20th Anniversary Memorandum

Memoirs of a Director of Consulting

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Introduction

“It was twenty years ago today, Sgt. Pepper taught the band to play”

John Lennon & Paul McCartney

Twenty years is a long time in anyone’s language! It’s the time it takes to raise and offload a kid (or perhaps not these days as they stay longer – the Japanese even have a term for them: parasitic singles!); it’s probably ok to say “long-term” in an investment sense after 20 years, although sometimes seven to ten years represents the long-term; and it’s as long as I have been at Frontier and its predecessor firm and therefore essentially represents Frontier’s life as well.

So, if you will indulge me, I will meander a little through the history of Frontier and cover what has changed in 20 years.

Early days

I remember the day I decided to leave my previous employer and join Industry Fund Services (IFS) very clearly.

It was the day of the second (there are three for the uninitiated) State of Origin game (the real footy, rugby league) and my beloved Maroons were up 1-0 in the series after one of the most spectacular final minute tries ever seen in the first game – it was so good one of the commentators screamed “that’s not a try, that’s a miracle!”. I was waiting at work to go to the second game, which happily was being played at the MCG (Melbourne being the only city in the world where you can get 90,000 people to watch a sport that they have no idea about). Anyway, I digress.[1] Ray King, who was in charge of Towers Perrin’s asset consulting business and my boss, then came into my office and told me he was leaving to start a new firm that would be focussed on providing investment consulting services amongst other things to industry super funds.

I already worked for a few industry funds and I liked the fact they were “not for profit” (although we now say “profit for members” – one of a number of changes in 20 years!) and that there was a strong connection with the people in those funds.

The nurses/other carers and hospital workers, teachers, building workers and other tradies etc who are everyday Australians helping to keep the country moving, but who didn’t have much superannuation (the SGC was still brand new and at 3% for most people) and even less financial education. It appealed to me to be able to help those people, and this remains a key motivation for me personally and for Frontier today.

We also didn’t want to complete timesheets (we were both scarred by the six minute billing cycle) although ironically we do now have timesheets at Frontier. Still, a twenty year break from timesheets is not too bad.

We also didn’t want to think about clients as just sources of revenue, but rather to have a partnership that would enable a long-term relationship, supporting investment strategies designed to achieve long-term real return objectives.

1. I would note that Queensland did not go on to win the 1994 series, losing to NSW 2-1. However, Queensland has won the most titles, 20, since the series started, including a magnificent 8 in a row.

Early days

So I asked Ray if he needed anyone to join him and six weeks later we found ourselves in a single but large office in Carlton sharing with Jacques Martin, the predecessor to Superpartners.

Our windows overlooked some student accommodation and Ray and I had a window each. Having grown up in the country and in Queensland, there were some surprising things in store for us most days! Lots of university students saying goodbye to each other on the doorsteps or hanging out windows in various states of undress. It was a little distracting at first but we grew used to it after a while; after all, we had work to do.

We started with two clients – Cbus and STA (one of the predecessor funds to AustralianSuper), but quickly added HESTA, Host Plus, PPWSF (one of the predecessor funds to First Super) and SA Fire.

We used to go to presentations carrying a LitePro, which contrary to its name, was not that light and not that pro! It was a projector used for slide presentations and it commonly broke as it was very temperamental, but we wanted to look professional and savvy so we put up with it. There was an order in which you HAD to do things otherwise the light bulb overheated and that was that.

In the early days, we would present with Garry Weaven, the founder of IFS and he used to say I was the token female and he was the token blonde. There were only three of us and it did generate some laughs, although not from me the first time I heard it!

I remember Garry driving us to presentations in his car – a bombed out (sorry Garry!) Ford station wagon in which he used to transport dogs, sheep or alpacas or perhaps some combination of the three! We had to pick the white hair off each other before we went in to the meeting. Those were classy days.

I have some very good memories of that time. It was hard and it was all so new and everyone was finding their way. I was also doing my Masters of Finance so that was a bit of a juggle. Standards were somewhat more lax though, and I do cringe a bit now when I think back to some of the things we had to do.

For example, I remember one of the “Plan Secretaries”, an earlier version of the CEO, going on holidays for six weeks and leaving me a pile of Fund letterhead to basically run the Fund is his absence. Naturally everything I did was within agreed guidelines, but there was certainly less letterhead to hand back on his return! That of course could not happen today and with good reason.

Many of the clients we won in those early days were also finding their feet. I recall we worked with one in the mid 1990s which had five balanced managers, two capital stable managers, three capital guaranteed managers and one capital protected manager as well as a few specialist managers! And all of that to invest $180 million! No need to worry about under-diversification there.

Of the total of those ten firms (one had two mandates – capital guaranteed and balanced), only three exist today and each of them in a different form than in 1995.

The more it changes, the more it's the same

Needless to say there were some quick wins in terms of restructuring that portfolio. This was the time when "balanced versus specialist" was very topical and we wrote many papers and did many presentations on this. Asset consultants were pretty keen to make the specialist argument and it was largely based on the view it was easy for a fund manager to be a "jack of all trades (i.e. balanced) and a master of none (i.e. specialist)" but it also required someone to make the asset allocation decisions, and this was the start of our work into dynamic asset allocation along with one of our locally based competitors.

In contrast, the most common approach to asset allocation at that time was as espoused by the large global firms, which I loosely call the rollercoaster approach. That is, you get on the rollercoaster (i.e. invest in the markets), pull your safety bar down and hold on with your fingers crossed that you won't vomit, fall out or die (i.e. lose money). Strategic asset allocations were reviewed on a fixed three year cycle and what happened in between was deemed to be irrelevant. It didn't matter at all if markets were expensive or cheap.

This approach seemed to have been largely imported from the US, but it resulted in quite unsatisfactory outcomes some of the time. In the late 1990s for example, it meant some funds kept buying equities as they became more and more expensive. In contrast, our clients had lower allocations to equities and dealt much better with that market environment as a result.

The "tech wreck" was not enough to cause many of the other asset consulting firms to change their asset allocation ways. It would take a much larger crisis, the GFC, to do that some nine years later.

Dynamic asset allocation is now the most common approach to asset allocation. Somewhat ironically, some of the balanced managers from the 1990s were doing just that i.e. moving their asset allocations around dynamically, but the move from balanced to specialist took that potential source of value added away from those firms and placed it either in the asset consultant's hands or nowhere (if the strategic asset allocation approach was followed).

In a further twist, the market has now spawned "new balanced" strategies, which the fund managers prefer to call "multi-asset funds", and these are essentially an updated version of the old balanced funds from 20 years ago. As the French say, "plus ça change, plus c'est la même chose."

The transfer of asset allocation "control" from fund managers to asset consultants and the general rise in influence of the asset consultants were not necessarily met with strong support from the funds management community. However, at that time, and this is still the case for a small number of firms today, asset consultants offered an independent view of the world and provided strong support to many fledgling superannuation funds who were typically staffed with a very small team and governed by Directors who were also still learning what superannuation was and how important it would become. Employing an asset consultant meant Directors could rely on an honest broker or an independent third party to monitor the fund managers and make sure they were doing what they say they would. Levels of accountability increased as did formal reporting and activity within the funds.

Markets were strongly led down by the tech wreck of 1999, compounded by corporate governance scandals in some high profile companies such as Enron and WorldCom and then the US-led invasion of Iraq. From March 2003 followed a glorious time in equity markets and this was probably the easiest period of them all in the last 20 years. Little did we know what was waiting around the corner.

The global financial crisis

The GFC was easily the toughest time in the markets in our twenty years. Happily, or unhappily, I was on long service leave at the time, and so the burden of the work fell on a number of my colleagues back in the office[2] and I know they found that a very stressful and difficult time. They felt like they were flying blind and every day brought new troubles and worried clients. In contrast, I was in Italy trying to work out why my Australian dollars were suddenly not buying as many Euros and thinking my long service leave had ruined my ability to do the maths involved in currency conversions.

The GFC period was exceptionally hard for everyone. Members panicked and moved money to cash, funds grappled with all the money moving to cash, with allocations to illiquid investments and unwanted currency calls. Many Directors, who had never experienced a tough market, were suddenly exposed to the devastation that a –54% peak to trough market can wreak. It was a tough time for everyone, and a tough time to be an asset consultant (given that this is the focus of this note).

Looking forward and strategising was replaced with hand holding, and trying to keep a cool head. As Ben Graham said, “Individuals who cannot master their emotions are ill-suited to profit from the investment process.”

As students of behavioural finance, we spent lots of time internally trying to stay rational and to work out when cheap would be cheap enough. In February 2009, we felt that equity markets had fallen by so much that surely most of the bad news was in the price. So we ventured out to clients and recommended they put money back into the market.

We recognised this was a hard thing for some Directors to do and so all of our consulting skills were put to the test. I recall one client who told me it was “very bad advice” and asked “how could we recommend buying equities when they had fallen so much”. I asked if he’d rather have bought them when they were twice as expensive. Needless to say that was a tricky meeting and there were some clients we couldn’t get over the line. However, we did manage to convince some and the timeliness of this advice and their action helped boost returns coming out of the GFC.

The period since the GFC has seen a strong increase in the incidence and more recently the size of internal teams, and this is definitely presenting challenges for asset consulting businesses. Some asset consulting firms have responded by moving further into funds management via implemented consulting (definitely an easier business model!), but others, such as Frontier, have chosen to stay independent, to specialise and to work hard to stay relevant and useful for the funds.

2. They know who they are, and I am forever grateful for the way in which they stood up to this challenge. That which does not kill you, makes you stronger!

Looking forward

We strongly believe an independent team of investment experts can continue to add value even as the funds evolve and employ more and more people themselves. Good ideas can come from anywhere and, as there are few certainties in investments, we believe the process of vetting ideas and putting them through the wringer before members' or sponsors' money is invested is a good thing. We also believe asset consultants can offer a separate perspective on the market and the portfolio. In the latter case, most commonly an internal team will largely be a team of specialists with relatively few people taking the helicopter view of the portfolio at this stage.

So many challenges lie ahead and we are all well aware of them. But there are also many challenges facing the finance and superannuation industry generally, including the continual need to deliver good net of fee returns for members and sponsors, the need to re-earn the trust that has been lost by the average Australian post the GFC and the need to wrangle ever changing and disrupted markets. We think asset consultants have a valuable role to play in this process.

My memory is not as good these days as it was but I can recall saying to one of the asset consulting industry's first members when we started Frontier in 1999 that I wished I could look forward to see the future and how things would turn out. He told me that I should just enjoy the journey. To be honest it hasn't always been that enjoyable! It's been really hard at times, with changing markets, regulatory and economic environments and of course changing client dynamics. But as my father says, life wasn't meant to be easy!

He also used to say that money doesn't grow on trees but I think that was just because he has three daughters.

When I look back now to the start of Frontier and even further back to the start of IFS 20 years ago, I can't imagine any other path I might have taken. Frontier today is the amalgam of all the people that have come before and all those who are here today. I have been privileged to lead it and to enjoy the support of the team and of the Board and the CEO. I am better at my job for the people I work with and have worked with and hopefully they are better for having worked with me. I have also made some great friends.

Those of you who know me know I don't drink wine, but I do know that good wines get better with age. From the early days of "the King and I" at IFS (we were the asset consulting business!) to the 50 people at the Frontier of today, we have definitely improved with age, even if some of us are a little wrinkly around the edges. But with those wrinkles comes experience and hopefully at least a bit of wisdom that we can continue to share with our clients over the next 20 years.

As I said at the start, this has been a little bit of an indulgent trip down memory lane. Hopefully it provides a perspective on the 20 years that is at least a little bit interesting! This business only exists because of its clients and its people, so I'd like to conclude by thanking all our clients for their on-going support and all of our staff for their on-going hard work.

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About Frontier Advisors: Frontier Advisors is one of Australia's leading asset consultants. We offer a wide range of services and solutions to some of the nation's largest institutional investors including superannuation funds, government/sovereign wealth funds and universities. Our services range from asset allocation and portfolio configuration advice, through to fund manager research and rating, investment auditing and assurance, quantitative modelling and analysis, and general investment consulting advice. With around $200 billion in funds under advice we have been providing investment advice to clients since 1994. Our advice is fully independent of product, manager, or broker conflicts which means our focus is firmly on tailoring optimal solutions and opportunities for our clients. At Frontier, we're on your side.