Ely Prudent Portfolios

The King and I

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It was just the king and I, a golf fan's fantasy. As every golfer knows, the king is Arnold Palmer. As fate would have it, Arnie and I arrived at the Silverado Golf Resort in Napa, CA, at the same time and parked in adjoining spaces. Not wanting to impose, I kept to myself. But to my amazement, he came over and started up a conversation. I was star struck. As a kid, all my friends wanted to be Mickey Mantle, but I wanted to be Arnold Palmer. My encounter with the king only served to reinforce those feelings.

Today, the world of institutional investing is star struck with its own king and everyone wants to be like him, too. The king in question is David Swensen, the Chief Investment Officer for the Yale endowment. The investment style Swensen pioneered has become known as the Yale (or Endowment) Model and is heavily weighted toward hedge funds and other illiquid alternative investments. Because of his long-term success, a significant number of endowments, foundations, and pensions have attempted to copy his investment practices.

But Swensen says they may "…think they are emulating Yale, but they are not… because most endowments use fund of funds and consultants, rather than making their own well-informed decisions." He explains, "If you are going to invest in alternatives, you should be all in and do it the way Yale does it — with 20 to 25 investment professionals who devote their careers to looking for investment opportunities… If you're not going to put together [such] a team… your best alternative is passive investing… in [a portfolio of] index funds with low fees [otherwise], you're going to fail."

You're going to fail, cautions Simon Lack the author of *The Hedge Fund Mirage*, because "…a huge imbalance exists between the [hedge fund] industry and its clients." Using a golfing analogy, he says it's okay to "…play a round of golf with the club pro for money, but you'd better use your handicap to get fair odds." For hedge fund investors, the odds are unfair because they don't have the clout to "…demand better terms, transparency, liquidity, fees, and information." Some investors (and their consultants) think the playing field can be leveled using funds of hedge funds, but that's not so, says Swensen. In a Wall Street Journal article, he blasts such funds as "…a cancer on the institutional-investor world. They facilitate the flow of ignorant capital… [and they layer] more fees on top of existing fees…"

The empirical results seem to overwhelmingly support the assertions of Lack and Swensen, but this reality hasn't stemmed the tide of ignorance. While this may seem like an arrogant statement, it is actually much more grounded in humility. From Warren Buffett to leading experts on neurological science, a consensus is developing that the key to investment success is not what you know but knowing what you *don't* know. In other words, investment ignorance comes from an overconfidence in one's ability, whereas investment intelligence requires an awareness of one's limitations.

I know that I will never be an Arnold Palmer and you need to know that you will never find a David Swensen to manage your money. You just don't have the resources or clout to succeed in the world of alternative investments. Heck, with the increased competition for investment professionals and for good opportunities even David Swensen will have a hard time being David Swensen. That means alternatives probably aren't a good alternative and indexing is still the King, and I (and you) need to humbly accept it.

Ely Prudent Portfolios, LLC is a fee-only investment advisory service working with individuals in or near retirement and non-profits. The firm is accepting new clients with a minimum AUM of $1,000,000

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