Silicon Valley likes to describe rarities in the field as unicorns. The term was coined to describe private tech startups with valuations of $1 billion or more. I’d like to co-opt the word for the financial sector and talk about a big little secret.

Individual investor, foundation, and endowment unicorns are rare, mystical, forward-thinking creatures creating portfolios and investing with emerging managers. On the journey to seek returns, these unicorns have discovered they can do well (in fact, quite well) as they do good, namely working with minority and women investment managers.

In particular, the New York State Comptroller’s office, which manages the NYS Common Retirement Fund, is the third-largest pension fund in the United States with $184.5 billion in net assets as of March 31, 2015. At a conference the office hosted in February 2016, it was clear that emerging managers and minority and women-owned business enterprises are central to the comptroller’s strategy. Under the leadership of Comptroller Thomas P. DiNapoli and Vicki Fuller, chief investment officer, the NYS Common Retirement Fund has committed a total of $5.2 billion to this effort, with programs in virtually every major asset class.

In many respects, foundations and endowments have been slow (glacially slow, depending on whom you ask) to do the same. Yes, many extol the virtues of impact investing and the need to create equality and opportunities across the economic spectrum. But I see very few unicorns when the conversation turns to how many women-led or minority-led firms have been added to their portfolios.

Barclays Capital found similar results in a 2011 study that found no endowments or foundations invested in hedge funds run by women or minorities (see figure 1).1

This seems unbelievable when you consider that foundations by their very nature seek to advance social change and provide opportunities for underrepresented populations. These foundations and endowments are missing an opportunity to amplify their missions by investing in and expanding opportunities for underrepresented managers, not to mention stimulating the economy, creating jobs and opportunities via the companies and deals in which they invest.

The W. K. Kellogg Foundation describes this inclusion of women and minority firms as “democratizing capital.”2 This label highlights the natural role that foundations and endowments can play in this arena.

It is time for the rest of the foundation and endowment community to catch up.

With 2016’s rocky start—the Dow losing 900 points in the first week—it behooves everyone to take a fresh look at the emerging-manager space. Everyone’s portfolio could benefit from some of the following:

- innovative investment strategies
- access to rising investment talent
- unlocking of market inefficiencies and differentiated deal-flow
- diversity in risk/reward
- long-term alpha
- alignment with one’s core values

So let’s look at the emerging-manager space, key players, performance, and some tips and resources that can benefit you and your clients.

A Rose by Any Other Name

The definition of emerging manager has gotten quite broad, so let’s use a few industry...
definitions to define it here as firms with less than $2 billion in assets under management (AUM) and at least 51-percent owned, operated, and controlled by a minority individual or group of minority individuals. Minority groups are defined as women, Black, Hispanic, Asian-Pacific, Asian-Minority, or Native American. It is worth noting that Prudential’s definition has the AUM level at less than $6 billion, which is a sign of the times and the robust nature of the sector.

Democratizing capital isn’t the only motivator for change, nor should it be. The good news is that the economics are very compelling. Research shows that the perceived risk that returns will underperform larger, well-capitalized firms is unfounded. The following are a few examples; note that these findings hold true across asset classes—public equity, real estate, or private equity—and despite whether the results are calculated in absolute returns or risk-adjusted returns.

Women-owned and -managed hedge funds have outperformed industry-standard Hedge Fund Research (HFR) indices nearly every year since 2007. … Annualized returns were 5.64 percent compared to 3.75 percent for the HFRI FWC Index …

Performance, both in terms of absolute returns and risk-adjusted returns, is substantially stronger for women and minority owned hedge funds than for the hedge fund universe at large. … Risk aversion, while academically noted in women investors, seems to play a role in capital preservation, with women and minority owned funds outperforming their non-diversity peers in market downturns.³

The findings of a report by the National Association of Investment Companies (NAIC) and compiled by KPMG conclusively affirm the tangible benefits investors may realize by investing capital in minority and diverse private equity firms that remain largely overlooked by institutional investors.⁴

Indeed, table 1, published in the NAIC report, illustrates this point; and additional supporting research can be found among the sources listed in the Additional Resources (sidebar).

**Table 1: NAIC Performance Finding Summary**

<table>
<thead>
<tr>
<th>Metric</th>
<th>NAIC</th>
<th>All U.S. PE</th>
<th>U.S. Buyout</th>
<th>NAIC Δ to:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median Net IRR</td>
<td>15.2%</td>
<td>3.7%</td>
<td>7.1%</td>
<td>All U.S. PE 11.5% U.S. Buyout 8.1%</td>
</tr>
<tr>
<td>Median Net MOIC</td>
<td>1.52x</td>
<td>1.11x</td>
<td>1.32x</td>
<td></td>
</tr>
<tr>
<td>Median DPI</td>
<td>70.2%</td>
<td>29.0%</td>
<td>51.8%</td>
<td></td>
</tr>
<tr>
<td>Upper Quartile Net IRR</td>
<td>20.9%</td>
<td>11.8%</td>
<td>14.7%</td>
<td>9.1%</td>
</tr>
<tr>
<td>Upper Quartile Net MOIC</td>
<td>1.99x</td>
<td>1.42x</td>
<td>1.59x</td>
<td>0.57x</td>
</tr>
<tr>
<td>Upper Quartile DPI</td>
<td>160.0%</td>
<td>67.1%</td>
<td>89.1%</td>
<td>92.9%</td>
</tr>
<tr>
<td>Capital Weighted Net IRR</td>
<td>27.5%</td>
<td>6.5%</td>
<td>8.3%</td>
<td>21.9%</td>
</tr>
<tr>
<td>Capital Weighted Net MOIC</td>
<td>1.88x</td>
<td>1.25x</td>
<td>1.34x</td>
<td>0.62x</td>
</tr>
<tr>
<td>Capital Weighted DPI</td>
<td>107.9%</td>
<td>52.2%</td>
<td>61.6%</td>
<td>55.7%</td>
</tr>
</tbody>
</table>


**Altura Capital.** This woman- and Hispanic-owned firm is focused on generating alpha opportunities for investors by leveraging the potential of undiscovered and underutilized investment talent. Their product offering includes a comprehensive database of emerging managers that can help you find managers based on a variety of search criteria. This unique perspective on the entire ecosystem has been a competitive advantage for the firm, making President and Chief Executive Officer Monika Mantilla a treasure trove of insight and information. “Emerging domestic markets (EDMs) and emerging managers (EMs) are two highly untapped, opportunity-rich segments for value creation both for institutional and private investors, especially those who wish to deliver returns and at the same time effect social transformation and community progress,” Mantilla said. “We are at the forefront of solutions, such as new and pioneering investment solutions, especially Community Reinvestment Act and impact qualified investment vehicles that harness EMs and EDMs and run on wealth management platforms.” Mantilla noted that Altura’s work led to the creation of Small Business Community Capital, a Small Business Investment Company (SBIC) impact fund that invests in small businesses nationwide. Mantilla is the first Latina in the history of the program to have been awarded an SBIC license.
Pine Street Alternative Asset Management. Pine Street focuses on delivering diversified, alpha-oriented risk-adjusted returns. Pine Street provides seed and accelerator capital to emerging hedge fund managers and invests with a broad universe of emerging hedge fund managers. However, Pine Street also seeks to exploit its competitive advantage in the under-capitalized but outperforming niche segment of women and minority hedge fund portfolio managers. In addition to providing transformational capital, Pine Street, unique to most seeding models, actively advises on all phases of establishing an institutional quality hedge fund. In exchange for seed capital, the Pine Street Fund intends to receive a revenue share of underlying emerging hedge fund manager fees as well as any appreciation from performance on the seed capital. Further, investors in the Pine Street Fund enjoy capacity rights in the underlying seeded emerging hedge fund managers. One of its founders, Brian Mathis, is an example of the impressive caliber of professionals in the market. His background includes Advent Capital, Pacific Alternative Asset Management Company, JPMorgan Chase & Co., time as a political appointee of President Bill Clinton at the U.S. Department of the Treasury, and service as a member of the Council on Foreign Relations.

Unicorns in the Big Apple
I am pleased to report that a large foundation in New York City got creative in starting an emerging-manager program last year. It is still very new and not ready for public disclosure, but the foundation’s leadership can be commended for seeing the gap and responding. They did so without a long, drawn-out process or too much internal politics. They recognized that they did not know many emerging managers and began hosting gatherings to familiarize themselves with key players and talent.

I would be remiss in not spotlighting another Big Apple unicorn, the NYC Comptroller’s office led by Scott M. Stringer. As custodian and trustee to the city’s $160-billion pension funds, Stringer and his team have been leading the way in advancing opportunity and strengthening diversity in asset management. The theme of their 2015 investment manager conference was “The Value of Diversity,” and at the same time they launched an initiative to incorporate diversity as formal criteria in the selection of investment firms. Additionally, consultants who help choose managers for the city’s five pension funds will be required to consider diversity in that selection process. The city later announced it will expand the City Pension Funds’ Private Equity Emerging Manager program by $500 million, thus bringing the total amount invested or committed with emerging managers to more than $14 billion—including more than $11 billion invested or committed to minority and women-owned businesses enterprises.

“Diversity is not just a social value for New York City, it has strong economic value,” said Carra Wallace, chief diversity officer, Office of the New York City Comptroller. “We know that diverse groups make better decisions, which is why we seek diversity among our investment managers as well as in the firms that do business with our city. We want to set an example of leadership, vision, and commitment to diversity that foundations and endowments can follow.”

Tips on Embracing Your Inner Unicorn
Breaking the system’s inertia needn’t be arduous or daunting. It can be a real value-add. Consider that many of the following key elements are readily at your disposal:

The diversity conversation. Discussions about diversity can be delicate, but there are resources available to help (see sidebar). Many impressive professionals and firms are willing to share their experiences, and there is general camaraderie and support among peers to help expand the field. This network is worth tapping into. Why not arrange a peer lunch or invitation to speak at an upcoming client or board meeting?

Start with leadership. Change requires leadership from the executive suite. Commitment and support of the president of the organization, the senior leadership, and especially the board of directors is critical. The chief investment officer is truly empowered when that support is available. Such support was a vital component of W. K. Kellogg’s emerging-manager program, which started in 2009 when the firm began to extend its diversity values into its investment strategy by hiring diverse investment managers.

Engage the investment committee. Empower the committee members by (1) increasing their knowledge of the sector, (2) helping them to set clear goals and metrics, and (3) aligning goals to the endowment or foundation’s broader strategy. All three will help to increase the likelihood of sustainability and decrease the chances that the committee’s efforts will fall into the short-lived special initiative category.

Amplify your value. As the emerging-manager momentum picks up, so too will the role of the investment consultant. Endowments and foundations will look to the services of investment consultants as a direct way to operationalize an emerging-manager program. As critical gatekeepers of information and advice, successful investment consultants will be expected to have well-prepared and active programs regarding inclusiveness and asset-manager diversity in their practices. I envision the need for building out this service offering and using it as a core part of a manager and consultant’s value proposition. Indeed, many clients will be expecting transparency and accountability as part of the consultant selection criteria. We should all be
prepared to ask, answer, and improve upon the following questions, among others:

- the number of emerging managers we've actively researched and tracked
- the number of emerging managers we've recommended to all clients
- the number of emerging managers we've hired
- the total AUM we have invested with emerging managers

Seek out other unicorns. Several organizations/initiatives exist to help exchange ideas, best practices, lessons learned, and network with peers. A few notables include:

- The Investment Manager Diversity Pledge by Association of Black Foundation Executives (ABFE), 100 Women in Hedge Funds, Association of Asian American Investment Managers (AAAIM), Diverse Asset Managers Initiative (DAMI), National Association of Investment Companies (NAIC), National Association of Securities Professionals (NASP), and New America Alliance (NAA).

Calling All Unicorns
Clients can benefit tremendously from access to the best investment talent, strategies, and high-performing firms that can deliver results. Smaller size, agile teams, and reduced operational bureaucracy are helping to drive strong returns among emerging managers.

Consultants and wealth managers have an opportunity to deliver untapped sources of performance across asset classes and at the same time ensure seamless integration into the existing asset allocation model. The tools, the professionals, the data, and the performance are readily available.

My hope for 2016 is that as investment and wealth advisors we can collectively increase the foundation and endowment unicorn population. Together we can help them realize their potential as savvy and inspiring leaders.

Gayle Jennings-O’Byrne is chief executive officer of The Prometheus Exchange, a convening and advisory organization for high-net-worth investors committed to innovation, creativity, and economic growth and equality, where she works to amplify social change. Previously she was a vice president at JPMorgan Chase Global Philanthropy as well as a mergers and acquisitions banker in the firm’s investment bank. She earned a BS in economics from The Wharton School and an MBA from the University of Michigan Ross School of Business. Contact her at letstalk@prometheusexchange.com.

Endnotes
5. See “Hedge Fund Pulse,” cited above.

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