



Meet The Manager

Big Apple Seeds

An interview with Adam Blumenthal which appeared November 7, 2003 on PrivateEquityCentral.net. Reprinted with the permission of PrivateEquityCentral.net.

Last month, the New York City Retirement Systems announced plans to invest \$175 million in small, first-time private equity funds with a particular emphasis on those funds run by women or minorities. The move marks NYCERS's continuing expansion into private equity, which began after a 1997 study by private equity consultant Pacific Corporate Group helped the pensions establish a 2% target allocation to the asset class. The group, comprised of the City Employees' Retirement System, the Teachers' Retirement System, the Police Pension Funds, the Fire Department Pension Fund and the Board of Education Retirement System, manages assets valued at roughly \$75 billion. First deputy comptroller Adam Blumenthal, alongside New York City's Office of the Comptroller, provides the pensions with guidance and advice on how to best invest their money. Blumenthal himself comes from an alternative investment background, having served as chief financial officer, president and vice chairman at American Capital Strategies, a \$1 billion publicly traded company that specializes in mezzanine and equity finance for middle market companies. Following a major asset allocation study this past September, the pensions will increase target allocations to private equity firms. PrivateEquityCentral.net had a chance to talk with Blumenthal on the pensions' asset redistribution.

PrivateEquityCentral.net: What prompted the New York City Retirement Systems last month to set aside \$175 million for investing in small, first-time private equity funds run by "emerging managers?"

Adam Blumenthal: We obviously invest in large funds just like any other pension system. However, we're trying to branch out and identify different opportunities that aren't always the easiest within the private equity realm. There's a substantial amount of evidence showing that first time funds and emerging managers are on balance. There's a greater dispersion of returns among them and the top quartile of them performs extremely well.

However, the funds tend to be somewhat smaller and much more labor intensive, both in due diligence and in monitoring. So we're putting a call out for fund-of-funds managers to find people to really sort through those opportunities for us. In this case, we are particularly interested in emerging managers that have substantial ownership positions by women and minorities, a sector which we think has been particularly hard for us to access in the past.

Our objective in this instance is to get the best risk-adjusted returns and to find ways to access the market with operational prudence. We think approaching this

sector with a fund-of-funds manager lets us access those risk-adjusted returns in a way that lets us exhibit operational prudence.

PEC: What is NYCERS' allocation to private equity now?

AB: The funds historically have had - from 1998 to this past summer - approximately 2% of their capital allocated to private equity. Over the course of the past summer, the five funds that comprise the New York system increased their allocation from 2% to 5%, which will substantially increase our private equity presence from between approximately \$200 million and \$300 million a year to \$800 million a year. The shift was really an attempt to improve the diversification of the funds.

PEC: NYCERS participating pensions recently completed a major asset allocation study. What was the purpose of the study?

AB: We began the asset allocation studies in the spring and concluded them between June and September. We then examined the results and took a look at where capital should be deployed over the next five years. The purpose was to review the capital market assumptions underlying the diversification strategies of each of the funds and to take into account the last several years of information and really to reassess where we're allocating money. Our conclusion was to put more capital into longer term and less liquid instruments with equity-like returns. And private equity and real estate both fall into those categories.

PEC: How are the systems' assets distributed at the moment?

AB: About 70% of assets are invested in equities and 30% are invested in fixed income. Of that, on the equity side, 55% is domestic and 15% is international, primarily in developed markets. Within fixed income, 5% is high-yield and 25% is designed to mirror the Lehman aggregate.

Historically, the investments have been weighted toward buyout investments rather than into venture capital. Our private equity program began in 1998, so we didn't have time to build up a large venture program. But fortunately we did not experience some of the really substantial issues that people with huge venture portfolios did. I think we will continue to build a broadly diversified portfolio of private equity investments, looking at buyouts, looking at ventures, looking at secondaries, looking at distressed debt. We would look to broadly diversify and not to really focus one particular asset class or one particular strategy within an asset class.

PEC: What is your role in recommending private equity allocations?

AB: The New York City comptroller is delegated the responsibility by the trustees of each of the five pension funds of New York City to serve as financial adviser - that's what we do, both with our own staff and with the help of pension consultants. My role is to oversee the financial advisers and services that are provided. We also serve as a trustee on four of the five funds. My role is to oversee the financial advice that is provided to the trustees, and to serve as the investment staff for each of the funds.

For a period of time I was president of American Capital Strategies, so I am very familiar with the asset class because of ACS's involvement in it. I have broad

responsibility for the investment strategy of the five funds, but within that I review and sign off on the recommendations that go to the boards. At the end of the day, it's the trustees in the five systems that make the decisions rather than the comptroller. We're advisors; we don't tell them to buy this fund and not that fund. We work with consultants to provide recommendations.

PEC: Have the pensions been happy with their private equity portfolio thus far?

AB: Yes, they've been quite satisfied. The private equity portfolio is still relatively new. Because of the well-known J-curve, it's very hard one when dealing primarily with projected performance in the early several years of investment. And since the program has been in place for slightly more than five years, many of our commitments were made only over the last several years. It's still relatively a new program, but that being said, I think people are quite satisfied with the program and the results, as evidenced by the increased allocation. One of the fortunate outcomes of our private equity investing is that we were not investing in large venture funds in 1999 and 2000, so we didn't experience the problems that some people who had large venture portfolios did.

PEC: What should people know about your private equity program before approaching you?

AB: Apart from the emerging managers, which we discussed at very beginning [of this interview], we look for funds where we can put substantial amounts of capital to work. We're looking to build a broadly diversified portfolio, sort of the best couple of opportunities in each sector each year. We're not averse to any individual sector of the market. Our staff and consultants are going through a process of looking at whole sectors within the buyout market on an annual basis and try to project what the deal stream is going to be. They're going through a fairly rigorous process to filter up the best opportunities

PEC: Are you planning any other initiatives similar to the emerging managers one?

AB: I wouldn't be surprised if we announced some others next year, but nothing yet. The initiatives are a result of our attempt to look at individuals, and take into account the information gathered by both our staff and consultants who look at individual sectors within the market, to find the best way to approach them. To the extent that there is something that we view as a good opportunity that can't be achieved through a strategy of looking at the market and picking the one or two best large opportunities, we'll look for another way to get it done as we did with the emerging managers.

The emerging managers program is a practical way of investing in smaller funds without taking on the managerial path: The initiative means having a lot of smaller investments, having somebody that is well situated to perform the extra due diligence, and having the select top quartile managers from a diverse pool.