FEBRUARY 2020 | A PUBLICATION OF INSTITUTIONAL REAL ESTATE, INC.

REAL ASSETS ADVISER

Diversification strategies for private wealth advisers

Taking a public profile

Richard Hough, CEO of Silvercrest Asset Management, sidestepped the RIA consolidation frenzy and maintained his firm's independence by taking his case to Wall Street

Alts and the SEC
Key compliance and due-diligence pitfalls advisers can avoid when vetting alternatives

Growth of private credit
Investors move to debt but pressure on interest rates remains an unpredictable variable

Impact venture capital
Investing star Sarah Cone is aiming to disrupt the VC business by doing good with technology

By Mike Consol

Taking a public

profile

Richard Hough, CEO of Silvercrest Asset Management, sidestepped the RIA consolidation frenzy and maintained his firm's independence by taking his case to Wall Street

When it comes to IPOs, the thrill is gone. It was once a process full of the romance and excitement of becoming a publicly traded company on Wall Street, but that has largely dissipated as the process has become too expensive and painful for many companies to bear. Underwriting eats up 4 percent to 7 percent of gross proceeds, according to research by PwC, plus an additional $4.2 million of offering costs such as the required financial assessment followed by the roadshow to visit and pitch institutional investors on the opportunity. Once public, CEOs estimate the annual cost of being public between $1 million and $2 million per year. Then, for many companies, there is the relentless short-term pressure exerted by shareholders to keep share prices aloft. Add the ill-fated IPOs of companies such as WeWork and it all helps explain why in 1996 there were more than 7,000 domestic companies listed on U.S. stock exchanges compared with fewer than 4,000 today.

But for Richard "Rick" Hough and his team at Silvercrest Asset Management Group, becoming one of the few publicly traded RIAs brought advantages, including being able to maintain their independence. Silvercrest was about 70 percent owned by three shareholders, including private equity, and was sure to be sold to a larger organization to create liquidity and capture the return desired by those with such large equity stakes in the firm. The IPO alternative created the liquidity event equity partners needed, maintained Silvercrest's independence and gave the firm access to a permanent source of capital on an as-needed basis. As for those pesky shareholders, Hough, the firm's chairman and CEO, actually likes interacting with analysts and investors and being responsible for explaining the firm's business plan and strategy. It is healthy for an organization to be held accountable, he says.

"We wanted to build an enduring enterprise that could last for an extraordinarily long time on behalf of the families with whom we work," Hough explains. "It also greatly raised our profile in the business, and it provided transparency to our institutional and other investors about our economics and the stability of the firm."

Hough (pronounced Huff) also cites the disadvantages, including the burdensome and expensive regulatory work involved.

"Many public firms get caught up in the short-term view of the markets or the hard times investors may give you," he says. "Frankly, we haven't struggled with that."

That might be attributable to Silvercrest's status as a microcap company with a relatively modest market capitalization of $180 million. Its stock is currently trading around $12.50 per share, with a 52-week range of $11.61 to $16.05 per share. But its AUM, as of Sept. 30, was $23.5 billion, 70 percent of which comes from its individual and family investors. Its more than 700 client relationships average a net worth of $30 million per client.

Given its relative protection and independence as a publicly traded RIA, Hough takes the liberty of pointing out the industry is in the midst of unprecedented consolidation, and many of the great names in private banking and investment counseling have either vanished or sacrificed their independence to become global consolidators. Clients of those organizations are sometimes victimized by the consolidators' business goals of greater scale, enhanced market share and global reach. Hough asserts that as a firm continually consolidates in search of scale, the ability to maintain a single-minded and entrepreneurial culture is diminished.

"Those things become infinitely harder," he says, "and it becomes harder and harder for advisers to bring their talents to bear on a client's account, and for clients to feel the benefits of the great skill that may be in those organizations. Without naming names, any number of the very large conglomerates in asset management or banking have wonderful people and intellectual capital buried in their structures, but it is extremely hard for that best thinking to come to the fore and be applied to client portfolios."

He also cites the conflicts of interest created when there are multiple lines of business seeking a greater share of client assets and firm profits.

"Ultimately, that is harmful to clients," says Hough. "We have no other lines of business, which is to say I don't have trading, I don't have banking, I don't get any interest rate spreads, I don't get any kickbacks or any other line of business that isn't dedicated to purely providing advice to our clients."

Silvercrest Asset Management by the Numbers

Year founded
2002

Clients
774 relationships

Assets under management
$17.5 billion

Average client net worth
$30 million

Assets under advisement
$23.5 billion

Personnel
139

Offices
8

THE ENGLISHMAN AND THE BUSH ADMINISTRATION

Hough attended Princeton to study history specifically under the expertise of historian Lawrence Stone, an Englishman well known for his work on the English Civil War. Stone unexpectedly retired when Hough was just two courses into the program, convincing him to choose another major. He settled on political philosophy — because he was interested in what motivates people — and delved into the classic works of Plato, Augustine, Machiavelli, Rousseau, de Tocqueville and others.

After graduation, Hough worked in the first Bush administration as a policy analyst and "was quickly fired by the American people" when Bill Clinton defeated George H.W. Bush in the 1992 presidential election. But he had already co-founded a nonprofit dedicated to educational reform efforts during Bush's tenure in the Oval Office, and that work continued under the Clinton administration and turned out to be fruitful, as the organization built an online network for educators during the internet's nascent days. By the mid-1990s he and a close friend co-founded The Children's Scholarship Fund to send children to private schools they could not otherwise afford. In 1998 the organization was taken nationwide with the financial backing of the late Ted Forstmann, billionaire co-founder of the private equity firm Forstmann Little & Co., as well as CEO of IMG, a global sports and media company, and John Walton, son of Walmart founder Sam Walton. It became one of the fastest-growing foundations of the late 1990s, providing scholarships to 60,000 children at the time.

"I am very proud of my role in building that program across the country and helping these families," says Hough. "I would have called myself a nonprofit entrepreneur because I started up more than one nonprofit."

FAMILY MAN

Interestingly, Hough had thought about the private wealth business during his undergraduate years at Princeton, taken by the notion of caring for families by securing their financial fortunes. Though he spent years on the nonprofit path instead, in the aftermath of 9/11 and all the changes on Wall Street, Hough determined that his skillset and background could be useful to people interested in starting something new and willing to take a chance on him.

"I love innovating and creating something new and, at that point, the scholarship fund was largely built and it was doing wonderful work," he says. "But it was, to my thinking, going to involve much more money-raising to maintain and grow the existing scholarships. It wasn't about building the program quite so much, and I wanted to build something new."

Following the advice of Ted Forstmann and his connections to Julian Robertson, the now retired billionaire hedge fund manager and philanthropist, he started networking. It was then he met Moffett Cochran, former chairman and CEO of DLJ Asset Management Group, a unit of Donaldson, Lufkin & Jenrette, which in 2000 was acquired by Credit Suisse. Post-merger, Cochran became president of Credit Suisse Asset Management overseeing a $300 billion asset-management business.

With impeccable timing, Hough and Cochran hit it off, right when the latter was looking for someone to help him execute his business plan at Silvercrest Asset Management, the new firm he co-founded to cater to wealthy families.

"That is what I came here to do," says Hough. "It was just what I was looking for, something entrepreneurial, something fresh and new, something that was going to require a lot of work and new ideas."

Among the components of the business plan Hough was tapped to develop was the firm's original alternative investments through fund of funds. He was also the person in charge of putting together much of Silvercrest's marketing materials, brand management and strategic relationships.

The firm blossomed, growing AUM from $1.9 billion in 2002 to $23.5 billion as of the end of third-quarter 2019.

CHANNELS FOR GROWTH

Hough expects the firm's future growth to come from a few different directions. One is the continued growth of Silvercrest's institutional asset management business, which was recently enhanced by the firm's July 2019 acquisition of Cortina Asset Management, a firm managing about $1.7 billion in small cap growth equity strategies.

Second, it will come from Silvercrest's latest initiative, outsourcing chief investment officer services to small endowments and foundations.

Third, the continued growth of the firm's clientele of high-net-worth individuals and families representing 70 percent of the assets it currently has under management, and that business will be partly driven by recruiting new portfolio managers who bring their existing clients along with them.

"That will include the occasional acquisition in key money-center cities," Hough says, "so I would expect, if you look five years out, we will be close to 75 percent larger than we are now, and perhaps double the size in seven years. We ought to be in two or three new geographies by then."

Silvercrest currently has eight offices, including its Manhattan headquarters. Its future locations are still in question, though Hough likes the notion of expanding the firm's footprint to Atlanta, Chicago, Los Angeles, Miami, Minneapolis, San Francisco and a Texas city.

> *"The firm recently added two active investing teams in anticipation of the kind of market changes and volatility that will require significantly more active management."*

"I can't predict what city will be next," Hough says, pointing out that Silvercrest will expand into an environment where it can add the best human talent to its operation.

"It is going to be a bit serendipitous because we are dealing in human capital who often are in boutique environments," he says. "So we don't know yet what city will be next."

ATTRACT AND RETAIN

What type of adviser will Silvercrest be in pursuit of during its expansionary recruiting phase?

"There are a few different attributes," says Hough. "Assuming they are mid-career, I want to see successful track record, a stable individual who is intellectually curious and from organizations I know are healthy. I want to find someone who is open, accessible and honest, someone who isn't just there to impress. People whose questions are mostly about the working environment and the culture. Someone who knows themselves well, who understands what they are good at, what they are not good at, what they like doing, what they don't like doing. You would be surprised how many people haven't examined themselves or thought deeply enough to know those things."

Building a culture that attracts and retains talent is the hardest thing the firm does, Hough says, noting that the firm's "dedication to and investment in talent has resulted in extraordinarily high employee retention."

ALLOCATION MAXIMUS

Silvercrest advisers often find new clients have been overallocated, as previous advisers mistook the sheer number of asset allocations for diversification. One client had 60 different allocations, creating complexity, duplication, lack of transparency and hidden risks.

"You tend to see new client portfolios with niche products that don't add a lot of value to the portfolio and bring higher risk," says Hough. "These investments tend to be the kind of things that people talk about at cocktail parties."

In those cases, Silvercrest advisers look to winnow those allocations down to around a dozen, with an eye toward improving the return profile, increasing liquidity and flexibility, and getting around the "misguided idea" that selecting numerous allocations will inherently increase the likelihood that something is going to do well, as opposed to prudently selecting the best option or two in an asset class.

Hough puts it this way: "We are going to select only one or two real estate allocations, and we are going to only have hedge funds or partnerships that serve very specific purposes and that don't overlap with other parts of the portfolio.

Alternatives and real assets at Silvercrest Asset Management

What alternatives and real assets has your firm been recommending to its clients?
Real estate, hedge funds, private equity, venture capital, energy and commodities are commonly part of allocations, although private client portfolios can differ markedly due to individual risk preferences, financial goals and a client's comfort with complex or less-familiar asset strategies.

Which specific real asset subsectors have you been using?
In recent years, real estate, energy and commodities have comprised the preponderance of our real assets exposure.

Talk about the role of alternatives and real assets in your clients' portfolios.
Alternatives and real assets are generally additive to core portfolios comprised of stocks and bonds. Alternative/real assets provide us with tools to help lower the volatility of a total portfolio, access a wider array of return and income streams, and mitigate the impact of inflation.

Do you expect alternatives and real assets to hold bigger positions in client portfolios in the years to come?
From client to client, this depends to a large extent on (a) a client's increasing comfort with alternatives, and (b) how the firm's views evolve on both inflation and expected returns.

What are your concentration limits for alternatives and/or real assets?
This varies by client but is generally up to a range of 30 percent for alternatives, inclusive of real assets.

Do you see those concentration limits changing in the future?
This is unlikely to change meaningfully.

What liquid alternatives and real assets are commonly used for your clients?
We access alternatives/real assets exposure through third-party separate accounts (vetted via our own, dedicated due diligence team) and through mutual funds.

Do you provide separate accounts, club deals, etc., to your firm's individual high-net-worth clients and families?
Yes, but rarely, and only in select, bespoke situations.

What alternatives and real assets are you especially optimistic about over the next two to five years?
At this time, we believe there are attractive opportunities in private real estate, private credit, venture capital and private equity.

We may have a broad private equity capability that diversifies the family across vintage year, sector and cap size with a couple of complementary direct investments. We would likely have venture capital, energy and commodities as part of the allocation, but it is going to differ substantially by client. We have a lot of families that are very liquid and have only publicly traded portfolios because that is what they are comfortable with. Ensuring that a family is comfortable with a portfolio is a very important part of the equation. The behavioral aspect of investing is often ignored by our peers to their detriment. It doesn't matter if you have created the most beautiful, optimal portfolio if the family cannot maintain it for a sustained period of time. The portfolio that is going to do better is the one the family can sustain, so we have to take that into account as well."

The firm recently added two new active investing teams in anticipation of the kind of market changes and volatility that will require significantly more active management. Though the firm uses some passive management strategies, Hough observes that one reason passive management has surged in recent years at the expense of active management has been the result of a long-lasting fairly low volatility bull market. The firm's new active management teams have been added, in part, to prepare the firm to handle volatile markets with more agility, as well as to enhance separately managed accounts, which are particularly appropriate for high-net-worth clients.

"We are always doing things for more than one reason, and these particular active strategies provide us with capabilities that we would prefer to have internally to add additional value to our client portfolios without costing our clients more money," Hough adds. "That helps us maintain our competitive advantage against a lot of open architecture firms and asset allocators who are pricing their advice on asset allocation rather than fundamentally being in the asset management business."

Getting Personal
Richard Hough

If you could go back in time, what would you tell a 25-year-old Richard Hough?
Do what you are about to do but worry about it less. You have capital no one can buy: youth. So be fearless. Life is long; you can make mistakes. Life is short, so do it now. You were right to marry that girl.

How do you like to spend your time outside of work?
Outdoors seeking adventure: backpacking, fishing, skiing, birding and more

First choice for a new career?
Inventor

Most influential book you have read?
Moby Dick by Herman Melville, *Democracy in America* by Alexis de Tocqueville, *The Idea of a University* by John Henry Newman, *The Closing of the American Mind* by Allan Bloom

What are you afraid of?
Letting people down

Biggest lesson you've learned?
Do not be afraid and trust God.

Best piece of career advice you ever received?
Find a mentor and never stop learning. (Best direct personal advice: Call Moffett Cochran at Silvercrest.)

Favorite quotation?
"That rug really tied the room together." — The Dude in *The Big Lebowski*

Tell us something people would be surprised to know about you.
I mostly grew up in Texas, I wanted to be an astronomer, and I bought my first new car when I was 42.

What is your idea of perfect happiness?
A room packed full of people I've never met, or complete solitude on a mountain stream.

You're organizing a dinner party. Which three people, dead or alive, do you invite?
Augustine of Hippo, Ingrid Bergman, Thomas More

What is your greatest extravagance?
Four children

What is your biggest regret?
I don't really have any and always look forward. But if I did, it would be not taking more chances.

What phrase is most overused in your industry?
Any noun used as a verb

If you could change one thing about yourself, what would it be?
Procrastination

What is your most pronounced characteristic?
Deliberation

If the most recent year were set to music, what would be the first cut on the soundtrack?
"Walking on Sunshine" by Katrina and the Waves

What book might people be surprised to find in your bookcase or iPad?
Lonesome Dove by Larry McMurtry

How do you want to be remembered?
As a good and generous man, father, boss and mentor.

AN EYE ON AI

Hough sees the firm's active management and portfolio construction capabilities becoming enhanced by the advance of artificial intelligence into the private wealth space. While so-called robo-advisers sent waves of trepidation through the industry a few years ago, they represent just the front edge of far more powerful technologies that Hough says will allow advisers to manipulate portfolio data in new and interesting ways.

In anticipation of the opportunities presented by AI, Silvercrest has enrolled some of its people in MIT artificial intelligence courses that drill students on machine learning and the use of robotics in business, as well as the future of artificial intelligence.

"It will only improve the services we are delivering," he says. "I see it as a huge benefit."

Indeed, Hough counts tech advances as the most exciting change happening in private wealth.

HOUSE RULES

Fundamental to Silvercrest is maintaining an organizational culture that is flat and entrepreneurial, where the firm's executives and advisers have minimal interference from bureaucratic processes.

"They will flourish in an environment where they are properly motivated, have skin in the game and are allowed to ply their craft," he says. "That is the culture you must create to build a dynamic working environment." ■

Mike Consol (m.consol@irei.com) is editor of *Real Assets Adviser.* Follow him on **Twitter** *@mikeconsol* to read his latest postings.

SILVERCREST

ASSET MANAGEMENT GROUP