BUILT ON SUCCESS

Silvercrest Asset Management Group was built on many of the principles honed at bygone investment bank Donaldson, Lufkin & Jenrette.

By Eric L. Reiner

G. MOFFETT COCHRAN,
CO-FOUNDER,
SILVERCREST ASSET MANAGEMENT

PHOTOGRAPHS BY JORDAN HOLLENDER

Picture the top two floors of a midtown Manhattan high-rise—nearly 20,000 square feet of office space—swallowing a staff of five. As the startup crew of Silvercrest Asset Management Group LLC worked out of boxes, the empty space shaped their perspective. "It motivated us to have success quickly," co-founder G. Moffett Cochran says. "In taking the space, we clearly contemplated having a good-sized operation, but initially a lot of people thought we were nuts."

It was January 2002 and the outlook for financial assets in a post-9/11 world was anything but certain. Yet Silvercrest, which marks April 1, 2002, as its official date of birth, gathered nearly $2 billion in assets that first year. Today, Silvercrest oversees about $9 billion. Headcount is north of 80 spread across three offices.

Putting up numbers like that "is a lot harder than it seems," Cochran offers. "In some ways, when I look back on what we've accomplished, I'm kind of stunned by how well it's gone."

Not that Cochran has much time to reminisce. The average relationship at Silvercrest is $27 million. Hence, clients are demanding. They are typically sophisticated, too. Many are in the financial industry or sit on foundation and endowment boards. "Our clients see everything. They give us good ideas and challenge our ideas. They keep us sharp. You've got to be playing your A-game twenty-four seven," Cochran says.

A TWO-PRONGED MODEL

The goal in founding Silvercrest was to create a full-service boutique dedicated to delivering outstanding investment performance and service to the exceptionally affluent. "Very few firms are equipped to constantly deliver on both fronts. If you can do that you are in rare company," Cochran asserts.

To execute the concept, Cochran strove to recreate his past. He had spent several years helming the asset management unit of bygone investment bank Donaldson, Lufkin & Jenrette. When he arrived at the Wall Street giant's tiny money management subsidiary, the unit didn't amount to a rounding error on the parent company's financials. By the time DLJ was sold to Credit Suisse in 2000, Cochran's group oversaw $40 billion in assets and contributed meaningfully to parent profits.

"We were going gangbusters," Cochran recalls. "For us, the sale to Credit Suisse couldn't have come at a worse time. It was hugely disappointing for us when that occurred."

By "us" Cochran means the 30-plus former DLJ professionals he hired away from Credit Suisse in the spring of 2002. But he took from the old shop more than human capital.

SPIRIT CARRIES ON

"DLJ had a winning formula. I brought what I thought were their best management techniques here to Silvercrest," Cochran says. Examples include fostering an entrepreneurial ethos and assembling an eclectic team. "DLJ was unusual in that it had people from all walks of life with different experiences, educations and points of view. The common thread was they were all smart, highly focused, self-starter type people. That was a big element of DLJ's success and I felt it could be a big element of ours," Cochran says. A review of the Silvercrest employee roster reveals natives of Holland and Australia, Ivy League MBAs, people with bachelor degrees in liberal arts, a Sorbonne graduate and an American fluent in Portuguese.

The desire to recreate the glory days even impacted how Cochran furnished the new digs. "We literally have the old DLJ furniture, carpeting and art. A lot of it was unused in warehouses. We tracked it down and bought it. DLJ was very important to the character of this firm and continues to be," Cochran says without apology.

And yet Silvercrest is almost equally defined by what it isn't. We stand "in sharp contrast to much of Wall Street and the financial services industry," announces the firm's Web site. "An antipathy for corporate bureaucracy and office politics" is also proclaimed while the firm's employee ownership is touted. What it means for the client is one fiercely independent advisor.

As Cochran explains, "Part of our concept is to be free of the financial conflicts that can exist at big firms. We're not a broker-dealer. We're not an investment bank. We don't do proprietary trading. We don't do anything but give advice to a clientele that is often tired of getting conflicted advice at other places."

The power of equity ownership as a motivator cannot be exaggerated, he adds. "It means spending a little more time, and giving a little more effort, on every problem we're asked to solve, and that definitely accrues to the client's benefit. The objectivity of our independence and everything that goes with employee ownership are central to our pitch."

SERVICE—SILVERCREST STYLE

Beyond providing objective advice, Silvercrest makes clients the top priority by listening closely to what they want and by finding innovative ways to help them manage their wealth, even if it generates minimal incremental revenue for the firm.

"For instance, we have found it's often difficult for very wealthy people to get their arms around everything they have," says Cathy Jameson, a Silvercrest managing director and one of the 30 DLJ alumni Cochran lured from Credit Suisse. With investments scattered across several providers, the affluent client may not know, and the advisor may not be able to readily ascertain, the client's total weighting in stocks and other asset classes. "So we developed some asset aggregation and reporting capabilities to pull it all together," Jameson says, adding, "Our brief stint at a much larger organization reminded us how important putting the client first had been in our past and in the business we hoped to create at Silvercrest."

The firm also respects the client's other advisors. Although Silvercrest offers tax, estate planning and other private wealth services, "we quickly explain to a new client's existing advisors that our role is to provide investment management and that we have no interest in taking on work they are doing. We tackle that head on," says Chief Operating Officer Richard R. Hough III.

It's an approach that can yield surprising benefits. When one client's attorneys bumped into an issue beyond their expertise, they called Silvercrest for help and the two firms collaborated on a solution. "It meant more business for both firms, but most importantly it made for a very happy client," Hough says.

SYNCING INVESTMENTS WITH CLIENT GOALS

While Hough, Cochran and others run the business, Jameson and a dozen or so other portfolio managers meet with clients. The portfolio manager's role is to ensure that the financial plan, asset allocation and investment implementation all sync up with the client's objectives. Behind the scenes, Silvercrest analysts scrutinize securities for the equity and fixed-income portfolios managed in-house. Compartmentalizing responsibilities this way keeps the portfolio managers focused on client needs while the securities analysts concentrate on what they do best—and neither group's attention is diverted by annoying business matters.

FIRST ROW FROM LEFT: G. MOFFETT COCHRAN, CATHY JAMESON AND STANLEY REESE. SECOND ROW FROM LEFT: ROGER VOGEL AND RICHARD R. HOUGH III.

A LOOK AHEAD

Private Wealth chatted recently with Silvercrest managing directors Roger Vogel and Cathy Jameson about the prospects for domestic equities and bonds in 2011.

PW: What does your equity research team see for 2011?

VOGEL: Although we take a bottom-up approach to equity management, our in-house macro-economist thinks the stock market can go up double digits, in the 10% to 15% range. We spend a lot of time talking to corporate managements and they are generally upbeat on their outlook, although companies that touch housing are struggling. Our basic valuation model forecasts four years of metrics such as earnings and cash flow and then discounts them back to a net present value today. The current fair values of the companies we own, as suggested by this model, dovetail with our economist's forecast for a 10% to 15% year in 2011.

PW: Are any themes emerging in stocks?

VOGEL: We are very excited about the prospect for increased merger and acquisition activity. Companies are sitting on a lot of cash and if we experience even a relatively meager recovery, they will look to supplement their organic growth with growth through acquisitions. A number of companies in our portfolios were acquired in 2010 and we're optimistic there will be more over the next couple of years. And we think this will mostly be a small-cap phenomenon. We doubt the investment banks are willing to fund massive LBOs.

PW: In fixed income, what do you make of the municipal market given governments' fiscal woes?

JAMESON: Unlike the federal government, most state and local governments have legal mandates to balance their budgets each year. They're not always balanced in a timely fashion and sometimes the process is painful. However, problems are being dealt with, even if all of them aren't being solved at once. Going forward we think the vast majority of municipal bonds will meet their obligations to investors. That's not to say all municipal bonds are created equal. Some issuers have bigger problems than others. But ultimately we think most of these bonds are going to be OK.

PW: What about on the taxable side?

JAMESON: You have to start to worry about a rise in interest rates somewhere along the way, and that's not built into bond yields today. A bond yielding 3% doesn't afford you a lot of protection if interest rates rise a little, and certainly if they rise more than that you would experience price depreciation.

PW: So what are you doing for clients who want income?

JAMESON: Many of them still own bonds. Yields on investment-grade municipals are 100% of Treasury yields, if not more, whereas normally they trade at 75% to 80%. That's unusual, and it tells us munis are attractive. In other situations, the yield on a corporate bond maturing in, say, five years might be lower than the dividend yield on the issuer's common stock. In some of those cases, we own the stock, rather than the company's debt.

Portfolio construction begins with an intimate and expansive discussion of the client's aspirations and fears, according to those at the firm. That determines which risk category is most appropriate for the client, explains Stanley Reese, chair of the firm's investment strategy committee and a managing director. Clients in the highest risk category hold between 80% and 100% in equities, with the rest typically in bonds; the next most risky category allocates from 60% to 80% to stocks. "Within each range we may encourage a client to go higher or lower, but we cut back or increase stocks when the portfolio grows above or falls below the range," Reese says.

Qualitative factors further shape the portfolio. "We look at the optimizer's output to see if it makes sense and we may tweak it or adjust the inputs. In many cases our personal judgment includes a significant assumption about regression to the mean, that asset classes which have outperformed for several years are unlikely to continue to outperform unless there are good reasons," Reese says.

Once the strategic allocation has been set, optimal stock and bond portfolios are determined independently of each other

because, for example, the client may want a relatively small but aggressively managed stock exposure to complement a large, conservative bond portfolio. "Other clients want a large weighting in stocks that isn't managed aggressively, but perhaps vice versa for bonds," says Reese.

MORE RETURN, LESS RISK

Roger Vogel, another DLJ veteran, has managed Silvercrest's value-tinged equity portfolios to an enviable record. Figures provided by the firm indicate all six Silvercrest equity strategies outperformed their benchmarks, which are the value versions of the Russell 1000, 2000, 2500 and 3000 indexes, for the three- and five-year periods ending September 30, as well as since inception. Five of the six also outperformed in the latest year. Moreover, since inception five of the six experienced less volatility than their benchmarks.

Factors contributing to that handsome risk-reward ratio include a commitment to diversification, says Vogel, a managing director. "We're not sector rotators. We tend to have exposure across most sectors and that tends to dampen portfolio volatility," he says, adding that he avoids highly cyclical industries.

"Also, we don't let position sizes within the portfolios get excessive. Much over 4% is rare," Vogel says. (Silvercrest's focused value strategy is an exception. It is a concentrated portfolio limited to 20 holdings and is the firm's highest-octane offering.)

Finally, Silvercrest manages risk by picking high-quality companies it anticipates holding for an extended period. "Although we think of ourselves as value-oriented managers, we don't do distressed value—companies teetering on the brink of bankruptcy. We try to find good companies that we believe are underappreciated by the market, which typically occurs when investors focus on shorter-term issues that obfuscate longer-term earnings power or franchise value. The companies we own tend to generate cash, are market leaders in their niche, have above-average return on invested capital, and have strong balance sheets that give them flexibility to grow their business," Vogel says.

Complementing Silvercrest's in-house portfolios is a select list of outside money managers. In choosing them, says Reese, "We look for long-term, mostly high-quality investors with a record that makes sense. We want a management team that can explain its security selection process to us in such a way that we really understand it and their ability to repeat past success."

In the alternative-asset space Silvercrest offers internally constructed funds-of-hedge-funds. It also helps clients build portfolios of individual hedge funds and relies on another firm, Ten-Sixty Asset Management in New York City, to provide the due diligence. "You really need specialists because of hedge funds' relative lack of transparency," Reese says.

> "OUR NUMBER ONE GROWTH STRATEGY IS MAKING SURE OUR CLIENTS ARE HIGHLY SATISFIED WITH THEIR INVESTMENTS AS WELL AS THE SERVICE AND ATTENTION FROM THEIR PORTFOLIO MANAGER."
>
> —RICHARD R. HOUGH III

GROWING FORWARD

Most new business comes from client referrals. "Our number one growth strategy is making sure our clients are highly satisfied with their investments as well as the service and attention from their portfolio manager. If we don't do those two things right, we won't continue to get referrals," Hough says.

Acquisitions figure into the plan as well. Chicago, Miami, Texas and the West Coast are particularly interesting markets to Silvercrest at the moment. But Cochran and the firm move thoughtfully, having examined dozens of advisories over the years and acquiring only three. "We grow when it makes sense. The culture has to be right," Hough says.

In the meantime, Silvercrest has plenty to do in its Manhattan headquarters at 54th Street and Sixth Avenue—the Financial Times Building, where the firm recently leased two more floors. "We like to keep ourselves motivated. It ensures that we never take our clients, or our success, for granted," Cochran says. PW