



## **Podcast Transcript**

Episode #42: Navigating the OCIO Landscape with Nikki Kraus of Strategic Investment Group

Brad Mook: Welcome to Rosemont Roundtable, where we explore the business of investment management with experts and thought leaders across the industry.

Chas Burkhardt: Welcome all to another edition of the Rosemont Roundtable. I'm Chas Burkhardt, CEO of Rosemont Investment Group. And today I'm pleased to be joined by my friend Nikki Kraus, who is CEO of Strategic Investment Group, a \$31,000,000,000 outsourced chief investment officer in suburban Washington DC. Strategic Investment Group has 38 clients and 95 employees, of which 29 are owners. Nikki has background at both SEI and Hirtle Callaghan, where I got to know her.

And she brings extensive experience advising investment committees on investment policy and governance. In addition to that, she's an accomplished speaker and author, and serves on a number of industry boards and committees. I'm really glad she could join me today. Nikki, look forward to this conversation.

Nikki Kraus: Thank you, Chas. I'm delighted to be with you today.

Chas Burkhardt: So Nikki, let's start with the OCIO and solutions business at large, a business which you're intimately familiar with and have worked in your entire career. I think one of the things that is very apparent to us at Rosemont here, especially over the last few years, is that it's really an evolving business and has multiple dimensions. It has dimensions of size, complexity, business model, client orientation, ownership, etcetera. And I'm curious how you think about strategic investment groups place in that world.

Nikki Kraus: Thank you. There's a lot there. I'll start with the client because to us and to me personally, it always starts with the client. For the client, the idea when this concept was founded, we were founded in 1987, was to be conflict free where the advice you were providing to the client was not dependent at all on any revenue. It was what was best for the client, a la being a CIO evident internal organization caring only about the performance.

Secondly, and maybe I should have started with this. It's always been about performance and getting better returns for the organizations we are serving. They and they might outsource for a number of

different reasons, but it is always been about performance. And then I'd also say having worked in the space, as you mentioned over thirty years, there is always an element of customization that is needed. They have an existing portfolio.

You have great managers you don't wanna get out of. You have legacy illiquids. And so if you hired a CIO at Penn, as an example, Peter Ammon is excellent. So they're, sure they don't need to make any changes there. But when they were hiring Peter, he comes in and he inherits a portfolio and starts with that as he looks forward.

The OCIO model should be bringing all of those benefits to its clients. I also often go back to the Casey Quirk study done in 02/2008, the new gatekeepers, which was a huge study in the space. In 02/2008, there weren't a lot of firms calling themselves OCIO. In the next five or six years, folks could disagree, but a lot of groups would say a 100 new firms entered the space. But to your point, I don't think a lot of the 100 can answer the original premise or fulfill the original ideas for clients that it be no conflicts, all about performance and bespoke.

So when you really look at how many OCIOs there are, I think that 100 number is greatly inflated.

Chas Burkhardt: Yes, that is interesting perspective. And on our end, Nikki, I really think a lot about kind of the different models, how they overlap or intersect. And on one hand, have the very large firms like BlackRock and SEI, Russell and Mercer. And then you've got firms more pure play businesses more similar to yours, like Partners Group, TIFF, McKenna, Spider, or even the firm that we've recently invested in, Northside. Then you've got consultant businesses like NEPC, Meketa.

So you've got a number of different types of firms with different agendas and different business models, some of which are taxable, some of which are tax exempt, some of which are quite customized, as you say, and others of which are of the Henry Ford variety. Any color you want, as long as it's black. So Nikki, how then do you view the competition from these different angles? How do you think about winning and losing and competing against folks who look a lot like you and those who look very little like you?

Nikki Kraus: Well, let me add two other things I was reminded. It's my anniversary of starting to work, thirty one years this Friday.

Chas Burkhardt: Congratulations. So

Nikki Kraus: remembering my first day in 1994 at SEI Investments, when Al West said you cannot both be a consultant and an OCIO. 1994. And SEI chose at the time to sell off the consulting business when it was an industry leader. And now here we are thirty years later with a lot of firms trying to do both, which is a very interesting thing. It goes back to the conflict point.

The other thing that, you know, there's many nuances and layers, but the other thing that's really important is discretion. And so if you don't have discretion over a portfolio, you are not accountable for the results. So what's happening right now is a lot of firms are saying, well, I have discretion on part of the portfolio, but not all of it. But I'm still gonna count the returns. I question that.

I question the ability. And so that is a long way of saying, I think it is very difficult for the average organization, no matter how sophisticated they are to wade through the complexity of the OCIO marketplace to get to even categories. So one of the things in the Casey Quirk study is talked about manager managers versus investment consultant. We would be considered in the dedicated, as you said earlier, there's also traditional managers. And so sometimes in searches, see one from each flavor.

Chas Burkhardt: Right.

Nikki Kraus: Other times in searches, you see three firms of the same category. It's a long way of saying a lot of groups have no idea what they want and are then unlikely to make a great decision. So we view this as one of the most important hires your organization is going to make. And if you were hiring a CIO internally, you would clearly engage many times as a headhunter. And we'll talk about the business and how it's evolved.

You would engage someone to help you, but you personally would interview the CIO a number of times, likely have dinner with him or her and their family to get a sense and spend a lot of time. What's happening a lot today is groups are taking eighteen months, twenty four months of special meetings to determine they want to look at the OCIO model. They are then extra meeting out and they have one meeting for forty five minutes where they choose a firm.

Chas Burkhardt: Interesting. And

Nikki Kraus: so you're asking, I think in advance to have to potentially get a divorce. So one of the things we've been encouraging groups to do is to spend time on your own, identifying what's important to you. And then when you do that, one of the critical characteristics of success in this marriage is similar investment philosophy. So to answer your question of where are we the best fit? We are the best fit where we have a similar investment philosophy to the client.

There are similar values. They understand the size of firm that we are, and they like that size. Some organizations want to be with a big firm some are okay, where they are relative to some of those critical characteristics. And then you have a much greater likelihood for a good match. Our average tenure is still about ten years, which we think is among the best in the industry.

Hard to get great stats on that what we've seen. And we take a lot of time in talking with organizations through the process if they'll allow us to determine if we are that right fit. We don't say yes to everything.

Chas Burkhart: I certainly appreciate that last point, Nikki. So let's talk about your place in the growing and morphing OCIO and solutions business. How specifically do you think about growth and kind of what you're trying to achieve over a long period of time? I know that you are not an asset grab business and a scale at all costs. So let's talk a little bit about your thoughts around that subject.

Nikki Kraus: The thing I'll say is from the day I joined Strategic ten years ago, we deliberately chose to have quote, measured growth. We think of that as an average of three to five new clients a year. So we can appropriately customize. Service doesn't scale infinitely and neither does alpha. And we'll talk a lot about that.

We don't believe we can grow 10 or 12 or 20 new clients a year and do our best work for clients. About a year ago, again, we had an off-site with our senior leaders and had a very specific conversation about we've been around thirty seven years. Who do we want to be in the next thirty seven? And I was thrilled that every single senior person in that off-site said we would rather do an excellent job for the clients that we have. And again, at this growth rate we've talked about, then as we like to say, I'd rather stay at the Marriott than stay at the Montage and feel good about looking at ourselves in the mirror every night.

I know the name of every single client. I've actually had prospects ask me that, do you know the name of each client? And I looked at them like, are you serious? Of course, I go see every client every year. And we never want to get to a level where the individual missions of each client are not important and known.

At our staff meeting, we have clients present to our staff. And I want every person of the firm to appreciate the work that's done, that we know every single basis point matters. So that is what we care about. And to that end have said our goal is to be the gold standard in the OCIO industry, period, relative to investments, to service, relative to reporting technology. We have very high aspirations for ourselves, yet feel strongly that our clients deserve that.

Chas Burkhart: Well, appreciate you Nikki being so forthright and specific. But look, it's an industry which is currently and has been chock full of deals and deal making. Much of which certainly is going to be very advantageous for sellers and for owners, one would think. But I do think there's a defense needs to be made of the client experience and the employee experience. But I think effectively clients have been a tacit currency in all the deal making of the last five to ten years especially.

But let's Nikki move on to the business itself. Talk a little bit about governance, how decisions are made, how the company works and your role as CEO.

Nikki Kraus: I think the primary first consideration is we are team based and have been since the founding of the firm. And so we are a collaborative group who loves intellectual debate. Our location here in DC means that it is this global education powerhouse and we try to have diversity of all types, backgrounds, countries, etcetera to make the best decision for our clients. Our governance structure is we have an executive committee. I am the chair of that committee.

It includes our two co CIOs, our general counsel, our head of people, and our chief operating officer. That committee meets weekly and excellent group of professionals. I have particular things as you might imagine that I am accountable for and responsible for, but we are the group who sets the strategic direction of the firm, the culture of the firm, the goals of the firm. We work together with our board, which is comprised of external people like Eve Guernsey, who was CEO of JPMorgan, North America, very talented individual, Bill Riegel, who spent a lot of time at TIAA. And then we have internal strategic people who are members of the board.

It is myself, the general counsel, one of our CIOs, Markus Krygier. And then B Flexion, our partner also has board seats. So at the board, we approve the budget, we approve significant hires over a certain level of compensation should we desire to do anything significant from a business perspective, meaning open a new office or go in a different direction, they would work with us. But I would say that has been an exceptional relationship which we can go into where we've gotten tremendous advantages from their technology person, as an example, advising us on our tech stack. So that's how the governance works and there are a lot of other details, but that those are the significant strokes.

Chas Burkhart: No. That's very helpful. So I wanna just start with the management committee. Have you had or were you to have some significant disagreement or not be able to reach consensus on an important issue before said committee? How have you?

How would you get to a decision? It

Nikki Kraus: really depends on the level. Ultimately, I do have a lot of authority, and there are decisions where I have heard the insight and feedback from my colleagues. But if it is at the executive committee level, I am empowered to make that decision. I am a collaborative person. A lot of times, if I feel like I'm not seeing it the right way, I might talk to a trusted advisor and say, Hey, here's how I'm seeing it.

But I do have tremendous authority relative to the decisions we need to make to keep the business moving forward.

Chas Burkhart: And if you now drill down from kind of that level and those types of decisions to the more functional org chart type orientation of the company, technology compliance, operations, etcetera.

Nikki Kraus: Great. So we have a 40 person investment team. I start there because that is who we are and very investment driven organization. The three co CIOs, excuse me, two co CIOs and a deputy CIO. There's an office of the CIO.

Very importantly, this is different from other organizations. We have centralized thinking. So what do I mean by that? If you work with Markus Trygier or Natalie Cunningham or Jeff Nasser, you are not going to get different managers and you're not going to get different tactical overweights or underweights. A lot of the firms out there, if you work with Chas, you get one portfolio.

If you work with Nikki, you get a different one. We are centralized thinking and the investment team is critical. So we can talk more about that, but 40 people in the investment function. Importantly, in the investment function, the group who works with clients, every client works with two investment professionals. Our client portfolio managers are Christine Kelleher, who was the CIO of the National Gallery of Art, Ken Shimberg, who was Deputy CIO at Brown University.

So these are very high caliber investment professionals who are part of the investment team in working with clients. We then have a chief operating officer where technology, finance and accounting and operations reports up to him. He reports to me. We have a people team and sales and marketing also reports up to me. So as lean as possible in other areas, yet I'd also say technology is an area where everyone is spending a tremendous amount of time and resource given the increasing technologies available and service requirements of clients.

Chas Burkhart: Not unlike some of the firms in which we are investing. Yes. Where, if anywhere, are you looking to hire in the near term across functional discipline?

Nikki Kraus: I feel great about where we're sitting today. That said, we've just embarked upon a lot of succession planning and looking across the landscape. Let me back up a second because this is also important. When you think of 38 clients and 40 investment professionals with an average tenure of the managing directors of over thirteen years, and the 29 owners you referenced are managing directors. We have a lot of very senior people.

We have also added next generation behind them and the next generation behind them to make sure as best as possible, we can have a seamless transition. We are one of few boutique OCIOs who's been through both ownership and leadership transitions successfully with solid performance and our team based process and that succession planning has been very important. So, as an example, we just hired Kevin Killeavy from Montgomery County in the Washington DC area, where he was the CIO to work with us in private markets. Paul Kramer has been here twenty six years. Exceptional,

delivered excellent results with his team for our clients and recognize at some point in the next ten years, he'll retire and wanna make sure we were strong there.

So we have done that across virtually all functions.

Chas Burkhardt: Well, was actually going to be my next question, which is, have you been intentional about getting on the runway of succession planning early? Yes. And it sounds with that example you have.

Nikki Kraus: Yes, I would say part of this is it's our way. And part of it is we are very fortunate to work with a number of organizations over \$2,000,000,000 who require us to have very formal, solid succession plans. So big clients make you better. We'd like to think we make them better too. But this is a great example of the structure being more robust and resilient because of that.

Chas Burkhardt: Well, I'm really heartened to hear that because at Rosemont, we view succession planning both functionally and often the transitions that come with it as happening and really just taken seriously so late in the lives of the leaders in the industry. It's somewhat incredible to us that folks that run competitive successful businesses just have this blind spot around why you wouldn't do it earlier. And I think for some people it's a bit of a personal affront in that they're incredibly capable and vital and energetic into their 60s, 70s, possibly beyond. But the notion that you don't realize that one of the best things you can do at any firm regardless of size or type is to make sure that as you're getting on towards the latter half of your career that you have somebody else or other people in place that are fully able to step up as opposed to dealing with it at the point of urgency. So this is a real risk, especially when something unexpected happens personally, which we've dealt with a few times in our career.

At that point, it's a four alarm fire and people have to step up.

Nikki Kraus: And we've all seen since COVID that there's been a lot more life decisions and life happening to people and not to say that lightly. So to have a structure where you are team based, and we have people who are quite capable across a number of functions, not siloed, really, really important. It's one of the key things we think about regularly here at Strategic.

Chas Burkhardt: And those are things that we think about at Rosemont too, Nikki. But I don't mind belaboring this point kind of generally because I think it's universal in our industry. And we think about it a little bit the following way. I think they're people that work for wealth creation. Whatever their monetary goals are, they're basically working to achieve those goals and when they have, they begin to check out or they're out of there.

Then I think they're those with specific business goals or their personal achievement interests at their firm. They've been hired to achieve a mandate, so all their actions really are basically driven by that

orientation. And then I think there are those, they're aware of the succession and runway issue and they're trying to be thoughtful early on, but their real focus is just on making the firm better. I think they live the culture, they wear it proudly. It's not work for those kinds of people really.

It's who they are and what they do. They don't really have a timeline. Their age is somewhat irrelevant as long as they're thoughtful about succession and transition. It's just much more about the overall success of the company. And those are really the fun people to invest with.

Nikki Kraus: Yes. And when I talk to investment committees about good investment committee members, I liken this to our people. You want someone, when they wake up in the middle of the night and say, oh my gosh, I forgot I owed Chas this email. I need to make sure I don't forget tomorrow. You want the people who put their feet on the ground and write themselves a note.

I do not want anybody who just rolls over. And if you're at the point in your life that you just roll over, it's okay, you've made the choice. But our clients, I just, you know, our clients deserve it.

Chas Burkhardt: You're obviously worth like there. Let's move on to ownership. Yes. And, you know, just if you could, for our listeners, chat a little bit about the overall ownership construct with B Flexion, and then we'll move into how the actual transition of ownership internally works.

Nikki Kraus: Sure. B Flexion is the entity affiliated with the Bertarelli family, which essentially created the fertility business, had a tremendous success, sold the business to Merck. They continue to be big investors in the biotech pharmaceutical area with a large part of their business. In another part of their business, they thought it was complimentary to the pharmaceutical business and the biotech business to have ownership interests in investment firms. Very importantly, is not a private equity fund.

There's no timeline. Let me take a step back because when we were talking about this a number of years ago, still remember the meeting where we said, we want an organizational structure that enables us to preserve what our clients think is special about strategic. Very important as a driving force. So it wasn't the scale word that we keep talking about. It wasn't growth at all cost.

It wasn't acquire everyone else, get bigger, get bigger. It was deliver excellent results for your clients and we're gonna get a healthy financial return if you continue to do what you've been doing. So that was the structure we chose in 2019. So we partner with them. They are our majority owner alongside as we mentioned, 29 internal people, directors, all managing directors have shares in the firm.

Once a year, I'll just say every year, part of our bonus goes into shares. So we are all incented to care about alpha client retention. And again, this this measured growth and relative to being good financial stewards of the business.



Chas Burkhardt: Now, the bonus shares effectively then are granted or earned would be a better word as part of the bonus compensation. Are you separately buying and selling stock as people retire, leave, whatever the reason?

Nikki Kraus: Yes, that is correct. Once a year, we call it the annual sale window or purchase window. We get a notice that, you know, do you want to declare you'd like to sell or purchase shares in this window? If you'd like to sell, here's how many are available. If you'd like to buy, what is your indication of interest?

We have an outside third party does a valuation of the firm. We've aimed to keep that the same firm with the same process. And then that price is struck. We approve that with the board And then the relevant folks are notified. And if they want to choose to buy or sell in that transaction, they can do so.

At the same time, when someone would like to retire, they will give us an indication and notice period relative to their intent to retire, and then they are bought out at the price that has been struck. Last year, we had a number of people get significant promotions where we granted shares and recognition of those promotions. And that process happens each year.

Chas Burkhardt: Are the purchased shares financed by the firm or the seller?

Nikki Kraus: Think of it as part of the bonus pool. So we say, okay, we have X amount of money for the bonus pool, an extra part that's in our budget for the long term incentive plan or the LTIP. We allocate that in the budget. The idea is over time our interest will increase steadily.

Chas Burkhardt: Right.

Nikki Kraus: And there are regular discussions as you might imagine with them on an ongoing basis relative to what those levels are, etcetera.

Chas Burkhardt: Talk to two issues which we see in droves, unfortunately, among employee owned firms. And let me know if you have experienced any great challenge with either one of these situations. The first would be the hangers on. Those that could retire, have been very helpful and had great tenure, and might feel that they have earned the right to put their feet up on their desk and spend the rest of their career there and hold on to their shares indefinitely, and whether or not you've had an issue in encouraging them to be more thoughtful about selling their shares down to those that are deserving and interested in buying those shares and kind of continuing the lifeblood of equity transition. The other side of that coin is, do you have at times, depending on the current fortunes of the company, do you have a lack of interest among would be buyers where the up and coming folk just aren't willing to write checks.

Yes, they can earn into the LTIP a portion of their bonus and shares, but in general, they don't want to really risk anything else. They don't want to risk part of their net worth or their liquidity. And so there is a dearth of buyers relative to sellers at kind of any one, perhaps multi year period. These are two issues which clearly exist in many, many places and really do affect the well-being of folks with employee ownership. What's your experience on those two?

Nikki Kraus: Yes. On the first one, I don't feel that we have anyone in building today who is a hanger on. I went to Notre Dame as you might recall, and I think it's a Lou Holtz quote to say, if you want to motivate somebody, get rid of the people who aren't motivated. So, So, when you have a high level of performance across the organization, people know who is performing at that level and it's pretty hard not to perform at that level. So I feel great about the folks in the building.

Relative to people purchasing, I go back to the best thing that we can do is have great performance, great retention. And then if we were doing those things, the value goes up. When the value goes up, people want more of it. And so I don't think we have a problem per se. I would say I think every organization would like people to buy more all the time.

That said, as you said, some of the young people, DC is a very expensive city and sensitive that people have kids in private school and things of the like. I don't feel that we have an issue in either way.

Chas Burkhardt: Well, I hear you loud and clear in terms of kind of personal financial situations and one's feelings around personal indebtedness, and how they may be extended at certain times in their life. And so I don't think it's the pejorative observation about folks that don't necessarily wanna buy all the equity afforded them, you know, offered at any point in time. In general, if you're going to keep a firm, you know, somewhat materially employee owned, that transition needs to continue to be healthy and active.

Nikki Kraus: 100%.

Chas Burkhardt: So glad to hear that it's going well. We have chatted for quite a while here and it's really been interesting and I appreciate you're willing to be specific and particular about a number of subjects, Nikki. I want to close with something that you touched on earlier that Rosemont is seeing all over the place, and we're not quite sure what to make of it. We're wondering whether, there's gonna be folks that will make a big deal out of the phenomenon that you and I just spoke to earlier in the podcast, and that is the notion that there are so many people that seem to be driven by growth, which is strategic priority one, two, and three. More scale, more growth, investors, whether outside or internal, but often external investors, whose whole reason for making the investment is to have the greatest reasonably possible return they can have.

And so you get into thoughts around just how much leverage is appropriate on one's balance sheet, how many acquisitions, whether or not they are really kind of the multi boutique affiliate model or the

more integrated strategic model, how many can be successfully done and worked into the fabric and the culture and the economics, in what period of time? These are all questions that kind of anybody in our business is thinking about. But the thing that strikes me is what is the effect on the client? The effect on the family, the foundation, the institution, etc, who one would hope is having a full and good client experience previous to said acquisition.

Nikki Kraus: Yes.

Chas Burkhardt: Or the second or third acquisition that may change the people and certain aspects of that business in terms of how those that work for those clients are motivated, paid, oriented, replaced, governance, etcetera. It just seems to me that this is a looming issue that has not really reared its head yet, and I can't see how it won't. What are some of your thoughts on that?

Nikki Kraus: I could not agree more. I just attended an industry conference with CEOs and scale is the buzzword of the day in the investment landscape. And to your point, it was all about how it was good for the firm, not at all how it was good for the client. And I would encourage anyone who has an investment advisory relationship to ask, okay, if you get access to Andreessen Horowitz at the size you're at, how do I ensure that as a family office client or a foundation client of an OCIO that I'm getting that access, it's not your largest consulting client. It's not going in a product for high net worth individuals.

Some of these deals you're seeing they've gone from dozens of clients to 20 clients to five twenty clients. It's a big change. And now the PE that was supposed to be for institutions is getting distributed to high net worth individuals and the team that was focused on managers for this big, very cachet organizations is now being watered down. I don't see how it ends well. I saw a search consultant who said, tell me how this isn't horrible.

I'm like, I think it is horrible. It's just people I'm not sure know the questions to be asking to understand how it's good for them. And unfortunately, I think it will be there'll be a lot of searches in two or three years where people realize this was not a good deal for me.

Chas Burkhardt: Well, I think one thing we could agree on, it's just an uncomfortable

Nikki Kraus: Yes.

Chas Burkhardt: Subject, and there are many who would just prefer that this was never discussed, and yet I think it's right there, right underneath the surface, and we're certainly conscious of it in terms of what we are expecting in terms of the firms that we invest in. And if we were invested in you, think we'd have a very similar orientation, and that is we want thoughtful long term growth. We certainly don't want it to be, you know, so strong or so point to point. It's not a five year, seven year, can we

make 20 plus percent on our money? From our perspective, with Markel as our partner, it's about making good double digit long term returns over decades.

And just that in and of itself is not the way the vast majority of the owners of such businesses therefore that ultimately govern the welfare of the client. Just they're not wired that way. They're not going to be wired that way because we have a very let's let's call it like it is. We have a very healthy, robust M and A market with no shortage of capital and no shortage of folks that are interested in exploring that capital. So in some respects it would seem like it's very active and nobody is forcing the sellers to sell and many buyers are finding that, you know, it's been an attractive place and a segment to invest their capital.

But like you, I think we're just very worried that, God forbid, we have a multi quarter or multi year significant downturn in broad markets or in the specific markets that affect the strategies of the firms that we're talking about. And, you know, there's a lot of expectation. I think it's very I think you just hit it on when you talked about the Bertarelli and B Flexion. You've talked a little bit to what they are thinking and what they would expect, and I think that's another subject matter that it's absolutely a very important topic. Those that would invest in you or own you, what are their return expectations?

What have they made? How are they doing relative to their scorecard? And then how does that align with how you're doing and the 29 employee owners?

Nikki Kraus: We just have been having this conversation a lot with groups to say it's really important to start with what does success look like and make sure you're on the same page. These are business relationships, but it's the exact same thing in personal relationships. Are we on the same page that we can have a good partnership? And I give the Bertarelli family and their team a lot of credit relative to really thinking through that and continuing to revisit that with us and make sure we continue to be the right match for them and fulfilling the part in their portfolio that they wanted us to.

Chas Burkhardt: Well, Nikki, we could continue on, but I really appreciate you coming onto the podcast and discussing the far ranging subject matter that we've covered. I miss you in Philadelphia.

Nikki Kraus: Thank you. I miss Philly too.

Chas Burkhardt: Come visit. Love to see you again soon.

Nikki Kraus: Okay. Will do. Thank you so much.

Chas Burkhardt: Take care.