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Profiles

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Profile: Jonathan J. Hirtle, Hirtle, Callaghan & Co.

While the outsourced chief investment officer model may not be considered mainstream to the institutional world, **Hirtle, Callaghan & Co.** has been no stranger to honing the investment structure, which applies an asset manager point of view to taking on the fiduciary role for an entire portfolio spread across different sectors.

Organization: Hirtle, Callaghan & Co.
Established: 1988
Location: West Conshohocken, Pa.
Leadership: Jonathan J. Hirtle, co-founder
AUM: $17 billion
Web site: www.hirtle-callaghan.com
Firms: Contact the organization's West Conshohocken, Pa. offices to speak with a member of the firm's research team, who will detail the information that should be provided.

"An outsourced cio has more in common with a traditional asset manager than a consultant," said **Jonathan J. Hirtle**, co-founder of the firm. "We are asset managers practicing what we call 'universal asset management' where, as opposed to only managing one asset class, a cio is responsible for managing everything."

The outsourced cio function that Hirtle started with **Don Callaghan** over 20 years ago stemmed from his experience working with billion-dollar institutions with sophisticated inhouse investment staffs throughout the U.S., which consistently outperformed other models. Now, the business has transformed to over $17 billion in assets under management, two-thirds of which is in the foundation and endowment space.

"Originally, people looked at our model and thought that all the special sauce came from the open architecture (structure), but I would make the case that it's not the key," he said. "The key is effective capital allocation—understanding the source of cash flow and for example, knowing how a deep value manager differs from a relative value manager and that there will be times when one will be more favorably priced than the other—then allocating capital accordingly."

Like a multi-billion dollar internal investment office that runs an endowment or foundation, Hirtle has built his firm around the philosophy that he should have inhouse experts identifying where the next source of strong cash flows are coming from—then execute those strategies through independent specialists—that is where the open architecture comes in.

"We want to have independent specialist managers working in every area ready to capture cash flows, at an attractive price, in that specialty," he said. "That's what a cio does, actively allocate capital among various sources of future cash flow to manage risk and capture return. Most institutions do not have a cio and consequently have no effective method to allocate capital."

The investment structure of the firm is built upon a method of pooling assets into various public and private market categories that are overseen by external managers and its inhouse staff, eliminating issues of access to the top-performing firms that require large minimums.

Whether a large or small institution, everyone has similar liquidity and payout requirements, he said. But regardless of size, Hirtle said his firm wants everyone to benefit from the best ideas of its internal staff, which is why every client gets generally the same external managers within its pooled portfolios.

"The ingredients are common, but the mix is custom," he said.

Assessing Managers

"We look at managers like managers look at companies," Hirtle said. "We're overweighting and underweighting managers based on the same kinds of analyses a manager uses to manage a diversified stock portfolio. That kind of top-down capital allocation process, what we call 'portfolio engineering' is sort of its own skill set, and not many know how to execute it."

The firm has its own proprietary database where it tracks and categorizes over 7,000 managers. Hirtle said that the system quantifies a manager's style so that the cio may know where their style leads them —towards a portfolio that is overpriced, underpriced or fairly priced today.

"The reason a manager has had great performance is that the pond they fish in has gone up in value," he said. "We understand managers differently, and we're working with managers that have high quality processes that are consistent, so we can look at them and know if their portfolio is either under or overpriced."

Hirtle said that a manager's performance has to be evaluated through an entire market cycle, that is, peak to peak or trough to trough. "There are going to be times where their style will be out of favor," he said.

"A lot of people manage performance, but you can't buy past performance. We manage risk. We want to lean toward cheap beta and away from expensive beta and of course we are always happy to achieve alpha. But alpha is valuable, rare and fleeting, so our programs are best described as beta driven and alpha seeking. "

Hirtle said the firm tends to implement through more established money management firms because the processes tend to remain in place even if a key employee leaves. Even though established shops have taken precedence over boutique managers for Hirtle, the firm keeps its eyes open for managers with new ideas, particularly those who are capturing a different kind of beta or some source of cash flow not presently being captured by the existing manager team. But he said that those managers are more difficult to identify.

"There are tons of good money managers out there, the key is understanding what they do and what they don't do—then using them wisely."

The Growth of the Outsourced CIO Function

Ultimately the most difficult part of investing is the human dimension, Hirtle said, making client service a significant component of the investment process. Without a high quality service, the outsourced cio structure will not be able to survive the negativity that has driven markets down.

If a December 2008 study by **Casey, Quirk & Associates** is any indication, survival of the outsourced cio function will not be as substantial an issue, with assets from U.S. institutional investors delegating 100% of their portfolios to outsourced managers, more than doubling in the past four years, to $195 billion from $97 billion.

The study estimated the outsourcing market will grow to $510 billion by 2012, representing 13% of assets and 25% of investors—creating a broad pool for both traditional and alternative asset managers to tap.

Hirtle said that the study has proven accurate for his firm over the course of the past year, with 2008 being the largest growth he's seen.

While he agrees that the changing investment atmosphere may make his structure more appealing, he believes it's the overall thought process among foundation and endowment boards that is pushing them towards outsourcing.

"Anecdotally, I can say we're growing fast, but logic would tell us it should because complexity has reached a tipping point, with fiduciaries saying we can't do an (investment) meeting once a quarter," he said.