The Skorina Letter

News, Interviews, Research for Institutional and Family Office Investors

Building the World's Best Investment Management

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Observations on a Plague Year

2020 has been a strange, tumultuous year. And, amazingly, it's not over yet.

But, after trudging through a cruel pandemic, rancorous politics, and vertiginous markets, there still seems to be some hope left in the world.

In the OCIO industry, for example, managers have amassed an additional $328 billion AUM over the last twelve months, topping out at a record **$2.7 Trillion** as of 30 June 2020.

That's a year-over-year growth of 14 percent!

A few firms sold themselves to larger players in 2020. Athena Capital Advisors joined Franklin Templeton, Focus Financial Partners acquired CornerStone Partners, and private equity investors CC Capital and Motive Partners teamed up to buy Wilshire Associates.

We've been charting the growth of the OCIO industry for over a decade in our annual OCIO reports and the heirs of Hirtle, big and small, seem (mostly) to have flourished.

Jon Hirtle of Hirtle Callaghan hatched the concept of an "independent investment office" managing family and institutional money over thirty years ago.

The idea was conceptually simple, but not necessarily easy to execute – or to market: take the proven success of sophisticated multi-billion-dollar investment offices and deliver those same benefits to smaller institutions and high-net-worth families at fees they could afford.

Four decades later we see not only independent firms like Hirtle Callaghan and Alan Biller and Associates, but also giants like JPMorgan, Blackrock, Vanguard, and AON; and boutiques like Edgehill and Disciplina. It's a big, wonderfully diverse industry and, as we've seen, still growing briskly.

Jon Hirtle and the OCIO Juggernaut

Mr. Hirtle was born in a small town outside of Pittsburgh. He had a very American boyhood; working with horses, learning to fish, camping with the Boy Scouts, and playing football.

At fifteen he and a classmate hiked several hundred miles on the Appalachian Trail – by themselves. The following summer he landed a job in Wyoming after typing (remember typing?) 100 letters to all the ranches advertising in the back of Outdoor Life magazine.

That first summer in Wyoming he dug ditches, built fence, rode broncs (the fun part according to Jon) and fell in love with the west.

As a Penn State undergrad he studied pre-veterinary medicine, walked onto the football team, appeared in musicals, joined a fraternity and, most importantly, met Debby, his wife of over 40 years and counting.

After graduation, Jon joined the Marines where he earned honors in officer training, led troops overseas, trained recruits at Parris Island and finally, returned to Penn State to recruit more candidates for officer training and earn an MBA .

After the Marine Corps he headed for Wall Street and Goldman Sachs. And that's where the story of OCIO begins.

The Promise-Driven Investor

Skorina: Jon, you served seven years in the Marine Corp after your BA. Not the standard money-manager career track. How did that come about?

Hirtle: Joining the Marines is hard for many people to grasp; when I told my mother, she burst into tears.

In some ways, it seemed like just my next great adventure. On another level, being a Marine is not a job; it's a calling; I felt I was called. I love being a Marine.

Skorina: A career at Goldman is something a lot of young men and women would kill for. But eventually you left to start your own business. Why?

Hirtle: I joined Goldman right out of the service, with a strong sense of idealism and mission.

On my first day in training, I asked my mentor to describe "the noble cause." He immediately replied, "the client", which spoke volumes about the firm I had just joined.

Skorina: Did you find Goldman a dramatic transition from the Marines?

Hirtle: Not really. My time at Goldman was the great foundational, professional blessing of my life. And it was exciting! Goldman was still led by The Greatest Generation. Integrity, hard work and success were just expected of us. In many ways it was just the commercial extension of standards I had been living for the past seven years.

Skorina: And that's where you conceived this idea of becoming a chief investment officer, but for many clients?

Hirtle: Right. I had the advantage of an outsider's perspective and an intense desire to never disappoint a client who, after all, was our noble cause.

I was fascinated to learn that the most successful investors in the world relied not on the big banks and traditional product-driven investment firms, but on their own, fully-staffed, internal, investment office led by an exceptional, big picture, money manager called a Chief Investment Officer.

Our founding idea was to deliver the indisputable advantages of that structure to our clients.

Skorina: And you took the idea to your managers at Goldman?

Hirtle: I did; they decided it was inconsistent with their business model because it conflicted with their core business.

That was unquestionably the right principle-driven decision for them. But since the client was our noble cause and we had discovered a better way to serve them, but couldn't do it at Goldman, we had to start our own firm.

Skorina: Was it hard to get started?

Hirtle: Yes it was. Debby and I often talk about the financial low point, when our checking account had dropped to $17, but we got through it together.

What kept us going was that everyone loved the concept. The idea of powerful, informed, energetic advocacy without the conflicts-of-interest that define the traditional investment industry was compelling.

They often said, "Come back and see me when you have some assets under management," but they all loved the concept.

Skorina: Turning back to Goldman for a minute, aren't they in the OCIO business today? We have them on our OCIO list.

Hirtle: Yes, they say they are. Goldman is still a wonderful firm, but much larger and much more complex than it was 35 years ago.

I will say, the notion that banks or other product shops can function as a CIO is absurd.

The first and most important requirement of a CIO is to be conflict free. Traditional Wall Street is riddled with embedded conflicts-of-interest.

Traditional firms are trying to claim the CIO role as just another way to gather assets. That's nonsense. Banks as CIOs is a non-starter.

Skorina: So Jon, don't hold back. Tell us how you really feel!

Hirtle: Think of it this way, Merck and The Mayo Clinic are both in the healthcare business. But Merck is a product shop while The Mayo Clinic delivers wellness programs or "solutions," if you will. Those solutions may or may not include Merck products.

In this metaphor, firms like Goldman and JP Morgan are Merck. Hirtle Callaghan is The Mayo Clinic. No one goes to a product shop like Merck for their wellness program.

Skorina: Jon, you also draw a bright-line between what you call serious investing and speculating?

Hirtle: I am baffled by how many people confuse speculating and even gambling with serious investing. The media doesn't help with their trading-screen-type visuals, their sensational story lines, and their hair-on-fire speech patterns about simple day-to-day market movements.

We don't speculate and we don't gamble. We manage serious, mission-driven money.

Skorina: Mission-driven?

Hirtle: Definitely. First of all, we work exclusively for providers of capital, serious investors who provide the capital to fuel democratic free enterprise, by far the most powerful economic system in the history of the world.

Working together, we are responsible for a meaningful portion of society's "monetized patrimony," if you will, wealth that drives philanthropy, security, scholarship, research… human progress. Manage it well: more progress. Manage it poorly: the opposite is true.

Skorina: Jon, you talk about promise-driven investing. I haven't heard that term before, and neither has Google. I believe it's another Hirtle Callaghan first. But what do you mean by that?

Hirtle: We all live in an uncertain world and yet, every day, we make promises.

We promise our families that we will continue to live in a certain way, we promise to support the causes we care for and often we promise to help provide for our children and grandchildren. In an institutional setting, we promise to support current needs as well as the needs of our community's future.

Those promises can be tallied up to calculate a "required return." Achieve that required return and we can fulfill our promises; fail to achieve it and we are likely to disappoint the people and causes we love.

Skorina: So, in that framework, you see unfulfilled promises as a risk?

Hirtle: The most important risk of all.

There are many kinds of risk – risk of financial loss, volatility risk, benchmark risk, career risk, etc. – and we work with clients to explore, explain, gauge, and prioritize these different kinds of risk.

But, when we ask our clients which risk matters most, they almost always place "mission failure" at the top of the list.

Serious investors care deeply about keeping their promises.

Skorina: So, speaking in terms of portfolio theory, I assume the goal is to maximize certainty around achieving a required return?

Hirtle: Right and the best way to maximize certainty is to maximize the breadth of our global opportunity set through what has come to be called "the endowment model" – but it can be custom applied to all serious investment challenges with great effect.

Skorina: Why do you say that is the best way?

Hirtle: It's the Law of Active Management:

Success = Skill X Breadth of the Opportunity Set

So, given a similar level of skill, the team that can evaluate the broadest number of opportunities wins.

The endowment model, without question, maximizes the opportunity set.

Skillfully selecting and assembling investments from that broadest opportunity set can maximize certainty around a required return.

Skorina: But in the end, Jon, isn't it just about the highest return?

Hirtle: Actually, a high reliable return is much better than a somewhat higher but unreliable return.

Skorina: Would you expand on that?

Hirtle: Serious investing is about consistency. Of course, a higher return is better and if only we could invest in retrospect we could simply pick which asset performed best last year and capture high returns with absolute certainty. But we can't.

Serious investors position their portfolios to succeed in a highly uncertain future. Each year, one of the worthy assets included in the program will perform best and one worst, – by random.

Skorina: But it's enticing to think, "if I could only predict which will be which…" but you can't?

Hirtle: No one can. Consistently predicting which asset will do best each year has proven to be impossible and trying to do so will almost certainly lead to mission failure – promises unfulfilled.

Skorina: How does the endowment model improve consistency and get your clients where they need to go?

Hirtle: It's the magic of skillful diversification, not just owning a bunch of things; but a carefully assembled collection of investments (from that broadest opportunity set) to generate complementary cash flows that rise and fall at different points in the economic cycle.

They offset each other's volatility, tighten the distribution around an expected return, and increase the certainty of success.

Skorina: And that is what you say an outsourced CIO firm is supposed to do?

Hirtle: It's what all serious investors are supposed to do and what a skilled, powerful CIO capability is best structured to execute. Delivering that capability broadly is the mission of OCIO and it's a breakthrough for promise-driven investors.

Skorina: Finishing up, Jon, one last question. I understand Hirtle Callaghan is open to acquiring other like-minded, OCIO firms and RIAs. Can you tell me more about that?

Hirtle: Well, we have always intended to build a new kind of idealistic, 21st century institution to serve our clients with excellence in perpetuity. And we always enjoy talking with like-minded professionals who share that passion.

Some may be interested in affiliating with an institution that adds real investment power and earned access without the unavoidable conflicts-of-interest that are so imbedded in the business models of banks and large product-driven investment firms.

Skorina: It's been a heck of a journey, Jon, and you have built a great firm. Pension and Investments named you "The Oracle of Outsource" a few years back and the industry you helped create is still growing at a record pace. But, apparently you aren't slowing down.

Hirtle: It's still early days at Hirtle Callaghan. Today, our talent, capability and distributed leadership make us twice the firm that we were just 5 years ago, even as my role is maturing.

The next generation of our firm's leadership runs things day-to-day giving me more time to do what I love: spending time with clients and mentoring teammates.

Why slow down? What could be more fun than building the next great investment institution?

Skorina: Thanks Jon.

Hirtle: Always a pleasure Charles.