Stanford CIO Has Cut Ties with Close to 90% of Third-Party Managers

By Aziza Kasumov March 5, 2020

Stanford Management **Company**, the entity managing Stanford University's $30 billion in assets, has drastically whittled its external-manager list over the last five years. As of June last year, less than 13% of the firms the team invested with when CIO **Robert Wallace** took the lead in 2015 were still in its portfolio, the school's most recent annual report shows.

"In mid-2015, we recognized that the portfolio had become overly diversified, with approximately 300 external investment partners," the report notes. "We believed that building stronger relationships with fewer partners would enhance investment returns while not increasing risk."

From then until June 30, 2019, the endowment cut ties with most of its external managers, bringing the list of active partners down to 75 — half of which only started working with Stanford in the last four years. Average exposure to those partners has risen, the report notes.

And the portfolio overhaul is far from over.

"We are pleased with these results but know that more work remains to be done," the report notes. The school's investment team is still waiting to get capital back from more illiquid investments to "redeploy in more desirable solutions."

Stanford is not the only endowment to have warmed up to a more concentrated portfolio in recent years. The University of California (UC), which has more than $126 billion across several asset pools, reduced its number of external managers from 280 to 98 between 2014 and 2019, as reported. This year, the team around CIO **Jagdeep Bachher**, who joined in 2014, plans to further reduce that number to 70.

"It's not unique to those two situations," **Heather Myers**, partner and nonprofit practice leader at Aon, said about the manager-list cuts at Stanford and UC. "We've seen that, and we've done the same thing, worked with clients to trim portfolios where we think it's almost too many line items in a portfolio," she added.

Part of the investment philosophy behind moving to a more concentrated portfolio is that having too many managers could cause investors to overpay.

Institutional investors are seeking to determine whether their portfolios are too diversified for their own good, Myers says. That includes asking questions like, "are the fees worth it? What's the role of the

manager? Are you going to get what you pay for net of fees? Are there indices out there that can offset some of the costs?" she says.

But the evolution of manager strategies plays a role too. With more managers capable of filling global mandates, for instance, there's less need for a portfolio to have an emerging markets manager, a U.S. manager, a developed ex-U.S. manager and more to cover all geographic regions, Myers says. That holds especially for fixed income and equity managers, she adds.

Stanford highlighted the returns of its new global equity managers in its latest report, writing that they have "generated an 11.3% net internal rate of return over the last four years, handsomely outperforming similarly timed cash flows invested in the MSCI All-Country World Index."

In the family office world, that investment philosophy has started taking hold with some as well.

"I think when you overly diversify your portfolio, you're just setting yourself up for an average return," **McCall Cravens**, CIO at the **Heinz Family Office**, said during a panel discussion at the Fund Evaluation Group's investment forum in Cincinnati in September. "If I'm going to outperform, it's going to be by concentrating in managers and not having too overly diversified a portfolio," she added.

Wallace, Bachher and Cravens are all relatively new in their CIO roles, compared to some of the titans that have sat atop an endowment or family office for decades. That the overhaul of their institutions' external-manager lists coincided with their arrivals is likely no coincidence.

"It doesn't matter what industry you're in," says Myers. "Most leaders, when they come in, [they] do this big … review on where are we today and where do I want to be."

A new CIO at an endowment or other institutional investor can mean danger for asset managers in the current portfolio.

"There's no guarantee that whoever is in the portfolio now [stays in] once the dust settles," says **Dan Sondhelm**, CEO of **Sondhelm Partners**, a consultancy for asset managers.

The risk is especially pronounced for smaller managers, where a large institutional client makes up a relatively big slice of their overall assets under management.

"It's a huge risk in the industry, and firms have to make sure they're prepared for a loss," Sondhelm says. "An institutional account can be such a big part of a firm's business and you don't even see it coming when they make a move, and all of a sudden your firm might be down 5% or 7%."

But there are some things managers can do to reduce their chances of getting thrown out of the portfolio — such as getting to the table quickly and proactively.

"Meet the new CIO or the new research team, [and] don't wait for that phone call," Sondhelm says. "And hopefully, someone at your firm has had a relationship with [the new CIO] previously."

Once at the table, managers should show that "you've earned your right to work with [the endowment]."