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Value Investing | Real-World Success Stories Video Transcript

George Sparks | Justin Whelan | Tom Barrett

George Sparks:

Bannockburn was a local startup and I think a lot of this hits on what you have talked about as far as somebody having an edge and doing something a little different. Can you kind of talk about that process with that one because I think it's run its course and I think would be very helpful for my partners and other people to hear that story, in particular. That's just putting what you're talking to, to a live example.

Justin Whelan:

That was actually brought to us by one of our existing clients that was already, he had come to me and said, "Hey, I want to get in this, figure out a way" and all he had was retirement money. So we had to purchase it through a retirement account, in this case, it was an IRA. And so I had to get that approved. I had to go through a lot of hoops. We had to get information. We had to understand what it was. We got it approved, we got him purchased, and then started to watch that for about six months. And I was really intrigued with the movement of it in such a short period of time.

Justin Whelan:

And when that happened, I reached out to their CEO, Mark Wendling, and said, "Mark, I might have an interest and I might have clients that would be interested in being involved. I see what you've done with our existing client and he's been very happy with the results. I'd like to know more about exactly what you're doing, how you're doing it, what you're planning", because we really weren't vetting the asset for the client, the client already wanted to do it. So once they piqued our interest and said, "this could be pretty profitable," then we dove in and Tom took a look and we determined that it was a really attractive investment to make; currency conversion basically is what Bannockburn, who sold to First Financial and they just were broke away from larger Credit Suisse, Chase, Fifth Third, and decided they wanted to make their own capital markets company. And so they were just converting currency and getting paid for that.

Justin Whelan:

But they had their costs had dropped dramatically versus the bigger banks, so they were able to do this much cheaper and they had a competitive advantage in doing that. And all the incentives were lined up with management on the firm, and so we said, this is a good opportunity. And so over a five year period from the time that we made our investment to the time we exited was three times our investment. And it's fun because it's a local story. People were very comfortable with the idea and you kind of root for the underdog, when they are smaller and they're competing, and gets much bigger firms, but boy, they really delivered, and that was a real nice one to give to clients.

George Sparks:

And we talk about the sleeve of alternative investments, we're not talking, taking a large position in clients' portfolios, what would be a standard, safe, because these are different type of investments, and some of the alternatives can be liquid market driven, but some of them like you just brought up and we just discussed is a non-market alternative, so it's completely independent of any market performance. But in portfolio design, those should take up no more than generally speaking…?

Justin Whelan:

Yeah. Let me take this one because I've got so many unique situations that we've had to deal with it. As a fiduciary, you're going to hear something in the top range of being about 20% in private venture in that type of area. But you also, you kind of hit it on the head, there's all kinds of degrees of risk in this. I had a client, we actually have a mutual client, that came to us. Oh, that had to have been about eight years ago and said, "I don't want any more exposure to the stock market. I'm getting close to retirement and I don't want that risk, but I'd like to have a high single digit return on an annual basis to not have the fluctuation." It's like, "Okay, well we can do that, but you have to understand, I can't do that in the public markets with public debt."

Justin Whelan:

And I have all kinds of things that we can do, from liquid 6%, one-year notes at seven and a half percent, two year notes at 10%, we have different funds that are very low volatility. So we had a lot of different tools, and in this case, we had to find a variety of those to fit in and get that non-correlated investments, and yet still keep the stability that the client was looking for, and still get those returns. So it's really hard in that case, it was a hundred percent.

Justin Whelan:

Now, was that appropriate? Well, the degree of risk wouldn't say that he was a hundred percent in venture capital or things like that. He had a lot of, we had some bonds that were paying 8% for him. So that worked out perfect for him, but you don't want just one investment being that, we need to diversify, and so have multiple of these. And it really is predicated on the risk of that client and their objectives. If they're saying, "I need to withdraw off my assets at 6%", then we've got to find something that's going to earn more than 6%. So I think a lot of it depends on that client's need, and then the reality of, okay, here's what you can do in the public markets or in the private markets to achieve your goal and then get input. And they drive that through what they really are looking for.

George Sparks:

So he was the unique situation, but most other portfolios that you see, I guess it depends on the overall risk tolerance of the client, what they're willing. It may not be appropriate at all for them if they're adverse to that or if their desire is not to have that, and that's fine too, but Tom, can you just tell me a little bit more about some of the other, a range? We just met with a client that we can have very conservative stuff or we can have very aggressive stuff.

Tom Barrett:

Yeah. The range, like Justin said, is very client dependent. In general, it's going to be anywhere between 10 to 25% in the private alternative investments. And we really believe that's a good thing to do because you can spread out the liquidity and you do not have to have it all subject to the illiquidity premium of locked up capital, where you're trying to earn the higher rates of return from the illiquidity premium. You can have it on a spectrum. And if it's on a spectrum and you have various buckets of investments within that, some of it being backed by real assets and collateral, others being more equity driven, you have that mix and that balance.

Tom Barrett:

Again, that is all client specific in terms of what their goal is, what are they trying to accomplish with this private portfolio? And we can curate that based on that whole risk reward spectrum. Some folks may say, "I just want to lower my market exposure," because anytime you add alternative investments to a traditional stock bond portfolio, you actually, historical numbers show that you shift that efficient frontier curve up a little bit. So for every unit of adding the alternatives on the risk reward spectrum, you're reducing the portfolio's volatility and slightly increasing that risk, because in this environment you're pulling away from low returning fixed income portfolios or high valued stock portfolios to fund that alternative sleeve.

George Sparks:

And that's the role I play with our clients too, is that I'm the one that's talking to them, asking these questions, helping define what their risk tolerance is, and then, like today, we met with a client to specifically discuss these various alternatives. But again, my role in that is to understand what the client is looking for, what their risk tolerance is, and then I'm going to Justin and Tom here to help fill in what those pieces of the alternative investments are.

Tom Barrett:

Yeah. Big difference between a low leverage commercial real estate strategy that's diversified across sectors and the country at 25 to 30% leverage, versus a venture capital private equity deal with a seven-to-10-year lockup. Totally different risks in liquidity.

George Sparks:

So they're able to, we can almost call it like a little ladder, if people think about a CD ladders, right, we have maturing at different rates, but same kind of thing inside of here. We can take that piece of the alternative investments and spread it out through into many different buckets that some are more liquid, some are going to have a little longer play, but have a, I think you called through what type of return you caught it, but it says allows for a little larger returns, more risk because you're tying the funds up a little bit longer. So we can spread that out over, meet client needs.

Justin Whelan:

I think another one, if I can just interject, is we'll get a lot of questions where someone has received a large sum and they have a substantial amount that they don't know what to do with, but they know they'd like to have something more than just the bank money market or a short-term CD. That's where we can help them. Depending on their particular risk tolerance, we can go from the institutional mutual funds that might bond liquid short term, that may pay 2% or so, upwards to there's a local firm here that we use that has a higher minimum, but is paying a 6% and credited it on a monthly basis, and you can get out that day. So it's a liquid type fund, all the way to items like one year notes at seven and a half percent. So if they can go out a full year, then we can get in that range. Or if we need to stay liquid, we've got other alternatives.

Justin Whelan:

Tom's got a whole group of what we call liquid alternatives, which are institutional style mutual funds that we can get in and out of immediately. So we have things like that, and as I said in the previous discussion that there are things, even if we can go out two years, that might pay them 10%. But again, it's all a matter of what is the client's risk? What is the time horizon? Do we have these different buckets that we can use that maybe we may be able to go out for a year or maybe it's only a quarter that we really want to have quarterly liquidity or maybe we want immediate liquidity. So that helps the client to at least have choices.

George Sparks:

So that's a nice fit with, we have a client that has smart cash positions. They maybe know that they are looking at making some CapEx spending in future years, but want to get a better than bank rate, but not necessarily have all the exposure of equities.

Justin Whelan:

Yeah. Just trying to find solutions for them. Give them choices. We're here to give them options. And as long as we can provide those quality options, they feel like they're getting good information that makes a difference in their life.