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SPECIAL REPORT

SMALL MANAGERS

Experience, not size, is what matters

Smaller firms yield full-size performance in P&I's review of 12 investment strategies

By RANDY DIAMOND

Executives of smaller money management firms with sizable institutional assets and top investment performance usually have one thing in common: years of industry experience before opening their own firm.

After that, tales diverge, some firms are only a few years old, others have been in business for decades. Some are battling back from severe asset losses suffered during the financial crisis and still haven't had enough inflows to get past the dark days, while others are seeing all-time record asset level highs from inflows and strong financial markets.

But the key theme that emerged from a *Pensions & Investments* analysis of 60 top-performing firms with $3 billion or less in total assets under management across 12 separate investment strategies is that running your own firm — even if it is small — isn't a game for newcomers.

For one thing, institutional consultants who help determine whether money managers will get contracts with institutional investors are looking beyond solid investment performance. They want prior institutional roots.

"We consider an institutional pedigree important," said Troy Saharic, a Seattle-based partner for institutional consultant Mercer. The pedigree can help identify managers with an understanding of reporting and risk management requirements essential to institutional investors.

Granite Investment Partners LLC in El Segundo, Calif., was only founded six-years ago, but "most of us have been in the business for 15 or 20 years," co-founder Geoffrey I. Edelstein said of his management team.

Mr. Edelstein was a portfolio manager at Transamerica Investment Management LLC before co-founding Granite.

The $825 million AUM firm's small-cap growth equity strategy was the second best performing product in the small cap growth category for small managers reviewed by P&I for the five year period ended Sept. 30, with returns of 19.6%.

Likewise, Harry W. Segalas, managing partner and chief investment officer of New York-based HS Management Partners LLC founded the firm in 2007, but his two-decade investment career before then included holding the post of chief investment officer at W.P. Stewart & Co. Inc.

HS Management's only strategy, the $2.1 billion concentrated quality growth equity strategy, was the top the performer among the large-cap growth segment for the five years ended Sept. 30, with returns of 15.7%.

The firm only had $172 million in assets in its first year of operation. Mr. Segalas said solid investment returns helped generate inflows. Mr. Segalas said he also was able to build on his existing relationships with institutional consultants in getting clients.

Another positive that helped the firm, making a substantial pre-opening investment (he would not say how much) to have in place when the new firm opened a marketer and operations systems to meet the needs of institutional investors.

P&I's analysis, based on data from eVestment LLC, Marietta, Ga., covered managers with at least a third of their total AUM coming from institutional assets. Eleven of the categories were equity strategies, the 12th was high-yield fixed income.

No compromises

Most of the more than a dozen managers interviewed want their firms to grow bigger, but insisted they will gather assets while maintaining a strong investment process — the reason clients have been attracted to their firms in the first place.

"We want to grow the asset base in a way that doesn't compromise our standards," said Elaine Hahn, president and chief investment officer of Hahn Capital Management LLC, a value-oriented money management firm in San Francisco with $1.1 billion in assets.

The firm's midcap value strategy was the No. 1 performer among small managers in the universe *P&I* examined in the one-, three- and five- periods ended Sept. 30. For the one-year period, the strategy produced results of 37.2%, for three years the figure was an annualized 23.6% and for the five years, an annualized 16.4%.

The strategy, its only institutional one now, is around half of its capacity; it can handle another $1 billion or so before it would be closed to investors, said Ms. Hahn.

Top-performing small managers

Ranked by 5-year return, by strategy, as of Sept. 30.

SMALL/MIDCAP VALUE

Manager	Fund	Return
Bernzott Capital Advisors	U.S. small cap	13.9%
Inv. Counselors of Maryland	Smidcap value equity	13.8%
GW Capital	Small midcap equity	13.7%
Cardinal Capital Mgmt.	Select value	13.2%
Steinberg Asset Mgmt.	Smidcap value equity	13.0%

Source: eVestment LLC

But looking to the future when the strategy does reach capacity, Ms. Hahn said the firm plans to offer a small-cap equity product this year.

Like many of the small firms examined by *P&I*, Hahn Capital Management has only begun to attract institutional investors in recent years.

The firm was founded in 1988 by Ms. Hahn, a financial-industry veteran, who was a former senior analyst at the now defunct Oakland, Calif., firm of Jurika Voyles LP before starting her own firm.

Hahn has seen a sizable uptick in assets in the last few years; AUM was as low as $250 million after the financial crisis in 2008. Institutional now assets account for 45% of the firm's AUM, she said.

Hahn Capital Management relies on a third-party marketing organization to engage consultants and market its products, a characteristic of many of the small managers.

Ms. Hahn said hiring a quality in-house marketer would cost $300,000 to $400,000 a year; the third party marketer is more cost-effective and frees firm executives to concentrate on investments. While several states prohibit their pension funds using firms represented third-party marketers, she said the number is very small, so missed investment opportunities are not a major issue.

Other managers in *P&I's* universe are ending their third-party relationships, bringing sales and marketing efforts in-house.

Bernzott Capital Advisors, Camarillo, Calif., made that move last August when it hired Andrew Rosenthal as director of institutional marketing.

"It made sense to have control of how our product is marketed," he said.

Mr. Rosenthal said it is always better for money management firms to tell their own story to potential investors. "It makes more of a powerful story in the marketplace, "he said.

The story Mr. Rosenthal is telling is one of strong recent investment performance. Bernzott's U.S. small-cap strategy had the best performance numbers among the small managers *P&I* reviewed in the smidcap value strategy for the five years ended Sept. 30, according to the eVestment data.

Even among small managers, Bernzott is small: the smidcap strategy had $229.3 million in assets as Sept. 30, about half of the firm's total $454.7 million.

Like a number of smaller managers that *P&I* examined, Bernzott has been attempting to build business back to the peak achieved before the financial crisis. Bernzott had total AUM of $950.7 million as of June 30, 2007; a year later, assets had dropped to $484 million. Assets have gone up and down since then. The firm's assets were as low at $375 million as of Sept. 30, 2012.

In contrast, Cupps Capital Management LLC in Chicago reached its all-time AUM high as of Sept. 30, reaching $1.6 billion in assets. The firm's client base is 100% institutional.

Cupps' flagship strategy, small-cap growth, was the fourth best performer for that category for the three-year period, according to the eVestment data, garnering returns of 25.3%.

Its midcap growth strategy, with $151 million in assets, was the best performer among small-midcap growth strategies for the three years. The strategy returned 21.9% in the period.

Opened in 2000

Chief Investment Officer Andrew S. Cupps along with two partners opened the firm in 2000. Mr. Cupps, like many of the other money managers on the rankings, had spent a long time in the money management industry before opening his own firm. His last position, before opening his firm, was as a portfolio manager at Strong Capital Management Inc. in Menomonee Falls, Wis., from 1994 to 2000.

He said the first six years running his own firm were a tough stretch. The firm had only around $50 million during that period, and convincing consultants and asset owners to invest was difficult, Mr. Cupps said.

Institutional assets started building steadily in 2007, he said, as the firm had a track record on which to stand. But the firm's biggest asset gains came in the 12 months ended Sept. 30, 2013. AUM more than doubled in that period, to $1.6 billion from $750 million, Mr. Cupps said.

Most of the inflows went to the small-cap growth strategy, but the midcap growth portfolio pulled in about $150 million and its all-cap growth approach pulled in nearly that much, reaching $149 million, up from about $1 million as of Sept. 30, 2012, said Joe Shelly the firm's director of sales and client servicing.

The two smaller strategies are essential for the growth of the firm; Mr. Cupps said he is committed to closing the small-cap strategy to new investors after it gains another $150 million in assets, Mr. Shelly said. "We are in the last inning in the small cap growth strategy," he said.

Mr. Cupps said building those assets further necessitated the hiring of Mr. Shelly in August 2012 and ending its relationship with a third-party marketer who represented several firms.

"We had a great relationship with our third-party marketer, but we only received a third of their time," said Mr. Cupps.

Historically, the money management industry has been full of entrepreneurs, talented investment personnel leaving larger money management firms to start their own business because they want to have equity, said Janie Kass, the San Francisco-based managing director for money management consulting firm Margolis/Kass Advisors Inc.

But Ms. Kass said building a business is not easy, particularly for long-only equity managers, as the defined benefit plan marketplace shrinks.

Smaller firms need to focus on building their assets through a variety of channels — institutional, retail and subadvisory, she said.

Ms. Kass said small-cap strategies are a particularly good way to build the asset management business for small managers, because large numbers of institutional investors want to invest in that asset class but can't because firms close their strategies because of capacity constraints.

Staying small

Still, not all the firms interviewed by *P&I* want to grow bigger, however.

Pembroke Management Ltd., Montreal, at US$2.4 billion in AUM one of the largest firms in the group reviewed by *P&I*, has seen explosive growth in its U.S. growth account.

The strategy returned 18.6% for the five-year period ended Sept. 30, the highest performer among small managers in the smidcap category, according to the eVestment data.

Ian Aitken, the firm's managing partner, said the firm plans to close the strategy shortly, noting it already is accepting commitments that will bring total assets up $1.2 billion in the next several months.

Mr. Aitken said the small-cap strategies fund can only grow so big before superior investment returns are hard to achieve.

The growth, however, has also been the result of other managers closing their small-cap strategies, giving Pembroke the opportunity to introduce its strategy to new investors, he said.

He said the firm began increasing institutional marketing efforts three years ago by bringing sales and marketing efforts in-house.

Explanation of Equity Performance — Performance Footnote Disclosure - 4Q2013

Bernzott Capital Advisors claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Bernzott Capital Advisors has been independently verified for the periods of Jan. 1, 1995 through March 31, 2013. Verification assesses whether the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The US Small Cap Value composite has been examined for the periods of Jan. 1, 1995 through March 31, 2013.
The verification and performance examination reports are available upon request.

	# of Portfolios in Composite at period end	Total Composite Assets ($ millions) at period end	Composite Equity Only Assets ($ millions) at period end[4]	Composite Dispersion [3] %	Composite 3 Yr Standard Deviation	Russell 2000 Value 3 Yr Standard Deviation	Russell 2500 Value 3 Yr Standard Deviation	Total US Small Cap Equity Assets[2] ($ millions)	Total Firm-wide Assets Under Management ($ millions)	Composite Assets as a % of Small Cap Assets at period end	Composite Assets as a % of Firm-wide Assets at period end	Bernzott Gross of Fees	Bernzott Net of Fees	Russell 2000 Value	Russell 2500 Value
1995[1]	2	< $1.0	< $1.0	n/a	n/a	n/a	n/a	$ 0.8	$ 3.0	n/a	n/a	**26.61%**	**25.24%**	**25.75%**	**29.76%**
1996	8	$ 1.7	$ 1.2	n/a	n/a	n/a	n/a	$ 2.2	$ 6.3	77.3%	27.0%	**28.53%**	**27.14%**	**21.37%**	**22.21%**
1997	17	$ 4.3	$ 3.0	4.7%	8.88	9.41	8.89	$ 5.4	$ 11.1	79.6%	38.7%	**32.57%**	**31.21%**	**31.78%**	**33.09%**
1998	33	$ 7.1	$ 5.9	3.2%	11.09	15.10	14.88	$ 8.6	$ 17.7	82.6%	40.1%	**11.52%**	**10.49%**	**-6.45%**	**-1.92%**
1999	53	$ 14.6	$ 10.5	5.6%	13.29	16.32	16.14	$ 16.6	$ 31.3	88.0%	46.7%	**-1.56%**	**-2.43%**	**-1.49%**	**1.49%**
2000	54	$ 19.0	$ 14.1	9.0%	14.23	16.61	16.55	$ 21.0	$ 37.8	90.5%	50.3%	**28.59%**	**27.53%**	**22.83%**	**20.79%**
2001	70	$ 32.1	$ 24.3	6.2%	13.24	14.65	14.62	$ 36.1	$ 49.6	88.9%	64.7%	**19.21%**	**18.37%**	**14.02%**	**9.74%**
2002	152	$ 53.3	$ 38.4	4.2%	11.28	17.39	16.27	$ 74.1	$ 100.8	71.9%	52.9%	**11.89%**	**11.13%**	**-11.42%**	**-9.87%**
2003	177	$ 123.3	$ 98.3	4.7%	9.86	18.42	16.97	$ 170.6	$ 195.0	72.3%	63.2%	**38.95%**	**37.92%**	**46.03%**	**44.93%**
2004	273	$ 168.4	$ 138.2	4.0%	10.73	17.51	15.68	$ 232.9	$ 299.4	72.3%	56.3%	**19.42%**	**18.51%**	**22.25%**	**21.58%**
2005	403	$ 436.4	$ 299.0	2.2%	11.28	14.09	12.81	$ 507.1	$ 515.9	86.1%	84.6%	**0.81%**	**-0.05%**	**4.71%**	**7.74%**
2006	338	$ 592.4	n/a	3.4%	10.91	12.33	10.85	$ 703.6	$ 800.4	84.2 %	74.0 %	**28.82%**	**27.72%**	**23.48%**	**20.18%**
2007	363	$ 564.8	n/a	2.9%	12.01	12.59	11.03	$ 622.3	$ 736.9	90.8 %	76.7 %	**-17.44%**	**-18.18%**	**-9.78%**	**-7.27%**
2008	320	$ 344.9	n/a	4.8%	16.99	19.14	18.38	$ 405.1	$ 405.1	85.1 %	85.1 %	**-21.33%**	**-21.85%**	**-28.92%**	**-31.99%**
2009	278	$ 442.5	n/a	5.8%	20.01	25.62	24.61	$ 481.8	$ 481.8	91.8 %	91.8 %	**25.32%**	**24.41%**	**20.58%**	**27.68%**
2010	94 *	$ 302.0 *	n/a	1.2%	20.55	28.37	26.97	$ 319.7	$ 470.8	94.4 %	64.2 %	**21.13%**	**20.23%**	**24.50%**	**24.82%**
2011	80	$ 195.2	n/a	1.3%	17.70	26.05	24.23	$ 198.0	$ 372.0	98.6 %	52.5 %	**9.02%**	**8.24%**	**-5.50%**	**-3.36%**
2012	34	$ 169.2	n/a	1.0%	14.21	19.89	18.41	$ 192.0	$ 395.2	88.1 %	42.8 %	**16.81%**	**16.04%**	**18.05%**	**19.21%**
2013	36	$ 237.8	n/a	1.5%	12.34	15.82	15.07	$ 267.9	$ 512.9	88.8 %	46.4 %	**34.38%**	**33.52%**	**34.52%**	**33.33%**

*[1] Equity product inception: January 1, 1995. [2] The difference between this column and the "total composite assets at period end" is the accounts that do not meet the size parameter for the composite and any new acct under mgmt that has not met the waiting period under mgmt to join the composite. [3] 1995 and 1996 dispersion values are presented as n/a since five or fewer accounts are in the composite for the entire annual periods presented. Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year, and is shown as n/a. [4] Presented composite performance prior to October 1, 2006 is based upon equity only returns including allocated cash. Composite performance following October 1, 2006 is based on total account returns. * - To accommodate the needs of our high net worth non-institutional clients, Bernzott Capital Advisors has and will purchase equities across the capitalization spectrum, and not limit those purchases to the small cap universe. Effective October 1, 2010, the composite was redefined to only include those clients with a specific small cap mandate. This redefinition and client accommodation has resulted in a decline of AUM in the US Small Cap Value composite without impacting firm wide AUM.*

GIPS Compliance Requirements:

Bernzott Capital Advisors is an equity portfolio investment manager that invests in U.S.-based securities. Bernzott Capital Advisors is defined as an independent investment management firm that is not affiliated with any organization.

The US Small Cap Value Composite includes all fully discretionary portfolios that invest in small capitalization U.S. stocks that are considered to have risk-adjusted returns purchased, at reasonable prices. The composite includes concentrated portfolios of market leading companies with consistent operating performance, significant recurring revenue, solid operating margin, moderate leverage and strong returns on capital. A size parameter of $250,000 is applied for composite membership. As of October 1, 2006, composite asset performance is derived from total account performance and eligible accounts are added to the composite after accounts are under management for two complete quarters. Prior to October 1, 2006, the composite was constructed from fully discretionary small cap equity only portfolios and fully discretionary small cap equity segment carve outs of accounts included in the firm composite. Prior to October 1, 2006, accounts were included in the composite their first full quarter under management.

The Bernzott's benchmark is the Russell 2000 Value Index (taken from published sources). The Russell 2500 Value Index is provided as a secondary benchmark.

Gross-of-Fees returns reflect only the deduction of trading costs. Net performance returns reflect the deduction from gross performance of all tradings costs, actual management fees and embedded fees.

Since January 1, 2005 non-fee-paying accounts represent <1% of the composite assets. For the period January 1, 2004 through December 31, 2004 non-fee-paying accounts represent 1% of the composite assets. For the period January 1, 1998 through December 31, 2003 non-fee-paying accounts represent 2% of the composite assets.

Bernzott performance is stated in US dollars.

Prior to 10/1/06 the annual composite dispersion was an asset-weighted standard deviation calculation for the equity only portion of the account in the composite for the entire year and calculations did not take into account the effect of cash. Following that date, the annual composite dispersion is an asset-weighted standard deviation calculation using total account returns. 1995 and 1996 dispersion values are presented as n/a since five or fewer accounts are in the composite for the entire annual periods presented.

Returns are presented gross and net of management fees and include the reinvestment of all income. Bernzott's standard institutional account fee schedule to-date is 90 bp on the first $10 million, 80 bp on the next $15 million, 75 bp on the next $25 million, and 65 bp on the next $50 million. Bernzott's standard private client account fee schedule to-date is 100 bp on the first $2 million, 75 bp on the next $3 million, 50 bp on the next $5 million. Actual investment advisory fees incurred by clients may vary.

Bernzott's composite was created July 1, 1999 and composite membership parameters were revised December 1, 2006 effective October 1, 2006.

A complete list of Bernzott's composites is available upon request.

The policies of valuing portfolios, calculating performance and preparing compliant presentations are available upon request.

Bernzott does not utilize leverage, derivatives or short positions.

Bernzott does not have any significant company events to disclose.

A size parameter of $250,000 is applied for composite membership. The minimum account size was implemented January 1, 2001. As of October 1, 2006, composite asset performance is derived from total account performance. Prior to October 1, 2006, the composite was constructed from fully discretionary small cap equity only portfolios and fully discretionary small cap equity segment carve outs of accounts included in the firm composite. Prior to January 1, 2004, the composite was known as the Small/Mid Cap Domestic Equity Composite. There was no change in the investment process as a result of the composite name change.

Prior to October 1, 2006, carve-out *portfolio segments were included in this composite and cash was allocated to the composite on a set percentage of 5%. As of October 1, 2006, portfolio segments are not included in this composite and all cash and cash equivalents are included in performance.*

An account will be removed from the composite membership if a cash outflow reduces the account value below the minimum size parameter. Additional information regarding the treatment of significant cash flows is available upon request.

Supplemental Information - Market Proxy : Russell 2000 Value

		Bernzott Annualized Std Dev	R 2000v Annualized Std Dev	Alpha	Beta	R-Squared	Cumulative				Annualized			
							Bernzott *Gross*	Bernzott *Net*	Russell 2000 V	Russell 2500 V	Bernzott *Gross*	Bernzott *Net*	Russell 2000 V	Russell 2500 V
1 Yr	12/31/12-12/31/13	10.14	10.90	5.80	0.81	0.76	**34.38**	**33.52**	34.52	33.33	**34.38**	**33.52**	34.52	33.33
2 Yrs	12/31/11-12/31/13	10.13	11.47	5.48	0.75	0.71	**56.97**	**54.94**	58.80	58.94	**25.29**	**24.47**	26.02	26.07
3 Yrs	12/31/10-12/31/13	12.52	16.05	8.39	0.72	0.85	**71.12**	**67.70**	50.07	53.60	**19.61**	**18.81**	14.49	15.38
4 Yrs	12/31/09-12/31/13	13.50	18.32	7.46	0.69	0.88	**107.28**	**101.63**	86.84	91.73	**19.99**	**19.16**	16.91	17.67
5 Yrs	12/31/08-12/31/13	15.22	21.61	8.34	0.66	0.88	**159.75**	**150.86**	125.28	144.79	**21.04**	**20.20**	17.64	19.61
6 Yrs	12/31/07-12/31/13	17.14	23.17	6.21	0.70	0.89	**104.34**	**96.04**	60.12	66.48	**12.65**	**11.87**	8.16	8.87
7 Yrs	12/31/06-12/31/13	17.00	22.03	3.46	0.72	0.86	**68.70**	**60.40**	44.47	54.37	**7.76**	**6.98**	5.40	6.40
8 Yrs	12/31/05-12/31/13	16.29	20.99	4.33	0.72	0.86	**117.33**	**104.87**	78.39	85.53	**10.19**	**9.38**	7.50	8.03
9 Yrs	12/31/04-12/31/13	15.67	20.24	3.59	0.71	0.85	**119.09**	**104.76**	86.79	99.88	**9.11**	**8.29**	7.19	8.00
10 Yrs	12/31/03-12/31/13	15.43	19.64	3.61	0.71	0.82	**161.64**	**142.67**	128.34	143.01	**10.10**	**9.27**	8.61	9.29
11 Yrs	12/31/02-12/31/13	15.11	19.41	3.92	0.70	0.82	**263.56**	**234.69**	233.44	252.20	**12.45**	**11.61**	11.57	12.13
12 Yrs	12/31/01-12/31/13	14.65	19.62	5.66	0.66	0.79	**306.80**	**271.93**	195.35	217.42	**12.40**	**11.57**	9.45	10.10
13 Yrs	12/31/00-12/31/13	14.39	19.37	6.24	0.64	0.73	**384.96**	**340.25**	236.77	248.34	**12.91**	**12.08**	9.79	10.08
14 Yrs	12/31/99-12/31/13	14.38	19.00	6.69	0.64	0.71	**523.61**	**461.46**	313.64	320.76	**13.97**	**13.12**	10.67	10.81
15 Yrs	12/31/98-12/31/13	14.38	18.72	6.19	0.64	0.70	**513.89**	**447.82**	307.49	327.04	**12.86**	**12.01**	9.82	10.16
16 Yrs	12/31/97-12/31/13	14.36	18.89	6.81	0.64	0.70	**584.62**	**505.27**	281.20	318.83	**12.78**	**11.91**	8.72	9.37
17 Yrs	12/31/96-12/31/13	14.20	18.56	7.05	0.64	0.70	**807.59**	**694.15**	402.36	457.43	**13.85**	**12.96**	9.96	10.64
18 Yrs	12/31/95-12/31/13	13.92	18.17	7.53	0.63	0.68	**1066.51**	**909.65**	509.69	581.21	**14.62**	**13.71**	10.57	11.25
19 Yrs (Inception)	1/1/95-12/31/13	13.71	17.79	7.69	0.63	0.66	**1376.97**	**1164.52**	666.70	783.93	**15.23**	**14.29**	11.32	12.15

** Equity product inception: January 1995.*

Past performance is not indicative of future results.

Prior to April 2013, Schmetter & Associates, LLC. (S&A) served as an independent institutional sales and marketing representative for Camarillo, California based Bernzott Capital Advisors. S&A continues to receive an annual fee and 20-25% of collected revenue from specified institutional clients. S&A is not a broker/dealer. All fees are paid to S&A by Bernzott Capital in hard dollars. No additional amount is ever billed to any client as a result of such payments.