Scary but Good

In investing, taking the path least traveled is almost always ideal. However, for exceptional returns (top quartile) relative to peers, not only do you have to be alone (or among very few others), but you also have to be right - therein lies the wrinkle. Many a job and good reputations have been lost by folks who found themselves alone and wrong. This very real risk of becoming jobless or having a reputation tarnished causes most to fall in line with the crowd. It is just easier to be wrong as a group than to take the walk of perceived shame alone. I have been faced with this conundrum many times in my career and have experienced all shades of outcomes – I have felt the glorious redemption of being "right and relatively alone" - I have used the herd as a defense when "wrong but together" – I have waded through the lagoon of self-doubt and embarrassment when "wrong and alone" – I have accepted unearned praise when "right and together". From a human, career, and risk-return perspective, being steadfast in an unpopular investment opportunity/strategy/fund has been the most fulfilling for me. So how does one increase the chances of ending up with unique investment ideas that outperform peers? The answer lies in facing fears by looking where others aren't. I am not advocating for a careless glory-seeking contrarian approach to investing. What I am prescribing is the application of proven thorough due diligence methods into generally avoided (usually because they are perceived by the herd as carrying high career and reputational risk) areas.

Below are a few places to find unexploited alpha – no nuclear launch codes are being revealed here but sometimes gems are hidden in plain sight – the energy required to polish these gems is what typically impedes universal adoption.

- **Emerging managers**: Emerging managers are defined using a myriad of criteria including funds in the early part of their existence (usually between Fund I and III), funds with some sort of diverse (racial, gender, untraditional geographies, etc.) tilt, funds that are still falling short of the institutional label, etc. However, the "emerging manager" landscape is united by a few factors worthy of exploration – they tend to be fertile ground for hidden talent – certainty that the next blue chip managers will emerge from this cohort - they are typically hungrier and more aligned (smaller funds, high transparency, higher appreciation/gratefulness for with LPs' capital) - unique points of view - traversing brutal fundraising terrains due to competition from peers and established managers, etc. LPs know that assessing emerging managers takes a lot more elbow grease than evaluating established managers. This causes many investors to completely avoid the category or create emerging manager buckets that siphon minimal dollars from their core programs. I have always found emerging manager buckets to be a subliminal way of saying "These folks are not yet ready for prime time" or "There might be one or two good ones in the bunch". So, in an asset class with very long fund terms, when do emerging managers graduate? I know dollars are dollars, and very few emerging GPs will split hairs when it comes to how LPs bucket their commitments, but I do think emerging manager buckets carry subliminal stigmas that subtly telegraph that constituents are not good enough. In my cynical mind, I believe bucketing these managers is a way to seem progressive or satisfy demand (in the case of funds of funds) while also absolving oneself from the perceived consequences of being different. I believe an LP should do the hard due diligence work, and either be in or out and not "sort-of-in" using bucket labeling as insurance.

- **Out-of-sight or out-of-favor themes/sectors:** In the investing world, we are all privy to what the flavor of the month is at any given point in time. Today anything that smells remotely like "AI" or "machine

learning" will at the very least grant the titillation of eyes and ears. A few years ago it was anything with "SaaS" or "as a service" in its definition. "Supply chain", "student housing", "EdTech", "solar", "alternative proteins", "meal delivery" and "electric scooters/city mobility", have all had their day in the sun. But does this mean that anything that no longer (for whatever reason) captures the public's infatuation should be damned forever? The answer is obviously "No". There are real reasons why some segments are no longer viable or desirable from an investment perspective – these include unit economics, inputs economics, competition/saturation, regulations, etc., but some reasons also just revolve around the hard work required to find the right executor/operator. It is much easier to throw the baby out with the bath water than to dig deeper. My approach is to, at minimum, be open to hearing ideas that don't quite fit the generally accepted current narrative. It is intellectually stimulating to hear counterviews from people who are going against the grain or strategically revisiting the darlings of the past. Of course, there is the genuine risk of being outright wrong, too early, or contrarian for contrarianism's sake, but the flip side is that you could be on to something interesting before the herd.

- **Hairy opportunities**: When an analyst says that a fund is "hairy", it is code for "it involves more work than your average investment opportunity". The term is mostly used in two distinct scenarios – as a self-congratulatory way of broadcasting work done (or work one is willing to do) or as a signal that there are better (or easier) places to spend one's time for a potentially similar return outcome. Either way, hairy opportunities offer a treasure trove of potential upside. Common reasons why some funds are deemed hairy include large write-downs/offs in past funds, a contentious break-up or departure of a senior team member, past deal attribution nuances, overly necessary/involved track record explanations, bold strategy tweaks, the absorption or merger of/with another investment entity, etc. – this list can go on forever. The shorthand quick explanation of hairy investments is that most superficially identifiable things that can easily justify a quick "NO" make an opportunity hairy. This means busy analysts with a plethora of investment options will more often than not avoid opportunities with hair. However, although the large top-of-funnel opportunity set offers forgiveness for anyone who wants to start due diligence from a relatively hairless point, I must underscore that occasionally going against your trained inclination can pleasantly surprise you. A word to GPs with hairy situations: An analyst's inclination to further pursue hairy circumstances is positively stimulated when GPs are upfront with their disadvantageous features.

- **Bad marketers**: Some GPs are not good communicators or marketers. To me, it is a turn-off when a GP admits this fact because it always sounds like they have said it to others many times before, and that in itself is evidence of not only bad marketing but some form of reverse psychological manipulation. My advice to GPs is to just be yourself - LPs are not looking to invest with marketers. LPs have been at this long enough to know who a silver-tongued wordsmith is, and who is more at home between the lines of an income statement or balance sheet. Regardless of charming world play, the investment strategy and unique execution capabilities always (or should always) take priority. I am not implying that it is okay for a GP to lack the ability to eloquently explain their strategy – that would be a clear red flag. I am saying that a dry, monotone, or even boring delivery that still exudes knowledge and enthusiasm (shown at a different frequency) should not be disqualified as passionless – some genuinely bad marketers are excellent investors.

- **Straightforward (what's the catch?)**: The inner skeptic of most analysts guides them away from simplicity - there always has to be a sort of catch. Simple strategies automatically tingle the spidey senses – What's

the catch? What am I missing? Complexity of any variety affirms the fact that analysts are doing something beyond the layperson's skillsets. So when things are too assessable, the knee-jerk reaction is that there is something wrong. But sometimes the best ideas are straightforward. Some investment opportunities don't need half a dozen detours to get to the endpoint – just a simple, disciplined, and clear-sighted plan being executed by experienced and competent people. The need (no matter how subtle) for complexity can lead to dead ends. Don't shy away from straightforward opportunities. Sometimes, it is just not that complicated.

- **Liquidity crunches:** Investment environments similar to the current one create very interesting and even shocking reactions from investors. You routinely hear and see seemingly staunch proponents of private investing go into ostrich mode when things get a little treacherous. What happened to the well-rounded understanding of vintage year diversification and consistency of allocation? Realistically, there are genuine reasons to halt preplanned investment approaches, but jettisoning core tenets of the asset class will always be a wrong tactic. Yes, liquidity is currently nonexistent, and yes, valuations from a few years ago seem porous today, but history teaches us that cycles are real, and we need to be steadfast in core beliefs because zeniths eventually nadir and nadirs eventually zenith – it's the cycle of life and investing. You cannot abandon foundational principles because things are getting scary - this is the time to lean in.

As you get older a recurring hallmark of maturation is realizing the deeper truths that exist within clichés. It is maddening because with clichés there are really no hidden meanings or triple entendres to decipher – it is all plain as day. No cliché stands truer than this paraphrased one that states, "What you are scared of is probably good for you". Applying this sentiment to investing can yield shockingly positive results.

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