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COMPETITIVE EDGE



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FOR PROFESSIONAL BUYERS

PMs NEED TO STAND OUT FROM THE CROWD TO CONVINC
JEREMY DeGROOT AND THE LITMAN GREGORY TEAM

20 CITYWIRE
YEARS

TIPPING POINT

Managers hoping to land a spot on Litman Gregory's recommended list need a clear edge on the competition to get Jason Steuerwalt, Jack Chee and Jeremy DeGroot on their side

VICKY GE HUANG

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eremy DeGroot didn't find his calling in life on the first go around, but he got there eventually.

He began his career as an economic consultant, a role he held for almost a decade before embracing what he calls his inner 'mutual fund junkie' and applying for a job at Litman Gregory.

'I read *The Intelligent Investor* by Ben Graham, and I subscribed to the Litman Gregory No-Load Fund Analyst – the firm's original newsletter, which eventually became

AdvisorIntelligence. I was fascinated,' he recalls. 'When you're spending your free time reading about something, it's probably a good sign that it's your passion.'

In 20 years, DeGroot (right) has gone from being a fan of the firm to serving as its chief investment officer, leading a six-member manager research team that oversees a \$7.5 billion platform.

He has also gone from reading the newsletter to writing it. Among other things, his team is responsible for publishing its research on managers, funds, asset classes and portfolios on AdvisorIntelligence.com, the site that has now replaced the old printed newsletter. The website hosts the team's recommended list, which consists of 83 mutual funds, 26 ETFs, 14 private funds, hedge funds, limited partnerships and two SMAs.

DeGroot's responsibilities do not stop there. His team's best ideas are also used to populate around \$1.8 billion of private client investments

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COVER STARS

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run by Litman Gregory's RIA, as well as \$3 billion in discretionary portfolios for various turnkey asset management programs and \$2.6 billion in Litman Gregory multi-manager mutual funds.

CUTTING EDGE

DeGroot is assisted in leading the team by senior analysts Jason Steuerwalt and Jack Chee, who are always on the hunt for top talent. Managers looking to get on the recommended list must demonstrate that they have an investment edge – meaning, as the trio puts it, 'something that sets them apart from the competition.'

'The edge is not as simple as having a repeatable, visible process. Instead, we try to be

more specific about what factors actually come into it,' Chee says.

'The edge is not a checklist – it's specific to the individual team. For example, the edge might be different with Guggenheim than with some other manager on our small-cap value fund, [such as] Segall Bryant & Hamill.'

Chee explains that for Guggenheim Partners, which serves as one of the managers on the Litman Gregory Masters High Income Alternatives fund, 'the edge' lies in the managers' expertise in credit analysis and the team-based approach.

'They have been great credit analysts, and they have this collaborative team that is constantly feeding into itself,' Chee says. 'We

think they're doing a lot of things really well.'

As for Segall Bryant & Hamill, the edge can be found in the firm's St. Louis, Missouri-based small-cap value team, which focuses on return on invested capital when selecting stocks for the firm's \$127.1 million Small Cap Value fund. The fund has been managed by Mark Dickherber and Shaun Nicholson since its launch in July 2013.

'They want to see an improvement in returns on capital, but they also want to understand how it is going to improve, when it is going to improve and why it is going to improve, so they study the businesses themselves and they challenge the management,' Chee says.

JASON STEUERWALT

2013 – present

Litman Gregory Asset Management
Senior research analyst

2000 – 2013

Hall Capital Partners
Vice president



JACK CHEE

2000 – present

Litman Gregory Asset Management
Senior research analyst

1998 – 2000

Value Line
Analyst



JEREMY DEGROOT

1999 – present

Litman Gregory Asset Management
Chief investment officer

1998 – 1999

KPMG
Economic consulting services manager



LITMAN GREGORY RESEARCH TEAM

JEREMY DeGROOT
CHIEF INVESTMENT OFFICER, PRINCIPAL

JACK CHEE
SENIOR RESEARCH
ANALYST, PRINCIPAL

RAJAT JAIN
SENIOR RESEARCH
ANALYST, PRINCIPAL

JASON STEUERWALT
SENIOR RESEARCH
ANALYST

ALISTAIR SAVIDES
RESEARCH
ANALYST

KIKO VALLARTA
RESEARCH
ANALYST

STILL AHEAD OF THE PACK

However, managers who win a spot on Litman's platform cannot rest on their laurels. DeGroot and the team are acutely aware that a competitive edge can be eroded.

'There are a ton of smart people out there, and they all have pretty much the same information, so you have to find some other way to differentiate. An edge can change, erode or grow over time – that's part of why the research is really important,' Steuerwalt says.

To ensure competitive advantages are maintained, the team keeps a close eye on charges. This does not mean that a manager will be dropped at the first sign of trouble. For example, DeGroot and his colleagues are still big fans of the Guggenheim Partners bond team, despite a series of news stories over the past two years that have suggested unrest within the firm. These included allegations of a feud between CIO Scott Miner and CEO Mark Walter, payments being made to deputy CIO Anne Walsh to incentivize her to stay at the firm, and one manager departing following an internal investigation into unspecified actions.

To outsiders, the sensational headlines might seem like a cause for concern, but Chee says that the team's confidence in Guggenheim remains strong. It is underpinned by thorough due diligence, ongoing conversations with members of Guggenheim's senior investment team, and the know-how that comes from running in-house mutual funds.

'One of the advantages of having our own mutual funds is that we have our own chief compliance officer and chief operating officer,' Chee explains. 'We have them on the phone

talking to Guggenheim's compliance officers. They're going to say that we don't fully understand [things], but our chief compliance officer really does. We're talking to at least 20 senior investment team members, so it's not just one conversation.

'We've done our third-party checks. We've talked to current employees, ex-employees – we've even reached out to recruiters to get their take on what Guggenheim is doing, as they get a sense of whether or not people are leaving,' he adds. 'We really threw out a wide net, but ultimately we believe that there are different businesses within Guggenheim and that the mutual fund piece isn't infected.'

WEIGHING THE EVIDENCE

If Chee's confidence in Guggenheim seems resolute, that's because the team has handled a similar situation in the past, when bond king Jeffrey Gundlach left TCW to set up his own firm, DoubleLine Capital, in 2010. Gundlach was sued by his former employer in an effort to put the brakes on his breakaway.

'We did a lot of work including hiring a lawyer to review public documents about the lawsuit,' DeGroot recalls. '[The lawyer] specialized in labor disputes in the investment field, so this was someone who had experience. He gave us his assessment of the validity of the claims on each side and how it would likely play out.

'We also talked to the chief administrative officer of Oaktree Capital Management to understand why the team there had made a 20% investment [in DoubleLine], why it believed in Jeffrey Gundlach and why it wasn't worried about this. You never have 100% certainty, but

you get the weight of the evidence and then make your best decision,' he adds.

TIME TO CUT LOOSE?

In the cases of both Gundlach and Guggenheim, DeGroot and the team deemed the risk suggested in news stories to be overhyped. These decisions ultimately proved to be the right moves, but sometimes the changes at an asset manager can be too significant to withstand – even if the Litman team is still convinced by the investment strategy.

That was the story with Northern Cross, a Boston-based asset manager that was a subadvisor on the Litman Gregory Masters International fund until it was cut in October 2018. The decision came partly in response to Northern Cross being dropped as the sole subadvisor of the then \$20.5 billion Harbor International fund in August 2018 following a period of sustained underperformance and outflows. Harbor's mandate had represented the majority of Northern Cross' total of \$25 billion in assets under management at the time.

DeGroot explains that it wasn't disappointing performance that prompted him to drop Northern Cross. Instead, it was the risk posed to the firm by it losing so much of its revenue when Harbor cut it loose.

'Our due diligence on Northern Cross at the same time that Harbor was making this assessment was that we believed the discipline and quality remained intact. It was just going through a period of underperformance, which can happen to any manager, so we stuck with it after it was cut. Ultimately though, the business risk was too great,' he says. ■