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THE MIKE ALKIN SHOW

TALKING STOCKS OVER A BEER

Announcer: Free and clear, the chatter from Wall Street, you're listening to Talking Stocks Over a Beer, hosted by hedge fund veteran and newsletter writer, Mike Alkin, who helps ordinary investors level the playing field against the pros by bringing you market insights and interviews with cooperate executives and institutional investors. Mike sifts through all the noise of mainstream financial media and Wall Street to help you focus on what really matters in the markets. Now, here is your host, Mike Alkin.

Mike Alkin: It's Tuesday March 26th, thanks for joining. I hope you had a good weekend. Normally I do this on Mondays but I had some stuff to do yesterday so I couldn't get to the podcast. Not that something's more pressing, but I did have some stuff that I had to do. But had a rejuvenated weekend. It's been a tricky couple of weeks for me. As you know, we're heading down to the wire in the NHL playoffs and the Cinderella team in the NHL, at least in my mind, has been my New York Islanders, who going into the season had lost superstar John Tavares, he went home back to the Leafs and he's having a monster season by the way, just scored four goals last night, he's got 45 on the season.

Mike Alkin: But when Tavares left, they got nothing. He left as a free agent, they got nothing back in return, and it was doom and gloom here on the island for a franchise that hasn't had much success since 1984, the last time they won a Stanley Cup, the '83-'84 season. It has been a long drought with just a couple of playoff runs, and here we lose Tavares and it was like, ugh. But us loyal, die hard Islander fans, we hang in there. We've become used to misery. All of a sudden, the season unfolded, and this group of young, hard-working grinders led by new coach Barry Trotz and GM extraordinaire Lou Lamoriello, have put together a system that plays to their talent.

Mike Alkin: Throughout the season they've been playing unbelievably well. They went from the worst defensive team in the NHL to number one. Their goalies were a disaster, now one of the same goalies, Thomas Greiss, is having a tremendous season. They brought in a free agent, Robin Lehner, who's having a monster year as well. For much of the year they were sitting in first place for quite some time, and then all of a sudden since the All Star break they've

just kind of lost their way. I mean, they took a drubbing at home against Boston. I tell my kid and I we can't go to games anymore because we went to a couple of games where they just got pounded.

Mike Alkin: It's really a tough month, and it's a tough month to have a drought going because you're going into the playoffs. But the NHL is so competitive you can't even say two, three weeks ahead of time, unless you're Tampa Bay who's having a ridiculous season, or just a couple of other teams, you can't say we're going into the playoffs because you could be in first place, yet the drop off to the last wildcard spot is six or eight points. You could be out of the playoffs if you have a bad run.

Mike Alkin: Well, the Islanders were having a bad run and what looked like a really tremendous season all of a sudden is still at risk. There's seven games to go. But they really were struggling, getting pounded. Then this weekend in back-to-back games they got their groove back, two big wins, sitting one point out of first. I mean, I'm pretty excited, I'm pretty fired up. If you're not a hockey fan, and I'm sure many of you aren't, but I do have a lot of Canadian listeners and US listeners too who like hockey. I know I do have a lot of hockey fans, but if you're not, do yourself a favor, tune into an NHL playoff game.

Mike Alkin: I know, I hear the complaints all the time. I can't see the puck, I can't see the puck. I love it in person, that's what I always hear. I love going to hockey in person, but on TV I can't follow the puck. Well, you know what, you probably watched 10 years ago, because if you watch it now the arenas are well lit, everything's fine, and focus. But the level of competition, the level of play, if you think about the pure athleticism of what these guys do. All these other sports you could use your feet, your legs. Here you've gotta be able to do something else that most people can't do, and that's skate. These guys skate like there's just ... it's unbelievable the level of skating and the energy that comes to an NHL playoff game.

Mike Alkin: Anyway, seven games to go. Islanders a point out of first, hoping we make the playoffs. But it's riveting. I joined NHL.com, you have games so I can watch any game any time. I walk around the house at nighttime with reading material in one hand and my iPad in the other watching games. My wife will check in on them and my son, my daughter not so much.

Mike Alkin: Anyway, that part of the weekend was good. Also had some other really good news this weekend. I was very excited to learn ...

My daughter's beset friend and her mom were over the house on Saturday and they're both 15 and 16 years old. We do a lot of family vacations and go away and stuff like that with them, and good friends, but they were planning a trip to Hershey. Normally they tend to go to Disney a lot or go to an island somewhere, and a lot of girls' trips. This trip was going to be a few hours away in Hershey, Pennsylvania going to Hershey Amusement Park.

Mike Alkin: My kid plays lacrosse, and if you play lacrosse on the East Coast you travel all over the place and you're up and down, and Hershey's just one of the places you go. And you've been to Hershey once, yeah it's nice, great, okay. Give the old Chevy Chase, Clark Griswold nod like you're looking over the Grand Canyon. You say okay, great, been there, done that. But it's not a place that I really need to go back to.

Mike Alkin: Anyway, the plans started evolving sitting around our kitchen counter that hey, you know what, let's go away for Memorial Day Weekend, and Hershey came up. Now, my son and I are gonna be in Hershey in June for a lacrosse tournament, but up came hey let's go to Hershey. I immediately had that sinking feeling, oh God the lines, the crowds. It turned out that it started to evolve into a kids' trip. So my son and daughter and our friends, all their daughters are gonna go, and moms. So I'm sitting here and I'm thinking, you gotta be kidding me. This can't be happening. Are the sports gods looking down on me right now? Is it possible that I'm gonna get a free three day weekend?

Mike Alkin: I love my family, love spending time with them. But I mean, come on, to go to Hershey? Sure enough it evolved, it worked out. Then they said, what about if the dads don't go and just the moms and the kids go? And our friend she said, that's not fair to Mike. And I said, listen I'm okay with it. My wife's looking at me laughing. She's like, are you kidding me? He's gonna walk around in his boxer shorts for three days, he's never gonna change, he's gonna have sports on 24/7. That was a great bit of good news. I'm gonna be devastated my family's not here, but I will get through it for those three days and have sports on and we'll be good.

Mike Alkin: Part of my day yesterday was the house alarm's been acting funny and for four or five days I couldn't get the alarm set. It kept telling me the mudroom door wasn't working. So I call up the alarm company, it's $169 service charge just to show up. I'm like, you're serious, right? $169, you're around the corner? I'm sorry, that's what it is. Okay, well what am I gonna do?

Mike Alkin: The guy shows up yesterday and he's in there and he's looking around. Oh, by the way, it's 90 bucks an hour on top of the 169. He's walking around and he's looking. He's like, ooh. I'm like, okay here we go. It's one door, it's telling me what door it is, and he's going to check everything else. He's checking because every minute goes by he's gonna prorate that fee. So he looks at me, he's a big hulking guy, and he said, do you have a screwdriver? Now first of all, the guy didn't have a screwdriver. You're a service technician. I didn't hear him, I just didn't hear him. I said, a screwdriver? He said, I'm sorry you probably don't even know what a screwdriver is, do you?

Mike Alkin: I said, excuse me? He goes, it's okay, I know you guys, you don't know what screwdrivers are. I'm like, okay. So I live in a nice town, I have a nice home, it's nice. When trades people come to my house they think that you're completely a moron, that you just sit and do nothing. So I said, I'm sorry do I know what a screwdriver is? What are you saying? And he's like, no I mean I don't know, how do I know if you know what a screwdriver is? I'm like, dude are you serious? Are you out of your mind? Do I not know what a screwdriver is? I said, I know what a hammer is, I know what a wrench is, should I go get my toolbox? He goes, you have a toolbox? Yeah, I have a toolbox.

Mike Alkin: This turned into a 15-minute thing about this guy not realizing that people actually don't live under rocks and that if you don't get your nails dirty every day you actually are not a moron and you could actually do something. It was pretty funny. Actually, it turned out we had a great conversation, but the first 10 minutes I was ready to drop my gloves. It was just ridiculous. Anyway, that's that.

Mike Alkin: Let's shift gears here for a minute. I like to talk about different things, you know I don't get on and say, hey the market did this today, and last week this, and I'm gonna tell you where it's gonna go, because it's all bullshit. You could watch CNBC for that, you could watch Bloomberg for that, you could watch the anchors who spend three seconds on something and move on to something else, you don't need more for that. Read the paper, I'm not gonna tell you which way the market's going tomorrow or what it did yesterday. We're gonna touch on that in a drop, but that's not the core here.

Mike Alkin: I like to look at a lot of different things, I'm a big geopolitical fan, I'm a geopolitical junkie. One of the things I want you to at least be aware of and keep your eyes on is Venezuela because it's starting

to … we're seeing a game of high stakes poker starting to evolve between Russia and the US that could lead to a standoff between these two powers that could have pretty wide-ranging implications.

Mike Alkin: Now, if you don't know, Moscow has long been a very ally of Venezuelan President Nicolas Maduro and Hugo Chavez before him. They're both fierce critics of Washington, and Venezuela's right in America's backyard. It's a symbolically important relationship for Venezuela, it says, hey look, we're not alone and we have others who are critical of the US and western policy. So because of that kind of tie, that common bond, the enemy of my enemy is my friend. That's partly why Moscow has expanded cooperation with Caracas in recent years. You've seen increased arms sales, they've extended credit, back in December they flew a couple of bombers in in last December to show a lot of support.

Mike Alkin: Now if you don't know, the Venezuelan economy is in tatters, it's imploded. Inflation is in the thousands of percent, it's a disaster. But Moscow's been there, they've lent a hand, partly because they're good citizens, or it's strategically important Venezuela. But Moscow does have a lot of dough at stake, it's sunk a lot of money into backing Maduro, and most of its loans, and if he's forced from office, they could lose it. You don't really know what the full exposure that Moscow has. Some people peg it at around 17 billion, but that's not confirmed.

Mike Alkin: But let's not kid ourselves. What's this all about? Venezuela sits on the largest prudent oil reserves in the world. It always comes down to oil, doesn't it? Wars are fought over oil. Last week or the week before I said, energy is everything. When Russia sent weapons, they've been sending some weapons in, were they thinking about collecting the debt? Was that their big concern, the 17 billion, if that's what the number is? I can't imagine. To them it's not chicken scratch, but that can't be what was on their mind. What did they want, besides being a good friend of Maduro? They want access to the oil wells, to production.

Mike Alkin: Low and behold, Russia's state-owned oil company, Rosneft, they now have stakes in multiple projects in Venezuela. They've issues huge loans to the country's sovereign oil company. But Venezuela's a little different than what the Russians did in Syria. Venezuela's not Syria, the Chinese and the Americans are much closer and they're there.

Mike Alkin: So what's happened recently? Why am I talking about this? With-

out any attempt to conceal, no under the cover of darkness, last week two Russian aircraft landed at Simon Bolivar airport in Caracas. One of the planes had 100 military personnel, and on that plane was the Chief of Staff of the ground forces, General Vasily Tonkoshkurov. The other landed with 35 tons of unspecified military equipment. Now, the unofficial official line, according to an unnamed Venezuelan military official, said the Russians are there as part of an agreement to assist the country in military training and engaging in cooperation.

Mike Alkin: So what's the backdrop here? As I said, the Venezuelan economy is collapsing, it gets worse by the day. President Maduro is under immense international pressure to step down, but he ain't, he's digging in. Russia is an ally, and they're trying to delay his departure as long as possible. What they did by sending these troops and this equipment is they just kind of upped the ante a little bit with the aim of trying to keep Maduro in power. Now, the Russian soldiers could be the first wave of troops that arrive.

Mike Alkin: Here's where it gets interesting. I always say you don't want to pay chess or poker with the Russians, they're pretty good. Those of you who know that I run a uranium fund will know that the Russians control the law with the nuclear fuel cycle, and they've been playing a game of poker and chess with the US. But here, why did Russian deployment raise the stakes for a possible US military intervention there? Because the use of military force to remove Maduro, this would ignite a big confrontation between Russia and the US military.

Mike Alkin: So what could Russia be doing? What do I think they're doing? They're probably testing the US's resolve and they're playing a hand that looks for the US to fold, because its bet is the US doesn't want military confrontation in Venezuela. But even a semi or a semi-permanent Russian deployment could make it difficult for the Us to oust Maduro, they want him gone. But it allows Moscow to make these strategic inroads into Washington's view that this part of the world is theirs. It's not quite the Bay of Pigs with Cuba, the Cuban Missile Crisis. You have to think about that. This hemisphere, this is where the US views its their domain.

Mike Alkin: But Russian involvement, further Russian involvement, entrenchment, what could that mean? It could deprive foreign energy companies the prospect of getting part of those biggest oil reserves in the world. The US, what could they do, how can they work around this, what's their response? I mean, Venezuela's important to the US. It's in our backyard almost, but the oil is geographic proximity.

So what could Washington do to counter these actions?

Mike Alkin: Well, let's think about what Russia could do. I mean, what could they be thinking? Their options, they're wide ranging from a small token force to a large scale mission along the lines of what they've done in Syria. If they do a large scale deployment it's gonna strengthen Maduro's government, it protects him against internal threats like a military coup or a big citizen armed revolt. Russia could spread its forces around the country, which could deter US intervention, under the assumption that the US is gonna really hesitate to do that. Do they really want to have big casualties of their own or Russian in Venezuela? So Russia could be calling Washington's bluff and calculated the US isn't going to risk a wider war with them just to oust Maduro's government and get Maduro out.

Mike Alkin: I mean, that's kind of what the calculus was in Syria. They increased their presence in Syria, restricted the US's ability to strike, they didn't want confrontation. The US wanted Bashar al-Assad, the Syrian President, out. But because Moscow was entrenched the US didn't want to go there and fight to the extent, they needed to get it.

Mike Alkin: Or the US, the prospect of a bigger Russian deployment, because they didn't hide what they were doing with this small movement, it could be a catalyst for the US to move in early to intervene before Russia can entrench itself militarily. A bigger deployment gives Russia the ability to pursue whatever its objectives are in the country: oil. But a big deployment also comes at a big cost, two ways. One, it costs a lot of Rubles, and the Russian economy is really just kind of getting its groove back a little bit. But also, Venezuela's a lot farther away from Russia than Syria is, so another risk that the Russians face is a bigger deployment, but not a full commitment, could really expose their military to dangers and threats from a security standpoint that are going on down there. It's a tough neighborhood right now.

Mike Alkin: There's a lot of measuring of risk and reward, just like you see in investing. What if Moscow plays its hands incorrectly? It could be a big problem for them. What if they play it wrong and a big Russian military presence doesn't deter the US from acting? What if the US anticipates this and the prospect of a larger Russian deployment could spur the US to move early and intervene? Or the Russians could have a smaller deployment, try and protect some of their interests, but it gives them a lot less room to maneuver. It'd be less expensive. Small deployment puts less troops in harm's way for them.

Mike Alkin: Some of the things I'm looking at you want to pay attention to as this starts to unfold. So far they've sent a handful of forces there, most of them are there temporarily supposedly. So far some of these deployments have included mercenaries, they've rotated some heavy bombers in and out, and then what you saw land a few days ago. You need to start looking out for indications that the Russians are starting to upgrade, if they are. It's present their by deploying troops for longer periods of time and preparing forces and material for longer missions there.

Mike Alkin: And if they're serious about keeping Maduro in, it's going to deploy military forces in and around Caracas and in and around oil production and export infrastructure. You gotta watch closely what the US is gonna do, and so far there's not really anything indicating that the US is gonna mull a serious military intervention to preempt anything Russia's doing, but that could change in a heartbeat.

Mike Alkin: Right now what the US has been ... I mean, it's strategy in Venezuela has been focusing on economic coercion to cripple the Venezuelan government, and they're trying to encourage military defections. At the same time, they're working with the Colombians and Brazil to try and figure out how to handle the fallout. They'd love a coup. The US also, they have to evaluate the long-term implications that Russia could potentially establish a military foothold in the Caribbean basin, and that undermines the exact core tenants of the Monroe Doctrine. It really complicates the US imperative to prevent foreign powers from interfering in what it perceives to be its geopolitical domain, that's where the US believes this part of the world is theirs.

Mike Alkin: Now the one thing, the threat of US military intervention has definitely hampered the Venezuelan government attempt to crack down on this growing internal decent. They don't want to trigger the US to start sending troops in, right? They've been very reluctant to arrest or exile the partially recognized interim President Juan Guaido because they don't want to kickstart US military moves.

Mike Alkin: There's a lot to keep your eyes on. Like I said, the US could look at some Russian deployment as a sign they gotta act sooner rather than later. It's gonna be curious to see. Remember, the biggest oil reserves in the world and more uncertainty. Whatever the case, the prospects of a greater Russian presence on the shores of the Caribbean, one way or another the decks in Venezuela are gonna get reshuffled. Something to keep an eye on, I think it's important.

Mike Alkin: A little bit closer to home, US economy. Friday was a big day for the bond market. The spread between the three month and 10 year US Treasury slipped into negative territory, or what's called inverted, for the first time since 2007. Why does that matter? Because it triggered recession warnings across Wall Street and stocks got hammered. Investors responded to the inverted curve because the data that showed negative relationship between those two yields is one of the foremost indicators of an impending slowdown, economic slowdown. And inverted yield curve has preceded every recession since 1975.

Mike Alkin: Now, Morgan Stanley was out with some work recently, their interest rate team I think it was, that came out with some interesting thought. It says there's a more accurate way to assess whether a recession is coming. It says while the three and 10 year inversion has always occurred before a recession, the curve was not flipped in the 10 days prior to the start of the past three instances. So what they looked at is they said a more accurate indicator, even though the other one is pretty damn accurate, are rate cuts from the Fed as a more compelling recessionary signal.

Mike Alkin: They went back and studied the past seven recessions and found that in '82 between the fourth and fifth economic contractions on a chronological basis, the Fed unofficially switched its approach to rate decisions. The central banks started targeting the Fed fund trade. Morgan Stanley found that the Fed has historically conducted its first pre-recession rate cut 160 days before each meltdown began.

Mike Alkin: If you were to go back and use last Friday, that puts you right on schedule for a recession by December. What's it mean for stocks? Friday could be a good sneak preview. But what happens if the Fed cut rates? In theory, rate cuts are good for equities. Accommodation helps catalyze, it's helped catalyze, the 10 year bull market. Lower rates drive stocks higher.

Mike Alkin: But not so much. One of the issues that the Fed has had and why they want to raise rates is because when an economy slows down, you lower rates, but from where? Rates are at 5000 year lows. It's kind of a quagmire these central bankers around the world have gotten themselves into. This rate cut is because the economy is struggling. I know what you're thinking. Wait, everything's great, unemployment's really low, everything I hear is really good. Look at the cheerleaders on CNBC, great, go buy. I bet on the bond market over the talking heads.

Mike Alkin: I talk about it a lot, know what you own, don't get caught napping, don't wait 'til it happens. Like I said, normally the economy is slowing, rates get cut, stocks go up. I think it's different this time. Know what you own, be prepared, start thinking about it.

Mike Alkin: I have an interesting guest today. One of the things I want to do is, again rather than talking to you every week about ... no, I'm not gonna tell you what stocks to buy. We talk about industries and sectors and stuff like that. But I want to peel the curtain back a little bit. We're gonna pull the curtain back and we're going to talk about capital allocation on Wall Street. You see these guys on TV, the hedge fund managers come on, you see mutual fund managers come on, money managers may come on. Where does their money come from? We're gonna dive into that right now.

Mike Alkin: For that I'm gonna bring on a guest who also happens to be my business partner at Sachem Cove, the uranium investment vehicle that we have. For many years he worked at a fund that allocated capital to institutional investors. Without further ado, I am going to bring him on and we're gonna peel the onion back on the world of capital allocation. Tim Rotolo, welcome to the podcast.

Tim Rotolo: Thanks for having me, Mike.

Mike Alkin: You and I are friends, we're business partners, just full disclosure. Tim is my partner at Sachem Cove where we have a uranium investment vehicle. Prior to that Tim spent a lot of years allocating capital to institutional investors. Tim, why don't you give us your background?

Tim Rotolo: Sure, thanks. Yeah, so as Mike pointed out, most of my career has been spend in some sort of allocator role. When I came out of college I joined a wealth management group out of Merrill Lynch. Then ultimately in 2007, great timing to be moving to New York for finding a job, went to work for Merrill's private bank, which is their ultra-high net worth group. Our clients were CEOs, we had some small endowments, foundations. In that role we were really allocating capital through what's now known as the Endowment Model, which has been pioneered by David Swenson at Yale.

Tim Rotolo: Then after about two years there I moved to Fund of Funds, which I think is a different type of allocator but it at that point was a much more important part of the market. Today it's been somewhat disintermediated. There we allocated to distress debt and event driven hedge funds. Then actually since then, for the last three years, I've been moving slightly closer to direct allocation of

capital or direct deployment of capital at my firm where I'm now patterns with Mike, which is called Lloyd Harbor Capital Management.

Tim Rotolo: We can kind of get into how I think actually my own personal career evolution is somewhat reflective of what's been happening in the overall market, which is I think I move towards I would call it convergence of allocator roles and disintermediation of certain groups like Fund of Funds. And I think more and more teams feel the capabilities internally, whether it's at a family office, pensions, endowments. Then also I think a really important trend is this idea towards really direct investment or co-investment, which is changing the landscape, but I think for the better.

Mike Alkin: Let's start up top at 50,000 feet and work down. People see hedge fund managers on TV, they're being interviewed, and there's kind of a mystique about it, a mystery to it, because hedge funds are a different type of investment vehicle. They don't tell you what they own unless the guy's pitching a stock, but there's not a lot of disclosure from them. They're only available to accredited investors, and it's kind of been in cloaked in mystery of many, many years, but there's trillions of dollars invested in hedge funds. Talk about the different pools of capital that work their ways into hedge funds that when you see a guy on TV who's running two billion, 500 million, 20 billion, whatever it is, talk about the capital that winds up in those vehicles.

Tim Rotolo: I think it's a really important component of how capital gets allocated, is really where it starts. I guess what you would deem who is that asset owner. There's more and more different types of pools of capital, but the way I think about it is you have pensions and corporate entities, so they have a different time horizon and really different investment mandate and objective than say an endowment or a foundation. Then you have fund to funds. Generally, fund to funds have become more specialized, but they might be a multi strategy, which means they're going to invest in lots of different types of hedge funds. Or you could have what Sandalwood was, where I worked prior, which was really a very sector-specific fund to funds.

Tim Rotolo: You've had these new groups which have become very popular in the media, which are family offices or multifamily offices, and I think those are really interesting groups to talk about because they are asset owners, and in some ways have a different perspective on allocating capital than a fund to funds or a foundation or endowment. Then you have ultra-high net worth individuals, wealth

managers, sovereign wealth funds, and probably one of the most important parts of the asset allocation world today are consultants, who are the gatekeepers to huge pools of capital which are represented by all of the groups that I just mentioned. But they are ultimately making the decision as to which manager is going to get capital from the asset owners or not.

Tim Rotolo: I think maybe even taking one step up from that, which is just thinking about asset allocation and what these groups are doing before they even get to the hedge fund decision, whether you're an endowment or a foundation or a consultant, the objective for these groups is to ultimately allocate capital across a wide variety of asset classes. In general they're building out some sort of investment policy statement based on the objectives of that underlying investor. It could end up looking like a 60/40 portfolio, but today it's certainly more nuanced than that and there's going to be allocations to equities, to bonds, to credit, to hedge funds, to private equity. Then the next level down is the manager selection, and that's more of a bottoms-up exercise about the merits of that hedge fund manager who's on CNBC. What is that guy's edge?

Mike Alkin: So Tim, let's talk about those buckets, endowments and foundations. Talk about the profile of that investor and what their investment goals are.

Tim Rotolo: Endowments and foundations, let's talk about endowments. I think foundations can be slightly different. In general these are tax exempt entities, which really changes how they think about investing versus a high net worth individual or a taxable entity like a family office. Number one, they have very long time horizons.

Mike Alkin: And we're talking, by the way folks, we're talking about a college endowment.

Tim Rotolo: Correct, Yale.

Mike Alkin: Yep, exactly.

Tim Rotolo: Yale, Harvard. Let's just use Yale, I don't want to pretend that I know everything about Yale, but I think there's been a lot written about them and the way that they think about things. These groups have a very long investment time horizon, and as a result I think have the ability to allocate capital in a different manner than you or I might if we were just thinking about our personal savings. It allows them to take more liquidity risk, it allows them to generally be longer term oriented investors.

Tim Rotolo: And I think a really interesting ... we can get into it down the line. A lot of these groups have developed cultures which allow them to be more progressive thinkers. Now, Yale I think is kind of the extreme example of that, in that they really built a culture in their investment team that allows them to take, I don't want to take big bets, but to shift their asset allocation very meaningfully in order to try and protect capital or to allocate to areas that they think are very dislocated. I think that's one of the big differences between allocators these days that are really driven by career risk oftentimes, what I would call a principal agent issue.

Tim Rotolo: But at the end of the day, they have a very long-time horizon, their objectives are driven really for the good of that college endowment in order to help drive spending there. They generally have some sort of mandate in terms of money that has to be given back to the university to meet spending objectives. So they have an ability to be more opportunistic, and I think what you've seen is because of that longer term horizon, Swenson in particular has really espoused the benefits of allocating more and more capital to private equity, to hedge funds.

Tim Rotolo: Actually, I just happened to be looking at their portfolio allocation the other day and they have I think 20 or 30 percent of their portfolio allocated to what they call absolute return, which are hedge funds. They have a huge amount of capital, I want to say 20 or 30 percent, allocated to venture capital. So I think what these guys have done is moved away from hedge funds as an asset class, and private equity or equity, and they look at all these things together. Private equity, venture capital, the S&P 500, all of these are ways to have exposure to equity markets, but they want to find where there's the biggest edge and the ability to outperform a tradition index.

Tim Rotolo: The way that they've been able to do that is by allocating to venture capital or buyouts or different types of private equity. As the cycle changes, they'll begin to slowly shift their allocation towards where they think there's more opportunity. And I think that's a very important component of how money is ... I think you're seeing this money flows follow some of these larger institutions, and then everyone ... and we can get into, again this is this principal of agent issue.

Mike Alkin: Let's talk about that, because it's an important issue. You mentioned a few minutes ago career risk. One of the things I always talk to the listeners about is understanding people's incentives. We'll bring it back to uranium for a second. I always say, if you're

a US fuel buyer buying uranium, there is zero, not a negative, nothing in the world that incents you to go out and call the bottom in uranium pricing. There is everything to incent you to buy it at the same price everyone is when everyone else is buying it. And if that means it's a lot higher, so be it, but it keeps you safe. There's no financial incentive for them to do that, there's more career risk to making a bad call. Talk about how that affects the world of capital allocation.

Tim Rotolo: It's so important to it. People don't want to talk about it, but there's a phenomenal piece, and I keep it fairly close to my desk, which is written by Jeremy Grantham and it's called, My Sister's Pension Assets and Agency Problems: The Tension Between Protecting Your Job or Your Clients' money. I just think unfortunately across the investment management industry, too often there's not an incentive to outperform, and that's a function of how people get paid, right? The average allocator, while he might make a good salary and good bonus, his job is not worth making a meaningful contrarian call on something unless all of his peers are doing that, because the risk is he loses his job.

Mike Alkin: He looks dumb.

Tim Rotolo: Yeah, you look dumb or lose your job. And what's the upside? What's the real incentive? You're not going to ... if you're running a billion dollar fund to funds, and you put an extra 2% into something that makes 10% when the market's flat, that incremental return does not outweigh the risk of your job. We used to always say, no one ever got fired for hiring Blackstone or BlackRock, and it's true. I think you see this particularly amongst, and this is nothing against consultants or fund to funds, but I just think post-Madoff, this institutionalization of hedge fund investing or really just investing and the focus and operational due diligence, has made it very challenging for allocators to make large contrarian calls or big asset allocation shifts, because the risk is their job.

Tim Rotolo: It's not like they're Bill Ackman, where if he puts 20% of his portfolio in something and it goes up 50%, they're not making $10 million or $100 million. They may not make anything more for that phenomenal of a call. They may get an atta boy, but that's about it. I just think it disincentivizes people to do things that are highly differentiated, which candidly creates a phenomenal opportunity for people like myself who have kind of just said, I get that that's the risk and I'm gonna structure my business in such a way that I'm going to go out and find those things that fall through the cracks because the institutional structure doesn't allow for people

to do these types of investments. Therefore, I should have an ability to go out, and now I need to find the pools of capital who can allocate to those things, but they exist.

Tim Rotolo: So I think that's what you've seen, is that in some ways some of these principal agent issues have now begun to self-correct themselves by more and more groups having special situation groups or finding ways, whether it's through co-investment mandates or direct investment mandates, in order to take advantage of these more differentiated opportunities within their traditional structure. But at the end of the day, there's still this very large herding issue. I don't know if you want to talk about Theranos, I just watched that documentary.

Mike Alkin: I watched it too, yeah.

Tim Rotolo: Yeah, I mean or Madoff. Actually, a lot of people have been trying to compare Theranos to Tesla, I think it's actually much more similar to Madoff in that people just didn't do the underlying due diligence on the product to see is this thing actually possible. And the people who did do that diligence passed, and then they looked like crazy ones because all these other incredibly smart investors were doing this thing. I think that's the ... but all of them did it together, so at that time they were okay making that decision. And I think you see that with a lot of different asset classes that get hot, it's really just FOMO. These institutions I think oftentimes they have a ... how do I put it? It's almost like an embedded risk of getting caught up in these trendy asset classes, but they're protected by the fact that many of their peers will also be along for that ride, so if it blows up they're gonna blow up together.

Mike Alkin: It's like I always say in hedge fund investing, you go to idea dinners or idea lunches where five, seven, 10 guys get together, or gals get together, and what do you like, what are you working on. And somebody pitches an idea and it sounds interesting, and now all those people at that lunch go back and they do a drop of work on it. But that person at that dinner articulated a thesis that they spent a lot of time on, but then they start to do a little work and they go and tell their portfolio manager, or they may be the portfolio manager, and they put it in the portfolio. Then they use that idea as currency for the next guy that they talk to. Hey, I've been working on this, and they tell them what they've been working on, and then it starts one phone call, another phone call, another phone call.

Mike Alkin: Next thing you know, 10 guys away owns this thing and they re-

ally haven't done any work on it. But it came from someone, but because a lot of quote "smart guys" own it, they feel good about it because it gives them that comfort. There's this comfort in crowds and you tend to see that, and it permeates everything. It's something that I think that you bring up as a really interesting point, and we see it.

Mike Alkin: Tim's business Lloyd Harbor Capital is a vehicle that time has that allocates capital in businesses and Sachem Cove is a separate business that Tim and I have that's an investment vehicle for uranium. But what you see is one of the things we notice when we talk to institutional allocators is one of the challenges they've had over the past decade is hedge fund returns have not been great because, A there's been so much institutionalization that money comes flowing in over the [inaudible 00:48:09]. For all the reasons you just mentioned, everyone wants to put it out into the same thing, and when everyone's doing something it typically doesn't work, it's already priced in.

Mike Alkin: Because the money that hedge funds can make, just from a management fee ... the industry has evolved so much over the 20 plus years since I was in it. When I first started, Tim, you got your 1% management fee and you had a small amount of capital, but the 20% incentive that you got on all the profits is how you could make a lot of money. As more institutions, pension plans, endowments, fund to funds, started putting money into alternative investment vehicles like hedge funds, others being venture capital and private equity, as they started doing that the assets started to grow and the fees started to increase from 1% to 1.5% to 2%. All of a sudden guys are running big pools of capital and they're getting wealthy just on the management fees, and they don't want to take risk as much as they used to.

Mike Alkin: And a lot of times when they're taking risk and putting up big returns, it is because you're doing what others aren't doing, you're being contrarian for the most part. That's what got so many big hedge fund managers to who they became, was by doing that, putting up these outside returns. Then they achieved them, and then the capital came flowing in, and then they went into conservative mode and they started buying what other people are buying. When you become big, there's only so much you can buy. You can't buy tiny companies, you can't buy small companies, you gotta buy big companies. And there's not a lot of ways to generate alpha in big, big companies like that.

Mike Alkin: You've seen this muted, watered down return profile the last

decade or so, and it's interesting because the observations that I have, and I know you see it, is there's now a little subsegment forming in the allocator world that says, I might normally allocate 8 or 10 percent to a position or 5 percent to a position, and I might get mundane returns like I've been getting, but maybe I'll allocate capital to a 1% position where I think I can get multiples on my return. Because they're having to look for ways to improve their performance.

Mike Alkin: Talk about the competitive pressures the allocators themselves are under. I mean, we mentioned endowments, then there's pension plans we're allocating capital, and then the fund to fund universe, and these consultants are out telling them who they like and who they don't like. Talk about what drives changes in investment philosophy along these lines because of the returns being so dampened over the last few years, because in the full market hedge funds are not fully long, they're not exposed to the market, most long shored equity funds. They have a net exposure, they're offsetting some of those longs with shorts, so they may be 40% long, 50% long. If the market's ripping, you have some of your portfolio that's short and you're not gonna participate with the index, and the index have been driven by passive investing. Talk about what you were, just expand a little bit about the funky nature that can evolve and how you're seeing that evolve.

Tim Rotolo: Yeah, I think that's also a function of where we are in the cycle, is that spreads are so tight on credit equity valuations are quite high, and so I think what you're finding is that there's a natural gravitation towards more nichey strategies. I think even ... I had the good fortune of watching my brother build a private equity to real assets business, and their mantra in 2005 or 2006 was, alternative alternatives. They were trying to be this differentiated solution to investors who were passed the point of allocating to hedge funds. They still allocated to hedge funds, but they were looking for other sources of alpha and differentiated return streams.

Tim Rotolo: I think what you've seen is now that's becoming more mainstream, and because yields are so paltry and equity valuations seem so high, I think the savvier investors are saying, we need to look outside of tradition hedge funds, we need to go find the uranium story, or cannabis, or these things which can earn us high returns. And yes, on a risk-adjusted basis they might be very attractive, but there is still real risk so we're gonna make smaller allocations. I think you're seeing that across these allocators.

Tim Rotolo: Now, I think the group who has been at the forefront of this, in

my opinion, is the family offices. And again, that's a function of I think they have a structural benefit, which is that they're asset owners, they're not allocators. They are allocators of capital in the truest sense of the word, they are actually deploying capital, but they're not constrained in the same way that-

Mike Alkin: Talk about that. It's [crosstalk 00:53:40]-

Tim Rotolo: It's probably the most important point, which is that if you think about how these people, these groups make decision-

Mike Alkin: Explain what a family office is for those who may not know.

Tim Rotolo: Sure. I mean, I think the term is being a little bit bastardized.

Mike Alkin: I agree.

Tim Rotolo: Everyone now, every guy who was a hedge fund manager 10 years ago and he's got 10 million bucks has a family office. I think the real sense is that it's an ultra-high net worth family. Either they've accumulated wealth from a private business, or sold a business and now they have 10 to many billions of dollars, either they're allocating that money themselves, the founders of that family are actually making the investment decisions, those are phenomenal groups to work with because there's no bureaucracy and you kind of get down to brass tax, or they might have built in an internal investment team, which is another evolution of this whole allocator space that we're seeing. Now more of these family offices are developing their own internal capabilities.

Tim Rotolo: Just going back, if you're a pension, or an endowment, or a foundation, or a fund to fund, I think they operate slightly differently. Those are quasi-almost political entities. Pensions are quite political. There's Pension Board, and so that investment decision takes a very long time to make. I think they're challenged to be highly opportunistic because they don't have the ability to act as quickly as say a family office. Mike and I have had a few interactions with groups who have met us twice and made an investment decision. I think what you see is it's a good process for all of these groups to go through, but many of these decisions are highly politicized, particularly when you have large boards like you see at endowments and foundations. There's also generally a CIO and an investment team who are pushing up decisions to a board.

Tim Rotolo: Then those board members may also have their own views, the might be investment professionals themselves, and they're tak-

ing into account what their peers are telling them. They might be saying, I don't want to do XYZ because our peer is not doing this. So you get this multiple level of agency issues and reputational risk issues. So that really I think challenges groups and constrains them to be highly opportunistic.

Tim Rotolo: We also have to keep in mind what these groups' objectives are. Pensions, endowments, foundations, fund to funds ... well fund to funds technically are kind of a hedge fund, but they are not hedge funds, their goal is not massive out-performance. I think people would highly question if an endowment was up 25% and their peers were up 10, because how much risk are they taking?

Mike Alkin: A little too much risk.

Tim Rotolo: Yeah, exactly. And it's something I say on the wealth management side. Today lot of these groups are RAA or financial advisors, if someone tells you they can outperform by several hundred basis points, I would run the other direction. That's not what those guys get paid for today in my opinion. In my opinion, a lot of these asset allocators are effectively coaches, right? They're looking to put athletes on the field to put up wins and to do it consistently and to not blow up, so that those entities, whatever it is that they're supporting with that capital, can continue to thrive. So I kind of poo-poo them not making these big opportunistic decisions, but it's also not really within their mandate.

Tim Rotolo: Now hedge funds I think have many of the same issue that we just talked about and are being disincentivized by those allocators to really try and significantly outperform. But I think there's just a lot of constraints put on investors in these asset allocation roles to their asset allocator roles today, whether it's operational constraints or risk management, to really do things that are quite different. One of the quotes that I keep in the back of my mind all the time, I can remember if it was from Swenson or Howard Marks, but it's that as an investor you can't outperform if you're doing the same thing as everybody else.

Tim Rotolo: So some of it is a function of what is your organization set up to do? Is your objective to outperform? I think a lot of people assume that it is, but in many cases these organizations, that's not really their objective. It's to just plod along and hit some sort of return target in order to fund a future liability. I think what that's doing is creating a lot of really interesting opportunities for those groups who can create a culture that does incentivize them to want to outperform.

Tim Rotolo: I think uranium opportunity is a perfect example of something that in theory and in a really efficient market shouldn't exist. But because all these people are disincentivized from spending tome on it, whether it's because it's too small or there's not enough research for people the spend the time, whatever it is, it creates these really interesting pockets of opportunity for organizations that are set up to take advantage of these differentiated things. And I think allocators are finding smaller ways to get involved in those, but I think it's a tough time. I would not want to be in a traditional allocator role today, it's a very challenging time in the markets to be thinking about how to allocate capital for the long-term with having all of those constraints on you, because there's just so many levers you can pull.

Mike Alkin: Talk about the due diligence that allocators do when they're looking at funds. Obviously, they have to start with their view, which we've been talking about, if you go to Yale, how they're thinking about long-term returns. Talk about the process and how they find someone. They go out and look at somebody and they're going to do due diligence on them, talk about the work they do to understand before they actually pull the trigger and make a capital allocation to whomever they're making it to.

Tim Rotolo: I'll speak from the perspective of hedge fund due diligence because that's my focus. Obviously these groups, whether it's a long only bond manager or long only equity manager, private equity guy, everyone's got their own due diligence process. Mike, as you point out, I think everything starts with what's your view of the market. What's your top-down view? I guess there are certain allocators that are purely bottoms-up, they're what I think of as being a Patriots fan, the Bill Belichick, they just want to put the best athletes on the field.

Tim Rotolo: I think a lot of people start with a view on the direction of the market and their top-down view, and then go from there. If you're a multi strategy fund to funds manager, you're looking at how much do I want to allocate to macro, how much do I want to allocate the relative value, how much too long and short equity, to event driven, all of these different buckets. Then you're gonna go and try to find the best manager in that space. Some of that might be absolute in that if you don't have someone there you might just say, okay I gotta go find the best event driven equity manager, let's just say merge arb.

Tim Rotolo: Some of it may also be if you have an existing portfolio, which was a situation I walked into, you have to look at everything on a

relative basis. Is this manager better than Third Point or is this guy better than ... how do I think about taking capital away from who I think is one of the best managers in the world? Then giving it to maybe some guy who just left Millennial. That's a big component of it and I think that's where a lot of the art comes into it.

Tim Rotolo: Then from a search standpoint, I think people are sourcing guys from different places. A lot of it is networking. If you've been in the industry for a while you're gonna know who's spinning out of leaving a big fund to start their own fund. You're gonna have input from prime brokers who are gonna be representing funds, you're gonna have third party marketers who are calling you and telling you. I think everyone has their own different sourcing network, but once you've compiled that pool of managers you're gonna start with traditional diligence.

Tim Rotolo: Looking at the firm's people, where do they come from, what school did they go to? I'm not a huge believer in the importance of educational pedigree. I think actually a lot of times that that's the FOMO and goes back to the same principle, everyone just allocates to all the guys from Harvard. There's obviously a huge opportunity, clearly there's very smart people who went to a million other different schools. I never tried to let stuff like that influence me too much. What's the strategy of that manager, what is their investment philosophy, process. And really all of these elements are about getting at what makes this guy better at his job than somebody else. What's his edge?

Tim Rotolo: Then I always thought a lot of it is figuring out particularly if he's had performance, is that flash in the pan or is this something that's repeatable. Does he have some structural investment advantage over his peers that he's going to be able to continue to exploit?

Mike Alkin: And that's tricky, Tim, because everyone you're sitting in front of, you interview hundreds of managers a year, and you're sitting in front of a hedge fund manager who gives you a 20 page PowerPoint presentation that shows you his investment process or her investment process, and the team, and the top-down approach and the bottoms-up approach. Everyone says the same thing, so how do you filter through all that?

Tim Rotolo: That's really hard. A lot of it has to be based on experience.

Mike Alkin: Their edge, their investment edge, right?

Tim Rotolo: Yeah, some of it is obviously there's some data analysis that can get done. I think one of the things that's emerged in the last few years is this ability to disaggregate factors and say, okay this guy has been generating his performance because he's allocating to small cap value, or momentum, or there's a credit component. I think that's really probably one of the most challenging aspects, is identifying is this guy a genius or is he investing in a bull market. Because that's another thing, it's one of the reason why investing early in managers is so challenging, because there's so many components that go into what that person did in the past. If he's coming out of a big organization, was he good or was he benefiting from the fact that he was at Millennial? How much of an edge did he get from the information that he had at that organization.

Mike Alkin: Think about prop desk traders who left the banks.

Tim Rotolo: That's exactly what I was just about to say. We used to invest in a lot of guys who came out of the same prop desks.

Mike Alkin: Explain a prop desk for people.

Tim Rotolo: Well, they don't really exist anymore.

Mike Alkin: What they were.

Tim Rotolo: Back before the Volcker Rule and Dodd-Frank banks, Goldman Sachs, Morgan Stanley … I guess they technically weren't banks back then. Investment banks used to have proprietary trading desks where they could take risk. They would buy positions and own those positions, and the benefit those guys had is they're making markets for their clients, so they know what's happening in real-time in those markets. So they might be willing to take a position in a security that they think is maturely mispriced, or there might be a forced seller in the market so they can provide liquidity, and just effectively be a buyer when someone wants to be a seller in situations where that person is under duress and forced to sell at very low prices. So those people then can take, that prop trader can take that position onto their balance sheet, the bank's balance sheet, and wait 'til the price recovers and slowly sell it out over time.

Tim Rotolo: A lot of those traders became hedge fund managers once Dodd-Frank. Now, they were already migrating towards hedge funds anyways, but there was a mass exodus towards hedge funds, and one of the challenges with evaluating those people is how much of your … yes, you had phenomenal performance while you sat at

Goldman Sachs' high yield trading desk, but how much of that was a function of the fact that you were sitting at Goldman Sachs' high yield trading desk? If I take you out of that desk and I take you out of that information flow, can you still do those same things? The answer for a lot of those guys unfortunately was, it's not that it was an outright now, it's just that it was I think more challenging to run a business, to try and be a trader, to manage a big team.

Tim Rotolo: I think what also happened is that some of these guys may have been taking very focused risk, they might have been trading only high yield. When they migrated to the hedge funds, in order to put out more money, they're moving into other assets. They're buying equities, maybe their risk management framework changes. There's just a tremendous amount of variables that come into trying to evaluate these people, and that's the first layer.

Tim Rotolo: Then obviously the diligence process. Let's just say I believe that this person has an ability to outperform, they have … I think the uranium hedge fund or strategy is very unique in that it's highly focused, it has a finite life, there is a singular thesis. Must hedge funds aren't like that, right? They're long short equity funds, maybe they have a value bent, so it's not just a one discrete event that they're playing for. They really have to have a highly built out process, a risk management process. How do they think about hedging, how do they interpret macro data? Do they put on overlay hedges, meaning do they have an option strategy to protect in the event of a big draw down?

Tim Rotolo: But those things change. These are discretionary hedge fund managers and they are people, and they are fallible. So trying to figure out whether if someone puts something in a presentation and tells you something, if that's gonna be how things actually play out over time, is challenging.

Tim Rotolo: Once you've gotten past that point, then you get down into some of the more mechanical, but I think arguably very important aspects, which are running background checks, doing reference checks, which I think have become really important in this day and age of is this person … if they've run a fund in the past, how did they treat their investors? If they were on a prop desk, how did they manage their team? Really trying to get at can these people, can they run a business? Can they run a large investment operation? What are their strengths and weaknesses? How do they think about managing capital when things are challenging, did they double down or did they cut risk at really bad times?

Tim Rotolo: Then you get into some of the stuff that's outside of my expertise, which is the operation work, which has I think become maybe one of the most, I say important, it's become a very large hurdle and has I think changed the industry the most, which is the operational due diligence. Post-Madoff there's been an intense focus on operations and the risk that operations have, and making sure that you're not exposed to fraud risk. What that's done to the industry is I think it's pushed up the break-even level for these companies as business, and it's made it much more expensive to operate a hedge fund.

Tim Rotolo: To some degree gone are the days of the two-man garage band sitting out on Long Island with the Bloomberg. I think everything has been hyper-institutionalized to the point where a lot of guys who should probably have an ability to raise a fund are not, because it's just so onerous. That part of the due diligence has become so highly focused, and so the expectation there is you're gonna have a top four auditor, you're gonna have a third party administrator, which I think are for the most part good practices or best practices. You're probably going to be SET registered, and there the compliance costs are really, really meaningful. They're going to evaluate which banks you trade with.

Tim Rotolo: Then the level of complexity changes depending on the strategy. We did a lot of stuff in the credit space at my fund, so our team was hyper-focused on counter party risk and did the team have sufficient operational bandwidth and expertise to trade certain credit products, like leveraged loans which can take a long time to settle. Trading things like CDS is very complicated. So that's an area that I think has gotten highly scrutinized and really can ... we gave our CFO a veto right. If you couldn't pass our operational test, even if you were the greatest investor in the world, you probably weren't gonna get into the fund, which I think is somewhat different.

Tim Rotolo: And I think that's actually one of the things that I've noticed about the family offices, is they're a little bit lighter on operational work and more focused on the investment merits. I think that's probably a function of those groups made a lot of their money as business operates and I think maybe have a different view of some of these institutionalized operational due diligence issues, and they're willing to take that operational risk if they think the investment merits warrant it. Whereas if you're a fund to funds, going back to that career risk issue, you don't make enough money and that allocation is probably not gonna be big enough to warrant there being an operational issue that blows up that hedge fund to allocate, even if you think it's the greatest investment ever.

Mike Alkin: What do you think of the star managers that you've seen? You see so many of these guys, they have good years, they became big household names, and then all of a sudden they struggle. Do you have a view on that? Is there a correlation between size of the fund, between notoriety of the fund, notoriety of manager, and performance?

Tim Rotolo: I think there probably is some. I think there's probably a lot of nuance to that because if you look at a lot of these guys who've struggled, it seems to be … some of them seem to be a victim of their own success. They get big, they have marital problems, they get overly vocal about one or two positions, and then those positions blow up and it causes people to become hyper-focused on their funds.

Tim Rotolo: I was never … there were certain groups that I passed on because of that level of notoriety or they're in the press too much. I always was kind of the devil's advocate on our investment team though, so if there was a group who was really underperforming and maybe we learned some information … that's the other thing, its' a pretty small industry so you can learn some pretty interesting things about people's personal lives and where they're spending their time, and maybe that's the reason they're underperforming.

Tim Rotolo: But I think a lot of the times the really good managers, if they don't shut down during that time period, they tend to be pretty resilient and some of them will bounce back. Ackman's a pretty interesting example, I was just looking at it, he's up 30% this year but he hasn't been in the press. There's plenty of other guys, I think about Paul Singer and Seth Klarman of The Outpost. I think they get a decent amount of notoriety but they just continue to plod along and do their thing.

Tim Rotolo: I don't think there's a hard and fast rule. I definitely think as guys get bigger, they get forced to change their process. A lot of guys, a lot of hedge funds, I'm sorry if I'm using the word guys, a lot of hedge fund managers are males. I think many of the managers that you're speaking about came up at the same time and they continue to trade on those track records that they built in very different times. The last decade has been probably more about them preserving assets and living on their management fees, rather than putting up the 30, 40, 50 percent returns that they did in the late '90s.

Tim Rotolo: I think that you just have to be focused on who's losing their edge and who are the guys that are just going through the doldrums.

There's a few guys that we were invested in, I can't remember what the exact year was, if it was '11 or '12. They were kind of flattish and everyone else was up double digits, and I think one of the guys had a 12 or 15 percent draw down, which was not only uncharacteristic of him but also didn't seem like it was market driven. It was highly idiosyncratic, tied specifically to his positions. And our team said, we're done with this guy. To me it felt like a very short-sighted decision.

Tim Rotolo: Some of it is a function of who the ultimate allocator … what is their own investment philosophy? Are you of the opinion that you're … are you allocating to strategies because you want exposure to merger arb or event driver or distressed? Or are you allocating to individuals or teams whose process you think is long lasting and repeatable, in which case I think you need to have the conviction to be able to stay with those groups when they're underperforming and potentially add capital.

Tim Rotolo: I just think again, going back to the incentive structures of a lot of organizations, it's sometimes not tenable to be able to do that. I think some of the better allocator organizations are the ones that actually have that embedded within their culture, which is we are truly long-term investors, short term underperformance should not deter us. We're not going to change our mind because everybody else is up screaming about Bill Ackman. We weren't invested in Pershing Square, but he seems to always come to the top of my mind.

Tim Rotolo: Again, I think a lot of it is are you incentivized to continue to be with that person or to churn managers and try and chase the hot dog? Which there's plenty of that as well in the fund to funds and allocator world.

Mike Alkin: For listeners who allocate their own capital to not individual stocks or to mutual funds, they want to do it to hedge funds, what are a few key points when you're looking at a manager? What are the things that you look at? By the way, I think when people allocate to a mutual fund they might just look at the fund. But I mean, it's run by people. What are the things that are the most important, that jump of the page at you? Putting you on the spot.

Tim Rotolo: Listen, I think as an individual, and I even see it not sitting in … I kind of am suffering from the same thing that I was talking about with those prop traders, is that depending on your seat you have access to very different information, so you need to be cognizant of the fact that who's on the other side of that trade? Are you being

sold at by a mutual fund wholesaler? At the end of the day it comes down ... I think it's very challenging. If you can't talk to a manager and have him walk you through his investment process, his investment philosophy, I think it's very challenging. Active management is very difficult, particularly in the mutual fund industry. I think passive makes a lot of sense. I think you want to understand how that person thinks they make money, and then try and figure out if that's actually how they make money.

Mike Alkin: That's such a good point.

Tim Rotolo: If they tell you that they invest in large cap growth stocks, is that where that person actually made their money? Now, that's gonna take some work, but you can definitely go back and disaggregate. You can look at their holdings on Morning Star and say, okay this guy tells me that he is a large cap growth manager and he likes stocks that are valued like this, but in reality all of his performance when he outperforms came from two or three mid cap or small cap services stocks.

Tim Rotolo: Then I think to me, long holding is very different than hedge funds because so much of my focus on hedge funds was how are these guys allocating capital within the fund to protect capital based on what they're telling us? I kind of know this guy's a high octane manager, he's gonna have more market exposure, he's gonna be 80% long and 20% short, and he might change his exposure based on how he feels about the market. A lot of it, to me, was about upside downside capture. Is he giving me 80% of the upside and 80% of the downside, or is he giving me 80% of the upside and 20% of the downside?

Tim Rotolo: With long only guys, again they fall prey to the same career risk issues. They're not gonna change, they're gonna be 95 to 98 percent long, with the exception of a few opportunistic mandates like a fair home, or guys that are doing asset allocation. I think you need to understand why you're investing in that fund, and it takes me back to if you're not spending your entire time investing in these things, passive makes a lot of sense. Buying a Vanguard or target date fund or the asset allocation are being made for you, or if you want to mix things up, find a ... BlackRock used to have a fund, I think it was called Global Allocation, where they're actively picking stocks within a 60/40 framework, and they're actively picking bonds within the 40% of the bond fund.

Tim Rotolo: Picking managers is really challenging, I think that's why you've seen this significant push towards passive investing on the long

only side. Yale is a great example, right? Almost all of their equity exposure is through venture capital, private equity, and then they have this absolute returns, but Yale has the benefit of being Yale. They have access, they have tremendous information and asymmetry, in that they get access to the best names, the best managers, they have capacity rights with these people.

Tim Rotolo: My personal investments tend to be in the things that I'm doing professional because that's where I feel like I have a real edge. I don't allocate to other mutual funds. I own a few single name stocks, but for the most part ... actually, I have a checklist for my business investments. Where are the things that I want to find and allocate capital to? The number two thing in my checklist is, would I invest a material amount of my own money in it? I just think if you're an individual investor you need to understand what your own edge is. If you can't identify that, I would say passive is a great option.

Tim Rotolo: If you feel like you need to invest in a more active strategy or something very idiosyncratic like a uranium fund, talk to the manager, figure out what his edge is, what his thesis is, how he thinks about risk. Then to the extent that you can do some operational due diligence, generally I think third party administrator is an absolute must, a well-known auditor. These are just mitigating fraud. A third party administrator where you're getting a statement from that group monthly or quarterly, audited financial statements, going back to Theranos. KPMG, PWC, they're not infallible, we saw that with Madoff, but it's a heck of a high bar. People who are not willing to have their financial statements audited, it's probably a pretty big red flag.

Mike Alkin: Absolutely.

Tim Rotolo: So at the end of the day I think a lot of it is common sense and it's pretty simple. Know the person on the other side of the table's incentives, and try and understand their edge, and then try and understand what your own edge is in the process.

Mike Alkin: Good stuff, man. Well, that was fun.

Tim Rotolo: Definitely, I appreciate you having me on.

Mike Alkin: Yeah, bro.

Tim Rotolo: I always love listening.

Mike Alkin: All right, good. Well thanks for coming on, and we'll talk soon.

Tim Rotolo: Sounds great. Thanks, Mark.

Mike Alkin: I hope you enjoyed listening to Tim and learning a little bit about capital allocation through the eyes of a capital allocator. In the interim, I hope you have a good week. Let's go Islanders. Speak to you next week, thanks.

Announcer: The information presented on Talking Stocks Over a Beer, is the opinion of its host and guest. You should not base your investment decisions solely on this broadcast. Remember, it's your money and your responsibility.