NONPROFIT NEWS
Investment Management News Resource

Profiles

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Profile: James Stoker, WaterStreet Investment Consultants

An extensive manager research focus and absolute return philosophy makes **WaterStreet Investment Consultants** a unique advisor to the institutional space.

Working with over 40 institutional investors, including foundations and endowments, the firm understands the importance of absolute return versus relative return, particularly for nonprofits that are required to make an annual 5% payout.

"In our view, returns should be based on absolute investment return as opposed to relative returns," said **James Stoker**, principal founder of the Austin, Texas-based consulting firm. "Following the conventional wisdom regarding asset allocation and manager selection is a sure fire way to fall short of spending or actuarial objectives, especially in the market environment we and many others expect to see for the next several years."

In order to further its absolute return mentality, the firm spends more than 50% of its time on capital market and manager research, including on-site visits with about 100 managers throughout the U.S. and Europe per year.

"For example, if a fund returned 7%, outperforming its benchmark by 2%, it achieved a favorable relative return. However, if the required actuarial rate of return is 9%, the fund failed to reach its objective," he said.

In 2007, the firm's trustee directed composite* for all of its funds returned 13.08%, compared to 5.52% by the **Standard & Poor's** 500 Index. In the past three and five years, the firm's trustee directed composite returned 13.80% and 16.24%, respectively, compared to 8.63% and 12.83% by the index.

Investment Research

While the firm itself is in its fourth year of existence, Stoker's experience spans over 25 years, 19 of which were for **Smith Barney Institutional Consulting**, where he worked with endowments, foundations, individuals and companies.

Since establishing WaterStreet, Stoker has brought on investment professionals that have both investment and research capabilities, employing a team of eight (12 members in total) that carries the role of both consultant and analyst.

"We think doing the due diligence is very important on the research and operational side, which is why we spend more time on that than anything else," he said.

The firm spends a great deal of time utilizing tools such as **Hedge Fund Research** and **MARHedge** databases for hedge fund research and **Informa Investment Solutions** for separate account managers.

Stoker said one of the unique advantages of working with WaterStreet is the firm's ability to be able to go from researching new managers to quickly implementing them for clients as opposed to larger consultants, who may take 1-2 years to input new managers into their proprietary databases to complete due diligence and research on managers for client use.

"The big advantage is that we can pick up research quick, with no stipulations like having a three-year track record or $1.3 billion in assets," he said. "If the people and processes are there, we will consider them."

Managers that contact WaterStreet are first required to fill out a questionnaire to get a better idea of their objectives and investment policies. Based on the firm's responses, the consultant will then schedule a meeting to further discuss the firm's investment philosophy.

Evaluating Managers

Stoker said that the WaterStreet often looks for managers that are providing clients a unique beta. To increase the probability of generating the required rates of return, the firm applies a forward-looking process to the strategic asset allocation. This process considers asset class valuation, global monetary policy, country and regional GDP growth, trade and budget balances and currency trends.

"We just try to hire talent. You can start with the quantitative part, but I'm not as concerned with that as I am with the qualitative," he said. "What is their thesis? How do they go about developing that? What is their investment process? Is it consistent? Is everyone given incentives the right way? Are key professionals incentivized and compensated appropriately? Is there a well defined career path for younger professionals?"

More importantly, the firm evaluates whether the professionals in place are enthusiastic about their roles with the firm, which may dictate future performance.

"It's trying to determine if they have what it takes to repeat what they did four or five years ago," he said. "If you have really good management and good processes, you'll get the returns."

Investment Board Education

For numerous consultants in the nonprofit space, getting returns well above the benchmark may not be as difficult as getting investment committee members on board to invest in the strategies it may take to get there.

"Most endowments and foundations significantly underweight higher returning, more illiquid strategies, which is unfortunate. If you are only spending 4.5 - 5% you could have significant exposures to illiquid asset classes such as private equity, real estate, and hedge funds with longer lock-ups and not have an issue," he said. "If you're an educational group with an endowment, the big fear is that you can't really take on a lot more illiquid (asset classes)."

In addition to the belief that institutional investors can't take on illiquid investments, Stoker said the greatest obstacle for the firm may be convincing board members to take on the risk that is often inherent in alternative asset classes.

In order to get everyone on the same page, the firm spends a great deal of time educating board members on the benefits of new and complex strategies that are now available to all types of investors.

"We want to spend a lot of time with educating investment committees so that we can implement more non-traditional strategies which is in our view required in this environment before we get married with them as clients," he said. "We want new clients that think like us and know that we can get the 9% they need. If they want to stick totally with traditional investment structures then we are probably not a very good fit."

**Description of Composite:*
The composite is the combined performance of funds with absolute return goals between 8.5%-10% with similar risk profiles. WaterStreet does not have sole authority to hire and fire managers but believe the performance is broadly based on our recommendations.

Organization: WaterStreet Investment Consultants
Established: 2004
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