

Bond Case Briefs

Municipal Finance Law Since 1971

Money-Manager Purge Boosts University of California's Return.

- **State system expects 14% gain after slashing dozens of funds**
- **About 100 venture capital, buyout and hedge funds liquidated**

The University of California's decision to cut back on outside money managers is paying off.

The state system, which oversees more than \$110 billion of assets, slashed about 100 funds in three years to reduce fees and better concentrate its bets, according to Chief Investment Officer Jagdeep Bachher. The strategy is working, with the pension and endowment gaining almost 14 percent in 11 months though May after losing money in fiscal 2016, he said.

"We're starting to see the results," Bachher, 44, said in a phone interview. "There's no change just for the sake of change."

The university is among the more extreme examples of institutional investors overhauling portfolios amid lower returns, slashing hedge funds and other money managers. While many endowments expect to report gains of more than 10 percent for the fiscal year ended in June, the average endowment lost money in the prior year, paring annualized gains over the past decade to 5 percent, according to an industry study.

Lackluster Returns

The California Public Employees' Retirement System and some other public pensions have eliminated their exposure to hedge funds because of lackluster returns while other institutions have trimmed their allocations and sought to negotiate lower management fees.

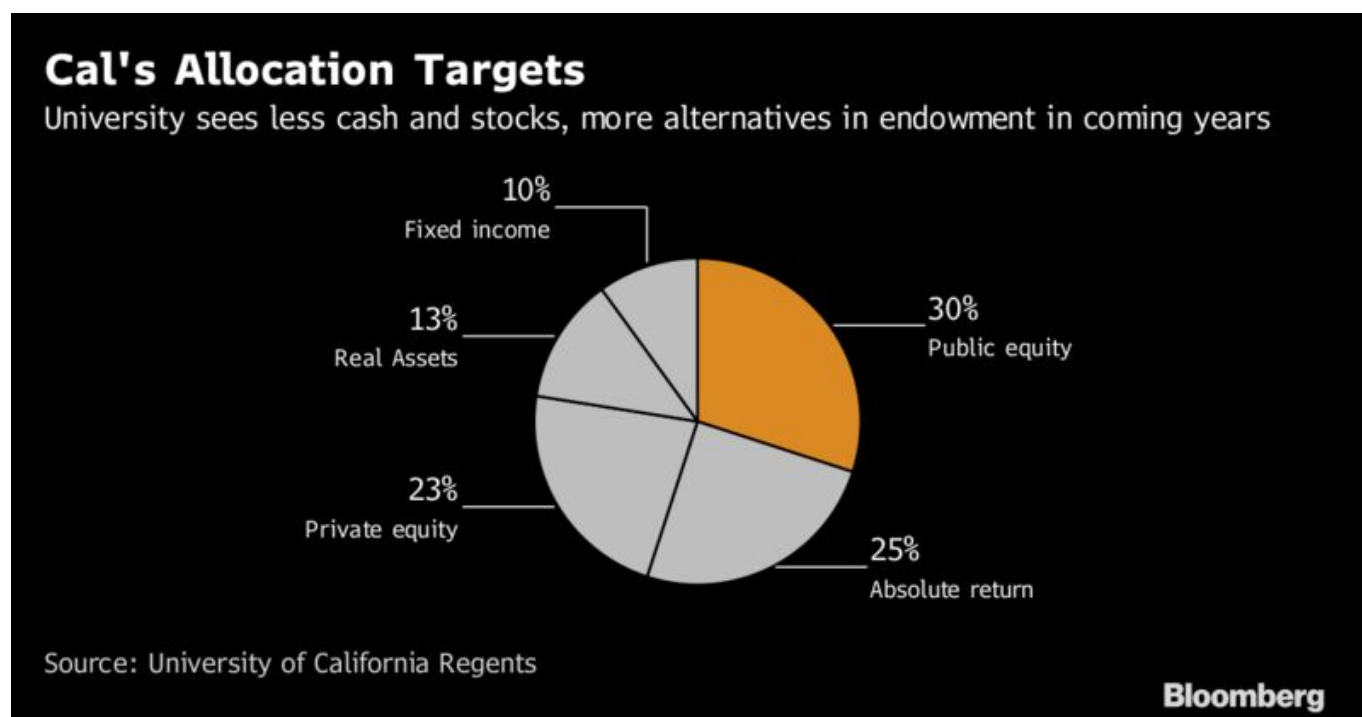
The University of California hired Bachher in 2014 from Alberta Investment Management Corp. amid mounting scrutiny from the school's board and its unions over the performance of its pension and endowment. Bachher, with a staff of more than 60, replaced most senior managers while developing discrete strategies for the pension and endowment portfolios, which used to be managed together.

He also promoted and hired people to serve as deputies for different pools of money. In May, Bachher hired Eduard van Gelderen from APG Groep NV to run the \$61 billion pension fund. Edmond Fong, the state system's managing director of absolute return, was put in charge of the \$10 billion endowment, Bachher said. They will be largely responsible for investing the more than \$4 billion of cash that the endowment and pension funds have amassed.

There are now about 140 funds in the portfolios, down from as many as 250 three years ago, as the university pulled money from dozens of stock and hedge funds, while divesting stakes in private equity, venture capital and real estate funds, he said.

"If you want to outperform, you have to take some risk," said Thomas Gilbert, an assistant professor of finance and business economics at the University of Washington who studies endowments and

investing. "Concentrating your bets is one way to get there."



The university liquidated about \$1 billion of private equity and venture capital funds in the past three years, while cutting ties with more than a dozen stock and hedge fund managers, including Viking Global Investors, which announced in June that it was returning some money to investors.

Cal also placed new bets. It made a commitment to Key Square Capital Management, which was founded in 2015 by Scott Bessent, the former chief investment officer at Soros Fund Management, according to university documents. And it invested in a joint venture with Owl Rock Capital Corp., a June regulatory filing shows.

The university expects to invest more in alternative assets while trimming its exposure to equities, according to a presentation prepared for a July 11 board meeting. The chief investment office boosted its target for hedge fund allocation to 25 percent of the endowment, up from 18 percent, and plans to double its private equity bets to 22.5 percent.

Poor Performers

The university's largest union, Local 3299 of the American Federation of State, County and Municipal Employees, is skeptical about the push to increase alternatives and issued a report last year criticizing the fees that were paid for poor-performing hedge funds.

The chief investment office "has taken some welcomed steps, but it has not gone far enough to correct its decade-long, failed hedge fund experiment," Claudia Preparata, a research director at the union, said in an email. "Everyone pays the price, but the burden is felt most by UC's most vulnerable workers, its lowest-paid front-line staff."

The investment office said the portfolio changes will help it cut the management fees it pays to fund companies by \$500 million over the next five years, according to the July presentation. Some of that will come from renegotiating lower fees from hedge fund managers as well as imposing performance targets that funds must reach before they can be paid.

“All those things help us pick up nickels and dimes,” Bachher told the university’s investment committee at last month’s meeting, according to a video. “It’s the only risk-free return that’s left in the market.”

Bloomberg Markets

Michael McDonald

August 1, 2017, 3:00 AM PDT August 1, 2017, 8:27 AM PDT

Copyright © 2024 Bond Case Briefs | bondcasebriefs.com