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TEEING UP RETURNS

MILL CREEK CAPITAL ADVISORS' SAM McFALL IS THINKING AHEAD TO DRIVE PORTFOLIO PERFORMANCE

BULL FIGHTERS
FUNDS RACING AHEAD OF THE RALLY

FRAUDULENT FUNDS
TOP TIPS TO SPOT A BAD SHOP

MERRILL PERIL
HOW MANAGERS INFLUENCE DUE DILIGENCE


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When lining up the perfect shot on the golf course or carrying out due diligence on a potential manager pick, Mill Creek Capital Advisors' Sam McFall knows there's nothing worse than rushing the task at hand

Sam McFall does not like to lose, whether that's in investing or on the golf course.

'I'm ultra-competitive, almost to a fault,' says McFall, who played professional golf in college and whose enthusiasm for the game remains undimmed.

'But golf requires a tremendous amount of patience, which I've probably only adopted over the course of many years.'

As vice president for investments at Mill Creek Capital Advisors, McFall balances those same two traits – ambition and patience – when seeking out managers and building portfolios. In short, he knows he has to think long term if he wants the best from his picks.

'We're looking for time-tested, patient strategies – not ones that are chasing the hot name, the idea du jour or any strategy that's using a lot of leverage,' he says.

McFall, who covers public equity and hedge fund managers at Mill Creek, is part of a five-person team that consists of chief investment officer (CIO) Tom Chapin, fixed income specialist Nora Pickens, private equity specialist Claire Kendrick and generalist Kevin Doyle.

Together, the team oversees a $6 billion platform featuring 25 mutual funds, 13 ETFs, 14 SMAs and 80 limited partnerships for more than 300 clients. The firm serves as an outsourced CIO for a number of institutional clients such as foundations, endowments and defined benefit plans. It also works with wealthy families and high-net-worth individuals. Client portfolios are built using the funds picked by McFall and his team.

SLOW AND STEADY

Despite the institutional nature of some of its clients and an abundance of private investment options, only about $400 million is invested in alternatives, as the firm focuses more on traditional investments.

'The focus here at Mill Creek is, first and foremost, a relatively conservative approach to managing investments on behalf of our clients,' McFall says. 'We have a fiduciary responsibility to grow their wealth prudently over time, so that naturally leads us to have a bias toward higher-quality strategies.'

To find such funds, the firm follows the usual screening process, starting with data from Bloomberg and Morningstar Direct for traditional investments, as well as from PitchBook and PivotalPath for hedge funds and private equity. From there, the team whittles down a list of hundreds of names to a manageable number for subsequent interviews and meetings.

McFall says it is this qualitative part that is truly reflective of the art of manager selection and allows him to avoid chasing the 'latest and greatest' names.

'We like to hire managers that have a philosophy and process that's pretty intuitive and simple and one that's easily explainable and understandable, so that when they do hit an inevitable rough patch, you can understand what might be going on,' he says.

'Anything that's convoluted or too complex is probably not going to get into our portfolios.'

READING THE GREEN

McFall explains that those managers who do end up in the portfolios tend to exhibit lower beta than the market, have consistent alpha generation through different market cycles and possess an acute focus on downside protection.

RÉSUMÉ

SAM McFALL

- **May 2016 – present**
  Mill Creek Capital Advisors, vice president, investments
- **May 2013 – April 2016**
  Pitcairn, senior research analyst
- **November 2011 – May 2013**
  The Bryn Mawr Trust Company, investment officer and analyst
- **April 2006 – November 2011**
  Brinker Capital, business analyst
- **September 2004 – March 2006**
  Delaware Investments, client service consultant

One example of such a manager is emerging markets star Rajiv Jain. McFall believes Jain is one of the few investors around today who is not only good at bottom-up research but who has also learned not to ignore the macro environment.

'One thing you like to see in a portfolio manager is that they evolve through time, because the markets are dynamic and are always changing,' McFall says. 'Rajiv, through time, has learned good lessons and bad lessons and he has evolved his process.

'He had been bullish on a particular country but macro headwinds – including the significant depreciation of the currency – led him to pivot and adjust his exposure accordingly. Historically, a portfolio manager might have held through the near-term headwinds because the company fundamentals remained solid,' McFall adds.

Another emerging markets manager that landed on Mill Creek's platform this year is Arlington, Virginia-based Sands Capital Management, which subadvises the Touchstone Sands Capital Emerging Markets Growth fund.

'Sands Capital is a new addition to our portfolios this year. It's having a great year in a particularly challenging environment for emerging markets,' McFall says. 'Their long-term growth-oriented focus was almost perfectly aligned with our approach in terms of concentration, holding periods and the level of due diligence.'

The fund has just 45 holdings and boasted an active share of 86% at the end of June, according to its fact sheet. Managed by the Citywire + rated trio of Brian Christiansen, Ashraf Haque and Neil Kansari, it ranks 63rd out of 202 funds in the Citywire Emerging Markets category for three-year total returns to the end of July. Over this period, which includes 2017's emerging markets rally, it is up 30% versus the peer group average of 24.2% and is narrowly ahead of the MSCI Emerging Markets index's 29.3%.

HIGH FLIERS

That philosophical alignment is important to McFall and his team, who look for high active share, high concentration and high conviction in active managers, regardless of mandates. The team has been able to find these characteristics in different types of firm – from big asset managers and small boutiques to hedge funds and venture capital firms, McFall says.

One boutique that fits the bill is Bernzott Capital Advisors, which the team considers a hidden gem. McFall had known about Bernzott while working in his previous role as a senior research analyst at multi-family office Pitcairn, and saw the chance to get back in touch when Mill Creek was looking

$6 BILLION ASSETS UNDER MANAGEMENT

25 MUTUAL FUNDS

TOTAL NUMBER OF STRATEGIES **132**

80 LIMITED PARTNERSHIPS

13 ETFs

14 SMAs

300 CLIENTS

for a small-cap value strategy.

'It became a good philosophical fit. They have a very long time horizon, in terms of both investing tendency and the average holding period,' McFall says. 'They don't get caught up in the quarter-to-quarter earnings reports, and their portfolio can look a lot different than the Russell 2000 Value index. That might be a reason why they get overlooked, because their tracking error tends to be a little bit higher.'

McFall was able to bring the strategy on board about two years ago when the fund had less than $50 million in assets and when its track record stood at less than three years. Run by a trio of Citywire + rated portfolio managers – Kevin Bernzott, Thomas Derse and Scott Larson – the fund has returned 45.4% over the past three years to the end of July, beating the benchmark's 43.7%. It ranks 28th out of 253 Small-Cap Core funds tracked by Citywire.

HOLE IN ONE

The Mill Creek team doesn't just like active managers in niche, less efficient markets though. Nor is it wedded to less well-known boutiques. McFall highlights the T. Rowe Price Japan fund, which is managed by Citywire AAA-rated Archibald Ciganer.

'We have maintained a slight overweight to Japan for a few years now, but we recently decided we wanted an active manager in the space. The list of available mutual funds was quite small, but we identified Archie Ciganer and his team as a strong fit for us,' he says.

'Additionally, we wanted to increase our exposure to the domestic consumer in Japan, which we achieve with the small- and mid-cap exposure. We also wanted to add exposure to companies that are improving corporate governance and focusing on increasing shareholder returns,' he adds. 'The cap-weighted ETFs are going to be biased toward the big multinational exporters or companies that may be slower or reluctant to change their governance policies.'

> YOU CAN'T BUILD A WINNING PORTFOLIO MONTH-TO-MONTH, QUARTER-TO-QUARTER

What really gives McFall confidence though is the portfolio manager at the helm of the fund.

'Since assuming day-to-day management of the strategy, Archie has intentionally reduced the name count in the portfolio and increased the small- and mid-cap exposure. By reducing the name count and increasing the fund's active share, we think there is a higher probability that the fund will outperform over time,' he explains.

LINE OF FLIGHT

This focus on the individual managers is an important part of McFall's process for selecting alternative funds too.

In the case of a $2.5 billion Boston-based hedge fund specializing in technology, media and telecommunications, McFall says the fact that the firm's owner and PM is the single largest investor in the fund is very important to the team.

'They have a unique look into tech. It's more of a venture capital approach to investing in tech, where they map different technologies to the S-curve that you see in venture capital,' McFall says.

'They're trying to invest in the middle of the curve in companies where people don't have a full appreciation of the earnings power of the businesses,' he adds. 'So they do own a lot of the higher-flying tech names that people know, but I would say their thesis is a little bit different than the typical Wall Street sell-side coverage.'

Another bet this year has been a value-based manager established by an activist investor. McFall explains that the manager not only runs a very concentrated global strategy but also employs an element of activism.

'I would say it's much more constructive activism, which has gotten more positive press than maybe some of his other fellow activists out there, but he will also do some special situation investing and M&A investing,' McFall explains.

Although investing in alternatives can mean a loftier price tag, McFall believes the long-term alpha generation provided by the right manager is worth both the price and the wait.

'We are fee-sensitive in the sense that we think fees should be reasonable given the manager's expectation for delivering excess returns, but we are willing to pay up for alpha,' he says. 'We think it is short-sighted to obsess about fees, so there can be an education process in explaining a manager's value add, but we think there are managers and strategies that can command a premium fee.'

The 'patience premium' is something McFall learned on the links, but he puts it into practice in the office. 'To me, golf is a game you can't become good at overnight,' he says. 'Similarly, you can't build a winning portfolio month-to-month, quarter-to-quarter.

'Winning in investments is about winning over 10-year periods, 20-year periods and meeting your investment goals, whether you are a high-net-worth client focused on philanthropy or an institution that helps to pay for scholarships and contributes meaningfully to an operating budget.'