THE MANUAL OF IDEAS ™

Value-oriented Equity Investment Ideas for Sophisticated Investors

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"If our efforts can further the goals of our members by giving them a discernible edge over other market participants, we have succeeded."

Investing in the Tradition of Graham, Buffett, Klarman

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When asked how he became so successful, Buffett answered: "We read hundreds and hundreds of annual reports every year."

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Exclusive Interview:

Jay Willoughby, Chief Investment Officer, TIFF Advisory Services

With compliments of The Manual of Ideas

Jay Willoughby on Manager Selection

Shai Dardashti, managing director of The Manual of Ideas, recently had the pleasure of interviewing Jay Willoughby, Chief Investment Officer of TIFF Advisory Services, based in Boston.

Prior to joining TIFF in 2015, Jay Willoughby spent four years as CIO of the State of Alaska's roughly $50 billion sovereign wealth fund, the Alaska Permanent Fund. Previously, he was Co-Managing Partner at Ironbound Capital Management and spent nine years with Merrill Lynch Investment Managers LP as CIO, Private Investors Group; Head of Research for Equity Funds; and Senior Portfolio Manager, Merrill Lynch Real Estate Fund. He received a BA in biology from Pomona College and an MBA from Columbia University. Jay Willoughby is a CFA charterholder.

The Manual of Ideas: Please elaborate on your organization's mission and structure.

Jay Willoughby: TIFF is short for *The Investment Fund for Foundations*. It was formed in 1991 when a group of larger foundations, including the MacArthur Foundation and the Rockefeller Foundation, decided that smaller non-profits needed a way to pool their capital to be more effective investors. Many of the smaller charities couldn't afford to hire their own investment staff. So TIFF was created to help point non-profits in the right direction, and we operate as a not-for-profit ourselves.

Our first endowment strategy was launched in 1995. We manage two complete endowment solutions, one offering daily liquidity and the other intermediate liquidity. Additionally, we run hedge fund strategies and private investment strategies. We work for approximately 700 member organizations in 43 states and oversee about $9.5 billion in AUM, including committed capital. All our members are non-profits.

"When we uncover a manager that we believe possesses a sustainable advantage, we work hard to try and articulate their edge. As long-term investors, we remain comfortable with a manager who hits a rough patch so long as their edge remains."

—JAY WILLOUGHBY

MOI: Please tell us about your background and how you became interested in investing. Also, how did you come to be a part of TIFF?

Willoughby: I will tell you what got me started: I was a senior in high school and bought $1,000 worth of a stock called Superior Oil Company of Nevada. A few years later, when I was a sophomore at Pomona College, I sold it for approximately $7,000 and it paid for a full year of college. I said, "Now this is the sort of thing that I want to do for the rest of my life!" After Pomona, I went straight to business school at Columbia, knowing full well what I wanted to do, which was be in the investment business. For the first three years or so after school, I was on sell side of the business and then starting in 1986, so for 30 years now, I have been on the buy side.

For the first 25 of those 30 years, my job was to actually pick securities. Over my career, I've managed money market funds, government bond funds, corporate bond funds, equity funds, and funds focused on Real Estate Investment Trusts. I have also managed exchange funds – a type of a tax structure, not to be confused with ETFs. I never did private equity, but I managed pretty much all kinds of assets throughout the first 25 years of my career.

In late 2010/early 2011, I was the co-managing partner of a hedge fund when the managing partner decided that his health wasn't what he wanted it to be – so we shut the hedge fund down and I started managing my own capital. That gets pretty boring pretty fast if you are a value-oriented guy, so another friend of mine said, 'Hey, there is this CIO job in Alaska at the Alaska Permanent Fund that you should apply for.' To make a long story short – I did apply, and I got the job, and so in the second half of 2011 my wife and I moved to Juneau, Alaska. I managed the Alaska Permanent Fund, which is the state's sovereign wealth fund, for four years before moving back to Boston, where we had lived back in the mid-1990s, to join TIFF.

MOI: You've called yourself a 'value-oriented guy' — is this a Charlie Munger business-quality orientation or a Benjamin Graham asset-focus? Where do you put yourself on the value spectrum?

Willoughby: I put myself on the spectrum somewhere between GARP — growth at a reasonable price — and traditional value. I am not looking for cigarette butts that are half-smoked. It is probably more the way that Warren Buffett looks for opportunities today than the way he did perhaps 30 years ago. I am looking for quality businesses where there is a margin of safety.

I also have a contrarian bone in my body. When I was in Alaska our Executive Director said, 'Jay likes to run to the fire' — and that is true. **I think you find your best investment opportunities where there is the greatest amount of stress.** This has been harder as all the central banks have been pumping capital into the system, for the last several years.

During the earlier part of my tenure at Alaska, in 2012, we made the decision to go out and buy single-family homes that were for sale at distressed prices, mostly on the courthouse steps. Wayne Hughes, the founder of Public Storage, was in the process of doing the same thing; we formed a partnership that is today American Homes 4 Rent, which is the largest single-family REIT on the stock exchange. Before their recent sale of shares, Alaska Permanent owned about 20% of the entire REIT. A situation like that, where there is pressure from significant price declines, is what I am attracted to. When I joined TIFF in 2015, we were attracted to energy – we looked and looked and actually found less than we imagined, so we didn't leap in with very much capital.

MOI: What is your typical workflow? Are you identifying compelling businesses, identifying compelling investment managers, or identifying compelling private deals?

Willoughby: We are a manager of managers; we don't pick individual stocks, we hire managers. We partner with managers, and what we try to do is partner with the very best managers we can. We are looking for firms where we think the people are really strong. Typically, they may have spun out from another really good manager who, essentially, taught them the business. Typically, our managers have learned the trade for a decade or so. That is kind of ideal.

The single most important quality we seek in a partner is a sustainable competitive advantage. Sometimes these come in the form of better information, sometimes in a different or better way of processing that information, and sometimes in the time frame that a manager brings to the security-selection process. When we uncover a manager that we believe possesses a sustainable advantage, we work hard to try and articulate their edge. As long-term investors, we remain comfortable with a manager who hits a rough patch so long as their edge remains. Often, the outperformance after one of these patches can be very meaningful.

Also, we are very interested in the way managers set up their business. If a manager is trying to do a whole bunch of different things, and gather a whole bunch of assets, we are not interested. Ideal for us is the manager who does one thing very well, wants to do it better than anyone else in the world, and purposefully limits the fund's AUM. Size is generally the enemy of alpha, and we are interested in alpha.

We want to look at the investments the manager is making – it is one thing to talk about the concepts we like to hear; we want to see it reflected in the investment choices that the manager makes. **I like to learn as much as I can about a manager or an organization, form my own opinion of how the manager should relatively perform in various market environments, and then test my own assumptions. If I don't understand the results, the performance doesn't fit with what I expect, then I need go back and try to figure out why.** The final thing we are looking for is the right fit with TIFF, and this is my primary role: how does the manager fit into the portfolio? If we already have several talented value-oriented global managers, we don't necessarily need another one. We might replace one, but potentially we are looking for a US-focused manager or a China-focused manager, or something similar.

TIFF has a pretty good track record of picking managers who can add alpha, which is one of the things that attracted me here – in addition to the mission. We have two unbelievable boards, one for our main advisor and one for our mutual funds, which are comprised mostly of CIOs of major institutions. Over the years, they've represented such non-profits as Harvard, Yale, Notre Dame, Williams College, the University of Virginia, MIT, Oxford, Columbia, Duke, Michigan, the Metropolitan Museum of Art, the Institute for Advanced Study, the Hewlett Foundation, and other great organizations. They are trying to identify managers and construct their own portfolios. A board member may have already worked with a particular manager we are researching or have previously passed over a manager we are in the process of exploring. Comparing manager notes is always interesting. We think our board members are the best in the business.

Lastly, I would suggest that many of the managers that you meet today who have been really successful in their lives are somewhere in their 50s. In some way or another, many of these talented managers are looking for ways to give back. **When and where a manager has an underlying drive to do something good for society – they see us as particularly appealing as a client.** That is one of the beauties of TIFF as an organization, with 700 not-for-profit members. Managers can manage capital for non-profits and do a really good job, as they have generally done throughout their careers, and feel like they are giving something back – because they are. They are supporting the missions of every one of these non-profits.

MOI: Invest too early in a manager and one doesn't know enough, invest too late and one misses the prime opportunity. How do you think through this paradox?

Willoughby: I think that is a really interesting question. When I was in Alaska, our executive director said, "I don't want you to come to me and tell me you're going to invest less than $200 million." We were over $50 billion in AUM, so we had a more limited universe. Here, at TIFF, with $9.5 billion, we are really at an ideal size, in my opinion. **We are big enough to be important, small enough to be nimble – we can be both.**

I think part of what you look for depends on who you are. We have managers who are brand new; in 2016 we seeded a hedge fund where the founder was spinning out from another firm. The founder had been part of two other really good hedge funds in the past – we liked him, believed he is a money maker. Our due diligence suggested that he was who we thought he was, so we participated in the founder's round. Similarly, we have set up a unique relationship with an industry veteran on the short side who has an extensive track record of alpha creation. So, one manager has more than 30 years of track record while the other launched only within the year. With the right asset size, we can look at both of these opportunities, and again the question becomes one of portfolio management and fit. We can craft a portfolio in a manner that incorporates the best of both emerging and established managers, and the key for us is that we incorporate differentiated alpha-generating return streams that will also bring diversification to the existing portfolio.

I joined Merrill Lynch Asset Management in the 1990s – and in the early/middle 2000s I was the Head of Research for equity funds. I got to work with a lot of portfolio managers, and everyone behaves differently when a market environment changes. **It is also important to understand how a shifting market environment affects a manager, especially new managers, and how it impacts the way they make decisions.**

MOI: How do you assess the incentives and alignment of investment managers? Do you apply a checklist? Do you adapt a framework?

Willoughby: It relates to the four elements we explore as we hire managers: business, people, investments, and fit with TIFF. We want to find a business that is focused and not over-proliferated. With regard to personal incentives and alignments, we want to make sure that there isn't one person who is trying to benefit at the expense of the rest of his or her team. We are really looking for people who are fair, if you will. We are looking for people who aren't trying to charge the absolute highest dollar that they can to clients, to people like us. Oftentimes, because of our size and who we are, we are able to achieve more attractive fees than whatever the rack rate is.

"One of the questions that I ask of anybody I'm considering hiring, is: 'What is the one thing, away from the investment business, that you have done in your life that you are the most proud of?'"

—Jay Willoughby

MOI: Let's please explore the attributes of exceptional managers and how you differentiate great from good. Do you identify excellence by looking for common patterns or is each situation case-by-case?

Willoughby: That's is the $64,000 question. You look for the attributes, which are the people. If you don't start with really smart people, then I don't think you have a chance to be a great firm. If people are forced to think about new products or too many different kinds of portfolios, the 'should-this-go-into-that-portfolio-or-not' type of issues, then I don't think you have a chance to be really great. There must be a consistent application of both the investment philosophy and investment process.

Whatever you are – if you are a value investor or a growth investor or a quantitative investor – you are forever trying to figure out how to get better. At the same time, if there are constant changes in the way you invest, then I don't think you have a chance to be a great investor. There is some amount of what I call 'background' that is necessary, an amount of 'consistency,' and then an element of 'foresight combined with consistency.' These things can inform a point of view that remains, regardless of the oscillations of the markets and small tweaks that can help make the team and process better. Those are the table stakes. You can't be great if you don't have those things.

Then, the difference between really good and great is just really hard to find. I worked with a gentleman who would say, 'If we can find somebody with rats in their gut, then that really helps." One of the questions that I used to ask – and I still do – of anybody I'm considering hiring, is: **"What is the one thing, away from the investment business, that you have done in your life that you are the most proud of?" What I am really looking for is somebody who has excelled in a field, it doesn't matter what the field is, if you made the sacrifices and put in the work, then you can appreciate the sacrifice that being great requires.** I think the final thing that people really need to have is a singular focus on success. There is just nothing that is going to stand in their way. All of those things give you a chance to be great, and then it never hurts to have a little luck on your side as well.

MOI: I had planned to ask in what areas or roles you believe fund managers can improve, but I'd like to apply that question to yourself. How have you improved over the decades? As you think about nature and nurture, what has been within your control to get better at, and how?

Willoughby: I have gotten better at understanding people and motivation – specifically when motivations of people are in alignment. Lots of people can tell lots of really good stories; what comes with experience, I think, is an understanding of when a story just doesn't hang together. Something is just not exactly right, which causes you to then continue to do additional due diligence – additional work that maybe wouldn't have been done in earlier days.

When playing poker – you can either play the cards or you can play the people, and David Swensen, for example, has gotten really good at doing both, and I think that is really the key. It is not just about the cards or just about the people. If you can excel at both, then you have an edge. Playing the cards, or the numbers if you will, is easier earlier in your career. Only as you get older, and you've seen a number of managers both succeed and fail, are you able to begin to piece together the mosaic of the people – whether or not the next manager really has a chance to be as good as he or she thinks.

MOI: How do you incorporate internal market outlook and return expectancies with the external expertise of managers you hire?

Willoughby: We work for non-profit organizations that typically are attempting to achieve CPI inflation plus 5% returns; so a 5% real rate of return. Foundations actually have to pay that out every year to maintain their tax-exempt status. Endowments can tweak it around a little bit, but that is basically what everybody needs to make: CPI plus five.

In the environment that we see going forward, it is going to be important to maintain a pretty heavy equity exposure to be able to achieve this level of returns. We are trying to find managers that we think are superior. There is one recent tilt that we have made, and that is toward China. We have hired three different Chinese managers; two are located in China and the third one is a Chinese national on the West Coast of the United States. We found organizations that we think are really strong, terrific analysts, with deep investment processes that are designed to take advantage of individual investments that volatility in Chinese stock markets will help to create. We are purposefully over-weighted in China because we think that these managers are almost like shooting fish in a barrel. There will come a time when China is going to become a bigger and bigger part of the modern financial world. Today, China is about 3% of the MSCI All Country World Index, really based on shares listed overseas, while the US is just over 50%. But China has the second biggest stock market in the world, and when domestic Chinese stocks – the so-called A-shares -- enter the MSCI index, probably within the next few years, China's index weight could move in phases into the low double digits. That means anyone invested in a global index fund benchmarked to the MSCI index will be adding domestic Chinese stocks. When that happens, there is probably a tailwind behind the shares, which we are not hoping for because then those markets will become a lot more competitive. Today at least, we think we have a good opportunity where our managers can take advantage of volatility that can push the stock prices up too high and down too low. When the prices go down too low we expect they will buy, and when they get too high we expect them to sell. At some point, China will come into the modern financial world, increasing the number of more highly skilled competitors in the markets, and then we will need to reconsider our positioning.

MOI: Once you identify an air pocket of opportunity, do you typically look for a generalist manager or a specialist manager?

Willoughby: Well, if you find the air pocket, then I think you go specific, right? If you don't have the air pocket, then you go general. So, in China, we hope we found the air pocket, and because we thought we found an air pocket, what we specifically did was look for managers in China. For the first two managers, we were able to leverage our boards of CIOs that I mentioned earlier. We sent a team of people to China, and I joined for the trip. Actually, there was recently another trip to China, for a couple weeks. You spend a lot of time. You kiss a lot of frogs. We probably started with about 120 China managers and whittled that down, and we ended up hiring two. The third manager was closed for a very, very long time – and when we heard he was going to open up we went and visited with him.

If we were just looking to increase our emerging markets exposure, I would look to hire a generalist. But if we are looking to increase our China exposure, a generalist can't help do that. Going back to the single-family home investment idea – we had to partner with somebody who was investing capital in the single-family home space, and not just a real estate manager. There is a pattern across many of our investment ideas.

MOI: If you can share advice to any members of The Manual of Ideas who aspire to manage money for TIFF – what could he or she be doing now so as to one day be qualified, or be even better qualified, to have the honor?

Willoughby: One of the things that, I think, disqualifies probably more managers than anything else is when they think about our business as a business. That means growing AUM and trying to have some sort of diversified revenue stream with different products.

For a manager to be attractive to TIFF, the whole key is alpha. If you can generate alpha, then you will be in this business for a very, very long time. The fit in the portfolio is for us to determine, but if we can partner with alpha generators, that is what puts the biggest smile on our faces.

MOI: Can you recommend either a recent book that has given you new insights into the art of investing or a book that's been lost to history and deserves a revisit?

Willoughby: One book comes to mind and it isn't even an investment book: *Basketball My Way* by Jerry West published in 1973. Jerry West was an exceptionally successful basketball player. He observed the following: if you can make three out of four of your free throws, and if you can make half of the shots that you take from the field, and if you play hard on defense – then you can be really, *really* successful. There were a number of elements to playing hard on defense, but these keys for success are generally attainable. This is similar to saying: **if you work hard to implement a better-than-average investment process that enables you to make investments where more of the stocks that you own go up, and if you have really good risk management to limit the losses on the investments that aren't good, then you can earn above-average returns and be in this business for a very long time. It is really *almost* that simple.**

MOI: What further materials could people track down if curious to learn more about TIFF?

Willoughby: Our website, TIFF.org, has a fair amount of background, subject to compliance restrictions. There is a lot of public information on the website about our daily liquid core endowment strategy, in particular. You'll also find a 25th anniversary booklet that will give you an appropriately detailed history and timeline of TIFF.

MOI: Thank you very much for sharing with our community so much of your time, and so many of your insights.

Connect with Jay Willoughby on LinkedIn: http://bit.ly/2iX8KI3 (if you would like an introduction, don't hesitate to ask Shai)