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EPISODE 54

The Art of Science of Investing

with PFM Asset Management

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'm thrilled to introduce our audience to Alex Gurvich, Director of Research for PFM Asset Management. Alex, welcome to the Philadelphia studios.

Alex Gurvich: Great. Thank you, Robert. A pleasure to be here. It's an honor. Thank you for the opportunity to be here.

Robert Morier: No, thank you. It was exactly… almost exactly 1 year ago today… our very first episode. The first time somebody sat in that seat with this podcast was your colleague, Floyd Simpson. He didn't know what he was getting into, and I didn't know what I was doing, so it worked out well. And in the end, we're now in our second full year. It's the first week of the new year in 2024. We're honored that you're here to celebrate that with us. So, thank you for being here. Before we get started and ask you all of these wonderful questions that we have in front of you, we're going to read your background for the audience. Alex has over 25 years of experience in finance, investment research, portfolio management, alternative investments, private equity, venture capital, quantitative research, and strategic consulting. He is the head of manager research and asset allocation and manages a team of 10 analysts focusing on investment research, asset allocation, and manager selection for PFM. Prior to joining PFM, Alex was a director of quantitative research at Commonfund, an outsourced CIO asset management firm for endowments and foundations. Before that, Alex was a quantitative equity portfolio manager at The Rockledge Group, a quantitative equity investment management firm that he co-founded. There, he managed portfolios for institutional and individual investors and launched a mutual fund and a long/short exchange-traded fund. He also worked as a venture capital investor for GE Capital and as a strategy consultant for Bain and Company. Alex has been an adjunct professor and a lecturer at Pace University and Stevens Institute of Technology. Teaching graduate and undergraduate finance courses such as investment management, alternative investments, valuation of the firm, and corporate finance. Alex earned a BA in Physics at the University of Chicago, an MBA at INSEAD in France, an MS in Financial Engineering at New York University Polytechnic Institute, and a PhD in financial engineering at Stevens Institute of technology. Alex is based in the Philadelphia area with his wife and 2 kids as well as a dog, which he also is happy to talk about during this podcast. Thank you for being here. Congratulations on all your success.

Alex Gurvich: Thank you so much. Very kind to be here.

Robert Morier: No, it's wonderful to have you here. Well, we usually start with the beginning. So, starting with your academic journey, you received a BA in Physics from the University of Chicago. Chicago, I believe, was home for you when you first came to the United States. So where did your interest in physics… sorry for the pun, stem from?

Alex Gurvich: Sure. That was kind of natural thing for me. I wanted to do for a couple of reasons. One was both my parents were engineers, and there's very strong rigor of science and engineering at home. And at the same time, I really wanted to… that unknowingly or knowingly, I wanted to do the hardest subject matter at probably the toughest school in the world for that subject and which I got myself into. I was happy that I was able to get myself out of it as well and graduate. But it was a very humbling experience to study physics at the University of Chicago.

Robert Morier: Any teachers that really stayed with you?

Alex Gurvich: Yeah, I mean, well, several. I mean, like, 2, maybe 3 of my teachers were Nobel Prize laureates. I tried to keep up. But it was very challenging. However, I mean, one of the things that a good teacher has is not just a subject matter, but actually being a good teacher. And some of those teachers were absolutely fabulous in that. Not everyone, but some of them were, and I will forever thank them for that.

Robert Morier: That's wonderful to hear. Thanks for sharing that. Well, you have analytical skills and these scientific methodologies that you learned over the course of your career. How has that influenced your approach to finance manager research, asset allocation. What were some of those fundamentals that you've carried forward?

Alex Gurvich: It's a really interesting crossover of knowledge. Part of it is literally applying kind of like systematic approach. You know, kind of like it's fact-based and data-based approach. And it's carried me through my entire career in finance, primarily when I worked as a quantitative finance person for my own firm… started that firm. I mean, that was key. You have to understand systematic perspective statistical analysis, quantitative analysis, and research. What's actually really interesting is that in my current role for almost 6 years now at PFM in the manager research, I actually had to unlearn some of that. And what I mean by that is that manager research is very challenging because you obviously… you hire managers to invest on your behalf based on your allocation of use. But you do outsource it to a certain extent, right? They're the final ones who make a decision. So how do you evaluate manager? And you know, typically, a very common way is just what's been performance recently, how they've done past year, 3 years, et cetera. And that's a standard approach. But a good manager researcher needs to go beyond that. So, it has to be more than just quantitative and analytical. So, I had to unlearn that and become more of a people person, which is always challenging. At least for me, it's always challenging. But it's an absolutely necessary skill set that you need to have in managing research because you're actually entrusting somebody to do what you expect them to do.

Robert Morier: How did you learn those skills?

Alex Gurvich: Trial and error. I mean, honestly, trial and error. Frankly, some of that is also being a parent a little bit just in terms of stopping and listening, which is not always… it's not always easy sometimes. So, it's literally trial and error and just basically learning from others. I spent some time with some good manager researchers who understand both the analytical and the qualitative aspects of it. But primarily, trial and error. And why that is so important because, you know, I have a degree in finance. That's a standard, right? And you can learn finance… cash flow is a cash flow no matter what currency, no matter country, et cetera, and no matter what asset class, right? But manager research is art and science, and it's never taught anywhere. So, the science aspect of it, you can learn through CFA… fabulous place to learn that or in school. But in terms of art, it's really on-the-job training, hopefully through mentors, and if not, trial and error.

Robert Morier: I couldn't agree more. Something I ask often I'm going to ask you at some point is understanding the people behind these processes. How do you get to know the person, the character, because it's so people-driven? So, the art of when a portfolio manager is faced in a down cycle or a portfolio manager is faced with an outflow that they didn't expect, you know, it can change the way that people behave. So those behavioral aspects to the manager research process I think are critical. So, it's interesting that you've brought that up early, but we'll definitely explore that more as we talk more about your process. It is interesting that you had to unlearn certain things, but you did go back to get your PhD relatively later in life so you couldn't get over learning. So, you did continue the learning process. And I do want to share for our audience that you received the Best Dissertation award when you went and received your PhD so congratulations.

Alex Gurvich: Thank you.

Robert Morier: Could you share with us the focus of your dissertation and some of the findings and maybe, again, to get ahead a little bit, how they apply to what you're doing today?

Alex Gurvich: Sure, so my PhD dissertation was primarily in environmental finance and specifically investing through environmental aspects through knowledge of carbon footprint. It's really important… I'll address it later, but it's really important to focus on data and how it's applied in finance and how people evaluate that data. So, my focus was on basically creating a factor… a carbon risk premium factor. We all know very familiar with the factor investing. Obviously, Fama-French pioneered… not pioneered it, but they really made it mainstream and appropriately so. It's a very, very critical aspect of investment applied across the board on any type of investment. But my focus was primarily to create a carbon risk premium, so I developed a very… I developed carbon risk premium factor, and my PhD talks about it. And the focus was how to… there was actually two challenges there. One is actually how to do this. That's plain vanilla finance problem that you have to figure it out, plain vanilla, but not easy. But the other aspect, which I didn't know until I got there, is that the data is very messy, and the focus is really how to figure out what's the right data to analyze. So, it actually came in 2 aspects of it, cleaning the data and actually creating a factor for a possibility of using it for investment purposes.

Robert Morier: Where did the mess come from? Was it coming from various sources where the source is unreliable? How would you constitute the mess?

Alex Gurvich: Sure. So, I mean… so it's from all over the place. Part of it is because it's brand-new science. I mean, when I say brand new, it's been around for maybe 15, 20 years. People focused on environment even longer than that, obviously. But primarily, the data is very challenging because there's no standardization. I mean, they've created different… like, there's scope 1, scope 2, scope 3 for emissions. There's reserves as well. But the data is very messy because how it's delivered, how it's calculated. Because what happens is it's primarily calculated and created by the companies themselves. There's no standardization to this process. There are major, major efforts for that, but there's no standardization. The second issue is that once it's reported by the company, my data is a little bit outdated, but only about half the companies report the data. The rest of the companies… let's say if you look at index, if you look at MSCI index, so you have let's call it 2,500 companies. Only about half of companies actually report the data. Again, might be a little bit stale, but that's the case. What happens to the others? There are data providers like MSCI, S&P, and others. They actually have estimation models. And what it means is that half the data… and that's just for scope one. For scope 2, scope 3… again, I'm getting too much into the weeds. But it's even lower number of companies that actually calculate and report it out. Again, it's not standardized, so there's even more estimation by the providers what it means, and basically, each provider has their own model. So, for the same company from different providers, very likely, you'll have a different data, and it's been shown by research that correlation between carbon data across the providers is actually very low.

Robert Morier: I can imagine. I would assume there's some inherent bias in there as well you have to sift through. So, thinking about that, how should investors and fund managers approach the use of carbon data emissions in constructing these sustainable… or at least environmentally friendly… portfolios?

Alex Gurvich: It's not easy. And it's still… again, a part of it is still a developing science. There are a lot more research has been done since kind of my thesis and my research work. But the way to approach it is really… the way I looked at it is from fundamental, just from fundamental data, just like you do any finance, right? And the goal there is to look at the actual carbon data. In this particular case, it's tons of carbon emissions per million or what have you. And then what happens is when you actually try to invest, how do you invest? You invest through products by major companies. But those major companies are relying on scoring methodologies, for example, 1 through 10, just an example. There are various ones. That's not necessarily… that's a derivative of the fundamental data. So basically, what you have is a derivative of a derivative. And it's very challenging because what you do is you're buying a product, a mutual fund or ETF, that has, let's say, reduced emissions or reduced reserves or lack of, but it's provided by the provider.

Robert Morier: Thank you for taking us down that path. I appreciate it. And I want to say as well, congratulations on your first published research paper in 2021. It was helpful for me to better understand what your thesis was on. Well, again, going back to your kind of career path, what motivated your transition from the world of physics to finance?

Alex Gurvich: It was a slow… what I call slow-burn process. I started on my way towards a PhD in physics. I worked at several physics labs and working towards a PhD. But at some point, I realized that I just won't be as smart as I originally thought I would be when I was in my youthful days in college. And so, I just pivoted towards business. And I didn't know anything about business. And when I say business… more in terms of entrepreneurial business. Like, I wanted to work for myself is something always appealed to me. So, I didn't know anything about the business. So, I did what a lot of folks from engineering and science do… they want to change careers, they go to business school. So that was like a natural pathway for me. And that opened up so many doors for me in a sense, not that the doors were closed, but my mindset was more open in terms of other possibilities and doing the life than just physics.

Robert Morier: And early in your career, you were with GE Capital, working in venture capital. So, what was that like in the beginning of your… most people try to get into venture later on in their careers, but you started with it.

Alex Gurvich: Yeah

Robert Morier: And at a really interesting time, too… '98 to 2002.

Alex Gurvich: That was probably the go-go days of venture capital and just when it's becoming mainstream. It was fascinating, and I loved it. We were a corporate venture firm, obviously, GE Capital. We also had a benefit of working with our businesses. GE was multiple businesses those days. And so, we were trying to co-invest with our businesses, which provided a really interesting strategic opportunity. I really loved it. It's probably one of… if I want to say it's one of the better corporate jobs that I had, simply because the topic was fascinating. I love technology, just kind of my own domain. And the group of people I worked with was fabulous. So, it was… I really enjoyed it, and we had some major successes. But you can't fight the tide. And when 2001 came around, it swept everybody, including GE and everybody else. So, it was great while it lasted, and I really enjoyed it.

Robert Morier: So, it sounds like it was the tides, then, that took you to Rockledge?

Alex Gurvich: Yeah, because frankly, it was very challenging to find another venture job at those days. I mean, just let's be realistic or be real. So, I tried to do some consulting, just kind of I worked with a lot of high-tech firms at those days, a lot of VC firms, obviously because I was on the board with several of them, quite a few of them. But again, VC, venture capital investing was pretty shut down for quite a long time. And so, a friend of mine just who was a quant basically said, I want to start my own business. I'm leaving. And he brought another one of his colleagues, and we literally started a quant shop. I call it a garage quant shop in a garage. And that's how it started out… Rockledge started out. 3 of us created a model, a statistical model. But fascinating topic which was not mainstream at that time. It was about sector rotation. In other words, focus was more on asset allocation than stock selection because we were, and still are very much, what I call old-world investors. Brinson, Hood, Beebower approach asset allocation provides the most variation in returns.

And you should expect the most return over a long time through asset allocation, not stock selection. And we created a really successful model and a very good… had a very successful track record based on statistical analysis and focused on sector rotation. Again, it was not mainstream in the early 2000s. So that was a great experience.

Robert Morier: But on to common fund.

Alex Gurvich: Sure.

Robert Morier: Starting with the manager, so was this the first time that you had done manager research—

Alex Gurvich: Correct.

Robert Morier: — formal manager research?

Alex Gurvich: Absolutely. Yeah, I mean, I went from being a manager and being a manager and doing the statistical quant analysis. That's why my PhD came in very handy or work towards a PhD. And I went on the other side… allocator, being on allocator side. And it was great. It was very interesting. Lots of learning experience because I had to… I literally understood what the other folks on the other side or managers go through, whether it's a sales pitch, whether it's investment process, whether it's going through a rough period… investing period. It was a great learning experience. It made me much more humble. I hope I still am much more-humble allocator now than maybe some other folks who basically have the key to the purse and focus on that.

Robert Morier: Were you skeptical of those pure bottom-up stock pickers, coming from a sector rotation asset allocation?

Alex Gurvich: So, I was not skeptical. Initially, I did not really understand that. What I'm saying… I totally… look, sector rotation is based on individual stocks, right? I mean, again, going back to what we talked about carbon finance, it's fundamental data. So, it's fundamental data. You have to look at individual companies. But I had to learn a lot about individual stocks and investing in individual stocks, even though I knew theoretically about it and very well because I was teaching valuation of the firm at that time. So, I knew exactly what I was doing, the cash flow analysis, how do we evaluate each individual firm. But again, academic experience applied to actually picking stocks is very different.

Robert Morier: Yeah.

Alex Gurvich: This is an obvious statement, but I think I have to remind myself. Everybody should remind themselves of that. So, I had to learn a lot about, not about valuations, but I had to learn about how, actually, investment managers pick stocks or pick stocks one over the other.

Robert Morier: And then combine those managers together.

Alex Gurvich: At a portfolio level. And of course, common fund was an OCIO, just like we are at PFM right now. It's a multi-asset portfolio, meaning public equity, public fixed, and private equity, private fixed, and real assets, of course, as well. So, you have to combine… it's not just individual managers, but also how to combine managers as well. That's a separate topic in itself, and which I really enjoy.

Robert Morier: Well, you mentioned PFM. So, we did as… and as I had mentioned at the top of the show, Floyd was here in the beginning of our life cycle. But for our audience, who may be less familiar with PFM Asset Management, would you mind just giving a quick background on the organization and then more specifically, your role within it?

Alex Gurvich: Sure. So, PFM Asset Management will be based here local in Philadelphia. We were a private firm until 2 years ago. We were acquired by US bank out of Minneapolis. And it seems… it's working out great. They're bringing more resources and a lot of new ideas which combine with what we've been doing for a long time. I think it's a really great combination. We are an OCIO. US Bank is obviously large… very large. It's actually, I believe, fifth-largest retail bank in United States. So very large bank, very well established, really good people. But we are the OCIO business within US bank, so only institutional. Again, similar to what I did at Commonfund. Our clients are retirement plans, OPEBs, and increasingly, endowments, foundation, quite a few. In my role… so it's a multi-asset portfolio, just as I mentioned before, just a classical OCIO clients. That's what you would expect of them. I'm a head of manager research there, covering all the multi-asset class… multi-assets. I mentioned equity and fixed real assets. And again, across public and private. I have a team of analysts… dedicated analysts, which are really good, and we're doing really good work and trying to pick the best managers for our clients. It's not easy, but it's… I think we're doing a reasonable job. Could always do better, of course.

Robert Morier: How is the team structured? So as head of the team, was there a decision around asset class or size of manager? I mean, there are lots of different ways to approach the world.

Alex Gurvich: Sure. So, it's pretty straightforward for us. We're structured by asset class. So, we have analysts on domestic equity strategies, international equity strategies, fixed income. These are all public assets… and an analyst. And private equity and private debt and an analyst, and real assets actually covers both public and private. So, it's asset-class structured in this time. There's some overlaps, of course. You know, obviously, domestic equity is equity, so there's a lot of overlap between domestic and international equity. But I think it does…you do want to focus on certain… on silos, to a certain extent. We don't work as silos. The team is great. It's very interactive.

Robert Morier: Everyone is in Philadelphia?

Alex Gurvich: Yeah, we're all right here, just down on Market Street. Work really well. The experience varies for different folks. But the team is very collaborative. That's very critical for me as a manager of the team. You can teach. I can teach. You can teach him at school how to do finance and valuation. I can teach him how to do manager research. But you really have to collaborate and learn from others. And again, manager research is not taught in schools. You really have to absorb it, and the team has done a really great job being collaborative, helping each other. So, for me, that is one of the critical things you can't even… when you hire a person, you don't know how they're going to do on collaboration, how they're going to do on the investment side or experience. But that part is just like manager research. That's definitely the art part.

Robert Morier: Just curious… the teams… putting your academic hat on, are you hiring entry level or do you tend to hire more mid to senior level folks?

Alex Gurvich: It's a mix. Usually, it's a mix. And you know, like I said, I have analysts who started out from scratch, meaning a couple of years out of college, 2 analysts who have over 15 years of experience. So, it depends on the need… depends on need at that time. But we're fortunate enough, like I said, I've been fortunate enough that the team has been really good and working together and collaborative and everybody… it's cross-pollinate in terms of knowledge and research. And again, very, very thankful for the team. Great folks. Great, great team.

Robert Morier: Well, as an OCIO, you have a lot of discretion. And that discretion allows you to go to a lot of different places. And I'm just curious from a sourcing perspective. So, if you think about the beginning of the process, how do you approach sourcing managers? Is there a methodology that you are kind of implementing with the team? Or are managers now, at this point, just coming to you? What does that process look like?

Alex Gurvich: Sure. That's a great question in a sense, but the answer is pretty straightforward for us. It comes from all sources. So just to give you, basically, just a plain vanilla answer in the sense, and I'll go into detail. So, we subscribe to all the databases. And we know, so we can do lots of screens there. We've been doing that for quite a long time. Myself and certainly the analysts are well, known and so we get lots of emails every day, both from people we know and people we don't know in terms of managers. And we go to conferences, and we also get referrals. So, it's a class… there's no secret there. It's both public sources and private sources and personal connections. What we do with that, that's obviously becomes a little bit more different, and it's going to be different from shop to shop. But that's a starting point.

Robert Morier: How about in some of those asset classes where it can be a little bit more difficult to get access to the managers, either because of your size or the size of the managers? So, venture capital… we'll stay there. I teach venture capital. You've got a background in it. But when you're thinking about a VC allocation for one of your clients, is the sourcing the same or is there a different nuance to it?

Alex Gurvich: So, absolutely different nuance. And that's a really hot topic, as you probably know, and very contested topic. I think if you talk… if you look in terms of… its venture capital or private equity, primarily. But if you talk to folks, allocators, a lot of folks say that it's very challenging to get to top-tier venture capital and private equity. And so why is that important? First, let's start with that. The reason it's important because the dispersion between the managers on the private side… again, I'm referring to private equity and venture capital. The dispersion of returns over the years is huge. It's very large relative to the public managers. So that's one challenge. So, you really want to be on the top. The other reason is that those managers are larger and sometimes less researched. They're not on databases or a lot of databases. So, it's really through connections. You have to focus on your connections, which take time to develop. And you also have to focus on what you can, how you can access those. That's a challenge you're talking about. But I do have a… we have a different perspective on that, and I can mention that as well. But that's the key reasons that some of the higher venture capital and private equity funds sometimes are closed or only allow current investors and they want very specific types of investors.

Robert Morier: Well, taking the other side of that, how early-stage will you go?

Alex Gurvich: Sure. For us, it's pretty straightforward. We are not… we are not early investors into very early-stage funds. That's just not… and that very much stems from our clients. There's a value to early-stage venture capital, for example, obviously, at a different level of risk and different allocation. But our clients are… for our clients, we probably prefer mid-stage, again, the stages when I did venture capital… the stage, you know, seed round was very different what seed round is now. A and B rounds are very different in terms of size. But we don't do anything pre-IPO. I think that's… again, that's my own preference and experience, not a right place to go. And it's irrespective of the market because then you're chasing it. You want to be somewhere in the middle. And for us, that's on the venture capital side. That's what I'm looking for into venture capital funds.

Robert Morier: That makes sense. Well, again, it is client by client, as you mentioned. But is there any type of top-down process? How are you thinking about the world? Is there a starting point before the sourcing begins? So is there… I didn't read the committees, but I know there's an investment committee in there somewhere. So how does that top-down process work?

Alex Gurvich: Just in general fund or just privates? Or—

Robert Morier: Yeah, actually taking a step in general.

Alex Gurvich: Sure. So again, so we start out with a need. So, for example, we have a… I'm just going to… just an example. We want to allocate to a large cap equity manager domestic… just an example. So, what we do, we start out, who do we know? And then we look at the databases. What else is out there? And then we do the initial screening. Again, this is plain vanilla. There's no secret sauce there by any means.

Robert Morier: No buy list? No grading of managers?

Alex Gurvich: So not at this stage because we… because we're an OCIO. We're not a buy shop like money warehouses. We have to be focused. So, we start out with that. And then, let's say, based on the criteria, let's say we want core large cap manager. We start looking at who are the managers, and we do a pyramid. Again, no secret there. We start out with maybe, I don't know, 30, 40 names. And then we dwindle down through our funnel, trying to what I call it the initial screen. Then we get down to what I call a long-short list, maybe about 10 names or so approximately. And then with those 10 names, we start having conversations or request information, and we do more analytics. Again, this is not… this is more analytical-based, performance-based. We may or may not be meeting these managers yet, although some of them we already know. And based on that, we bring down further to what I call a shorter list, maybe anywhere from 3 to 5 names, which is what we do call short list. And that's when we have very, very heavy due diligence analysis, meeting managers several times, visiting them, and trying to see if they're the right match for the mandate that we have.

Robert Morier: Makes sense. Is there an operational component to that? Do you have an operational due diligence that goes alongside?

Alex Gurvich: There's definitely aspects of it. So, we talk when we meet with the managers. When we meet with the managers, we talk about… we meet with compliance. We meet with trading people, with definitely risk people. So, there's definitely a component of that. You have to have it. You have to see that their shop actually exists, right? So yeah, as a proverbial kick the tires, you have to be in space. That's why in-person meetings at the office at the manager are pretty important. It doesn't have to be fancy. That's not the point. But there has to be people, systems in place that you can feel and touch to a certain extent.

Robert Morier: Any views or opinions on outsourced vendors… so someone who outsources their compliance. They outsource certain aspects that, at larger shops, are generally in-house? Do you have a view?

Alex Gurvich: So, I do, and it's, I'm indifferent in the sense that as long as it gets done because we are an RIA, and we have to comply by many, many SEC regulations. We expect the manager to do the same thing. So, if a smaller shop and they cannot afford, you know, hiring their own compliance officer, I think that's fine, as long as the processes is in place and the vendor is reputable. It's just like an accounting firm to a certain extent. You want to trust the accounting firm. You want to trust the compliance firm. So, we're a little bit indifferent that. The only… not challenge for us. We probably because… again because of the type of our clients, we probably wouldn't invest in early-stage managers with a shorter track record. So, it is important, but it's probably a little bit less relevant because just it's not applicable type of managers we look for.

Robert Morier: Makes sense. You've mentioned your clients a few times. How often do you interact with your clients?

Alex Gurvich: Me, personally?

Robert Morier: You and the team.

Alex Gurvich: Sure. It depends. Sometimes, we don't interact at all. Sometimes, we interact on a regular basis because we do have a client management team. We do have a strategies team. They're much more client focused than we are. We're the research. We sit at the desks and do our research. But we do interact on a couple, several basis… sometimes when we want to introduce new manager to the client. They may pull out me or one of the analysts to talk. Client management person will pull out and ask us to provide more detailed information. They might want us if they're picking managers on their own, for example, they can say, well, let's go over some of the managers that you're recommending. So that can happen. Sometimes, they just want to know about the markets. That can also… those instances, we can also come and talk about our specific markets that we're responsible for.

Robert Morier: One way to ask this is what are some of the must-haves that asset managers need. If we talked about operations, they need to have a compliance function, obviously.

Alex Gurvich: Sure.

Robert Morier: And you could think about this across a few asset classes. But are there any specific characteristics that you and your team look for in investment teams? It could be the size of the team. It could be… some people have preferences for investing in privately owned businesses rather than publicly traded. I'm just curious. Any must-haves? And the other side of this, any must-nots?

Alex Gurvich: Sure. So, this is where the art part component comes with it is that we need to talk to the team. And the must-haves… that the team has to be cohesive, and they have to be motivated. And so obviously, that's where compensation obviously comes from, right? How they're compensated. But so, the must-haves is that we want to meet with the team and we want to know how they operate. Again, that's the art aspect of it, if you want to call it art. I don't have a better word. So, we need to know what their track record is. And when I say track record, I'm not talking about just the numbers. I'm talking about what they have done with their career and to the point where they are right now… why they're different from others. How do they think? How they invest? Because anyone can put a DCF model, assuming the company uses DCF. Some don't, et cetera. But we need to understand how they make decisions. We need to understand who makes decisions. And I'm going back to the point of the art part. How do they operate together? What does the team look like? There's a classical methodology we call the 4 Ps of investment manager. I expanded it to 5 Ps. But basically, I wrote a short paper on that. But it's somewhat common. But the idea is what are the 5 Ps? Parent, who is the owner, right? Who is the owner of the company? People, who are the investment manager? Who is the team… PMs, analysts, et cetera? Process… how do they think? What do they do? What's their investment process? Portfolio, what is a portfolio consists of, OK? And the last one, what I call performance. You have to look at performance. That's certainly not the sole. You don't want to invest in hot managers. But you need to look at the performance and on the historical basis. And what I mean performance, specifically, how they've done over different business cycles. How long they've been doing that. What have they done in what you mentioned earlier… in the times of crisis? How did they react to that? Was it a knee jerk reaction or not? Whether they stayed with a process or whether they changed anything. So, I call it 5 Ps. And so, the manager definitely has to have good, good understanding of how they do business, and that's what's necessary to be part of that kind of to make it on our list. And I think that's pretty straightforward.

Robert Morier: So, you've done all of this work. Now it's time to put the portfolio together. So how do you size these managers? What is the optimal—

Alex Gurvich: Sure.

Robert Morier: What's the optimization process look like?

Alex Gurvich: Another hot topic. But before I mention that… we pick managers, but we have to go through… research goes through rigorous process of due diligence. Then we have several committees who go through manager committee, manager selection committee, and then we go to the investment committee for the final OK. Once that happens… but part of the investment… I'm talking of new manager approval, for example. Part of the new manager approval we also… it's also our job to size the managers within a portfolio, just as you mentioned. It's critical because even though it's, again, core large cap managers, there are very, very few managers that actually core. Just an example. They're all going to be very idiosyncratic or have their own… their portfolio will look and reflect their investment process. But there are other aspects of it. Is this a fundamental manager, bottom-up? Or is this a quantitative manager? Quantitative manager is a more diversified fundamental… can be very concentrated, somewhat concentrated, or not concentrated. So, you want to put it, what are the— we look at holdings analysis between the managers. We look at correlations and critically, residual correlations between the managers within that portfolio, and we size it appropriately. We also have… we look at risk budget. How much do we want to allocate to overall to… if it's a higher… it's a more concentrated, higher-tracking error, what is the risk contribution of the mana… Could be the managers at a portfolio and what's their tracking errors going to be? How does it fit within the rest of the portfolio? The other component that's very somewhat unique for us… not maybe unique anymore, but it's been special. We're also big users of passive indices when the markets are more efficient. So, for example, on a domestic equity, we use more passive indices. Where opposed to fixed income, we use more active managers.

Robert Morier: Interesting. Is that a tactical… or is it a strategic—

Alex Gurvich: It's strategic.

Robert Morier: OK.

Alex Gurvich: A strategic perspective because it's been shown, and we've done research, that on the domestic equity… US domestic equity, it's very challenging to outperform over a period of time. There's a classical thing saying 80% of managers underperform. And it's much more, but it very depends on the asset class and within asset class as well. So, within domestic, more managers underperform in large cap than the small cap. And that's kind of makes sense. There's a reason behind it. Small cap is, on a relative basis to large cap, it's less efficient. Emerging market is going to be even less efficient than the domestic small cap. So, you want to have more active allocation there. There's more opportunity for active managers to do well.

Robert Morier: Where you have that active exposure, could you talk to us about your philosophy on the exit? Underperformance is going to happen at some point or another, either because of markets or because of the process. What's your philosophy on underperformance?

Alex Gurvich: Sure. Very challenging question to answer. There's no short answer. Some major red flags are that the lead PM leaves. I mean, those are big. I'm just going to… and again, I wrote that what is the change of ownership of the company, you know? Companies being bought—

Robert Morier: The parent.

Alex Gurvich: A parent, exactly. And so, is the compensation going to change? So that could be a red flag. It might not change our view on the manager, but it might change our perspective where the alignment is. Did they make some really major… there's some compliance issues… really major. But those are pretty straightforward, right? And I think they kind of make sense. They're somewhat intuitive. The more challenging are issues are the manager underperformed for a year. Why? So, we have to do… what we have to, and we do, we dig into the portfolio, and we try to understand where the underperformance came from. You know, did all the… let's say it's a fundamental not quantitative manager. Did their stock selection was poor? Or maybe there's some other reasons. Last year, in 2023, it was a very challenging year. And one of the reasons it was challenging is because the market did several zigzags throughout the year. And typical fundamental manager wouldn't do so well in those markets. So, you can't blame everything on the manager. And you have to have… and that's where I think a person in my type of a role has to be more humble and say, well, just because you underperform for the year, why, to your question? So, you have to understand, was it the manager? Was it the market? Was it something else… a major red flag, you know? PM change, it completely may change your philosophy. So, you have to really dig into that and understand because… and the last thing that I want to mention, which is critical. As an allocator to outsource to a manager, you have to set your expectations. There's no such thing as perfect manager. There's the same thing is just to be… again, be humble. There's no such thing as perfect allocator. That doesn't exist. So, you have to set your expectations in terms of that there will be periods of underperformance. And it's not that there won't be. There will be. How do you deal with that? How do you deal with that? What do you do? What is your process of managing it? Whether you have knee-jerk reaction getting rid of the manager or that you actually spend some time with the manager, trying to understand where they come from and whether it's, again, it's market driven, manager driven, or macro driven.

Robert Morier: It comes up as it relates to the people, as we kind of alluded to, but kind of assessing the character of these managers. I fully understand and agree that you have the compensation and the parentage, making sure that they're in the right place with the right infrastructure and incentives. But when it comes to… we keep using the word art, but the art of understanding a person. Is it just time?

Alex Gurvich: The time is on your side.

Robert Morier: Mm-hmm.

Alex Gurvich: It's not just time, but certainly, the time is in it because the longer you know the person… and in our case, manager… the longer you know the manager, the more you understand how they do things. Because it's like most of us, we're human beings. What we do is not always… what we see is not always what we do and vice versa. So only time tells your reputation. Your reputation, whether it's a manager or allocator, it's built over time. So, time definitely helps answer that question.

Robert Morier: One last question as it relates to the manager research, just areas of opportunity that you're seeing now. Any specific parts of the market where you're spending a little bit more time? We have a lot of asset managers that tune into these calls. This is the million-dollar question for a lot of folks.

Alex Gurvich: So, there are two aspects of it. One is simply opportunistic. An opportunity… timing. We, last year, we needed to replace one type of manager, just in certain asset class. We have to look for one. So, it has nothing to do with our views on the market. We just needed it to replace the new manager. So, we needed to replace one manager. So that's kind of… it just, that comes our way, and that has to be done. And that's not market driven. In terms of specific areas, we constantly looking at all the areas. I mean, that might not be the best answer that you're looking for. But the reason is to give you just an example on the private side and private real estate. Is this a good time to invest? The markets are suffering, and they're expected to suffer further. I'm talking about private real estate. But I mean, public reads as well, right? And I don't think we're probably near at the bottom. The question is, is this the right time to invest? And that drives our question. And even if you think yes or no, you still have to find the right manager. And a manager that's nimble enough can navigate what potentially could be further worsening, potentially, just in an example. But the other… but that's just one example. In terms of the other areas, one of… I mean, I've said that before. I mentioned that it's really difficult to outperform in large cap space domestic equity, but there's actually, interestingly enough, there's one space that's even harder to outperform, and that's all-cap domestic equity. So, we're always on the lookout. It's a perpetual on the lookout for all cap Russell 3 core manager.

Robert Morier: Good advice for the managers out there in that space.

Alex Gurvich: It's very challenging for a whole bunch of reasons.

Robert Morier: Does it tend to be tilted? I'm not as familiar with the space. Does it tend to be tilted towards small and mid-cap? And then it's kind of… I don't want to say buffered, but dovetailed with those kind of large cap… so Super 7?

Alex Gurvich: So that's the whole point. That's the whole point. That's a great question. And because if you're core manager, you should be… if you're core manager, you should be close to the core. So yes, of course. You're expected to make tilt. Let's say you're in all cap. Let's just… simple large, mid, and small. That's part of it, right? You're expected to have tilts… small, mid, large. But the question is, how much? And also, when? Meaning, are you looking at macro? And the last question, most managers don't look at macro environments. Most of the time, they won't take a view that small cap is going to expect to outperform large cap in the next, whatever, 12 months. Most managers don't do that. What most fundamental managers do, they basically… their portfolio is a product of their individual stocks. So, you have to evaluate, is the process right? Does the process take into consideration future valuations or not? Or is the process what's the best promising companies for the next 3 to 5 years as an example? Doesn't matter what the macro says. And we, as an allocator, have to make the decision is the right approach that matches our view as well. So those are the challenging questions for us to make.

Robert Morier: Well, before we go, a question that you ask asset managers often I'm going to ask you. What is PFM's competitive edge?

Alex Gurvich: So, I think I'll start with our client. We've had really fantastic growth because of the people. And I think one of the interesting things about it, and as I learned that came on board, is that our client servicing people are phenomenal because they are really taking care of their clients and both large and small clients. And that's kind of… I want to give them lots of credit. It's typically smaller clients that are usually underserved. And I think our client folks have really good managing both large and small clients. So that's kind of on the client side. And we have some really good visionaries in terms of our leadership, where they came from in terms of… not where they came from, how they see the company grow. And I think the hat should be off to them for building such a business. But of course, on the manager research side, where I sit in, I do think we have somewhat differentiated views in terms of how we pick managers. Again, for a general audience, they're probably not going to be interesting because it'll be slicing the… slicing and dicing very small parts. But within manager research, I do think we have somewhat interesting perspectives how we look at managers, how we pick them. And it's some quantitative tools that have been brought to the table that we use and also some qualitative tools that we try to use more and more. And I do think that over the long term, it will give us a better track record in manager selection and allocation.

Robert Morier: That's great. Thank you for sharing all that. I'm not going to let you go without asking you about your teaching.

Alex Gurvich: Sure.

Robert Morier: And a little different… what did you learn from your students?

Alex Gurvich: So, the very first thing that I learned… and this is some of my motto how I manage the team is there's… and it has to be repeated over and over and over and over time across the board anytime. There's no such thing as stupid question because… and you teach. You probably may appreciate it. But what I've learned is that, again, through students. What I've learned is that if you have a group of students, if there's one person asked the question, that means I didn't explain it correctly or there's just not enough material. And equally, that means that somebody else has the same question. They just were afraid to ask. So, I think that's one of the important aspects that I learned. And the last… not the last thing. As a follow up on that is that there's no stupid question… such thing as stupid question. I have to take that whatever that question was, no matter how trivial it sounded or may have sounded to me, I have to give full and authentic answer to that question, no matter it might seem really trivial or simple or maybe it has been repeated before.

Robert Morier: Well, one other thing. You're also on the investment committee at Germantown Friends School. What's it like working as a trustee on an endowment?

Alex Gurvich: Sure.

Robert Morier: Is there an outsourced CIO?

Alex Gurvich: Yeah, so first of all, I have to say… my compliance said I have to say that I don't make any investment decisions there in the sense that we are working with an OCIO. So, we have an oversight. It's a fantastic opportunity. My kids are in that school. And it's great to see that endowment grow and put to good uses for education, which is one of my personal interests, education, et cetera. And so, we are overseeing it. It's a great committee… very experienced committee, asks really good questions. It's a mix between… which is a good, in my opinion, a good way to run an endowment committee. It's a mix between administration people, finance people, meaning, you know, finance and accounting, and investment folks. And I think it's a really good mix. So, it's just a pleasure and an honor to be part of that and that I can contribute to the school.

Robert Morier: That's wonderful. It sounds like a good balance—

Alex Gurvich: A great balance.

Robert Morier: — personally and professionally.

Alex Gurvich: Exactly, yeah.

Robert Morier: Well, we're getting close to the top of the hour. I cited a quote last year for one of our guests that I'm going to carry forward into this new year. What you are is an expression of history. So where does your history show up in your life today?

Alex Gurvich: That's actually somewhat straightforward to answer because it's basically through my kids. I mean, to a certain extent, maybe it's overused. But for me, certainly, I live for my kids. I make sure their education is right. They're good people, and they'll be successful in the world and contribute to the world. So, for me, that's kind of… and again, I have younger kids so it's really critical. And that's part of the… because I'm so focused on education in general and endowment space in general, it's very close to my heart.

Robert Morier: Well, you mentioned it sounds like you've learned a lot from them as well.

Alex Gurvich: Absolutely.

Robert Morier: So, the very last question. I'm always interested in the mentors… the people who have helped you along in your career. You've had a very successful one, and it's been very interesting for me, and I know for our audience to hear today. So those people or those experiences that have stayed with you?

Alex Gurvich: That's a really tough question for me to answer. It's like, maybe it's easier to answer in the sense that I have not been fortunate enough where I had mentors. So, I've had to learn a lot. At PFM, I had one person who provides me really interesting advice, maybe now 2 people, which is great. I'm like a dry sponge and listen to what these 2 people say. But before that, I have to be honest.

Unfortunately, I have not had mentors. Not for lack of trying, just some people are fortunate. Some people are less so. And I was in the latter category, so I had to learn a lot by trial and error. But it is absolutely critical if you can convince somebody to you mentor and to be authentic mentor, both in terms of… and again, two aspects. One is in your career, into business… presuming it's a business or finance, but also how to work in a particular organization. I think that's that is so critical, and the earlier you start the better. And the last thing I want to mention that if you have a mentor, you have to listen to the mentor. You don't have to agree with everything they say, but you do have to listen. That's the whole point of mentorship because if they're authentic mentor, they will do well… they will give you good advice.

Robert Morier: I would agree. I think the other side of that for mentors is to be present and available. I've been at a few organizations over my career that have tried mentor matching. And I think it's a wonderful way to do it. But if you're going to volunteer to be a mentor, to be there and to be present with that authenticity.

Alex Gurvich: So that's basically one of the things I mentioned in terms of how I manage the team. It's not just enough to be what we call asking for tasks to do, right? Because that's the management sometimes is… maybe sometimes can take you that route. I'm trying to be a mentor to each one of my team members. And the challenging aspects for me… and that's part of my management style that I'm trying to improve and continue improving. I think I've been doing reasonable job, but it's a process, is that each individual person… each person is individual. And I mentioned our team is very diverse in terms of experience, age, and backgrounds. So, you have to mentor each person. You have to get to know that person, just like you have to get a manager… get to know the manager. You have to get to know the analyst and spend more time with them and talk both about business and personal life in a sense just to be on the same page and share your experiences. Which means my own experiences, nothing opens up a person than basically sharing your own challenges and my own trial and errors. I think that's that that's been really helpful for me. And so mentoring is critical, and I try to do that within the team.

Robert Morier: Thank you for sharing your experiences with us today. This was wonderful. I learned a lot myself. So, thank you for being here. Thank you for making the time. Congratulations on all your success. We wish you nothing but more in this new year and ahead.

Alex Gurvich: Thank you. It's a pleasure. It's an honor to be here. I thank you for listening. I love sharing knowledge and experiences. And hopefully, this is helpful both to all the audiences. And it's really an honor to be here. Thank you so much.

Robert Morier: If you want to learn more about Alex and PFM Asset Management, please visit their website at www.pfmam.com. You can find this episode and past episodes on Spotify, Apple, or your favorite podcast platform. We are also available on YouTube if you prefer to watch while you listen. If you'd like to catch up on past episodes, check out our website at dakota.com. Finally, if you like what you're seeing and hearing, please be sure to like, subscribe, and share these episodes. We welcome your feedback as well. Alex, thank you again for joining us. And to our audience, thank you for investing your time with Dakota.