Differentiated Talent
Few people remember this given the company’s outsized success today, but in the mid-1990s, Apple was on death watch. Co-founder Steve Jobs had recently returned to the company, but one of the greatest turnarounds in corporate history hadn’t yet taken shape and the company was hemorrhaging cash. At a technology conference, Michael Dell, the founder of personal-computer powerhouse Dell Computer, was asked what he would do if he were CEO of Apple; famously, he said that he would shut the company down and return the cash to shareholders.

The iPod was still four years away from being released, and Apple had miniscule market share among businesses in the desktop market, with machines running Microsoft’s dominant Windows operating system holding a virtual monopoly. One of Jobs’ first undertakings was to put Apple’s advertising account up for review, and he invited in TBWA/Chiat/Day, the agency that had created the iconic “1984” ad, to pitch. After much work and internal debate, the agency presented Jobs with a single idea; after some quick consideration and contemplation, Jobs was sold.¹ This idea would set a new tone for the company in the market’s eyes, and help drive a resurgence that continued, largely unabated, through the next two decades. It involved a number of iconic 20th century figures – including aviation pioneer Amelia Earhart, to whom the quote at the top of this page is attributable – who flouted convention and fought criticism while reshaping elements of society for the betterment of all. The tagline was simple, but captured the key essence of how Apple wanted its customers to not only consider Apple’s products, but to consider themselves: “Think Different.”

Thinking differently is a powerful concept, and its application shouldn’t be restricted to companies in turmoil. Every industry can benefit from thinking differently, but too often in the investment industry, thinking differently has resulted in an ever-expanding menu of investment products sold to clients. This has generally resulted in complexity that creates great value for the seller (in the form of high fees) at little discernible benefit to the buyer.

From our perspective, however, the most important products in the investment industry are the people, the best of whom embrace and value such fundamental concepts as hard work, experience, and self-reflection. But while capital markets frequently provide exceptional long-term outcomes for those with these traits, the significance of thinking – and being – different is frequently overlooked by investors. We know this as much as anyone because that used to be our perspective as well.

¹ “The Real Story Behind Apple’s ‘Think Different’ Campaign” Forbes, Dec 14 2011
Identifying the Problem

The roots of change at Colonial were planted seven years ago, when the CEO of a long-standing client asked us a simple question:

“Why don’t we have more investment manager diversity?”

At the time, the question didn’t resonate. While admittedly we had never measured or seriously thought much about investment manager diversity, we assumed that it would naturally result as a by-product of our process, which emphasizes diversification in all forms as a way of controlling risk. We believe that investing is ultimately an exercise in controlled risk-taking, with the goal of achieving returns that satisfy long-term objectives. How do we achieve this? Prudent diversification, exercised by blending various security types, investment styles, geographies, industries, ages of portfolio managers, their gender/race, where they are located, their level of concentration, etc. This idea is at the heart of our view that fiduciaries are not pressing their advantage when they forego the free lunch of any and all of these portfolio diversifiers. Given this process, we thought that certainly we would capture diversity among the investment decision-makers.

Yet, when we examined our historical track record in considering and recommending diverse managers, the reality was quite different. We were shocked to discover that not only were we failing to tap into the benefits of diverse investment decision-makers, but we were failing badly. This meant that our consideration of the issue wasn’t on par with that of other forms of diversification, and so there must be significant flaws in our process.

This was an eye-opening exercise for us, and we knew that in order to properly address the issue of manager diversity, we needed to start thinking differently about it.
Faced with a clear shortcoming in our work, we began by considering what might be the source of the problem, and concluded that the responsibility fell squarely on our investment leadership for not providing clear direction regarding the significance of diversity as a potential enhancement to client returns. Major change in this area required continuous discussion/debate, and led us to consider where macro- and micro-level unconscious bias may have crept into our work. While this effort remains ongoing, considerable progress was achieved through open dialogue and decentralizing our decision-making process.

We then faced the structural fact that our sourcing strategies had not turned up enough diverse managers to choose from. Because we have a very high rejection rate universally, we must have volume to compensate, and this became a problem due to two factors we hadn’t thought to consider. First, years and years of frustration had led many diverse managers to essentially give up on the non-profit sector from a capital-raising perspective. Our sourcing strategies didn’t account for this factor, and as it turned out, we had a very poor structure in place for finding diverse managers. Second, there was a somewhat stronger tendency for diverse managers to be concerned with the product preferences of investors, which led to a larger-than-expected number of multi-product offerings and curious strategy variations, especially from some very small firms.

In order to rectify these issues, we knew that we had to think differently about how we sourced manager ideas, and how we considered firms with multiple products. With regard to sourcing, we had to get the message out that we wanted to speak to as many firms as possible. Although we pass on far more managers than we approve, we could guarantee a fair review and the opportunity for significant capital to those that met our standards. This led to a meaningful and ongoing investment in supporting various trade organizations, attending countless conferences, and creating an internal review structure where diverse managers would not be overlooked. With regard to multiple product offerings, we came to realize that most of these firms recognized the shortcomings of added complexity and deviation from their true calling as investors, but the realities of attracting capital left them with little choice. This is a sensible point and caused us to rethink our deeply ingrained reaction to what appeared to be irresponsible asset-gathering tendencies.

So where does that leave us today? The steps discussed above have been in effect for about two years, and the impact on our deal flow has been dramatic. The amount of undercapitalized talent that we have uncovered thus far has been nothing short of stunning, and has caused us to wonder what took us so long.
A recent study commissioned by the Knight Foundation and led by Bella Research and Josh Lerner from Harvard Business School concluded that less than 1.1% of the $71.4 trillion asset management industry is managed by diverse-owned firms\(^2\). This is a woefully insignificant percentage and one that neither reflects the financial benefits of diversity nor the talent available.

As of 11/30/18, Colonial clients in aggregate had allocated $2.2 billion of their capital to diverse managers, which equates to a four-fold increase from five years ago.

While we are nowhere near our potential for fully capitalizing on this form of diversification, we are pleased with the early progress.

While insufficient time has passed for victory laps, the following table provides a snapshot of the performance of the diverse public-market managers that we recommend. Note that, in each instance, we have measured performance from the point where the first Colonial client allocated capital, with returns\(^3\) compared to those of an appropriate benchmark.

Considering the woeful state of diversity in the investment management industry, we have been struck by the fact that there is still serious discussion of whether or not people of color and women are average, above-average, or below-average investors. It’s truly astounding.

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\(^2\) “Diversifying Investments: A Study of Ownership Diversity in the Asset Management Industry” May 2017

\(^3\) Returns are annualized if the period measured is longer than one year.
Those who have read about, discussed, and considered the issues of manager diversity will note that much has been left unsaid here regarding how one defines diversity, the role of bias, fairness in our society, etc. These are certainly important topics that deserve attention, but in this context, we don’t want to confuse the simple and central idea that drives our initiative: Diversity equates to differentiated experiences, and differentiated experiences lead to differentiated perspectives. This is the secret to having portfolios that fully realize their potential.

Time, experience, and introspection have allowed us to more fully appreciate this point, although it remains far from the mainstream of the broader investment community. We assume (and hope) that gale-force winds of change are coming, but in the meantime, we will utilize our early-mover advantage to secure capacity with a longstanding and thoroughly talented pool of diverse managers that will serve our clients over the long-term. We hope that client capital inspires them to express the purest form of their talent, thereby allowing portfolios to meaningfully benefit from the differences that make our world so very fascinating. Diverse managers have known for a long time that their differences are advantages, not weaknesses, and the rest of us are slowly getting the message. This sentiment was expressed quite nicely, and meaningfully, by one manager we’ve gotten to know well over the course of the last year:

“We've spent our entire life fighting against being placed in a box and conforming to external pressures. The fact that you encourage and value our differences is empowering. We are so grateful for the opportunity to do what we love and what we were meant to do.”