strategies in general however we're about to increase those weights. Mexico is a bright spot because it will be the first to benefit from increasing US growth. It's less vulnerable to the same shocks that afflict other markets. Argentina's fundamentals are not attractive enough yet for our portfolios. Brazil is a bad situation getting a little better. If their elections deliver a new government that could be a positive surprise. Mexico may be a better near term opportunity over Brazil and then Argentina. Curtis.mewbourne@pimco.com


Mario Epelbaum

Mario Epelbaum
Tree Capital

Painting assets with a broad brush creates a generalization problem. Decoupling provides a lot of different colors. For example Chile is cutting rates and Brazil is raising rates. Overall, LatAm consumption was booming from 2003 to 2011 primarily because commodities were booming. Now they're decelerating and that's a big adjustment. Fortunately, flexible exchange rates, a proper banking system and good financial controls are providing excellent adjustment mechanisms. Low debt-to-GDP levels are very important too. The economies of the Andes have good valuations. The currencies will get weaker. Peru has grown the fastest but it's too dependent on commodities. Chilean currency hedging costs are workable though. Look for secular stories that benefit from currency weakness. Chile's power generation is interesting because electricity prices are too high. Chile's price-to-book is the same as 2008, a fifteen percent discount to the five year average. It's committed to capitalism, flexible exchange rates and it's open. Mexico is the most interesting macro story. Before the reforms it was exciting as well. Unit labor costs between Mexico and China are the same due to productivity gains and no growth in wages. Proximity and transportation to the US make Mexico a very interesting manufacturing platform. Mexico has shipped more cars to the US than Japan. It's the largest manufacturer of flat panels in the world. Mexico has graduated more engineers than China. Manufacturing is growing slowly and steadily. Mexico hasn't had a consumer boom in 15 years. Consumer credit penetration is low. There's pent-up demand for credit and consumption. Good growth from the US could spark a consumer-led boom in the Mexican economy. Mexican reforms, both social and educational, have been dramatic. Labor, financial and energy reforms are underway. Energy investment has been quiet for 75 years. Now Mexico's constitution is being rewritten to allow private investments in the energy sector. However, stock market valuations are high and GDP isn't very good. Stock market activity will increase as spin-outs, M&A and IPOs increase. Buy Mexico today for a three year buy and hold. Or buy the corrections and, until we see better economic statistics, sell the rallies. Banking penetration from future consumer-led booms hasn't been priced into the market yet. Security from crime is a human issue, not an investment issue. Brazil has attractive valuations with a price-to-book of 1, below 2008 levels. Brazil is an efficiency story after a long consumer boom. Labor costs and its currency are too high and outflows are heavy. Companies on the supply side are interesting. Infrastructure is terrible and they're just beginning to privatize the build-out. Elections may be an upside surprise. Barring that look for 2-3 percent growth at best. Brazil has a terrific entrepreneurial spirit that Mexico lacks. Columbia has a very interesting infrastructure story. mario.epelbaum@treecapital.com


Jamie Rice

Jamie Rice
Wellington Management

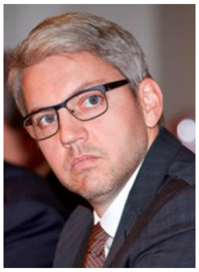
Over the next three years Mexico will be very interesting. Energy reforms are the most exciting story of all emerging markets and it's misunderstood. For Mexico it could be bigger than NAFTA. They're going to auction-off the deep water and shale assets near the US border which will generate jobs and dollars coming-in. Global oil companies can leverage their US operations and it will have an immediate effect on the Mexican economy. Pipelines are being built for natural gas to generate electricity in both Mexico and the US. Mexican electric costs will drop which will lower manufacturing costs, lower than China. Converting power generation plants to natural gas is underway. Combining Mexico's manufacturing sophistication on top of its natural resources provides for a more balanced economy, multiple sources of income, and an opportunity to boost GDP over the medium term. Enthusiasm over Mexican reforms has led to more IPOs because there haven't been many energy plays before and there's a need for capital. Mexican REITs are interesting too especially in the North where higher rents and occupancy rates are possible from their proximity to the energy activity. Fifty thousand people may be working around each new rig. Mexico's public sector is growing and finance companies lending to this sector are another interesting play. Reforms create short opportunities too. The telecom sector may lose ground under the reforms because their costs are too high. Monopolies such as cement and beer may experience difficulties as well. Argentina's demise is greatly exaggerated. *A Century of Decline* just hit the cover of The Economist which may be a leading indicator of opportunity. Everyone's focused on what went wrong but important things are changing. Argentina is a story being driven by a move to relative political stability. Argentina desperately needs dollars and it realizes that reforms and credibility are needed in their financial institutions. It's a relative improvement story going from really bad to bad, just muddle through as credit spreads narrow from 900 basis points over Treasuries to 600. Brazil has many challenges. Their headwinds include slow Chinese growth, US tapering and its own monetary and fiscal policy. Earnings revisions have been negative for several years. Pessimism is slightly ahead of fundamentals. When the economy starts to grow again Brazilian companies have terrific operating leverage. Venezuela is not a pretty story after it descended into dictatorship. jfrice@wellington.com


Ted Seides, Jack Buchmiller, Peter Fisher

Winning in Lilliput: Adding Value in Micro-Caps

April 17, 2014 • UNDERWRITTEN BY HAMLIN CAPITAL MANAGEMENT

Greetings from the Greenwich Roundtable. Our topic *Winning in Lilliput: Adding Value in Micro-Caps* is believe it or not the first time we've examined this strategy that's been known to outperform all other stock categories. Inefficient pricing is our grail and these tiny companies are fraught with mispriced possibilities. Our speakers are all practitioners, all originally analytical and all hard-closed to new capital. They shun the limelight and we're grateful for their insights. Since 1992, smaller companies have outperformed larger companies by 6 percent per year. Recently both groups are neck and neck. The bottom 1000 companies in the Russell 3000 make up 1.5 percent of the capitalization. Rian Dartnell organized and moderated today's session after thoroughly researching and committing capital to the strategy. Rian continues to lead the conversation on how we make money and avoid making mistakes on the road less traveled. Rdartnell@shlcap.com



Brian Bares

Brian Bares
Bares Capital

I'm just a research analyst and I don't run a hedge fund. Sarbanes-Oxley and buyout firm takeovers have reduced the number of micro-cap companies in the US. In 2000, CRISP tracked 6000 companies. Today it's 3500 and 1100 are under $200 million. Our universe has shrunk. The companies who couldn't afford to be public are gone and there's more legitimacy to those who remain. Micro-caps don't have institutional coverage. When I started the firm we didn't fit into an institutional style box. I tried to remove the agency issues by targeting long-term compounded growth and creating managed accounts for the endowment community where there are fewer intermediaries. Our portfolios are concentrated with 10 stocks of best ideas and inefficiently priced companies. We believe that internal compounding of business values drives stock prices over time. We look for the qualitative factors that create a competitive advantage like management and operational excellence. You've got to do your own work with micro-caps and this creates a structural advantage. They're either barely covered or not covered at all because there's no investment banking business and very little trading volumes. We've been collecting a list of good quality companies for the last 14 years. Institutional start-ups don't have our advantage. Ultimately they move up and out of our space altogether. Those who remain tend to over-diversify to gather more assets. We return capital to our investors to stay right-sized for this space. It's a difficult compromise because we can get close to companies to get a better feel for the business that's just not possible in the large cap format. We'll buy a company when it's small but we'll let it get bigger beyond the micro-cap definition. We don't typically take a Board position because our companies don't need fixing. If we're right then our exit is easy because liquidity expands. If we're wrong and it's a roach motel, then it can take months to get out. Fortunately they're all in public markets where exits can be continuous. It's a blast. It's full-time treasure hunting. bbares@barescapital.com

Tom Lynch

Tom Lynch
Mill Road Capital

Mill Road focuses on the value end of micro-cap market. We run a classic private equity fund so we're not subject to the liquidity spiral or forced redemptions. We've no incentive to push prices up because we're paid only on realizations, not marks. We'll take a small investment as a calling card to meet management. Ultimately we'll own 5-20 percent, take them private and take a thought leadership position on the Board. Simply put a micro-cap is $500 million or less or the bottom 2 percent of the market capitalization of the US. This is 50-80 percent of all companies. Micro-caps have two groups, value and growth. Value has a low beta, low liquidity and retail ownership. Growth has high beta, high liquidity and institutional ownership. Micro-caps are an attractive asset class that should be part of your portfolio. It's a class that's exceptionally conducive to creating alpha. And despite those positives there are very few structured pools to invest in. The asset class has between 2000 to 8000 companies to invest in. Most of the outperformance can be explained by three factors. Low liquidity outperforms high liquidity by 1500 basis points. Second factor is that value materially outperforms growth. Finally, size does matter. It's small size that matters most. The smallest micro-caps outperformed the largest micro-caps by 1000 basis points. The opportunity to create alpha is characterized by low liquidity, value bias, and small size. Micro-cap valuations are almost always less than the market. Standard deviation around the mean valuation is quite broad. The reason is that there is almost no institutional research coverage and it's mostly held by unsophisticated, uninformed retail investors. These stocks are marked by poor guardianship with unsophisticated and modestly engaged board members with no strong shareholder value agents governing the company. They operate below the radar and get away with a lot more than bigger companies can. There are heavy costs to being a public company, almost $2.5 million per year. There's a strong motivation for these companies to maximize revenue, not profits, because they can grow out of their micro-cap discount. This makes them an exceptional candidate for private equity and creating alpha. How do you exploit these characteristics? Dimensional Fund Advisors have a series of smart index funds in the space. But mutual funds are not economically efficient structures because their minimum scale is quite high and those that clear the hurdle find themselves gravitating to the larger names. Hedge funds have a misalignment of incentives, liquidity and horizon. Incentive fees are driven by performance which can be easily manipulated in thinly traded markets. If you decide to build your own portfolio from the bottom up you'll need to do an extraordinary amount of due diligence. tlynch@millroadcapital.com

Adam McConkey

Adam McConkey
Henderson Volantis Fund

For ten years I've been singing the virtues of micro-caps. Last year was the first year in twenty with inflows. No one seemed to be listening until now. So I'm a little worried about speaking here. We organized our hedge fund to avoid liquidity issues by asking for longer lock-ups. Everyone's worst discipline is the sell discipline. If you're a long-only manager and something doesn't smell right you move on. In a hedge fund that smell will trigger you to explore the possibilities of what can go wrong, a potential short. The shorting discipline attenuates you to understand risk more keenly. Our job is to wander around the world looking for moments of clarity. We visit 800 to 1000 companies every year trying to listen closely. AIM is London's junior market of 1600 companies, most under £200 million. Average size is £75 million. It's a rich & broad tapestry of UK and international companies. Before 2008 AIM grew fast, perhaps too fast. After that the appetite for risk dropped out and regulatory scrutiny prevailed. Structurally the institutional compliance officer is chasing their portfolio managers out of this market for suitability or liquidity reasons. This is an opportunity set rather than an asset class. What we're trying to capture is the small cap effect which is not pegged to any kind of timing or economic cycles. It's the gap between the market's perception and the business' reality. Understanding the business' reality will deliver significant returns over time, especially if you can identify the scale of change within. Patience is proportional to reward. You can't engineer a realization or predict when the return will happen. Investors with patient capital can provide the company with patient capital. Fund structures are important insomuch as underlying capital must match the liquidity characteristics of the portfolio. The lack of liquidity is your friend. If you can't sustain the investment then liquidity is your enemy. If lock-ups are a dirty word then this isn't the right opportunity set for you. Public markets tend to over react on the upside more so than a private sale to a strategic investor. Hedging in a long-only structure is not possible. Embrace volatility. Hedging to reduce volatility is an illusion of control. Stewardship is a big issue. Micro-cap managers must have a duty to engage managements. We've realigned compensation structures, made strategic suggestions and provided managements with confidence to make some tough decisions. We'll take a non-executive Board seat on our larger positions or nominate someone to provide oversight. adam.mcconkey@henderson.com

Steve McMenamin
24 April 2014

The Role of the Investment Committee: Getting Alpha from Good Governance

May 22, 2014 • UNDERWRITTEN BY COMMONFUND

Greetings from the Greenwich Roundtable. Our topic *The Role of the Investment Committee: Getting Alpha from Good Governance* is a continuation of our series on the influence that good leadership can have on the investment process. As investing gets more competitive and complicated we've been looking at the chief investment officer and their interaction with the board. In 2010 we declared in *Best Practices… Portfolio Construction* that the duty of the CIO is to educate the investment committee. And the duty of the IC is to protect the staff, allowing them to exercise their creative freedom. Today's session dove a little deeper revealing several variant perceptions to conventional wisdom. Lower returns, heightened transparency and increased regulation have greatly increased the degree of difficulty and responsibility on the IC. Behaving productively an IC can increase returns. Our speakers are three (four if you count the moderator) thought-leaders in the field. We're lucky to get them in one room. It was a real treat. John Griswold organized and moderated today's session, nurturing the conversation and adding a seasoned practitioner's point-of-view along the way. jgriswold@cfund.org

Keith Ambachtsheer

Keith Ambachtsheer
Rotman International Centre for Pension Management

Getting alpha from governance isn't the right starting point. The more fundamental issue is getting value from good governance. Boards face two questions. What business are we in? What defines success and how do we know we're successful? In the retirement context it's all about creating a fit-for-purpose pension design and implementing it in a value-for-money fashion. A sustainable fit-for-purpose design ought to include a target benefit that's achievable, sensible and has proper costing of any guarantees that are part of the arrangement. The investment program should focus on two things. First is return generation and long-term compounding. Second is the certainty of payments. Finally the system needs to be understood by participants. Value-for-money demands investment realism or understanding investing the way it really is. Chapter 12 of Keynes' General Theory, 1936, is the best thing written about investment beliefs. Are you a beauty contest investor or are you in the business of creating wealth, turning savings into wealth producing capital? How do you implement sensible investment beliefs? Do you in-source or outsource? Do you have the scale to in-source? Or what's the most effective way to outsource? Strategically, these are the value-for-money considerations for the board. What kinds of people are capable of making these board decisions? What kinds of people do we want on our board or investment committee? These people must have a passion for the cause. They need to be able to think strategically, to think conceptually in a long-horizon context. They're capable of asking the right questions at the right level. Finally the legal context of care, loyalty and impartiality is important. What that means has evolved over time. We've moved away from a box-checking definition into a more conceptual one of reasonable expectations. Is the board capable of understanding the context in which they're operating? And are they making reasonable decisions and oversight in that context? Look at your agenda. How much time are they spending on strategy and how much time on housekeeping? What can boards do to create alpha, to create risk-adjusted net excess returns? It can be done. Keynes ran Cambridge's endowment from 1921 to 1946 and generated 6 percent over the benchmark. It was generated by a clear set of high conviction investment beliefs over a long timeframe. Develop a skill experience matrix (i.e. audit, risk management) when mapping out the qualities for selecting an IC. This is a practical exercise for reorganizing a dysfunctional committee, perhaps one that's been put together by a political process. It's important for the stakeholders to understand where the deficiencies are and who they should be looking for the next time IC members are recruited or appointed. The ideal tenure for committee members will be three three year terms or nine years. Indexing great but there is no price discovery in the private markets. But then there is the two and twenty problem. Is there any value-discovery left? Keith@kpa-advisory.com

Myra Drucker

Myra Drucker
GMO Director

Good governance is having the right people making the right decisions about the right issues. Deciding the wrong issues is the biggest weakness of most investment committees. They haven't spent time thinking about how should we be spending our time? Most committees listening to managers make presentations. Agendas are governed by the amount of time the managers want to take or the staff reviewing quarterly performance. All of that is a bad use of the committee's time. The most important decisions a committee should be making are about the resources that are available to the organization. Going beyond the decision to in-source or outsource, the IC should be assessing whether the staff is good enough. Is the staff adequately structured? Is the compensation system aligning the staff with whom they're investing or the mission? Investment committee should not be making investment decisions. Have you ever sat through an IC discussion on what the next tactical asset allocation decision should be? Have you ever sat on an IC with Dominant Donor Dan, Helicopter Harry or Self-interested Sam and everyone else just listened politely? How many times have you seen an IC make a contrarian decision? This is very difficult for a committee because of behavioral issues. And yet we all know the contrarian, value-oriented decision ultimately pays-off. The IC shouldn't be in the business of selecting managers. It's a beauty contest if they're selecting managers. I've been a consultant, a portfolio manager, a CIO and an IC member. I've seen all sides of these issues. You need good staff to perform deep due diligence and to develop good relationships with good managers who won't be flipped-out for short-term performance issues. A good staff will truly understand the manager's investment process or decide whether that process is broken. Committees meeting four times a year shouldn't be making these decisions. Committees shouldn't be in the business of selecting managers, making asset allocation decisions or reviewing quarterly performance. The long-term horizon is essential to a successful investment program. Committees should be in the business of optimizing their resources whether they're internal or external. Get into the business of thoughtfully evaluating those resources. I believe the IC chair should be a silent but strong presence…herding all the stray cats into a good consensus decision. Committee members should have a fiduciary mind-set where they separate their personal needs from the needs of the mission. If you're considering joining a committee ask yourself 'can I get along with these people and can I make a difference here'? Stay away if you think something unethical is going on. Small committees of highly engaged people between 5 – 10 members are ideal because you'll always some free riders. As a committee we need to be testing the quality of the thought process of the people who are making decisions. myradrucker@sbcglobal.net

Charley Ellis

Charley Ellis
Partners of '63

Any IC who honestly believes they can add value by selecting securities or managers will do harm. I don't care how marvelous their human values are, they will doing serious unintentional harm. The evidence lies in the data. Seventy five percent of committees pick undifferentiated managers. Twenty five percent pick managers who are decisively worse. One tenth of one percent selects managers who are decisively superior. The harm being done is terrific. Greenwich Associates surveys institutions. Every year every one of those institutions believes their managers will outperform the averages by one percent. This belief that they can add value stands in stark contrast to the data that shows the exact opposite. Today over a third of all graduates of the leading universities of the world want into investment management. The talent of these people is spectacular. They're well paid, they're having a wonderful time and they've figured it all out. And that's the good news. The world of investing is divided into two parts, price discovery and value discovery. The crowd of these brilliant young people have figured-out price discovery so well, debating whether the market is perfectly or semi-perfectly efficient. The rest of us just stand back and say 'it doesn't matter'. Given the magnitude of the fees the net result of being active, active, active just doesn't work. The first test for an IC is 'do you understand what's going on'? If you do then you'd say 'what are we trying to do'? If you're spending time on anything related to management then it's wasted. If you're spending time on governance then you have a shot at making a difference. The secret to governance is simple. Write down on one side of a sheet of paper the guidelines that you expect your committee to follow. Get approval of those guidelines. And leave the room forever. The most important questions are what problem are we trying to solve, what are we trying to accomplish, and what are the unique needs of our organization? The value-discovery opportunity is rich with privileges and can make a difference. If you make the time to develop an accurate understanding of what's really important to the institution or the family then you can easily reverse engineer the appropriate investment program to serve their legitimate interests. Everyone will be happy when you harmonize the investing program with the real needs of the investor. The secret message in selecting IC members is twofold – plays well with others and really understands what investing is really all about. They should've read and understand David Swensen's book. The chair must have an exceeding need to be silent and to facilitate the success of others. A servant leader is the perfect IC chair. A good chair will spend quality one-on-one time with each member. Highly productive members will serve for 6 – 7 years. Chairs will have ten year tenure but need to be replaced to create a stronger committee. Smaller committees are always better between 5 to 8. An ideal IC will have decided to invest in index funds because price discovery has already been worked out. Picking the right managers or timing the market is folly. That game is over. After fees the great majority of managers fall below the benchmark. Avoiding the mistakes that other committees make will allow you to add alpha on a relative basis. charley@partners63.org

Opportunity & Outlook on the Recovery in Europe

June 26, 2014 • UNDERWRITTEN BY BOARD OF THE GREENWICH ROUNDTABLE

Greetings from the Greenwich Roundtable. Our topic *Opportunity & Outlook on the Recovery in Europe* is a continuation of our look into a set of markets that continue to exert one of the strongest gravitational forces on the planet. As is our custom we like to examine out-of-favor strategies. Two years ago we began planning this session when Greece defaulted on its debt. Thankfully we waited because the conversation back then was whether the European Union would fall apart. That's no longer the main concern thanks to a speech by Mario Draghi and the actions of the ECB. George Coplit conceived, organized and moderated this session with a seasoned allocator's eye for quality and diversity. George.Coplit@lgt.com

Chris DeLong

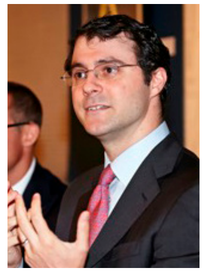
Chris DeLong
Taconic Capital Advisors

Sometimes the psychological environment drives our outlook. When it comes to negative psychological atmospherics, Europe hits all the buttons. The demographics are terrible especially in countries where women are treated badly. Since WWII it has been a two speed economy. The north has been efficient and the south has been forced to devalue its currency. Now with one currency Germany increases its efficiency and the south must devalue in the form of painful social adjustments. That pain and pressure will not go away. Europe with a few exceptions has poor creditor rights, poor shareholder rights, terrible union problems, and the recovery has been sluggish. There's not much reason to think that will change. Psychologically there's tremendous hostility towards capitalism amongst Europe's elites. They really don't like us. This toxic psychology creates a strange dynamic in which capital get allocated. Europe's been a banking culture for the past century. It's never developed credit markets (outside of sovereigns) like the US. Why is that? Creditor's rights have been poor. Relying on the law has been a mistake. Local courts have a history of protecting delinquent local debtors. So credit got extended if you had a relationship with a bank. If your company had a relationship with Deutsche then you get credit. Thus a banking culture developed instead of functioning credit market. Since the crisis the banks are wounded and haven't been properly recapitalized for political reasons. As a result you've got a wealthy continent that is capital poor. And it's not likely to change. This is the opportunity. Someone will need to provide capital. Shrewd investors will be able to provide capital at above market rates for a good long time. Europe is still a wealthy continent with valuable brands. Their economies are functioning and they need capital. The opportunity to provide capital is an important one. The Euro may not exist in its present form in 10-15 years. Those decisions will be made by politicians not yet in office. However it's not going away anytime soon. Angela Merkel behind the scenes has marginalized the skeptics in her party. Party politics are important in Europe and they've aligned themselves with keeping the Euro together. The central bank has aligned itself as well. Europe will stay together. The continent remains capital short. Price discovery is tricky in the smaller economies. cdelong@taconiccap.com

Mark DeNatale

Mark DeNatale
CVC Credit Partners

Today the opportunity lies in Europe's banking culture. In the last 15 years banks have provided 65 percent of all leverage financed debt. In the US it's less than 20 percent. European distressed corporate debt delivering risk adjusted returns between 15-25 percent is the big opportunity that's been in formation for the past 5 years. Billions were raised beginning in 2009. What's the catalyst in 2014? The difference is the Asset Quality Review (AQR). For the first time Eurozone banks will have a uniform regulatory framework for marking impaired loans. This is massive. The ECB will be the single supervisory mechanism. Twelve hundred financial analysts are reviewing 130 banks and managing 85 percent of those balance sheets. In 2014 the banks are getting ahead of the AQR ratings by jettisoning their questionable loans. Some say it could be $400 billion. Banks can either raise equity or dispose of bad assets. This is the single best opportunity I've ever seen in Europe. The first deal we saw was Ireland's second largest power producer creating a 15 percent return. The second deal was debt coming out of a German bank on a UK ferry system where we own all the assets and a 20 percent return. The third opportunity is a Spanish retailer delivering a 25 percent return. These are healthy returns but there are clear risks. The first is settlement risk. Settlement is long and complicated. You need a team that's a deeply experienced operations team. Second is liquidity. These are not daily redeemable investments. Since the crisis and Dodd-Frank the broker dealer community has committed 75 percent less capital. You need to understand the jurisdictional and corporate risks in this space as well. Sourcing the deals directly from banks can be tricky and you need a network. We're trying to align our commitments with our resources in Western Europe where we have 15 offices. mdenatale@cvc.com



Mark Mezvinsky

Mark Mezvinsky
Eaglevale Partners

We are incredibly bullish on Europe. The risk that Europe falls apart has diminished. Coalitions are forming to tighten the fabric and hold it together. Not a single bank has updated their growth forecast for Europe. The ECB has used a bigger bazooka than everyone thought in the last 3 months. These developments haven't been priced-in to the market yet. We think assets can appreciate 100-200 percent, especially in Greece. The bar for Greece has been set very low. Portugal has just left the IMF program, life support is off. Italy has twin surpluses in its balance of payments. We're students of history and if history's a guide then you want to be long Greece. Rogoff says Greece has been in default 50 percent of the time since 1822. If you've done the work those numbers won't scare you. Greece performed an enormous debt restructuring in 2012 and gave everyone a 5 percent haircut. In 2013 it was the first country in history to be officially demoted back to an emerging market in the MSCI. Before that Greece was being held to developed markets standards. Now the lens is in focus. Their parliament is maintaining its austerity program. Their political dynamic is relatively stable. Greece is poised for growth. Greek debt to GDP is 187percent. It may be high but the amount of private sector debt is 10 percent the rest (which will be renegotiated in October) is being held by German banks and the IMF. Their cost of servicing debt is miniscule, less than 50 basis points. In ten years less than 10 percent of the debt will need to be refinanced. Defaults if any will happen in ten years. Vehicle sales are up 18 percent year over year. Greece was the best performing equity market in 2013, up 100 percent from the bottom. And it could double or triple again. A huge catalyst is coming in October when Greek public debt is renegotiated. We believe they will 'pretend and extend' rolling their 30 year debt to 50 years…betting that they'll be able to inflate this debt away with rate hikes in the next 15 years. We believe there are 3 sets of instruments with healthy upside: Greek Government Bonds (GGBs), shorter duration paper throughout Europe and the Greek version of GDP growth warrants. Finally we believe Greek equities have incredible upside, specifically the cyclical stocks. Greek banks have incredible pricing power because they shrank from 25 to 4 banks. Greece is a risk premium asset play. It's not for the faint of heart. First risk is liquidity. Greece isn't good if you need overnight liquidity. Greek stocks can move 8 percent in one day so volatility is alive and well in equities. Third risk is any global macro shock. Greece will be affected if any external shock hits the world economy. Finally there is an AQR risk that the IMF will require banks to increase their equity when they renegotiate in October. Security selection is needed here. Return potential is outstanding but you've got to do the work. mmezvinsky@eaglevalepartners.com

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Upcoming Exhibition at the Bruce Museum

For the past 19 years, the Greenwich Roundtable has been holding our monthly symposia at the Bruce Museum in Greenwich, Connecticut. The Bruce, a staple in the community for over 100 years, is blessed with Peter Sutton, CEO, who is considered to be one of the leading experts in the world in the Old Masters genre. At the Bruce we've been treated to a broad array of modern, contemporary and classical works of art while we listen to scores of the most talented managers in all kinds of exotic strategies. We include this art here to give you a sense of the visuals.

Abraham van Beyeren (1620/21—1690)
Banquet Still Life
Oil on canvas, 118.2 x 167.6 cm
HOHENBUCHAU COLLECTION, on Permanent Loan to LIECHTENSTEIN: The Princely Collections, Vienna

Hendrick ter Brugghen (1588—1629)
A Laughing Bravo with his Dog
(Diogenes?), 1628
Oil on canvas, 83.2 x 68.5 cm
HOHENBUCHAU COLLECTION, on Permanent Loan to LIECHTENSTEIN: The Princely Collections, Vienna

Northern Baroque Splendor: The Hohenbuchau Collection from the Liechtenstein Museum

Bruce Museum, Greenwich, CT: September 20, 2014 to April 19, 2015
Cincinnati Art Museum, Cincinnati, OH: Summer 2015

The Hohenbuchau Collection is one of the largest and most varied collections of Northern Baroque art assembled anywhere in recent decades. It was gathered by Otto Christian and Renate Fassbender and has been on long-term loan to the Collections of the Prince of Liechtenstein in Vienna, where it was exhibited in its entirety in the former LIECHTENSTEIN MUSEUM in 2011. A selection of some 80 paintings from The Hohenbuchau Collection was recently shown at the Staatsgalerie Stuttgart in Germany (11/08/2013 – 02/23/2014), and paintings from The Collection are regularly being displayed alongside The Princely Collections, in the permanent exhibition in Vienna as well as on touring exhibitions worldwide. The show will appear in Stuttgart and possibly Paris in 2013/2014. The selective showing at the Bruce Museum in Greenwich is the inaugural venue in the U.S. and we anticipate one or two other American stops. Primarily comprised of Dutch and Flemish seventeenth-century paintings, it exhibits all the naturalism, visual probity and technical brilliance for which those schools are famous. While many modern collections of Old Masters specialize in a single style or subject matter, the Hohenbuchau Collection is admirable for offering examples of virtually all the genres produced by Lowland artists – history painting, portraiture, genre, landscapes, seascapes, still lifes and flower pieces, animal paintings and hunting scenes. Netherlandish artists tended to specialize, whether in figures, landscapes or still lifes, but they were not averse to

Jan van Goyen (1596 – 1656)
A River Landscape with a Parish Church, 1651
Oil on canvas, 55.5 x 67 cm
HOHENBUCHAU COLLECTION, on Permanent Loan to LIECHTENSTEIN: The Princely Collections, Vienna

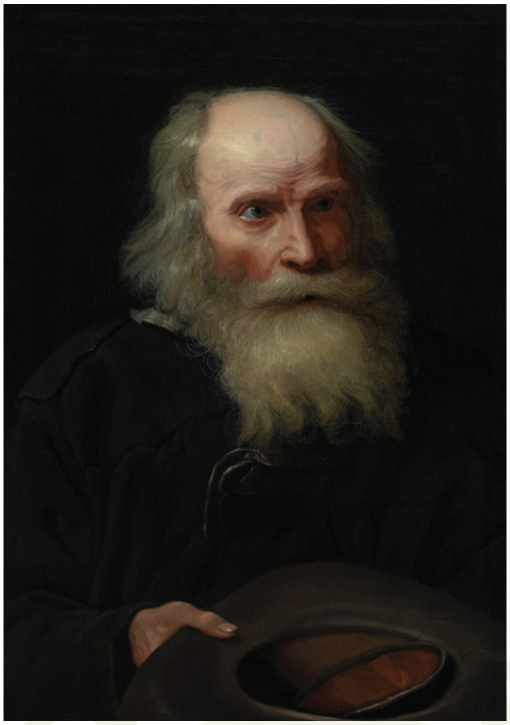
Frans Snyders (1579—1657)
Still life with Fruit, Dead Game, Vegetables, a live Monkey, Squirrel and Cat
Oil on canvas, 81 x 118 cm
HOHENBUCHAU COLLECTION, on Permanent Loan to LIECHTENSTEIN: The Princely Collections, Vienna

Salomon van Ruysdael (1600/03—1670)
River Landscape with a Ferry, a Yacht and other Vessels, with a View of Gorinchem in the Distance, 1647
HOHENBUCHAU COLLECTION, on Permanent Loan to LIECHTENSTEIN: The Princely Collections, Vienna

Gerard Dou (1613—1675)
The Wine Cellar (An Allegory Of Winter)
HOHENBUCHAU COLLECTION, on Permanent Loan to LIECHTENSTEIN: The Princely Collections, Vienna

collaboration; the collection is distinguished for its many high quality, individual paintings executed by more than one artist, working as it were in double harness. It is also distinguished for its emphasis on history painting, subjects sometimes neglected by modern collectors, featuring outstanding Mannerist (Joachim Wtewael, Abraham Bloemaert, and Cornelis van Haarlem), Utrecht Caravaggisti (Gerard van Honthorst and Hendrick ter Brugghen) and Flemish and German history paintings. Other strengths include genre scenes by the Leiden fijnschilders, Gerard Dou, Frans and Willem van Mieris, fine game still lifes by Jan Fyt, Hendrick de Fromantiou, and Jan Weenix, outstanding banquet pieces by Frans Snyders, Abraham van Beyeren and Joris van Son, as well as fine Dutch landscapes from the so-called Classic period by Salomon van Ruysdael, Jacob van Ruisdael, Allart van Everdingen and Aert van der Neer. The Flemish paintings include works by renowned artists such as Peter Paul Rubens, Jacob Jordaens, and Jan Bruegel the Elder, as well as excellent works by Joos de Momper, and David Teniers. There also are little known paintings by artists once forgotten but today again held in high esteem, like Michael Sweerts. With its colorful diversity, naturalism and technical brilliance, the show appeals to the general public, but there also are surprises for the specialist and connoisseur, for example the only known signed pictures by several artists.

The show was organized and its 500-page, fully illustrated catalogue written by Peter C. Sutton, Executive Director of the Bruce Museum, and a Northern European painting specialist.



Michael Sweerts (1618—1664)
Portrait of an Old Man Begging
HOHENBUCHAU COLLECTION, on Permanent Loan to LIECHTENSTEIN: The Princely Collections, Vienna

Simon de Vlieger (1600/01—1653)
Dutch Merchantmen in Rough Seas off a Rocky Coast
HOHENBUCHAU COLLECTION, on Permanent Loan to LIECHTENSTEIN: The Princely Collections, Vienna

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The Greenwich Roundtable

One River Road, Cos Cob, CT 06807

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