



**Published Date:** October 2nd, 2021

***What Ted's Thinking***

**Wash U and Kim Lew**

When Warren Buffett and I made a charitable bet in 2007, Carol Loomis wrote a terrific story about it in Fortune magazine. Within a day, dozens of news reports followed based on her piece. Almost every other story got the facts wrong.

What gets reported in the media often isn't quite right, and at times misses the mark entirely. This rule of thumb serves as a constant reminder of the importance of primary research.

Sometimes the news shares a headline that hints at the truth, even when that truth lies below the surface of the story. The recent reports of the Washington University of St. Louis endowment's exceptional one-year return and Institutional Investor bestowing a Lifetime Achievement award on Kim Lew are perfect examples. One-year performance is irrelevant in the grand scheme of things. Scott Wilson's approach and implementation are not. Similarly, while Kim is a superstar and worthy of a lifetime of accolades, she is just getting started on what will become her most impactful accomplishment when we look back a decade or two from now.

When I left Yale almost twenty-five years ago, my instinct was that I would improve my skill set as an allocator by spending time as a direct investor. In my time at Yale, I learned of repeated success stories of former operators turned investors that professed an edge for understanding companies more deeply than financiers could. I suspected the same would apply to allocators, so off I went to business school and a few years immersed in public and private equity. I didn't find my home, but the experience gave me a perspective I could not have attained had I remained an allocator my whole career.

In the ensuing years, the movement of allocators towards direct investing played out slower than I anticipated. Harvard University's endowment once housed predominantly direct investment teams, and large Canadian pension funds shifted their activity towards internal investment, but for the most part the proposition has been either/or, either allocate to managers or invest directly. Most of the marginal direct investing by allocators focused on fee reduction through co-investment.

Overdiversification is one significant drawback of an allocator's global, multi-asset class, multi-manager portfolio. While selecting talent bottom up, these pools end up with a manager roster that resembles a modestly concentrated stock portfolio in number (75-150 names). Each of the managers, in turn, may hold 15-80 positions (for fundamental strategies and many more for others) depending on the asset class. Even a concentrated portfolio of managers ends up with an underlying portfolio with well over 1,000 line items.

This overdiversified portfolio construction prevents allocators from taking advantage of their exceptional information flow, one of their greatest areas of competitive advantage. Allocators receive incredible access to idea generation, research, and conviction from their managers, just about all of which is diversified away and used only in the evaluation of the managers. Part of this occurs because asset owners frequently face CIO and Board turnover. Rather than make incremental enhancements to their portfolio over long periods of time to compound their informational advantage, most change the composition of their manager roster and fail to catch up to the value-added potential that lies beneath the managers.

Scott Wilson is the first head of a large endowment in the modern era who set out to monetize the underutilized asset of manager ideas and conviction. Wash U selects managers with an eye towards bottom-up security selection and strives to be more concentrated than the 100 best ideas of its managers. To implement this portfolio strategy, his team requires a direct investment skill set, which it employs both to re-underwrite individual names in conjunction with managers and to select managers for their skill at unearthing those names.

Scott's team combines this portfolio approach with a process both managers and allocators dream about. Wash U was the first institutional allocator to commit to Brent Beshore's Permanent Equity (Fund II – the non-institutional among us may have also invested in Fund I). In response to the news about Wash U's stellar performance in fiscal 2021, Brent shared this Twitter thread describing his experience and relationship with Wash U's investment team. The thread exemplifies an ideal interaction between a manager and allocator – thorough, respectful, probing, and supportive once on the same side of the table.

Scott and his team should be commended for their 65% return. The single-year figure is a sure-fire headline grabber, although it is a short-term anomaly. Thus far, the news missed that Wash U's returns were driven primarily by its concentrated positions and not by the venture capital allocations that are driving its peers in this banner year. The real story is the governance structure, investment strategy, team, and implementation that got them there. I expect more exciting things to come for Scott and Wash U in the ensuing years.

I titled this piece Wash U and Kim Lew for the rhyme. Both Scott and Kim deserve their special place under the sun for different reasons, so I'll write about Kim next time.