

In Brief

Q&A: Investing with Diverse Managers

July 2020

Past performance is not necessarily indicative of future results. No assurance can be given that any investment will achieve its objectives or avoid losses.

ABOUT GCM GROSVENOR'S DIVERSE MANAGER PRACTICE¹

- + Invests across alternatives: private equity, hedge funds, infrastructure and real estate
- + First investment in 2002
- + \$6.6 billion invested/committed
- + 80+ managers
- + 170+ investments

How Investment Programs Can Become More Diverse

What are the key factors to investing with diverse managers? Are the sourcing and investment processes the same compared to more established managers? What's to be gained, and what are the risks? The GCM Grosvenor team that focuses on investing with diverse private equity managers answers these and other frequently asked questions. In doing so, they address reasons behind the dramatic upswing in the number of diverse manager fund launches and discuss sourcing, implementation, and maintaining a robust pipeline.

The team has focused on sourcing, sharing best practices, and allocating capital to diverse private equity managers since 2005. In this time, they have helped numerous corporate and public pension plans and other institutional investors build diverse manager programs from the ground up.

WHY IS THERE INCREASING INTEREST IN INVESTING WITH DIVERSE MANAGERS?

We believe there are three main reasons. First, there is much evidence that investing with diverse managers is good business. Surveys, studies, and our own research and experience support diverse managers' ability to produce attractive risk-adjusted returns and the potential to generate alpha. One recent study conducted by the National Association of Investment Companies (NAIC), to which GCM Grosvenor contributed, notes that its universe of diverse manager funds reliably outperformed relevant benchmarks over long time horizons.² The study attributes performance primarily to smaller fund sizes, differentiated deal flow, and managers' investments in first-time funds.

Second, many endowments, foundations, and pension funds (and the entities that govern them) continue to highlight the importance of equal access to capital in their investment programs. Some investors are influenced by external sources like regulatory requirements. Others may be influenced by C-suites, boards, and trustees who are realizing the diversity of their investment management falls short of the progress they have made toward diversity in other parts of their businesses.

There has also been a new wave of interest among investors sparked by the increased focus on racial justice in the US and globally. These investors tend to emphasize underrepresented minorities such as African Americans and Hispanics. Given the current dialogue, limited partners, corporations, foundations and others are exploring how they can leverage their influence and investments to ensure equal access to capital.

Third, the population of diverse manager talent is much deeper than in prior years. Diverse professionals have risen to more senior levels of established firms, giving them the experience and track records to launch their own funds. The number of funds launched by diverse private equity managers has increased significantly since 2008.

DEFINING:

Diverse Private Equity Managers

Firms in which diverse professionals account for at least 33% of firm economics; diverse professionals are:

- + African Americans
- + Asian Americans
- + Hispanics
- + Native Americans
- + Women
- + U.S. military veterans
- + Persons with disabilities

“We believe in the efficacy of diverse manager investing; over one-third of our private equity capital commitments in the last three years have been to diverse managers.”

Significant growth in funds launched by diverse private equity managers:

Data based on GCM Grosvenor's evaluation



Data as of March 6, 2020. For illustrative purposes only and subject to change.

ARE THERE PARTICULAR SKILLS OR TRAITS COMMON TO THOSE WHO HAVE SUCCESSFULLY ACHIEVED MORE DIVERSITY IN THEIR INVESTMENT PROGRAMS?

Yes, we do see common traits. For one, these investors have a thorough knowledge of the diverse manager universe. They meet frequently with managers and are proactive in sourcing talent rather than relying solely on placement agents or general partners (GPs) that approach them. Doing so helps build their reputations as investors that are accessible to diverse managers. At GCM Grosvenor, we have an “open-door” approach toward meeting diverse managers, which has allowed us to see hundreds of opportunities and commit more than \$1.3 billion to diverse private equity managers over the past two years.

In our experience, successful limited partners (LPs) immerse themselves in the diverse manager community and actively participate in relevant industry organizations. We see firsthand how being involved with associations of diverse professionals can create new relationships and strengthen existing ones. GCM Grosvenor typically sponsors or attends over 25 industry conferences per year and hosts two premier industry events that spotlight diverse and emerging managers. Fostering a community in the diverse manager space remains important to us during the current global pandemic. Thus, in 2020, we moved our hosted events to virtual settings and remain committed to sponsoring and attending other virtual industry events.

Established investors in this space also have the ability to consider managers with complex stories or shorter track records. These LPs are prepared to invest early in funds that may be smaller and less well-known and can often move quickly to execute co-investments with managers.

Finally, LPs in this space often have diversity on their boards and investment teams. We don't think this is necessarily a requirement, but there's an element of “walking the walk” in doing so.

WHAT ABOUT LPS WHO WISH TO INVEST WITH DIVERSE MANAGERS, BUT ARE SHORT ON RESOURCES?

Investors can supplement their efforts by working with an advisor or consultant at varying levels of engagement. For example, LPs in the early stages of diverse investing may require advisors for help with sourcing, due diligence, and implementation. Others may play a more active role by participating in deal flow calls to get an advisor's views on managers, or invest alongside the advisor in its commitment to a particular manager.

It is important that the LP holds its advisor accountable by asking the right questions:

- How many diverse managers did the advisor meet with last year?
- How much capital did it allocate in the past three years?
- Is the advisor acting on behalf of all its clients, or just those that request diversity?
- How diverse is the team itself?

“
When we are asked by LPs, “Why isn’t my manager roster diverse?” we often answer with another question: “Are you looking in the right places?”

- Which diversity-focused conferences did senior members of the firm attend?
- How many within the organization spend the majority of their time focused on investing with diverse managers?
- What is the advisor’s view on investing with first-time funds?

Answers to these questions may help an LP assess whether the advisor is fulfilling its fiduciary responsibilities by executing broad and inclusive searches.

CAN AN LP APPLY ITS SAME INVESTMENT PROCESS TO SOURCE AND EVALUATE DIVERSE MANAGERS?

Yes and no. Diverse managers are not an asset class based on ethnicity or gender. A buyout manager is a buyout manager and is evaluated by investors on the same criteria – alignment, track record, how long the team has worked together, strategy, and potential competitive advantage – and nothing should be compromised. LPs are looking for benchmarked performance and, just because it’s a diverse manager, the standards for underwriting don’t change.

That said, there may be nuances in sourcing – how and where investors are finding diverse managers. LPs must be able to sort through complexity to identify and evaluate managers that may lack a long history or typical track record. But that’s a common theme in emerging manager investing broadly. It’s about rolling up your sleeves and doing the work to understand the deals a manager has done and vetting its performance.

So, when we are asked by LPs, “Why isn’t my manager roster diverse?” we often answer with another question: “Are you looking in the right places?” Frequently, that answer is “no.” But establishing a network of diverse managers does not happen overnight. At GCM Grosvenor, we have been evaluating emerging and diverse managers since the early 2000s and have identified and follow over 450 diverse private equity funds, with over 50 in fundraising.³

ARE THERE RISKS ASSOCIATED WITH INVESTING WITH DIVERSE MANAGERS?

There isn’t anything unique about the investment risks associated with diverse managers. In general, alternative investments are subject to risks such as strategy risks, manager risks, market risks, and operational risks, but investors with diverse managers are often exposed to a different type of risk: perception risk.

We have come across some investors and consultants that are of the mindset that there is additional risk in seeking investments with people that are somehow different than them. That is a misperception. The fact that some believe they must step outside of their comfort zone to evaluate a person or team whose story is not “typical” – that’s perceived risk. In our experience, meeting with and evaluating a team like this is an opportunity, not a risk.

HOW CAN LPS HELP KEEP A FLUID PIPELINE OF TALENTED DIVERSE MANAGERS?

When it comes to maintaining a pipeline, LPs should hold themselves and their advisors accountable. It is not about meeting quotas, but LPs may benefit from being more “intentional” in asking themselves questions like: Are we invested with diverse managers who have generated exceptional performance? If not, why not? How many diverse managers have we met with this quarter? And if we’ve not met with many, why not? Who’s in the pipeline? It is critical that an investor, its staff, and advisor leave no stone unturned to find the very best opportunities.

It’s also important that LPs stay connected to the feeding organizations that supply talent, as there is a need for established managers to have their own diversity of staff and promote growth among diverse professionals. Considering that only 19.7% of employees at alternative investment firms are female, and just 11.9% occupy senior roles,⁴ investors should help drive change and influence managers by inquiring about their diversity initiatives and stressing the importance of having an inclusive culture.

ADDITIONAL NOTES

- 1 Hedge funds data as of January 1, 2020. Private equity and real assets commitments as of September 30, 2019.
- 2 NAIC, "Examining the Returns," 2019. Full report at <http://naicpe.com/wp-content/uploads/2020/03/2019-NAIC-ExaminingTheResults-FINAL.pdf>. **Past performance is not necessarily indicative of future results. No assurance can be given that any investment will achieve its objectives or avoid losses.**
- 3 Diverse manager universe as of March 6, 2020. Fundraising data as of June 30, 2019.
- 4 Source: Preqin.

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ABOUT GCM GROSVENOR

GCM Grosvenor is a global alternatives investment firm with \$55 billion in assets under management in hedge fund strategies, private equity, infrastructure, real estate, credit, and multi-asset class opportunistic investments. We have specialized in alternatives since 1971, and we are dedicated to unlocking value for our clients by leveraging our cross-asset class and flexible investment platform.

Our experienced team of approximately 500 professionals from diverse backgrounds serves a global client base of institutional and high net worth investors. GCM Grosvenor is headquartered in Chicago, with offices in New York, Los Angeles, London, Tokyo, Hong Kong, and Seoul.

OUR SMALL, EMERGING, AND DIVERSE MANAGER PRACTICE

GCM Grosvenor promotes equal access to capital in alternatives by driving increased investment with small, emerging and diverse managers. We have over \$19 billion invested and committed to these managers across private equity, hedge funds, infrastructure, and real estate. Our experienced team leverages a network of contacts built over decades to source the next generation of talent, helping to drive a more diverse and inclusive industry. To further drive the success of these managers, we host multiple industry-leading annual conferences that train, educate and promote small, emerging, and diverse managers while connecting institutional investors to these managers, further accelerating their growth.

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