Five Questions - Episode One

Pete: Hi, my name's Pete Mann, and I am the president and Co-Chief Executive Officer of Grayhawk. Welcome to the second season of our podcast, five questions, which will see one partner, Grayhawk, paired up with another to touch upon relevant topics as they relate to the economy, investments, and what is going on in the world as we see it. And sometimes we will invite special guests to join us so you can also hear their views. With me today is Greg Gipson, Grayhawk's Chief Investment Officer, who is responsible for shaping our investment philosophy and portfolio strategy. Welcome, Greg.

Greg: Hi, Pete. It is great to be back for season number two or as an American I would say our sophomore season of five questions.

Pete: That's great. It has been almost 18 months since the end of season one. I am so excited for all that we are planning to cover in season two. A lot of things have changed in the world. For example, in our season one, there was a stage that oil was actually negative, and today it is approaching $100 a barrel. Growth stocks, as we may recall, were in absolute rarefied air where people were paying anything for the proposed or for the expectation of future prospects. Today, many questioned the actual viability of those businesses. And then finally, I would be remiss if I did not mention how much Grayhawk has actually grown during this period of time. We have approximately doubled in size in both people and assets under management. And it has been just an incredible journey. This season, we are going to focus our efforts on a number of topical issues. So much of what we are trying to do is really simplifying the complex. It is often much easier said than done. Maybe the first thing you wouldn't mind touching on is your view on the simplicity of why people actually invest, Greg, why don't you talk a little bit about that for us?

Greg: So, let us start maybe on the first topic of simplifying the complex or simplifying the complicated. So, when you think about investing, you know, any website throws all these different terms out at you. But in reality, and in my opinion, there is really only two main objectives, when you make an investment. The first is you are buying something that you want to go up in the future. The second is buying something that will pay you something in the future. And that is it. We can use fancy terms like capital appreciation for things that go up or income generation for things that pay you. But every investment you make falls into those two categories. And the long-term objective of your investments is merely choosing how much of one, capital appreciation versus the other income generation that you are looking to achieve.

Pete: You know, it is so interesting, Greg. You hit on many valuable points and the reality is that we as an industry have a tendency to continually make things more difficult for people to understand, sometimes for our own personal benefit and gain, because often when people do not have a depth of understanding, it's a lot easier to convince them that you're the expert and they are not. And that is something that we always must be very mindful of. But as a follow on to that, you could talk a little bit about how we think about investing from a risk allocation versus return expectation. Too often people get obsessed with this idea of being able to say, I will make you 6 to 8% with no parameters around how that is achieved or what the goals and objectives are being stated outside of what the return expectation is. Could you touch on that a little bit, please?

Greg: Great point, Pete. Anyone who guarantees you something should raise a specter of what we like to think of as trust but verify. In the vein of simplification. And when you look at any investment, we always like to say that, you know, with absolute certainty you will incur some level of risk and some cost to make an investment. You aspire to realize a return that compensates you for taking on that risk and cost. So rather than focusing on the return component, which is the aspirational piece, which is the uncontrollable piece of an investment, our focus is really on managing a prudent allocation to risk and managing the costs of making those investments. It is particularly important to remember that there is no free lunch in investing. It is important to remember that taking risk is not a bad thing, but not taking into account the risk of an investment can be disastrous to your long-term results.

Pete: Okay. Thanks, Greg. That is really helpful. We touched a little bit of this on season one, but we continually hear about people talking about the death of the 60/40 portfolio. And for those that do not know what the 60/40 portfolio is, it is this long-term view that an optimal allocation is 60% equities typically in the public market and 40% public market bonds or fixed income. Greg, I know you are of the view that even with low interest rates that the 60 40 portfolio is here for a long time into the future. Why don't you touch a little bit on that for us?

Greg: Absolutely and I think we could spend an entire podcast on this topic alone. So again, remember from the top of our conversation, the media loves sensationalism. So big bold statements like the death of anything is always going to garner attention. But think back to what we were speaking about earlier around capital appreciation and income generation. So, the 60/40 portfolio the entire investment industry will have you focus as to how you invest your dollars, investing $60 into public market equities, $40 in the public market fixed income. In reality, what is the 60/40 portfolio. It is merely a balancing of capital appreciation against the protection, the shock absorption of income generating investments. For any long-term investor over any material a long period of time. So, if you think and there has been many academic studies that have shown this, that 90% of the variability of your returns is driven by how you allocate capital across capital appreciation and income generation. More important though is how you invest or what you invest within those two areas of a portfolio. The best way to think about this is with an example. So, if you look over the last thirty plus years, if you had invested $10,000 into a portfolio of 60% global equities, 40% global bonds, that $10,000 would be worth roughly $100,000 right now. What if instead of investing in global equities, you invested 60% into U.S. equities and 40% into global bonds, near identical risk profile but that same $10,000 would be worth upwards of $150,000. So, it is not only how you allocate across different types of investments, but also what you actually invest in. That is the driver of return.

Pete: You know, Greg, that is a great lead-in to our next question, which is really around the alternatives exposure in a portfolio. Today, what people are struggling with, as you rightly pointed out, is that the U.S. ten-year Treasury bond is at approximately 2%. There is not a lot of income there to be generated in that type of asset. So, people are desperately seeking alternative forms of income and they are finding that more often in private markets than they are in public markets, because those are areas that have less regulatory oversight and allow for the framework of being able to design differentiated opportunity sets. So, why do not we talk a little bit about alternatives overall. Often referred to as alts. Maybe you could talk about what our process has been. How is it evolved? What are some of our learnings and why we feel so strongly that this will be a valuable contributor to long term returns and capital appreciation?

Greg: Thank you, Pete. Yes, alternatives have been around for decades. Their role in a portfolio, particularly in the current market environment, as you described, can actually be quite additive for investors. So, if you think broadly of alternatives, what are the four main benefits to investing in alternatives: potential for higher return, reduce the volatility of returns, portfolio diversification relative to public markets, and the ability to access unique opportunities typically in the private markets. So, if you think again, we go back to our thoughts about capital appreciation and income generation. That same 60/40 portfolio could now instead of having 60% in public market equities could allocate a portion of that into an asset class such as private equity where you can gain the benefit, the potential of higher return with lower volatility. So, you get that shock absorption against public market volatility which is what many news pundits and TV stations around the world like to scream at you on a near-daily basis. The challenges that many investors face when looking at investing in alternatives, again, focus on four main aspects: access, so are we able to invest in these unique opportunities, analysis, are we able to appropriately assess these opportunities as a prudent choice within our portfolio? Portfolio construction, can we gain exposure to alternative asset classes in a diversified manner, and liquidity because often in the alternative space, capital is tied up for longer periods of time. Our focus is to provide exclusive access to top performing managers from around the world while building a diversified portfolio that reduces the risk of any one manager or any one strategy underperforming for a period of time.

Pete: Thanks, Greg. Listen, we had a great question from one of our clients. He stated that he views the markets as indicators for upcoming changes as to how we live in the future. And I am wondering if you feel the same way or if you have a different perspective on that?

Greg: That is actually a very interesting question. And it speaks to what are public markets. You know, you see news stories about our markets, you know, a lottery, you know, are they a casino? You know, should small investors be allowed? So, there is some large investors who feel that public market should be the place for professionals. But if you just take a step back and think in reality, what are public markets? They are merely a realization of the consensus view of all participants in the market. Sometimes the market will lead. Sometimes the market will lag. But it will always be the consensus opinion, whether that consensus is right or wrong. Irrelevant. It is merely a single moment of time that investors are in agreement. When you think about where the opportunity to see where economies are going and where is the world moving to, where you often see innovation, or the world of tomorrow is through private markets. Technological innovation, innovations in communication, innovations in how we interact with our world: so, think of impact investing, can we make the better world along dimensions such as social interaction or banking or climate change or food development? These are areas that we believe have a very long runway into the future and where the world is moving to. But accessing these opportunities in public markets is extremely challenging.

Pete: Listen, I could not agree more. What is so fascinating is that we are at that stage, particularly in some of the areas that you were just describing, where there are really no known winners yet, there are no known champions. And like 20 or 25 years ago, pre the advancement and massive growth of Google and Amazon and Facebook and multiple players that have really taken the control position in their areas of focus. It is fascinating to watch this develop and as you rightly pointed out, extremely hard to capture because typically consensus cannot be found in markets that are just germinating where there are no known winners. And so, kind of playing back to your point, that is so relevant really interesting. Okay. So finally, if you recall, we typically leave the last question open for a less formal and dare I say, more personal insight. So, with that in mind, I would be curious to know as to how you think about success today versus one or two years ago and prior to COVID. We've both been working from home, as have millions of people around the world. We are having a lot more time with our family, probably seeing the world from a completely unique perspective. Have all of these inputs adjusted your interpretation of success?

Greg: So, I have always viewed success along a number of different dimensions, both professionally and personally and family. And an individual much wiser than I have said that time is the one true commodity. And when you look over your career and in how you organize your life, it is always about time allocation and optimizing the use of your time. What COVID has taught us is that perhaps our use of time, our allocation of time could be done in a different or more efficient or dare I say, even better way. And much like a portfolio is allocating investment dollars into capital appreciation and income generation. Similarly, one is allocating their time to work, to family, to social gatherings, to interests and hobbies. And what I do believe coming out of COVID is there has been a slight asset allocation or time allocation shift for individuals as they have really had the opportunity to assess where they truly gain value.

Pete: So, in some ways, if you were to look at it from a portfolio allocation, capital appreciation is your sort of focus on work life, income generation is really your focus on family.

Greg: that is an absolutely excellent example. Pete and I probably have an exceedingly small sliver that's focused on martial arts as well, which is the mental health component to balance out the entirety of the pie.

Pete: That would be your crypto piece.

Greg: My crypto piece, excellent, excellent. I like it.

Pete: Terrific. Well, listen, this has been a great conversation. I am so excited that we are back together doing this. Look forward to the team members that are going to join us on this season, the new people that we are going to have. We hope that we have an opportunity to share all of this with a growing number of our participants in and so listen, we really want to thank you. It has been great. Well, that is it for the first episode of season two of five questions. I am Pete Mann, President and Co-chief executive officer of Grayhawk. On behalf of my partner, Greg Gipson, our Chief Investment Officer, we want to thank you very much for listening. We will be back in two weeks with a new episode. This podcast is for informational purposes only. It is not meant to be relied upon for investment or tax advice. It is the opinions of those on the podcast and does not necessarily reflect the opinions of Grayhawk. If you would like to offer any feedback or pose a question for inclusion on the podcast, please reach out to our Chief Experience Officer, Allison

Comeau, at acomeau@grayhawkwealth.com. We look forward to chatting again in a couple of weeks.