FUNDfire
A Financial Times Service

# Track Records Optional: Cambridge Searches for Untested Talent

By Alyson Velati

October 25, 2017

For most investment consultants, track records are a pivotal portion of the vetting process for asset managers. But one consultant firm says looking past previous performance and focusing on skill gives them access to opportunities that are often overlooked by peers.

While Cambridge Associates recognizes that track records are crucial for conducting due diligence, it doesn't necessarily indicate deep expertise, says **Noel O'Neill**, head of global investment research at the firm.
"My sense is that there are a lot of people in the investment consulting business who use track records as a screening tool and obviously with emerging managers that are in-between five-year track records generally won't pass that screen," he says. "Basically, our approach to finding compelling investments doesn't start with historical performance screens."

The research team looks for firms that can prove they have experience investing in their relative area.

"Sure, there are some track records that we can validate, but not something that can just be published in marketing materials," he says.

Indeed, upstart managers need numerous factors beyond a track record to get into a consultant's good graces.

For example, **Usonian Investments**, an $800 million Japanese and international value equity manager spun out of Advisory Research in July may have a track record, but CEO **Drew Edwards** says the firm still needs to prove that its operating efficiently. Although Usonian is in the beginning stages of updating data on consultants' databases, Edwards suspects that consultants are aware of the firm's previous credentials. However, at this stage, the dialogue with a consultant becomes more

comprehensive, as the research team gets deeper into the weeds of how the firm is operating, says Edwards.

“They want to know how you’re spending your time,” he says. “Are you focusing on research or are you distracted by other stuff other than investment-related activities?”

Consultants want to make sure the work is being delegated to the appropriate people at a new firm, he says.

But consultants still look for the same aspects as larger firms like the team, organizational structure and ownership, he says.

O’Neill and his team also look for the same qualities as they would with any other investment firm like a coherent strategy, organization, team and good alignment of incentives.

“What I would boil this down to, is that at the end of the day what is the secret sauce and what truly differentiates the firm from others, even more so than regular firms,” he says.

Part of the attraction to these managers is their smaller-size, says O’Neill.

“You’re typically getting in situations where asset size is much smaller than with well-established managers,” he says. “It can be a competitive advantage by allowing them to invest in inefficient and less-traveled segments of the market.”

Indeed, having a smaller-sized asset base could be a positive attribute in a low-return environment, says **Anna Dunn Tabke**, director of research at Alpha Capital Management, who previously worked as an associate at Mercer and as a consultant at **Rogerscasey**.

“[Since] return expectations are so compressed… You are taking risk with start-ups, but they’re smaller and can implement ideas that aren’t worth the time for the bigger firms,” she says.

But at times, consultants need to prove to investors that newer managers are worth the investment.

Indeed, O’Neill and his team have dealt with institutional investors that want to focus on established managers as a basis for investing.

“We’ve had a lot of success convincing our clients that newer firms are compelling places as long as they demonstrate capability,” he says.

Once the team has identified the managers they want to work with, “we can eventually fund them and convince our clients that they can being them enough capital to put them in business.” That factor has given Cambridge leverage to negotiate fees, terms and incentives, he says.

For example, less than a year ago, a global long equity manager spun out of an established firm that O’Neill and his team have known for a decade. The standard fee was at 100 basis points, but offered Cambridge 65 basis points, which was eventually notched down to 40 basis points, he says.

The team also negotiated with a first-time long short equity manager, that initially had a fee of 50 basis points plus 20% over the S&P 500 hurdle. They eventually settled with 35 basis points as a flat fee with no hurdle, he says.