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EPISODE 40

Assessing True Alpha

with Xponance

Robert Morier: Welcome to the Dakota Live Podcast. I'm your host, Robert Morier. The goal of this podcast is to help you better know the people behind investment decisions. We introduce you to chief investment officers, manager research professionals, sales leaders, and other important players in the industry who will help you sell in between the lines and better understand the investment sales ecosystem. If you're not familiar with Dakota and their Dakota Live content, please check out dakota.com to learn more about their services. Before we get started, I need to read a brief disclosure. This content is provided for informational purposes and should not be relied upon as recommendations or advice about investing in securities. All investments involve risk and may lose money. Dakota does not guarantee the accuracy of any of the information provided by the speaker, who is not affiliated with Dakota. Not a solicitation, testimonial, or an endorsement by Dakota or its affiliates. Nothing herein is intended to indicate approval, support, or recommendation of the investment advisor or its supervised persons by Dakota. Today's episode is brought to you by Dakota Marketplace. Are you tired of constantly jumping between multiple databases and channels to find the right investment opportunities? Introducing Dakota Marketplace, the comprehensive institutional and intermediary database built by fundraisers for fundraisers. With Dakota Marketplace, you'll have access to all channels and asset classes in one place, saving you time and streamlining your fundraising process. Say goodbye to the frustration of searching through multiple databases and say hello to a seamless and efficient fundraising experience. Sign up now and see the difference Dakota Marketplace can make for you. Visit dakotamarketplace.com today. Well, I am very proud to introduce our audience today to Tracy Cao and Adam Chopin of Xponance welcome to the show.

Tracy Cao: Thank you.

Robert Morier: Yeah, thank you for being here on the desk in the studio. It's always nice to have people visit us live. As always, my friend to the right, Dan DiDomenico of Dakota, welcome.

Dan DiDomenico: Thank you, Robert. Thanks for having me.

Robert Morier: And thank you for being here. Well, we have a lot of questions to ask you both. But before we do, I'm going to read your biographies for the audience. And then we'll get into the questions. Tracy Cao is vice president and team lead for manager research multi-manager strategies at Xponance. Xponance is a Philadelphia-headquartered multi-strategy investment firm focused on active global equities, systematic global equities, US fixed income, and alternatives. Xponance's active global equity business is reflected by an emerging manager of manager investment program, focused primarily on non-US public equity strategies with a core belief that small, entrepreneurial managers have a performance edge in capacity constrained strategies, which can be a vital source of portfolio management innovation. Having joined the firm in 2013, Tracy identifies and evaluates prospective asset managers for their multi-manager strategy platform on a global basis. Additionally, she sources boutique managers, conducts frequent on-site due diligence meetings, and produces original research for clients on a variety of global equity related topics. Prior to Xponance, Tracy was an equity research analyst intern at UBS Investment Bank in both Amsterdam and Hong Kong, as well as an investment advisory intern at Merrill Lynch Wealth Management in Baltimore, Maryland. Tracy earned her MS in Finance from Johns Hopkins University, her MS in business economics from the University of Amsterdam in the Netherlands, and her BS in Insurance at Dongbei University of Finance and Economics in China. She is a CFA charter-holder and calls Philadelphia her home with her family. And your husband is in the studio with us now. So, we will say hello to him. Adam Choppin is vice president and assistant portfolio manager of multi-manager strategies at Xponance. Adam also joined the firm in 2013 and is the assistant portfolio manager for emerging market equity strategies on the multi-manager strategies team. From 2008 to 2013, Adam founded and ran a boutique investment advisory firm, which advised on private investments in South America, Africa, and the Middle East. Previously, he worked for several US government agencies, including as a trade and economic affairs liaison in Iraq, Afghanistan, Cape Verde, Sierra Leone, Ghana, and Mozambique. In 2008, he organized the first US government trade mission… official US government trade mission to Iraq in over 25 years. Adam earned his BA in International Relations from the University of Southern California, USC. His MA in International Economics and Business from Yale University, and a postgraduate diploma in Finance from the London School of Economics. While a student at USC, Adam also read in Latin American Economics and Politics at the University of Sao Paulo. Adam is also a chairman of the board of the Association of Professional fund investors. He is also a CFA charter-holder and calls Philadelphia his home with his wife and two daughters. Welcome to the show. Thank you for being here. And congratulations on all your success.

Adam Choppin: Thanks Rob.

Tracy Cao: Thank you.

Robert Morier: Well, it's a lot of fun to be able to sit with both of you today. Mainly because I worked with both of you for four years. So, I have an undergraduate degree in both of you. You guys have gone on to receive your PhDs in Xponance. And Dan is new to school. So, we're… but a very seasoned and experienced salesperson. So, we're really excited to have this conversation today. It really is a gift. So, thank you. We always like to start with the beginning with our guests. How did you come to be in this seat, particularly after 10 years at the same firm, which we also always find very interesting? So, Tracy, would you mind sharing with us your path to the United States and ultimately how you found Xponance?

Tracy Cao: Thanks, Rob. First of all, thank you so much for inviting me and Adam to come here and joining you for this episode of Dakota Live. I'm very honored. Speaking of my path to the States, it is very straightforward. As you mentioned earlier, I came to study in Johns Hopkins. And in the last semester of the program, I found this manager research internship opportunity in FIS Group. At that time, the firm was called FIS Group. And I did it for three months. And I got tremendous exposures during that three-month period. As the time went by, I had a stronger and a stronger feeling that I had passion in this area. And I wanted my career to start from here. And I was lucky. After the internship, I got the full-time offer from the firm. So, I started full time right after college in summer 2013. Actually, Adam and I joined the firm at same time. 10 years later, here I am. And here we are.

Robert Morier: That's wonderful. I'm happy for you both for being there for 10 years. Adam, you've taken a much more circuitous route. Just reading your biography, lots of countries, government, entrepreneurship. So, can you tell us a little bit about your path?

Adam Choppin: Yeah, most people have a straight path. I have that Family Circus meandering cartoon thing going on.

Robert Morier: You do.

Adam Choppin: Yeah, I mean, this is my third career. And there's a longer story over a beer I can tell you about the first two. But when I was looking to make a change, I had a classmate who was at a firm in Philadelphia I'd never heard of in a field I'd never heard about called FIS Group. And I talked to him. And it turns out they needed someone. And I was a good fit. They needed someone who looked at a lot of entrepreneurial firms and could learn on the fly what it was in this industry. And it's been really great. I love working with entrepreneurs, high conviction folks who put all their skin on the line to do what they believe in and absorb a lot of pain. We like to say that we work with a lot of masochists. And that's a lot of fun.

Robert Morier: The energy is contagious, isn't it?

Adam Choppin: It is, because people… I don't know, it's different when people really are doing something they believe in so strongly. They're willing to take a lot of risk.

Robert Morier: Yeah, absolutely. Thank you for sharing. Well, Tracy, we're going to talk a lot about Xponance. But maybe for our audience, Adam was actually here last year. So, he set the stage as it relates to the emerging manager program. But would you mind taking a step back, just telling us more about Xponance, how you approach active global equities through boutique entrepreneurial asset management business?

Tracy Cao: Sure, absolutely. So, investing in emerging managers is a central part of our investment process. We believe small, entrepreneurial managers have a performance edge, particularly in the capacity constrained strategies. And that can be a vital part of… the source of our alpha generation for our portfolios. Now, the challenge with this approach is you have to do a lot of work, spend a lot of time evaluating a manager's business and infrastructure because those risks are heightened with small managers. Now, at Xponance, we have an incredibly in-depth sourcing and evaluation process on boutique managers. This is a very labor-intensive value proposition on our part. But the bottom line is we don't shy away from early-stage managers. And we try to be early, which is what we've done. But we don't make our investment decision-- manager passing a minimum AUM. But we need to identify the manager's defined investment edge that we believe will persist through time. And the manager has to be equipped with the institutional qualified back office. Both parts need to go through our in-depth due diligence process. I know later, we will get there with more details.

Robert Morier: That's interesting. Thank you for sharing that. We look forward to it. Well, Adam, you've seen FIS into Xponance. So, there's really been this kind of true evolution of the business. It evolved through acquisition, through Piedmont, which was active fixed income, systematic equities, expansion into alternatives and financial technology, and then ultimately, the rebranding into Xponance, as we mentioned. So how have you seen the business develop over this time from your seat as a manager… now, a manager research veteran in career three?

Adam Choppin: I mean, it's been really awesome. I mean, the firm started even before we got there, as a consultant back in the mid to late '90s, evolved into a discretionary multi-manager long before we arrived. And then has taken that to the next level in terms of offering other products that meet our clients' needs. Our clients are all institutional, largely big public pension plans. Our founder Tina, she knows exactly what pressures they face and what needs they have, having been in that seat herself a long time ago. So, we've been lucky to find some of the opportunities. We've created some of the other opportunities in terms of Founding April and starting the relationship on the staking business with Investcorp, and then of course, finally, the acquisition with the Piedmont to bring them in house. No, and I think there's still more to come. I mean, look, as the needs of our clients evolve, we will evolve with it. We've done that over the years. When the firm started, we did almost all US equities as a consultant. And now, we do very little US equities in the multi-manager business. And so, 10, 15 years from now, it'll probably look different too.

Robert Morier: Yeah, and speaking of Tina, so Tina Byles Williams, she's the CEO and founder of Xponance. She was many, many moons ago, she was the CIO of the city of Philadelphia. And I remember those stories hearing her speaking to these young, boutique managers wanting to find a place for them in their portfolio, in the city's portfolio. But it was difficult for a variety of reasons. So that's ultimately what led to FIS. And as you just very eloquently described, this evolution over time has been very interesting to watch from our seat in particular. So, one of the questions though that we always get, particularly as we talk about our emerging managers and emerging manager allocators, is, how do you define an emerging manager. So, what constitutes an emerging manager as it relates to asset size, length of track record? You had a lot of checkboxes on that list. So, we'd love to hear how you define it.

Tracy Cao: I think the commonly used $2 billion to define emerging needs to be customized to reflect a couple of factors. For example, the product capacity limits for, say, international small cap strategy, $2 billion may be an appropriate level to consider closing. But for a large cap growth equity manager, that number should be much higher. So, you need to think about the asset class, the investment style, and even the client diversification. So, like $5 billion firm can be far away from out of the woods in terms of the firm risks. Now in the past, we have witnessed some larger firms that fall business just one or two of their consultants remove them from their buy list after a period of underperformance. So, the bottom line is it's hard to use a single number across the board. It's really… you have to consider their style, their asset class, and their client diversification case by case.

Dan DiDomenico: Just the follow-up question on that because we often work with or know about some large asset managers that may be ceding strategies or initiating new strategies. So, they may already have the embedded assets at the firm level. But those individual strategies that they're launching are set up a different way. Do you invest in intrapreneurs?

Tracy Cao: That is a very good question, Dan. it also depends. First of all, it depends how large is this large manager. If that is a $30 billion firm, it's definitely outside of the emerging manager universe, at least for us. Now, if this manager, large manager, is relatively larger than a typical emerging manager and they launched a new strategy either through acquiring a new team or just develop a new strategy based on their internal team, if that strategy happens to be in the capacity constrained area, like emerging markets, international small, we will consider, we may consider. And always, we find every way to support diverse managers. So, it's really case by case. Have to look the manager scenario by scenario.

Dan DiDomenico: In terms of evaluating managers, how is the team structured in terms of coverage?

Adam Choppin: Haphazardly.

Robert Morier: Like your career.

Adam Choppin: It's a little bit circuitous. I mean, we tend to cover… continue to cover the managers that we source. And there's no rhyme or reason necessarily to how we source because we're all covering everything. And so, it comes up. And so, there's no… there's no particular organization. So, anybody looking at the bios online and trying to figure out who covers what is going to have no success. Even with that, we've changed… we trade managers as we have people come and go, which hasn't been a lot. And Tracy and I have been there 10 years. But we've had some other people come and go from the firm. And so, things moved around a bit. And even between us, we'll trade managers just to even out coverages. And it's really a workload issue. So, there's not really a good rhyme or reason. What we do try to do is to have all the analysts, all the folks on the team, covering sort of someone in every asset class. So, everyone gets an international small cap manager. Everybody gets an emerging market manager, that kind of thing. Just so that those… we're not too lumpy in our knowledge base across the different spaces. But otherwise, it's fairly haphazard.

Dan DiDomenico: Well, I'm sure that fosters really good conversation internally as well since you all have exposure, and experience, and perspective across all those asset classes. But maybe you can take us through the typical manager underwriting process. And perhaps even take us through a recent example. So how was that manager sourced? What were the characteristics that you found compelling? And how long did the process take?

Adam Choppin: Yeah, so I mean, there's no typical process. And because it really depends on where the manager is in their business life cycle more than anything else. So, it's very different talking to your quintessential two dudes in a Bloomberg versus your 20-person shop, but it still happens to be sub-institutional scale. But let's say we find a manager that we like with a process that we like, and enough-- and a long enough return stream that we can have confidence in their style. And this is one thing that a lot of managers don't appreciate is that as a multi-manager, it's… one of the most important things is not so much just understanding if they are any good but understanding what they're going to do vis a vis the other managers in our portfolio. And that's a fit, exactly. And that's hard to know-- it's generally hard to with shorter track records. But there's always another way to figure it out. It just depends. But so, depending on how long a manager's track record is coming in, that will dictate a lot about how quickly we can get comfort with what they do. And then depending on what their back office looks like will dictate how quickly we can really approve them. Sometimes, we have some managers need a lot more handholding. They need to be told what kind of insurance policies to get, what kind of OMS to get, all these other things. Others are ready to go on day one. It just depends. So, I would say that even the fastest manager who's ready to go on all those things, at least six to six or seven months is sort of like the minimum time from like conversation to approval onto our buy list as a process. And then as an example.

Tracy Cao: Yeah, I can provide a recent example. I know you have a lot of questions on how we engage with early managers. I think this recent example will be a good demonstration on how we resource and work with early managers. So, this manager, first of all, they are very early stage. The firm was only launched around 2021-ish. I call it Manager A, maybe. The manager was founded by 2 female co-founders who used to work together in their previous firm. Now, this is a quant shop. And the two female co-founders, they are super talented. And one is focusing on the investment… she is the architect of all their portfolios. And the other one complements her very well. And the other one is an expert on the technology platform infrastructure, that kind of thing. So, they were introduced to us about late 2021 or early 2022. And we had a couple of calls with them and with their team. They have a team about five or six, including them. All of those are very high-quality talented quant researchers. And we really like their process. And we think they have a good potential, a good fit for us in the future. However, at that time, they have no assets. They only seeded their strategy using very minimal internal money. And they have no infrastructure because there's no accounts. But they have people. So, the manager like this, you can imagine how many work… how much work we have to do if we're going to proceed with them. But we see potential. So, we will go with our conviction. So, we… on top of our already in-depth evaluation process, we understand their people background, and their investment process, their model factors step by step. And there is a huge team collaboration among our team and also among our different departments in Xponance. So, our quant team performed a quant review on this manager because that is what we do for all the quant managers that go to our buy list. And for the operations, you can imagine, our operational team and our ODD specialists, they spent a lot of time working with this manager at different stages throughout last year. Literally, we helped them to build up their back-office infrastructure. And on the financials, we leveraged our CFO's historical experiences on evaluating this and also forecasting early-stage managers. And we use that complex financial forecast model to just make sure the manager has sufficient capital to support themselves for the next at least five years. And also, we have other senior members providing coaching to this manager from day one throughout last year. So, you can see, this is really a collaboration of all the teams working together. And by the end of last year, we all believed they were ready to manage our clients' money. And we approved them to our list. And we became their first dollar investor earlier this year.

Dan DiDomenico: Very neat. So out of curiosity, Manager A, did you know them prior in their prior world, their prior experience, the prior firm? You hadn't had any experience with them directly?

Tracy Cao: No. They worked for a larger firm individually. So that is not our investment domain. But they were introduced to us right after they launched the firm through some industry contacts.

Adam Choppin: But to answer a previous… to go back to the previous question, Dan, about how we organize some of the way the team works, the ones that are really hard and complex like this, I try to give to Tracy because I don't want to do all that kind of work. And if the ones are like nice exotic locations, like Cape Town, that's usually my domain.

Robert Morier: Clearly from your biography, we're sensing a trend here.

Tracy Cao: I'm used to Adam's jokes all the time.

Dan DiDomenico: That's great. I was just going to dive into those investment committee conversations. You started getting there and the debate around the table and being that everybody has a lot of great perspective that they're bringing to the table. Maybe you can just talk to us a little bit about your approach. And you have to sell the idea, right? So, if you're the one underwriting the manager or the strategy, you bring it to the table, maybe just take us into that conversation. So how are you showing that conviction that you have in that manager to your colleagues?

Adam Choppin: Yeah, I mean, well, so first thing is we don't want to oversell because a good chunk of our compensation is based on the performance of our client accounts. So, it's not in our interest to win as an analyst. It's our interest to win to have better performance. The first… and we're all tied the same way.
So even though we like become advocates a little bit for our managers, we do root for them. But more important is what performance looks like. But so, when we do bring a manager, you want to present… so you want to present them fairly. And you want to present them accurately. You're not… we're not in the business of bringing managers that we don't think are going to outperform. And we don't collect… I say often, we don't collect butterflies on our buy list. We try to use the managers that we spend our time to bring forward to the committee, which is part… one of the most frustrating parts for managers on the outside. Because this is something they don't have any visibility or control on is not whether or not they're any good, whether or not they're going to have a chance to get an allocation. Sort of my rule of thumb is if I need to see that there's at least a 50/50 chance that we're going to use a manager in the next 18 months in order to bother to start to work on them to bring them on to the buy list. That's kind of like the rule of thumb we have. And from the

outside as a manager, or as a marketer, or whatever, that's so hard to see. But we try to be honest with our managers and say, I don't see it right now. Keep in touch. And go from there.

Robert Morier: Do you glean a lot from that process? I mean, that's a lot of patience for someone who's starting with very little money. They have a staff. They put a lot of risk on the table, not just on the portfolio, but personal. So, I would assume just, if you think about the character traits that you see from that, what are some of the insights that… because you're very people-driven as well. This sounds so private equity. So much like venture capital, where you're taking a stake… and we're going to ask about that ecosystem and how you work, and partner, and coach these managers. But how do you evaluate the people?

Adam Choppin: Carefully, slowly, patiently, judiciously. Me having lived this as well, there are lots of ways where the business gets in front of the investments. And this happens at a big business too. But it can be a little bit different and entrepreneurs. I mean, one of the things that I like to say is that there's a point… what you want to do as an entrepreneur is get into the black because you never want to be desperate because desperation is a stinky cologne. And allocators can smell it. And I know in particular because I used to stink when I was an entrepreneur myself. And I was really desperate. So, we try to look for… I mean to the point of the long sales timelines, really long sales timelines in the institutional business. You just got to be patient. And so… if you're an entrepreneur out there, you need to plan for a very long, I mean, at least five years to be treading water. Do what you can to get in the black as quick as you can. Get time on your side. But one of the things we look for, I mean, beyond all the investment stuff, is really, are they… are they in a comfortable place? Do we feel like they can really tread water not just financially but psychologically for another year or two without losing their mind? Because it's hard. Most emerging managers or successful portfolio managers have made a lot of money at some other big shop somewhere else. Now, they're out on their own as masochists. And they're spending their own money to keep themselves afloat. And even if they're in the black operationally, they're not making money. That weighs on a successful person. That weighs on them psychologically after a certain period of time. So, you got to assess that just by reading them, body language. This is one of the things that was hardest to do, frankly, in the pandemic, is to assess this sort of psychological business risk. Because that takes-- it's generally better done in person. But sometimes, when they're really desperate, it even comes over on the phone.

Tracy Cao: And you have to have that expectation that the firm will not be profitable within the next five years at least. Based on our financial model, even manager gradually adding assets to like $10 million each year still, usually, it takes longer than five years to be profitable. So that mindset expectation is very important for the manager. And on top of that, during that five years, seven years, the manager still needs to be focusing on their strategy, not businesses. Otherwise, they wouldn't get the attractions from the larger audience. And also, we like the manager to be curious and humble. Sometimes, we send out some questions, maybe just research related, not related to their portfolio. We like to hear the insights from the managers. Usually, those managers really focusing on research, really focusing on managing their portfolio, really have a passion in this area, will deliver consistently good research to us. And those are the traits we like to see among those managers. And that will build up our conviction to the managers, not necessarily just the performance.

Robert Morier: Interesting, well, these are a lot of individual characteristics. So now, you have two co-founders who have come together potentially for the first time. So how do you evaluate that cohesion? Is it… is it time? Or is there something else that you're trying to look for?

Tracy Cao: Time definitely is the most reliable factor. But it's hard. We cannot wait for five years to see if they still stay together, or they divorce. But I think we try our best to do… we do background check. When we talk with them, we try to include all their team members together, even if it's virtual. And myself and our ODD specialist, we flew to their office all the way in the… it's far from our office. And then before we present the manager, we try to collect everyone in the same room for three, four hours. Then you can definitely… you can get more insights from their behavior and their team dynamics.

Adam Choppin: It's art. It's not science. There are no boxes to check. There are no forms to fill out. It's about understanding people, getting to know where they are in their lives, what… how much stress they feel in terms of the business, and how realistic they are about their business plan. A lot of entrepreneurs think, oh yeah, I'm going to go from $20 million in the first year to $100 million in the next year, and $500 million in the third year, it's probably not going to happen. I mean, it can. If your name was Rajiv Jain, it happened. But other than that, or actually, that was even faster. But like other than that, that's about it. That's the only one. So, you need to have very, very sober expectations.

Robert Morier: No, that makes sense. It sounds so consultative and a little bit like therapy. So, it sounds like there's a lot of helping hands.

Dan DiDomenico: And a reality check. Because we work with many, many managers that are just getting started, just launching the strategy. And they share with us their financial models. And we tell them, you have to start that over. You have to root your expectations in reality. And it's hard out there for emerging managers to get started. And it's great to have folks like yourselves doing the work that you're doing because that gives them the podium. That gives them the audience to bring their story to life and be able to bring their business to life. And maybe just talk us through… because you also done a fantastic job of investing in promoting women and minority-owned and managed strategies. Although there's a number of female-founded startups have been trending up over the past few years, those emerging managers generally see a smaller portion of the capital and deals relative to the overall industry. What do you see happening that can change those statistics?

Tracy Cao: I think the industry has improved incrementally. But you can see slowly, it's improving. Led by quite a lot of firms truly that are inclusive in terms of hiring diverse managers or hiring diverse professionals. And I'm proud to say Xponance is one of those firms. But I think as allocators, make sure our hiring practices are truly inclusive because we are the decision makers. And that is crucial to transform this industry.

Adam Choppin: Yeah, I think there's two things evolving, which are the most hopeful, but which are both very long take a long time to mature. One is… so looking back at how women and minorities are discriminated against in this industry, it is often at the level of the middle management at large firms. It is easier to be promoted as a mediocre white guy than as a woman or a minority in a large firm. That's one thing that has to change. Because in order… you need to be a senior person at a large firm in order to then have the cachet, the resume to go out and to start your own firm, right? Because otherwise, it's going to be very difficult for you to raise assets. And that's true for anyone, whatever color or gender. The other thing that's changing is… and I do think that is changing on the margin. You hear anecdotal stories. You see some numbers. It's slow. These things take years. But I think that is changing a little bit. Probably not fast enough but changing a little bit. The other thing is reporting. The same thing that happened in Europe with sustainability and environmental reporting is happening in the United States with DEI reporting. It is now accepted, demanded that you report on DEI. That is the first but necessary step in order to drive change in all the different investment processes, whether you're at a consultant, or whether you're at a pension fund, or an endowment, just to see… to force managers to report and to be embarrassed, perhaps, by what they are reporting will change behavior slowly, but eventually, in the same way that it did in Europe with sustainability reporting. Now, the next step beyond that would be to have more allocators making active decisions based on that reporting. That will probably be slower yet. But all of these things are at least moving in the right direction, but glacial.

Robert Morier: How about the collaboration with other investors? Because we have been hearing, I know Dan in particular, we're talking to a lot of emerging manager allocators. There are more, I think, coming online every day. So as a result, that should help, we hope, those statistics as well. But as you think about collaborating with other emerging manager of managers, trying to identify these newer businesses, and then potentially combining efforts, is that something that's part of the day to day for you all as well?

Adam Choppin: I trade names with my colleagues from all stripes, whether they're family offices, endowments, and Tracy does too. We collaborate with the cap intro platforms and other folks like that. There aren't a lot of our peers who are as brave or have… are willing to put in an amount of work or whatever you want to call it in terms of looking at really small managers. I mean, we've taken managers from $2 to $3 million up and even less. The manager that Tracy was just talking about I think had half a million in AUM. And there's not a lot of folks who really do that. But there's plenty of folks who will look at like $100 million manager. And so, we definitely trade names around. And because we've been doing this so long both individually and as a firm, we get a lot of calls in from… whether it is colleagues, or 3 PMs, or former managers, or whatever being like, hey, I got a friend who's doing this. And so, we get a lot of that as well as just a result of us being known that we're out there.

Robert Morier: I think a statistic worth noting is that 47% of diverse and women-owned business enterprises products currently funded by Xponance were not found in investment. So, you are going outside. So, we talked a little bit about sourcing before. The databases tend to be kind of a lot of salespeople's kind of first point of entry, particularly asset managers. So maybe just taking kind of a step back into that world, collaboration is one way to source managers. But how else do these managers come across your desk?

Tracy Cao: Yeah, I think sourcing is really… our sourcing is outside of the traditional, including… but most of the time, it's outside of traditional database screening or just the cap intro event. Like Adam, myself, and my other manager research colleagues, we travel all over around the world. We do hundreds of phone calls and in-person meetings. And many of those investment options initially look nothing like we would invest in. We met with a long-short manager… we focus on long only. And we will convince them to cut out their long book for us. Or this is a global strategy, and we look to see if the manager has the edge to manage the international strategy. So, we work together with them to carve out their international portion of their book and then to eventually develop a secondary product for us. So, there are many other examples. But the bottom line is typically, you have to do a lot of work for those early stage and undiscovered managers before they are well known to the markets.

Robert Morier: So, you're working with long-short managers, carving out… carving out long only, which means you're carving up their fees, which is a four-letter word to hedge funds when you're thinking about reducing that number. So, if you could take us through what that process looks like, because that's… we talk about this a lot. That's the give up for these asset managers. Is that they do get into a relationship like Xponance, which provides an ecosystem, advice, assets, clients, public pension funds. But it does come at a cost. So, what does that conversation look like from your seat?

Dan DiDomenico: Be open minded and be creative. That's what it sounds like you're doing with these managers within those conversations.

Adam Choppin: The two-to-three-year contract hired gun commissioned sales guy, we're not their favorite phone call. It's the salespeople who are more prone to call us are the ones who are actually partners in the firm and who are going to be there for 10 years because it's part of a building process. So, the back of the envelope that we tend to use for whom it makes sense to take… to accept the kind of low fees that we can offer. And to put it in perspective, because our clients are giving us are allocating to us $300 million to $1 billion at a time, we're getting those fees right at those small institutional rates at separate account… separate account rates. And then we have to pay managers 30% to 40% less than that. So, the… so it's not a ton of money. Well, and it's certainly not hedge fund money. And there's also no carry. So, the… but what it does do is it enables you to get a foot in the door in the institutional space. And that is a really hard door to crack open. And it is a way to build scale, to build capacity, and to build a business. But what does that mean in the front end? Well, you want to have that business. You want to have an institutional business. You believe that your products, you have $3 to $5 to $10 billion in capacity in your investment products that you could sell some day. But you need a path to get there. And we are a really good path to get there. If you don't want that business, don't call us because it doesn't make sense. If you've got a $300 million product and you've got $100 million in it, we're not the phone call you should make. But for managers who really want to grow their institutional business, this is a really good path forward.

Tracy Cao: And for us, we treat them the same as the other long-only managers. It's just another product for them. Take it or not. We won't treat you differently because we're focusing on long only.

Dan DiDomenico: I'd love the build upon that. Because that's the path that most are going down. And they want to achieve that level of scale. They want to have that institutional business. For you all, what happens when a manager achieves that? So, they get to that point of growth, is there a… what does graduation look like for you all from that manager?

Robert Morier: Is it a success or is it a curse?

Tracy Cao: I prefer the former one. So yeah, we have talked a lot of about how we build a connection to new managers. And we have to have the discipline to be the first dollar investor. The same thing is true for getting out of a successful strategy. You call it graduation. Yeah, so if a… so we believe every strategy has a capacity, across in which, returns will diminish. So, this is our philosophy and also our discipline. So, if a truly skillful manager, they have the track record, the assets grow. And you will see their-- typically, their AUM will increase rapidly within a short time period. Now, if they're approaching to their capacity, we need to have the discipline to get out. That is very difficult because they are still generating alpha. And they have generated a lot of alpha for our portfolio. But we have to stick with our discipline. We often say that we are typically sneaking from the back door when everyone is rushing to the entrance.

Adam Choppin: It's also not the business we're in. Our clients come to us to get the things that they can't do directly, either by structure or by the reality of how their team can allocate their time. And their consultants are also similarly constrained because they also have large economies of scale, much larger than ours. And so, we pass the baton off. And we… it is a success. We don't get anything directly out of it. We don't get… we have no rev shares. We have… we're not taking any equity stakes in these managers or anything like that. But it's a big feather in our cap. We love it. We boast about it. We boast about it to our friends as allocators, to other managers, to our clients. But that's… but that's kind of as far as it goes. So, we are very big cheerleaders for our managers to get graduated. And we'd love to see it happen more often. And we're happy that we've had two or three… three, as far as I can remember, over the past three or four years. And we have two… four that have graduated at least in one account in the past three, four years, and one more that's poised to go in a few more.

Robert Morier: Can you talk to us about the tool kit? So, what tools do you use to assess skill? So, when you're thinking about a manager, particularly earlier stage managers, how do you think about… you talked a little bit about the quant team. But what tools are you utilizing in order to make these assessments?

Tracy Cao: We mentioned the April platform. I believe you introduced one Xponance about in the first beginning. So, April is kind of an outgrowth of our internal quantitative tool to analyze the style and the skill of a manager. So instead of… the first thing we do is to judge a strategy, not to the broad index but to its clone, which is a factor replication of a strategy. So, we want to see if a strategy can persistently generate alpha on top of its passive style, which is the true alpha we pay for their expertise. So, we use that tool a lot. But we still do a lot of work from a bottom-up perspective, analyzing their… understanding their process step by step. The April results just provide another path of insights, independently from our bottom-up research.

Adam Choppin: Both Tracy and I we're doing the same process for five years-ish before we had April, and five years after. And to me, the biggest change is it's a huge efficiency gain. What used to take us about probably a day and a half of analysis, and labor, and uploading holdings, and crunching numbers or whatever is done now in 10 minutes. And that is… and that's the judgment of style, which, again, as I covered earlier, is absolutely critical to building a portfolio, and thus, is really one of the first passes. I mean, it doesn't shortcut any of the real skill assessment. It disaggregates style versus skill. But in terms of really judging skill, that process is more or less the same as it's always been. But the efficiency that you can get there now with it is so much better. And I think there's still some improvements to be made there. In terms of the efficiency of it, the way you bring in new data, and we're exploring some of those in house.

Dan DiDomenico: Can you talk to us a little bit about your engagement with your clients? So, what do those client relationships look like… Adam, even from the last time you were here talking with Tim and with Gui you've grown tremendously across the institutional and the intermediary markets. But maybe just talk to us how your client conversations go and what it is that you're actually creating for them.

Adam Choppin: Every client is a little bit different. These are big, institutional clients. Of our… across the $5 billion in the multi-manager platform, we have 15-ish clients. And the vast majority of the assets are across seven. So, it's very chunky. And every client wants something a little bit different from us. And that's… and that's great. Some are very involved in the early stages of looking at the possibilities of who might go into their portfolio in the coming years. And some are really involved in understanding how these underlying exposures in the portfolio that we have for them are going to impact the rest of their portfolio. And so those require very different sort of outputs in terms of what we do with the clients. Others… we do also do a lot of ad hoc research for our clients depending on what they want. Right now, we're in the middle of doing a deep study on international small caps for one of our clients who's really curious about how that's going to look over… that specific allocation is going to look over the next couple of years. We'll do that. We've done all sorts of… in fact, a lot of the papers that you can find on our website were originally, at least from the manager research section, were originally client requests that we just then cleaned up and published. And so that's true of… we did one at the beginning of last year when value had an abnormal behavior where only six of the… or seven of the 80 some EAFE value managers that we had in the universe outperformed the EAFE value index. So, we're like why does this happen? What are the factors at work, and things like that? Those sorts of things are outgrowths of client requests a lot of times. Or in that one specifically, anticipated client requests.

Robert Morier: So, it sounds like it can be quite bespoke. So, you're working with clients. It's very collaborative. Are there any other areas of the market right now you're doing… or spending a little bit more time? You mentioned international small cap. It sounds like it's more of a case study for the asset class as it relates to their interest. But are there any areas or priorities right now as you think about the current book?

Adam Choppin: It's supply and demand. So first of all, we build our portfolios with at least one manager in what we consider to be every sort of bucket of style. And we do it across the factor styles. So, there's deep value to aggressive growth. And then we have some other sort of more nuanced slices within there. So, we always want to have one manager in every portfolio in each of those buckets. How we size them is much more artful. And that will vary a lot more over time. But in every portfolio, we want to have one allocated to it. So, what does that mean then in terms of our research process and the buy list? Well, we want to have equally distributed representation across that. Here's where the supply is unequal. It is… if you were a value manager any time over the past 10, 15 years, you didn't start up a new shop because you were an idiot to do so. Because you were an entrepreneur who's looking to make money. And so you didn't come out and start it up until, I don't know, November 2020. And so there is less supply of value managers than there are of growth managers in the long only marketplace right now. We could… I can throw a nickel into my computer and pick up 40 global growth managers. There's probably three in sort of the true or deep value segments in comparison. So that means we do… because we want to have equal supply in the distribution across our available managers, we do have to do a little bit more digging right now for those value managers. That's where we're doing a little more like carve-outs and examination of long books off of long-shorts, and just having to put in a little more labor to make sure that we have all the options we want for our clients.

Tracy Cao: Similarly, international small cap.

Robert Morier: Would you mind, just for our audience, we have a lot of folks who spend their time specifically in alternatives. And Xponance recently launched an alternatives business, doing GP staking, for example. Would you mind just telling us a little bit about that business and what would be the best way for a GP to approach Xponance in that regard?

Adam Choppin: Yeah, so we launched this business, XAlts in 2021. You probably know better, Rob.

Robert Morier: Yeah, that's right.

Adam Choppin: You correct me when I'm wrong.

Robert Morier: Yeah, I did. I gave the pitch. I remember it a little bit.

Adam Choppin: So, Rob knows more about this than I do. So, what it is, it's a fund that invests takes stakes in diverse-owned, private equity, and venture capital firms. It's a collaboration with Investcorp, the Bahraini private equity shop. It's been very successful over the years, $30, $40 billion, again, Rob probably knows better. And so, what we offer to our clients is the ability to make investments in private equity firms themselves, as opposed to being an LP in the funds. So, it's a different way to access the private equity market and a different way to diversify your risk… your risk exposures if you're one of our LPs, if you're a pension fund that's looking to invest with us. We manage the part of the fund that invests in early-stage private equity, and VC, and also private credit managers. So, sort of funds two to fund are the kinds of firms that we look for that we are the investment manager for. And then we co-invest alongside Investcorp in their fund, which is taking stakes in more mature, diverse, and women-owned managers, sort of funds 5 to 10. Did I get that right, Rob?

Robert Morier: You did. Correct. You passed that very good. Tina and the crew will be very happy.

Dan DiDomenico: I love that. And I love this question because this is one of the great things that I love about our industry. And I'm sure you would agree with this is that how fast it evolves, and how you're constantly learning. Can you share with us a moment in your respective careers where you had to venture into uncharted territory and how that experience shaped your approach to manager research?

Tracy Cao: I wouldn't say uncharted territory. But I probably want to share our Under 40 Investment Group, this program, with you, with the audience. So, about a year or two ago, we started this investment subgroup called Under 40 group, which are basically the young people within our investment team, no offense, Adam.

Robert Morier: Yeah, we're all out of it.

Tracy Cao: So, each quarter, this group of team members, we collect… we select one topic in the investment space. But typically, that is something new, trending, and outside of our traditional focus. And then we do a lot of research. And then we collectively present this-- the new idea to our broad investment team once a quarter. So, some of the topics we've done, like Bitcoin, or NFT, secondary PE, or most recently, AI. So oftentimes, we got a lot of good back from our team. And I think it's also a chance to give this leadership to the young people in the firm and then to let them lead and think out of the box. So that is something I want to share.

Robert Morier: What were their conclusions on artificial intelligence just because it's everywhere? I joke around. So, I teach at Drexel. And we have these pitch contests. So, students pitch their business ideas. Seven years ago, it was maybe blockchain, a little bit of crypto. More recently, obviously, it's artificial intelligence, everything is AI. So, I'm just curious from your seat, two ways to look at it. One is the manager themselves. Do you see them starting to innovate with artificial intelligence solutions? And then you all, do you find that the way that you approach the technology solutions that you have at your disposal are starting to change a bit?

Tracy Cao: For quant managers, actually, they have been using AI long ago. There's… I can already think of some of our managers using AI to machine learning in their process, natural language. And for the commonly used ChatGPT thing, it's more kind of adopted by fundamental managers recently. But it's not… because the data is limited. It's only back to 2021. But I can see the trend. People begin to look… to use more on this tool. But I definitely see there will be a bigger trend in the future.

Adam Choppin: As far as in house, we're in the same boat as every other company. We've got to figure out the data part first. We're not… we're not putting our clients' data out in the cloud for the whole world to see. So, we got to make sure that whatever solution we have is truly in house. And so, we're in the same boat as the rest of the industry in trying to figure that out. And we'll probably get to it you know about the same time everybody else will.

Robert Morier: Yeah, and then you have to update your code of ethics. There's a whole compliance component to this as well, which we've been talking about recently. It's one thing to have the tool from an investment perspective. Then your CCO, and your COO, and everyone else in the firm has to figure out, well, how do we put a policy around it. So, I can imagine your managers are trying to figure out the same thing.

Adam Choppin: Yeah, we've got a committee in house that's exploring this. And we'd… some of our service providers like FactSet and others, they're obviously going to be the ones to bring in solutions first. And since our data is already in there, well, that's the way we'll use that for the data that's in there. But we have other data as well. And so how that plays out will vary a lot depending on the pacing of the vendors. But yeah, we have the committee that we have has our quants, our lawyers, our tech people, right?

Robert Morier: Yeah, it's a big group. It makes sense. Well, Adam, you spent a weekend at Vladimir's house this summer. I don't know if… I doubt this was… I doubt this was client directed. I have a feeling this might have been you writing about the failed non-coup coup attempt by the Wagner Group. Things did not turn out well for

Mr. Prigozhin. But you did write something very interesting in that paper. Do you still believe that Chinese and Taiwan risk assets are attractive?

Adam Choppin: Sort of, but not necessarily for the same reason. So, in the paper, I was making the point that if the war… if the non-coup coup attempt was a turning point in the war in Ukraine, then that would be good for… that would de-risk some of the fears about Taiwan… Taiwan being invaded by China amongst investors because then war is not quite as present in the mind. I still would make the same connection. But the non-coup coup attempt was not as bad for Putin as it seemed at the time. It was very bad for Prigozhin. But the… so I think that… I do think that Taiwanese, the risk of an invasion of Taiwan is overblown, and certainly overpriced in the market. It's not that there's no risk. But I don't think it's as high as the markets sort of assign value to it. That is sort of a hard even statement to make because this has been so present in the minds of so many investors. I mean, we talked to… we talked to investors anecdotally about it all the time. It's like well, emerging market managers who don't really look at Taiwan, I'd say that of… which are probably, I'd say, maybe a third or 40% don't really spend time on it. Then when you ask them why, it usually falls into one of two buckets. One is they don't really tech, and that's about half of them. And the other one is that they are worried about the invasion risk from China. And so, I think there is something to it in the market. And I think it's overpriced because I think the risks are fairly low. China is a different animal. They've got their own economic cycle going on right now, well publicized, well discussed. I think that it's probably more of a buying opportunity now in China than not. But that's not a high conviction call.

Dan DiDomenico: But it's an interesting topic because it does come up in a lot of different client conversations. And I'm sure it does for you as well when thinking about portfolios and thinking about ex-China portfolios. So maybe help us forecast how you see China playing a part in emerging-market-equity portfolios in the future from your respective seats.

Adam Choppin: I think allocators should be doing ex-China, not because it's a beta call against China. But as an allocative call to control the way that you allocate to this huge market separately. I mean, it's first of all, it's a market that's increasingly on an island in terms of its own internal market behavior. And so, some of the strategies that work really well in the rest of emerging markets don't work as well in China. It's the one where a lot of… especially in the local A-share market, which is becoming a little less localized as it takes more international money in. But it's a… but… so I think just for… it's big enough that it deserves its own separate allocation. And it's different enough that it should be focused on in a different way. And so, whether or not it's a beta call is a separate question.

Robert Morier: Well, as we're getting close to the end of the show. I usually like to quote an author to set the stage for a conversation. But I'm going to quote your own marketing materials, which are—

Adam Choppin: Did you write this, Rob?

Robert Morier: So, for a note for our audience, I'm quoting myself. I'm just kidding, I did not write this. But I always enjoyed reading it, which is, develop a strong firm culture. And the rest will follow. So how do you advise firms on how to develop a firm culture? It seems so difficult at times. But it's so important when you're assessing a business.

Adam Choppin: I mean, it's like how do you advise your kid how to be a good grown-up? I mean, it's a really hard one to crack. I think that you just got to… as a leader, you got to set an example. You got to be better than yourself sometimes. It's hard. You're always… you have to remember that as a leader of an organization, you're always in the spotlight, even if you don't think you are. People are modeling their behavior off of you. It's like being a parent. For some of us, we know how hard that is. And that's… the culture of the firm will follow the culture of the founder. Only once… at least for a certain point. Until you get to 40, 50 people, or multiple offices, or whatever, only then do independent subcultures start to emerge in a firm. But for a smaller manager, that's the way it comes to be. If you have multiple founders, it'll be based on the relationship and interaction between them. So, you just have to model it and live it. And that's a lot of pressure. And so, if you're thinking about being an entrepreneur, you don't want that pressure, think about it.

Dan DiDomenico: Good advice.

Robert Morier: Well, when you think about your respective careers, if you could share with us, and this is something we ask of all of our guests, who are the people who have really helped you throughout your career? Who are the mentors that have helped you to get to this place?

Tracy Cao: If I look through my career path, I feel fortunate I have been able to work with a lot of talented, intelligent colleagues like Adam. And I have good directors. I have a lot of people giving me a lot of good advice. And those are incremental, ongoing. It's not like there's one big thing that will change… it's a really incremental thing. But if I look at the common traits among my colleagues, my directors, my role models, I think one thing they share is growth mindset. I think that they are curious. They are hungry. They are humble. They always think out of the box. I think this is a good attitude, not only in my career, but also my personal life, with my family. That growth mindset is very important.

Adam Choppin: At FIS, I mean it was Cesar, Tina, and Mac who really took a chance on me. I didn't have a resume like Tracy's that was clean and clearly was coming from the industry. I was coming from left field. And so, they took a chance on me, identified some skills in me that I didn't know would be useful to them. And as a failed entrepreneur, I thought I'd have the Mark of Cain for the rest of my life. And maybe I still do. I've at least found some utility in that. And Xponance was a good place to do that. And then my undergraduate advisor, I mean, I wouldn't be anywhere without him, Jerry Bender, he was a wonderful soul. US expert on Angola and advised Kissinger and Nixon in the 1970s on the wars in Angola, super fascinating guy. But he was my mentor. And I wouldn't be anywhere without him.

Robert Morier: Well, we're all parents. And like good parents, we're not allowed to have favorites. But this has been one of my favorites. So, thank you so much. It's always good to have you.

Dan DiDomenico: Absolute pleasure. I've learned a lot. Thank you very much for joining.

Adam Choppin: Thanks for having us.

Tracy Cao: Thank you, Robert. Thank you, Dan.

Robert Morier: If you want to learn more about Tracy, Adam, and Xponance, please visit their website at xponance.com. You can find this episode and past episodes on Spotify, Apple, Google, or your favorite podcast platform. We are also available on YouTube if you prefer to watch while you listen. And finally, if you'd like to catch up on past episodes, please check out our website at dakota.com. Thank you again, Tracy and Adam, for being here. Dan, as always, it's a pleasure. And thank you to our audience for investing your time with Dakota.