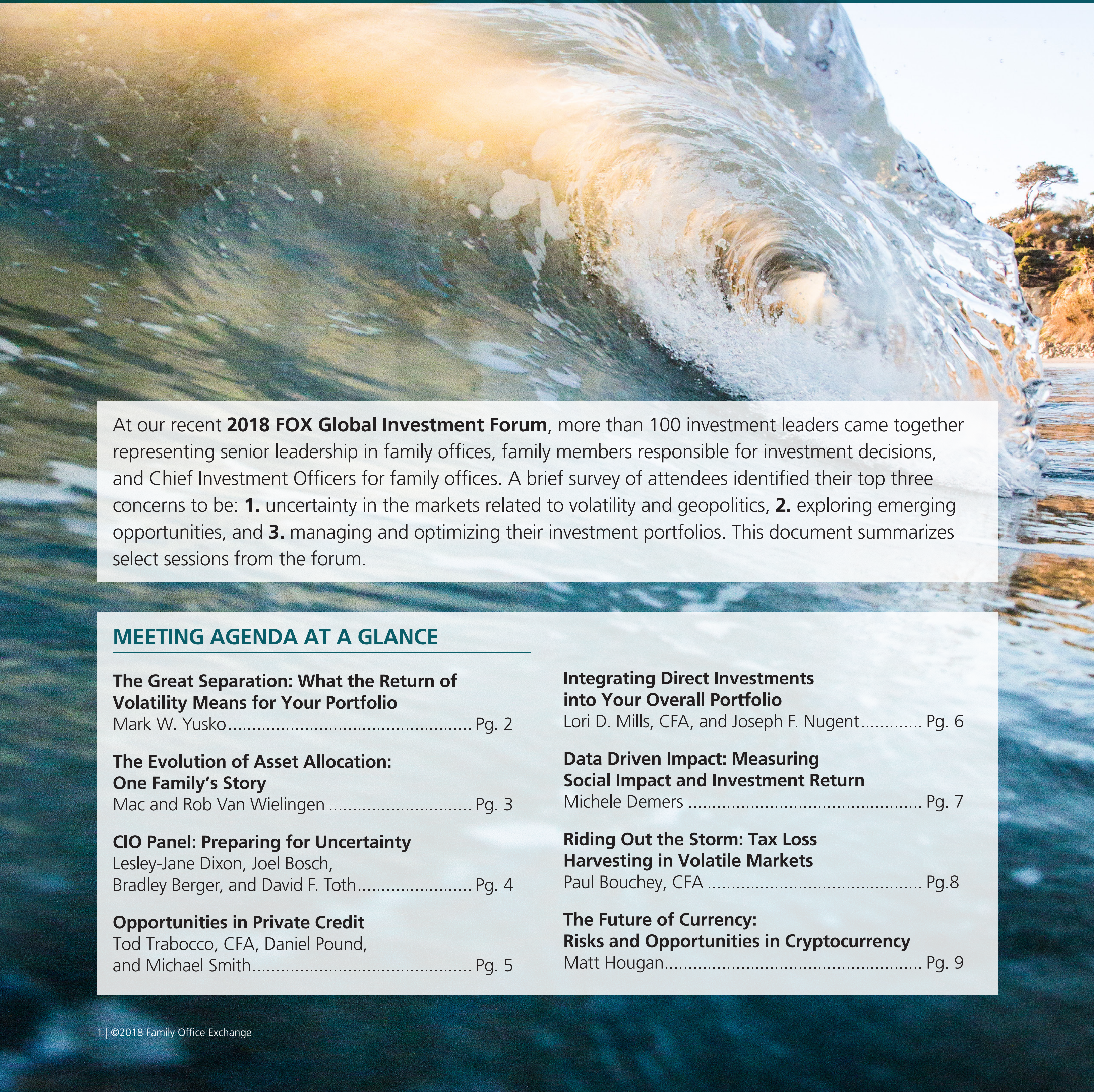
Family Office Exchange | FOX AUTUMN GLOBAL INVESTMENT FORUM™

# Insights & Takeaways

## September 13, 2018 | The Metropolitan Club | New York, NY

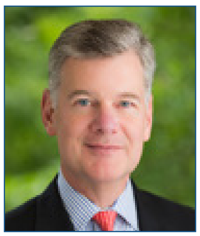


At our recent **2018 FOX Global Investment Forum**, more than 100 investment leaders came together representing senior leadership in family offices, family members responsible for investment decisions, and Chief Investment Officers for family offices. A brief survey of attendees identified their top three concerns to be: **1.** uncertainty in the markets related to volatility and geopolitics, **2.** exploring emerging opportunities, and **3.** managing and optimizing their investment portfolios. This document summarizes select sessions from the forum.

## MEETING AGENDA AT A GLANCE

# The Great Separation: What the Return of Volatility Means for Your Portfolio

## PRESENTER



**Mark W. Yusko**
Founder, CEO and
Chief Investment Officer,
Morgan Creek Capital
Management, LLC

## PRESENTER QUOTE

*"There is no such thing as passive, it is just slow active. Today, there are more indices than stocks. That is not good for investors. They are guaranteed to have the worst investments at the wrong time."*

## SESSION DESCRIPTION

Since the end of the Global Financial Crisis, abundant Central Bank liquidity has created a global rising tide for financial assets. Stocks, bonds, and real estate have been locked into a relentless, low volatility "melt-up" in valuation over the past nine years, culminating in the extraordinarily low volatility of 2017. This year has ushered in a new volatility regime as global Central Banks move toward a more restrictive monetary policy framework. This session explored the beachfront of investment opportunities to see which are "swimming naked" (per Buffett) as the liquidity tide recedes, and which strategies may add value to your portfolio in the new volatility regime.

## KEY TAKEAWAYS FROM THE SESSION

- Yusko forecasted a "Great Separation," as central banks raise interest rates and volatility returns to the markets, creating more dispersion across strategies, potentially rewarding both active managers and short sellers.
- Portfolio returns will best be achieved through exposure to four different kinds of risks (in this view, risk is the way to view markets rather than a more return-based approach):
    - Credit risk
    - Equity risk
    - Illiquidity risk
    - Structuring risk

    - Active management will be rewarded going forward in the more volatile markets and as the great bull market fades.
    - There are several areas investors should consider as attractive opportunities in today's financial markets, namely:
        - Emerging markets (where demographics and cheap valuations stand out)
        - Real assets (cheap compared to paper assets)
        - Illiquids (illiquidity premia is above average making private investments attractive)
        - Hedge funds (attractive returns per unit of risk compared to past several years)
        - Blockchain (sector likely to usher in period of unprecedented wealth creation)
- Financial indicators are still strong late in the cycle, but risk comes on fast in such conditions and all investors should be preparing for increased volatility and other headwinds.
- In sum, Yusko warned the "smart money started trading in January [2018] and has been selling ever since" and "in the coming "Great Separation," stock pickers and short sellers will be rewarded again."

# The Evolution of Asset Allocation: One Family's Story

## PRESENTERS

**Mac Van Wielingen**
Founder and Director,
ARC Financial Corp.

**Rob Van Wielingen**
President, Viewpoint
Investment Partners
Corporation

## SESSION DESCRIPTION

This session shared the perspective of a private equity entrepreneur and a significant institutional investor who works with his son to develop their family's long-term investment approach. The family shared how their investment program has evolved from concentrated private equity holdings within their single-family office to a systematic, global, factor-based multi-asset approach for themselves and other families. They outlined a long-term stewardship approach that encompasses private, alternative and public investment strategies, and which challenges a conventional asset allocation approach.

## KEY TAKEAWAYS FROM THE SESSION

- As a family moves away from wealth creation into wealth stewardship, a different approach and different skills are required to make this transition. The Van Wielingen family moved away from a large, concentrated position in the company that created their family wealth - as part of a 100-year plan.

- The family considered the challenges to address in creating a 100-year stewardship plan, including: underperformance of active managers; difficulty in selecting successful managers over an extended period; high costs associated with global investing; difficulty in aligning the goals of managers and investors; home country bias; and behavioral biases. The family felt that neither consultants nor active managers added value (citing studies showing they detract value). This caused them to build a robust model and manage the assets internally.

- The family established a set of principles and beliefs that helped shape their stewardship plan. A critical element is the belief that long-term portfolios should have a global, low-cost, liquid, foundational strategy underneath higher-risk entrepreneurial investment activity. Rules-based, systematic asset allocation is a superior framework to achieve goals and protect capital and the family has conviction that there are indisputable benefits in investing globally.

- Every investment decision is active. The only true "passive" investment approach is owning everything available in all global markets. Any decision to allocate to one asset class, geography, or manager is an active one.

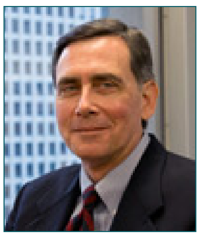
- Following their stewardship plan, the family has shifted over time from a portfolio 100% invested in an entrepreneurial venture, to an asset "pyramid." Their asset allocation pyramid has four categories – 1. Global Beta (low-cost, global, liquid portfolio), 2. Quantitative Asset Allocation (a systematic factor-based overlay to adapt the Global Beta portfolio based on pre-determined signals), 3. Alternatives, (with expectation of "absolute return"- niche-oriented hedge and private equity/credit strategies) and 4. Entrepreneurial Investments (primarily direct investments). With this balance, they believe there is zero risk for total permanent family loss of capital over the long-term and it provides a low-cost program with less reliance on outside parties and enables each generation to tailor the plan for the long-term (over 50-year periods).

**PRESENTER QUOTE**

*"I needed to diversify away from myself." (explaining the need to shift from operating business to diversified asset pool)*

# CIO Panel: Preparing for Uncertainty

## MODERATOR



**David F. Toth**
Managing Director,
Family Office Exchange

## PANELISTS

**Lesley-Jane Dixon**
SVP/CIO, Clark Enterprises, Inc.

**Joel Bosch**
Controller, 42 North Partners LLC

**Bradley Berger**
President, Kompass Kapital Management LLC

## SESSION DESCRIPTION

In this session, a panel of single-family office Chief Investment Officers discussed how they are positioning the family portfolios. This session shared actionable investment suggestions as the CIOs prepare for the potential return of volatility and explored how they are assessing risks and opportunities in an uncertain investment environment.

## KEY TAKEAWAYS FROM THE SESSION

- Family Offices tend to think of asset allocation differently than institutional investors, and these panelists were no different. One family practices "thematic balance sheet deployment," and the other two split buckets by private/direct and public.

- The purpose of the traditional marketable portfolio is to manage liquidity and fund private investments. Private investments are where the families are most interested and what they view as the primary long-term driver of value/return.

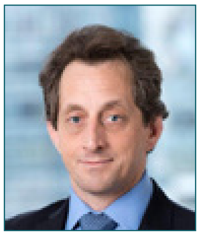
- Both families that have family members involved in investment decision-making seek unanimous decisions. For the third family office, the family is removed from the investment decision-making process, and the CEO is the primary decision-maker (with the investment team prior to the decision). In all three cases, it seemed that consensus across the board was more important than doing what might be quantitatively the "right thing."

### PRESENTER QUOTE

*"The benefit of a Family Office is that you don't have to invest. You can sit out if the deal isn't right."*

# Opportunities in Private Credit

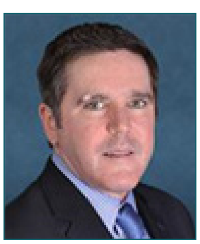
## MODERATOR



**Tod Trabocco, CFA**
Managing Director,
Cambridge Associates, LLC

## PANELISTS

**Daniel Pound**
Managing Director,
Angelo, Gordon & Co.



**Michael Smith**
Co-Head of Credit Group,
Ares Management, L.P.

## SESSION DESCRIPTION

In this session, we discussed where we are in the credit cycle and how to consider opportunities in private credit, focusing on direct lending and distressed debt. Cambridge's Head of Private Credit Research moderated the discussion and portfolio managers from Angelo, Gordon & Co. and Ares Management discussed credit strategies broadly, with a focus on their direct lending and distressed strategies, as well as other timely opportunities.

## KEY TAKEAWAYS FROM THE SESSION

- Past fundraising: New entrants to the direct lending space and total assets raised have increased dramatically post 2008-2009 crisis, with a meaningful step up in the 2013-2017 period while 2018-to-date has seen a pace notably less than 2017.
- Future fundraising: The number of active direct lending funds is likely to remain relatively static and the growth in assets have and will level off.
- Direct lending is typically an all-weather strategy but note that managers with cash reserves will be the winners as they will have dry power late in the cycle to take advantage of opportunities. The key will be to find managers that can find good companies with bad capital structures offering a good entry price. Retail was highlighted as a sector that is particularly challenged.
    - As interest rates rise in the U.S., the number of defaults will increase (with a significant lag of 12-18 months) as rates are still low compared to historical averages.
    - In Europe, companies are not as healthy as in the U.S. (The European Central Bank owns 20% of investment grade corporate credit).
- Factors to consider when selecting a direct lending manager include: the size of the team; strength of the manager's relationships in the market place and ability to source opportunities (typically the close rate for a manager is 3% and as such deal flow is important); and being on the side of the transaction that controls the legal documentation.
- Distressed debt is more cyclical (compared to direct lending) and deployment of cash is expected to be slow in today's market environment. The panel felt that this would be an interesting time to consider a distressed strategy.

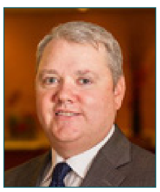
## PRESENTER QUOTE

*"While there is no one signal for the turn of the credit cycle, the amount of covenant-lite issuance suggests that we are at or near the end of the cycle. Investors should be cautious but opportunistic."*

# Integrating Direct Investments into Your Overall Portfolio

## PRESENTERS


**Lori D. Mills, CFA**
Managing Director,
Asset Consulting Group



**Joseph F. Nugent**
Director, Asset Consulting Group


## SESSION DESCRIPTION

As interest in direct investing among ultra-wealthy families continues to grow, so do the challenges. How do investors maintain the discipline and risk controls of their overall investment program while allowing for the greater flexibility needed to take advantage of the opportunities in this space - while managing the many risks specific to direct investments. In this session, we explored different structures and approaches used by families to meet these challenges.

## KEY TAKEAWAYS FROM THE SESSION

- Almost three-fourths (71%) of family offices invest in real estate properties, with almost half (47%) investing directly in operating businesses, according to the 2018 FOX Global Investment Survey. Nearly half (45%) are actively looking at direct deals, and deal networks dominated (41%) the source of deals entered in 2017.
- A key component of a successful private investment portfolio is the development of a plan that provides a framework for deploying capital at risk and that provides flexibility to allow for inevitable changes to the plan. Having a plan reduces the chance of an over-allocation mistake and provides a framework for determining the appropriate number and size of investments.
- As families consider a direct investing program they should consider whether to develop an in-house program or find an experienced partner. They should understand what models are available and which ones actually work. A successful direct investing program will include: sourcing, diligence, selection, execution, monitoring, and realization.
- Families engaging in direct investing should engage in active risk assessment to measure the risk/return for direct investments in their portfolio. Dynamic financial analysis was recommended as a comprehensive approach to measuring risk.
- Best practices for adding direct investment: 1) Deal Flow: investors must see enough deal flow to be discerning and selective; 2) Exposure Management: develop guidelines and stick to them and budget for follow-ons and the unexpected; 3) Be Flexible: sometimes opportunities are not neatly wrapped; 4) Process: put a diligence and approval process in place before considering direct investment opportunities; 5) Alignment: make sure it is there between management, deal lead, and other investors.
- Important considerations and watch-outs: don't forget the basics (private, illiquid investments are private and illiquid), don't start investing without a plan, don't pick a bad partner (only invest with the highest quality, most trustworthy and capable partners), don't forget that structure matters, and don't drag your feet (say "no" quickly and let partners know where you stand).
- The speakers presented two case studies to show how a direct program can be integrated into an overall portfolio allocation. In one instance, the family brought legacy direct investments and the advisor worked to "reconcile" the direct investments within the overall portfolio, from the perspective of risk allocation, benchmarking, return expectation, and valuations. In the second instance, the family requested an allocation to direct investments, and the advisor helped size and source the direct deals.

# Data Driven Impact: Measuring Social Impact and Investment Returns

## PRESENTERS

**Michele Demers**
Founder & CEO, Boundless Impact Investing

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

### PRESENTER QUOTE

*"A rigorous, data-driven methodology of defining and measuring impact can help investors track and manage outcomes relative to their goals, and make better financial decisions."*

## SESSION DESCRIPTION

Many family members and family offices are attracted to the idea of aligning their values with their investing. Yet many are confused or frustrated by the lack of straightforward methods and metrics to define an "impact investment," particularly how to contrast these to more traditional investments. This session discussed the significant evolution of analytics to determine whether investment returns on an "impact" investment are concessionary, and also new metrics to help quantify the social or environmental contribution of an investment.

## KEY TAKEAWAYS FROM THE SESSION

- Nomenclature is probably the biggest challenge with impact investing. Many people are confused and that causes them to avoid the topic altogether. Most consider "value-aligned investing" as a spectrum. In its most mild form, you can opt to remove companies whose practices do not align with your values (SRI/ESG, socially responsible investing/environmental social governance), you can intentionally seek companies whose practices and behaviors align with your values (sustainable investing), or you can deliberately invest in companies whose products/solutions are tied to your values (impact investing).
- Impact investing intentionally seeks social/environmental AND financial returns. It is a very deliberate use of capital and must achieve both types of return for it to be a "success." Impact investing has a social promise of harnessing the potential of entrepreneurship and market-based solutions to promote scalable solutions to some of the world's most pressing needs. A clear measurement of outcomes is a cornerstone of impact investing.
- You do not have to give up financial return to invest according to your values. Some investments naturally produce higher returns than others (i.e. – private equity vs. investment grade fixed income) and some investments have different purposes (riskier seed funding for new social initiative vs. growth capital for established and expanding organization). According to the GIIN 2018 Impact Investor Survey, 91% of investors reported financial returns in impact investments that met or exceeded their expectations.
- Value-aligned investing is not one-size-fits-all. It spans the entire capital spectrum, return spectrum, and value spectrum. It can be a carve-out in your portfolio or you can align 100% of your assets with your values. It can be in your personal investment portfolio or your foundation.
- The session covered quantitative metrics to determine "impact." Existing tools rely on self-reported, subjective data and there are few frameworks that create a complete picture of how impact and profit align. A rigorous, data-driven methodology of defining and measuring impact can help investors track and manage outcomes relative to their goals and make better financial decisions. Several data-driven methodologies were presented and continue to be developed.

# Riding Out the Storm: Tax Loss Harvesting in Volatile Markets

## PRESENTER

**Paul Bouchey, CFA**
Chief Investment Officer,
Parametric Portfolio
Associates, LLC

## PRESENTER QUOTE

*"Given low volatilty and dispersion, 2017 was one of the worst years for tax loss harvesting."*

## SESSION DESCRIPTION

A turbulent market can increase the effectiveness of harvesting tax losses – if you have an active tax-management strategy – and stick to it. This session discussed the market's uptick in volatility in Q1, why there are loss-harvesting opportunities even in bull markets, and the compounding benefits of tax alpha over time. The speaker discussed the recent tax cuts and shared his views on a tax-aware approach to investing in today's complex markets.

## KEY TAKEAWAYS FROM THE SESSION

- The speaker reminded us that capital markets were built to off-load risk on a broad set of investors and provide easy capital access, but not necessarily built for investors to earn returns.
- While it is always wise to have a tax loss harvest strategy, bear markets with high volatility and dispersion of returns offer the best time to harvest tax losses.
- In this environment, the speaker likes low volatility defensive stocks that produce good dividends.
- When selling and re-purchasing the same stock, beware of the 31-day wash sale rule.

# The Future of Currency: Risks and Opportunities in Cryptocurrency

## PRESENTER

**Matt Hougan**
Global Head of Research,
Bitwise Asset Management

## PRESENTER QUOTE

*"The bottom line is cryptocurrency is not going away and you need to understand it. The hyperbole doesn't help: if you may want to invest in it, you definitely need to understand the risks."*

## SESSION DESCRIPTION

Cryptocurrencies like Bitcoin and Ethereum get headlines, but is there really any "there" there? This session took a hype-free look at what cryptocurrencies are, how they work, and why some people are so bullish about their long-term potential. The session also covered the biggest risks to the cryptocurrency experiment, including regulation, fraud, market fragmentation, and market manipulation.

## KEY TAKEAWAYS FROM THE SESSION

- Crypto 101: Crypto allows for digital, peer-to-peer transactions without a central authority. It provides quick, immediate settlement, minimal fees and no "rent-seeking" middleman. Uses blockchain with a "proof of consensus" protocol, creating a uniquely secure database of the transaction.

- Crypto 201: There are three ways to look at crypto currencies. Thesis 1 - Cryptocurrencies offer a store of value. Just as with gold, early on, stores of value are volatile. Stores of value are a large market (gold, art, off-shore assets). Thesis 2: Reinventing financial services by simplifying transactions and eliminating middlemen, enabling fast, secure transactions at a lower cost. Thesis 3: Creating a new business model for, for example, securing file storage. Blockchain enables file hosting in a secure, low cost way.

- Crypto 301: Role and risks of cryptocurrency in a diversified portfolio. Though data is limited, Bitcoin has exhibited low correlations to traditional asset classes historically. A study of performance over the last four years shows crypto may be able to increase the risk-adjusted return in a diversified portfolio (but data is limited).

- Crypto 401: Blockchain vs. cryptocurrency – "Private blockchain" is just a confusing word for a shared database – Arvind Narayanan, Associate Professor of Computer Science, Princeton University. The market is changing rapidly for cryptocurrencies, with over 2,000 cryptoassets. As we don't yet know the winners in cryptocurrencies, there are benefits in diversification as the space is evolving rapidly and multiple cryptoassets and blockchain have interesting features.

- Crypto 501: Risks to consider: crypto is like an early-stage venture capital investment, but liquid and repriced daily. There are high potential returns, high volatility, high risk, and a multi-year return horizon. Important to understand custody. Regulatory environment is unfolding and evolving rapidly. Conclusion: underselling technology is usually a bad bet.

# 2019 FOX Learning Programs

For more information on upcoming
FOX Learning Programs, please visit:
**www.familyoffice.com/learning-programs**

## FOX Forums

### FOX Global Investment Forum™

**March 13-14, 2019**
New York

### FOX Family Office Forum™

**July 16-17, 2019**
Chicago

### FOX Wealth Advisor Forum™

**May 1-2, 2019**
Dallas

### FOX Family Enterprise Forum™

**October 28-30, 2019**
Chicago

## FOX Workshops

### FOX Private Trust Company Workshop

**February 6-7, 2019**
Florida

### FOX Trustees and Beneficiaries Workshop

**December 10-11, 2019**
New York

# FOX is for Everyone in the Family Enterprise

## Connection • Guidance • Learning

**Family Office Exchange (FOX)** is the world's most respected peer-to-peer network for ultra-wealthy family enterprises, their family offices, and their trusted advisors. Working every day with the world's leading families, FOX has become a thought leader on family enterprise strategy, family governance, investment strategy, family office best practices, family learning, impact philanthropy, and advisor partnerships. Established in 1989, FOX is based in Chicago with offices in New York, San Francisco, Madrid, and Sydney and has a professional staff of 45.

FOX members come from 27 countries and include 375 ultra-wealthy families and 110 multi-family offices (MFOs) and advisory firms. Our global community is made up of more than 6,000 individuals.

### What FOX is Known For


### Who Belongs to FOX?

- Family Leaders
- Board Members
- Rising Generation
- Family Office Execs
- Trusted Advisors

Each person finds peers and programming to learn from within the FOX community. The triple benefits of membership are **Connection**, **Guidance**, and **Learning**.

**Connection** comes in a number of ways. FOX Peer Councils allow you to engage with other individuals with similar experiences. FOXChat™ allows members to answer questions and share experiences online. Members also interact at the FOX Forums and Regional Briefings.

**Guidance** Guidance is provided by an experienced Member Advisor familiar with your goals. The Member Advisor helps you 1) find the resources you need, 2) meet other members who can help you meet your objectives, and 3) stay informed about questions and issues you should be considering. FOX also offers custom Advisory and Education Services for families desiring bespoke solutions.

**Learning** is at the heart of the community. FOX keeps members up-to-date on a wide variety of topics through bi-weekly webinars, white papers, surveys, videos, content from other FOX Advisor members, and sessions at FOX Forums and Workshops. FOX also provides resources for educating rising-generation family members.

Further information is available at www.familyoffice.com.

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