

Investment

THE VOICE OF INDEPENDENTS

ADVISOR



TED SCHWARTZ

TIM LAWRENCE

TIM and TED'S
EXCELLENT
ADVENTURE

BY JOHN SULLIVAN

PHOTOGRAPHY BY
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The principals of Capstone Investment Financial Group thought the height of the financial crisis would be a wonderful time to launch their own mutual funds. Are they crazy?



The answer to the question everyone's asking is "like a fox." It might seem like a major investment in a product or service outside your core competency—at a time when most advisors are simply hanging on for their lives—isn't the shrewdest move. But then again, diversifying your revenue stream at a time of heightened fee compression and shrinking margins can't be all bad.

Tim Lawrence and Ted Schwartz came through the worst of the market downturn pretty well, and soon other advisors got word and came knocking. They asked the partners of Colorado-based Capstone Investment Financial Group to manage their portfolios in order to free up time for more client meetings and prospecting, and Capstone was happy to oblige.

"Market conditions and uncertainty are a good fit for what we're doing," Schwartz says. "It's all about trying to compound money efficiently. Unfortunately, we think most financial services companies and funds don't do it well."

Big talk for the former Commonwealth Financial Network reps (and now affiliated with TD Ameritrade through their independent RIA). But they're backing it up, partly because they have that most rare of skill sets: math geeks with personalities and people skills, which makes them ideally suited for the business in which they find themselves.

"This field is a good combination of going back and forth with using those analytic and math skills, but also building relationships and working with people," Schwartz adds.

Lawrence, for his part, did his requisite stint in banks and wirehouses, most notably with Dean Witter and U.S. Bank. His reasons for eventually making the switch to the independent channel are awfully familiar.

"I didn't like the way they said, 'OK, push this,'" Lawrence says. "It was whatever the 'investment du jour' was. The manager was a dinosaur who wanted you to pound the phones for 300 calls a day and didn't really care about the client. I wanted it to be more about the best thing for the client, rather than the best thing for the company."

Both eventually found themselves at Commonwealth. In 2001, Schwartz approached Lawrence about joint marketing efforts and the relationship developed to the point where it made sense to merge their books. Today, the firm has 200 clients and is completely fee-only.

When asked about what specifically sets them apart as a firm, it (unsurprisingly) led to a discussion of the mutual fund launch.

"When the market dropped in 2008, we were already tactical with a very diversified portfolio, including alternatives," Lawrence explains. "We really blew up after that, and the assets started coming in. We

were down probably 10% to 14%. That's when some advisors we knew from Commonwealth approached us to manage their client assets."

Not that it's been easy. Schwartz says the biggest challenge in launching the fund is getting people to understand it, because it isn't traditional.

"We're calling it variable risk investing," Lawrence adds. "What's the optimal asset class to be in for today's valuation?"

Schwartz says there are three basic ingredients to their investment philosophy. The first is their decidedly global view, although they don't ignore domestic investments. The second is their "endowment philosophy."

"I would say it means we're super-diversified," he says. "Instead of just looking at stocks, bonds and cash, we're looking at stocks, cash, bonds, real estate, real assets, absolute return strategies, foreign and domestic bonds; like I said, super-diversified."

Because they have that most rare of skill sets—math geeks with personalities and people skills—Lawrence and Schwartz are ideally suited for the business in which they find themselves.



And, of course, downside protection is paramount.

“Going back to the marketing thing, the unfortunate truth is that, right or wrong, probably the best reason for the asset gathering success we’ve experienced is a really horrible market period,” Schwartz admits. “We’d just as soon not go through that, but if the market drops 40%, we’ll again be gaining assets pretty quickly when people see how we do versus our competitors.”

The CIFG MaxBalanced Fund, their so-called “all weather fund,” has that endowment philosophy in mind. It’s a core holding fund designed for absolute return and alpha production with an emphasis on outperformance through whole market cycles. It has a focus on risk management and employs broadly diversified, tactical strategies.

The fund’s use of active management, commodities, alternative investments and traditional equities, bonds and mutual funds is designed to create gains regardless of market direction. The fund uses earnings momentum, value to price, total value and equity income to evaluate investment opportunities.

Lawrence says every position has a sell stop or hedge point to limit potential losses. The sell point is adjusted upward on a monthly basis. If the price of an asset drops below its 10-month moving average, it will be sold or hedged.

“By using this disciplined approach, we seek to reduce volatility and control drawdowns if an investment fails to perform as anticipated,” he says.

Their second fund, the CIFG MaxOpp Fund, is designed to provide long-term capital growth. Also using a tactical investment strategy, the fund invests in equities through the use of exchange-traded funds. Positions are actively managed based on current market conditions and perceived opportunities for superior performance within selected sectors and geographic markets. As a result, portfolio holdings will change throughout the investment period in response to the risk environment of the market and economy, and may include cash or bond positions.

The MaxOpp Fund is actively managed and invests in funds that have greater volatility than the overall stock market. Ideally this volatility is to the upside, but Lawrence says investors should be willing to accept greater short-term volatility and a risk of loss to achieve higher long-term potential growth of capital.

All well and good, but when asked where they’re currently finding alpha, Schwartz is somewhat circumspect. He says they’re “fairly fully invested right now” across all asset classes, but cautious. He likes emerging markets, both in terms of equities and bonds, which he sees as having long-term higher growth rates and therefore justifying their valuations easier over time.

“We’re trying to become more agnostic in our investing world,” he says. “We’re listening, rather than predicting. Real estate, frankly, is the one area in which we are fully invested and it’s doing fine, but I really couldn’t tell you why. It just keeps going up. There are more and more vacancies, and less and less property value, and yet it keeps going up.”

As for the recent threat of a U.S. government downgrade, debt issues, unemployment figures—do they think it’s time for panic?

“Probably not that extreme,” Schwartz says. “As far as the threat of downgrade, I don’t think they really brought anything to light that wasn’t already known. But that’s one reason we own foreign bonds and currency. We are cautious at best and slightly pessimistic about the U.S. dollar long-term. It doesn’t mean it won’t do fine in the short term, but yeah, we tend to buy currency-type investments in our absolute return portion that would profit from the dollar declining.”

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