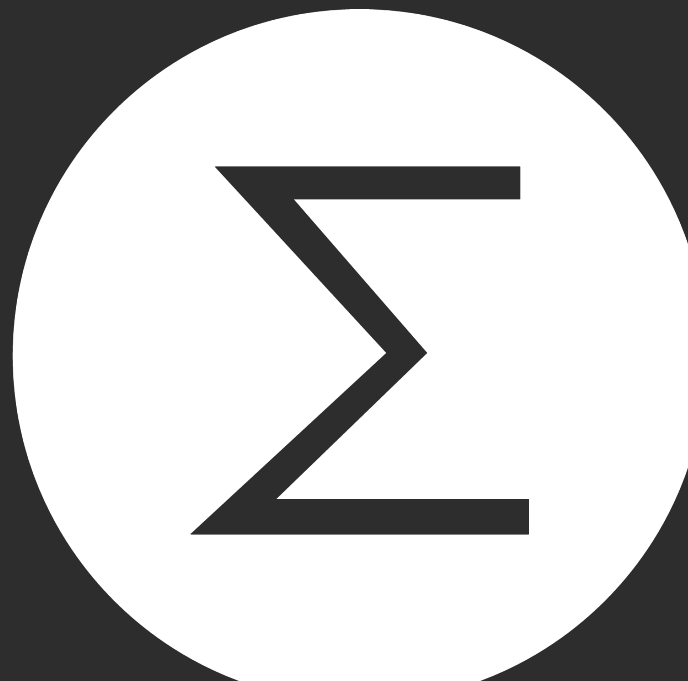
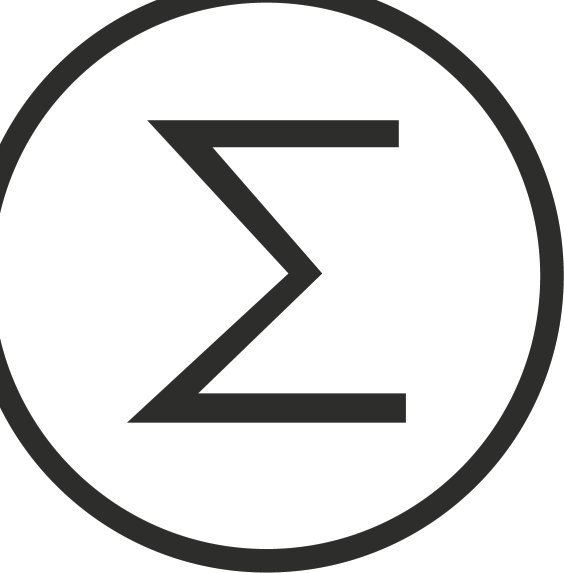




UCLA'S CIO ON THE EMERGING MANAGER EDGE: RAW HONESTY

MAY 2019





ABOUT THE INTERVIEW

This is the sixth installment of the SumZero Allocator interviews, a series of discussions focused on emerging manager selection and allocation.

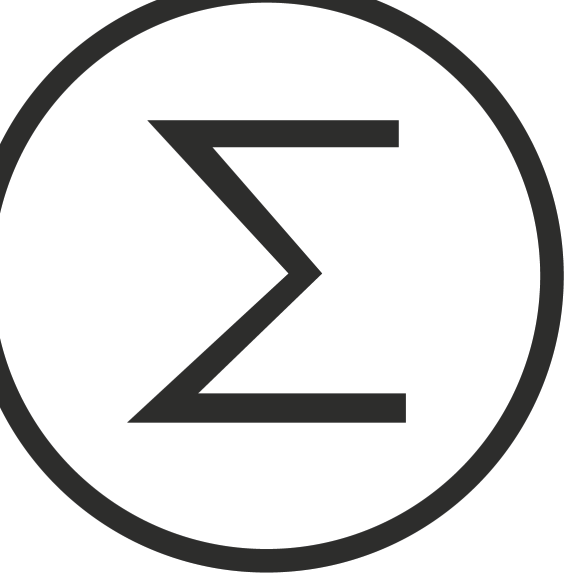
My name is Nicholas Kapur, and this will be my final Allocator Q&A. At the time of this interview, I was SumZero's COO and head of the firm's internal fund manager program, Cap Intro. I am currently a Managing Director at Cruiser Capital, a research intensive hedge fund focused on industrials and financials based in New York City.

I was honored to sit down with Mr. Justin Barton, the President and Chief Investment Officer of the UCLA Investment Company, the organization responsible for the management of the Los Angeles-based university's \$2.5B endowment fund. The UCLA team is a long-standing allocator member of SumZero's Cap Intro program. We reached out to Mr. Barton to learn more about UCLA's approach to manager selection and, specifically the organization's due diligence process.

ABOUT THE INTERVIEWEE

Mr. Barton is President and Chief Investment Officer at the UCLA Investment Company. Along with the Investment Company team, Mr. Barton oversees all aspects of the endowment including executing investment strategy, portfolio construction, and governance.

Mr. Barton began his investment career in Brown University's investment office before joining Old Square Capital, a New York-based investment firm. He moved to London in 2011, where he worked for Investec Asset Management, an institutional investment manager. Mr. Barton has a BA degree from Princeton University and an MA in International Relations from the University of Cape Town. Mr. Barton holds an Investment Management Certificate from the CFA Society of the UK and the Chartered Financial Analyst designation.



NICHOLAS KAPUR, SUMZERO: Justin, to start, thank you kindly for your willingness to chat. It is great to have you.

I want to begin by highlighting that UCLA is active in the emerging fund manager space and looks seriously at earlier stage investors. That is not very common within the big, multi-billion dollar endowment space. What does your team like about this space?

JUSTIN BARTON, UCLA: Thanks, Nick. It's a pleasure, and frankly I find these types of discussions a good exercise for framing our thinking, so it's somewhat self-serving on my part!

It's important for institutional investors to both identify their needs or objectives, as well as the competitive advantages they possess. We know we have a really challenging long-term objective of more than 5.0% real returns. We also know that at ~\$2.5 billion we are large enough to make meaningful investments with managers, but not so large that niche strategies won't move the needle for us.

Emerging managers, or managers at an earlier stage of their life cycle, fit well with those two dynamics – objective and competitive advantage. We want to be able to enter into long-term partnerships, which means we want a long runway for

that manager to compound our capital and their capital. It's much easier to compound capital from a smaller starting base, so talented, younger managers who are just getting started are highly appealing. We know we are in a risk taking industry, not every investment will work out, but we have to stay engaged.

NK: *You mentioned to me that UCLA is not a 'high-volume player', meaning that you manage a relatively focused and long-term portfolio of funds. What brings new ones onto your radar if you're not seeking them out?*

JB: It's a persistent challenge – balancing the right number of relationships to create a global, multi-asset class portfolio that is not overly diversified. We put in so much work upfront getting to know our managers and their strategies that not pursuing a more concentrated, low turnover portfolio just doesn't make sense. The reality is there is no “set it and forget it” portfolio. Our portfolio is in a constant state of evolution because our managers are in a constant state of evolution as are the markets. It's a giant, complex adaptive system.

“Our portfolio is in a constant state of evolution because our managers are in a constant state of evolution.”

So, we have to be looking for new talent even if we aren't trying to fill a portfolio role right now. Typically, we are looking for people who are deeply passionate about what they do, have a sustainable approach to doing it, and are at a size that we think will enable them to keep doing that for a decade or more. We have a pretty wide aperture; we find new managers in all kinds of ways and places.

“Hubris is a recipe for disaster and we see it all the time.”

NK: *How does UCLA evaluate the qualitative elements of an earlier stage manager, i.e. the process and temperament, since there is often little quantitative data to lean on?*

JB: With great difficulty! It first starts with pattern recognition. Can we identify some of the elements that make for successful long-term investment partnerships with this firm. Interestingly, some of the more qualitative elements are easiest assessed with managers in their earliest stages, there's just a raw honesty at that point that is refreshing.

We have some questions that are probing. There is no right answer, but we think the answers that are given provide a lot of insight into a manager's mindset, temperament, and attitude. We also spend a lot of time referencing people to build a picture of who they are. Finally, we have to remain aware that we aren't right all the time. We'll get some investment decisions wrong, either omission or commission and that's ok. It shouldn't prevent us from engaging in the process.

NK: *Stanley Druckenmiller disclosed in a recent Bloomberg interview that he “never made a buy at a low that [he] didn't just feel terrible and scared to death making it.” I am curious what you would make of this statement if you heard it from a manager that was not nearly as well-known and respected? Should they be that candid with you?*

JB: Absolutely. I've never made a commitment to a manager where I didn't have at least a little bit of doubt. This is an intellectually rewarding and highly competitive industry. I love it, but it's also humbling. Anyone with a long career in this industry understands the dynamics of skill and luck. There are no guarantees, no certainties, only probabilities. You can't know everything and certainly can't control everything. Hubris is a recipe for disaster and we see it all the time.

I'd also point out that there is a bit of marketing spin in his statement. He's referencing stocks that he bought at a low, implying they succeeded. It's really easy to say “I was scared to death on this trade that made me a lot of money”... much harder to say “I was scared to death on this trade that went to zero.” Framing is a really important device.

NK: *Nicely said. To stay on theme a bit, do you seek temperaments like Druckenmiller's which may experience intense emotion, but likely have the self-awareness to manage it and perhaps employ structure/process to mitigate its worst effects? Or do you look for folks who can execute dispassionately in moments of great stress? Quite a difference between the two, I think.*

JB: We look for managers who are self-aware. One of the things that makes successful investing so difficult is the necessity of balancing deep seated conviction with the objectivity to change your mind when presented with new

facts. Being able to be present in both those states is enormously difficult for the average person.

We have some managers that I would say fall into either of your descriptions. I think what they have in common is a willingness to think independently and understand what they know and what they don't know. The other point is creativity. The DCF is easy, it's predicting the future (what will this business look like 10-15 yrs from now) that requires some creative thinking skills.

NK: *You mentioned before that UCLA looks for managers that act as long-term owners of assets and folks that will own great businesses for a long time. Does this preclude more heavily value-oriented or event-driven strategies from being considered?*

JB: We have a strong preference for managers that think like business owners. Sometimes, the right decision for a business is to liquidate, sell non-core assets, or be acquired. It's rare that a management team or business owner will think this way, but not entirely unknown.

The majority of our portfolio is invested in companies that we believe - through our managers - will continue to drive value to shareholders by compounding their business. We have some managers that pursue quite idiosyncratic strategies around deep value or event-driven opportunities.

NK: *Let's say you have a manager that is just getting started but has been lucky enough to secure a meeting with your team. What can they do to be taken seriously even with a nascent capital base and brief track record?*

JB: Honesty. If this relationship is going to go anywhere, it has to be built on honesty

and trust. When we ask you a question, don't tell us what you think we want to hear. Tell us what you believe and what you do. Because that is going to come out eventually anyway. Either your process will appear inconsistent or your numbers (I don't mean performance) won't add up.

We aren't looking for the most polished people. We are comfortable with quirky. We just want to find people who love what they are doing and are consistent in what they do. Also, quirky doesn't mean incoherent. If you can't explain what you do, we can't invest with you.

“We are comfortable with quirky...[but] quirky doesn't mean incoherent. If you can't explain what you do, we can't invest with you.”

NK: *I have to return to an excellent quote from our phone conversation. You said, “I have never, ever had a manager tell me that his fund's strategy is to buy bad businesses at terrible valuations, which means that the opposite, 'buying good companies at cheap valuations' cannot be considered a distinctive investment strategy--because pretty much everyone wants that.” Very insightful. So if not discussing that exactly, what is the right way for a manager to pitch themselves?*

JB: Yeah, one of my pet peeves is “value” or “growth” definitions. Even “quality” is a bit nebulous. I recognize the industry need for categorization and shorthand, but really, I’m still waiting on the deck that says “we buy overvalued businesses, run by terrible management teams, in industries with low barriers to entry.”

Managers should take the following as given: you look for companies that are undervalued, and you build a portfolio of some number of these companies. Tell me how you get there. Being a security analyst is easy. Be a business analyst. Tell me how you determined the factors that are important to you as an investor. Are there industry frameworks or fundamental ratios you look for? What is the right number of companies for a portfolio? How do you tackle your research process? These are much more relevant for how you plan to achieve your goals.

“Being a security analyst is easy. Be a business analyst. Tell me how you determined the factors that are important to you.”

NK: *What might immediately disqualify a prospective manager from consideration with you?*

JB: A felony conviction for investment fraud. As I mentioned, we have a pretty wide aperture, so we look at a lot of

strategies, and at managers with all sorts of backgrounds. However, we also know what we like and there are certain heuristics you develop after looking through thousands of presentation decks.

We can typically get a good sense of fit in terms of portfolio structure, investment approach/philosophy, and business structure in a quick review. We may overlook some diamonds in the rough, but we pick up enough for us.

NK: *Let’s talk about the fees. What do you think is the right fee model for an emerging manager to embrace while they are seeking institutional capital early on?*

JB: This is a really tricky, because ideally we like the old Buffett partnership model, which can be really difficult for businesses at an early stage. There are a few things that I think every manager should be thinking about. Your investors (if they are like us) have a cost of capital. If you have returned less than 6-8% to them over a 5 year period, how pleased are they going to be with you taking 20% of profits?

Management fees are supposed to help you manage the business. That involves paying salaries, conducting research. Essentially, managing an investment firm. They shouldn’t be a profit center. Figure out what amount you need and set a management fee at that level, or create a sliding management fee that disincentivizes AUM growth. Finally, don’t have a modified high-water mark. Maybe I should add that to my answer to your last question!

NK: *We discussed how managers frequently position their funds as a solution for all investors, instead of honing in on a core customer based on the fit. Can you elaborate on that a bit?*

JB: There are so many different types of investors out there, each with different needs and constituencies. You can't have a one-size fits all investment strategy for clients. You should have a one-size fits all strategy for yourself as a manager. Know what you think is the optimal investment strategy.

We are typically asking our managers to have 90% or more of their net worth in their strategy. They better believe that a portfolio of 10 tech stocks, or 20 consumer stocks, or a 100 stocks across multiple industries is the best investment approach for them. I can guarantee you there is an audience for all three of those portfolios, but it won't be the same investor.

Too often I see managers who are clearly trying to position their portfolio for "institutional investors" without realizing that it's a wide space. Appealing to the lowest common denominator is a terrible business decision.

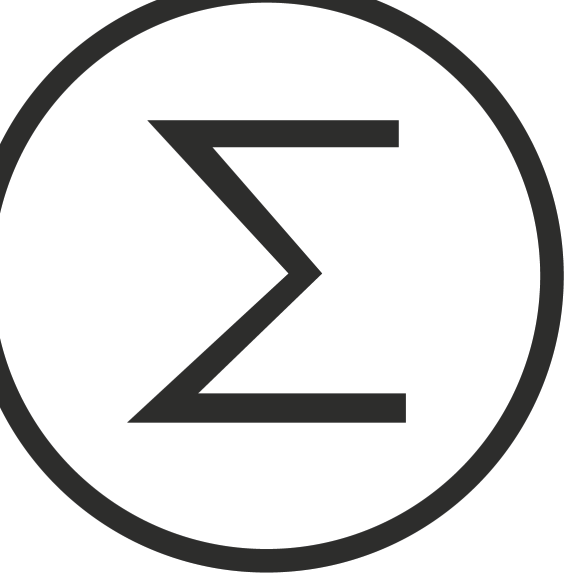
NK: *Final question and the one I ask everyone: What do you think is the most important thing an individual can do to increase the chances of them being a viable target for a prestigious institution like UCLA?*

JB: You have to be fully committed. This is an unbelievably competitive industry. You can't beat a shrinking alpha pool by doing part-time work. You need a very clear investment philosophy and strategy. You need high conviction on why it makes sense for you and for others, how the process demonstrates repeatable success, and why it is differentiated. And then you need to be able to explain that succinctly, while demonstrating the depth of your analysis.

"You have to be willing to do this job with the AUM you have now. If you never raise a dollar more, are you still going to be doing this?"

You have to be willing to do this job with the AUM you have now. If you never raise a dollar more, are you still going to be doing this? Ask yourself truly, what success looks like for you.





ABOUT SUMZERO

SumZero is the world's largest community of investment professionals working with the industry's most prominent hedge funds, mutual funds and private equity funds. With more than 16,000 pre-screened professionals collaborating on a fully transparent platform, SumZero provides direct access to thousands of proprietary investment reports every year and fosters on-going communication within the network.

The research on SumZero cuts through the noise that pervades the industry and provides its community with in-depth, actionable investment research and data. SumZero offers several ancillary services in support of our research platform. These services include capital introduction, buy-side career placement, media placement and more.

ABOUT CAP INTRO

SumZero Cap Intro is a passive, reverse-solicitation platform that connects eligible funds with pre-qualified institutional LPs for the mutual purpose of capital allocation. Cap Intro is available on an opt-in basis to all hedge funds, private equity funds, and other asset managers that are actively fundraising.

Using Cap Intro, fund managers leverage direct exposure to a community of more than 700 pre-vetted allocators by presenting their strategy and performance via a self-curated fund profile. In turn, allocators use these profiles to discover, screen, and initiate direct conversations with funds. Since 2014, Cap Intro has catalyzed hundreds of inbound inquiries to funds from accredited institutional investors.