

## Breakfast of Charlatans

Mariko Gordon\*

January 13 2009

*Advisor Perspectives welcomes guest contributions. The views presented here do not necessarily represent those of Advisor Perspectives. We saw this article in a newsletter from one of our readers, and we thought it was a good follow-up to our article last week, [Due Diligence from a Distance](#).*



**Five years ago, in February of 2004, I read a profile in *The Wall Street Journal* of a 28-year-old hedge fund manager that was so weird, I clipped it out and saved it in my notebook.**

The story focused on the return to high living in financial circles, and used Brett Grebow, cofounder and principal of The HMC International Fund, as its prime example. Among the excesses he shared with the reporter were his purchase of a \$160,000 Lamborghini ("his first 'treat' in months") and the chartering of planes for \$10,000 a pop to fly between Florida and New York (an air corridor not exactly underserved by commercial aviation).

**But what really caused me to whip out the scissors and save Mr. Grebow's story for posterity was his reasoning for spending \$10,000 on a private jet instead of say, \$300 on JetBlue: "It's fantastic. They've got my favorite cereal, Cookie Crisp, waiting for me, and Jack Daniel's on ice."**

Hmmm. If Warren Buffett, a bona fide billionaire, is compelled to christen his private jet when he finally buys one "The Indefensible," it would seem that Grebow was guilty of a serious lapse in judgment - in both capital allocation and discretion (if not taste in breakfast cereal).

**I remember wondering at the time how good at investing a guy like this could possibly be.** Not to mention what his clients would think once they saw how he had presented himself to the world.



**Almost two years later, in a Christmas present to investors, the [SEC filed suit](#) against Grebow and his partner** for stealing \$5.2 million of the \$13 million they'd raised from 80 investors. The HMC International Fund, whose motto was, ironically, "integrity & performance," was promptly shut down. From there, all the woulda, coulda, shouldas came forth in the press and blogosphere, as a cursory check of Grebow's background on Google and other sources would have shown a, shall we say, troubled past.

### **More than just the numbers**

In today's post-Madoff world, money managers - whether egregiously spouting off to reporters or not - can count on being googled as a matter of course. It's easy, convenient and free. **But assuming no rap sheet or obvious shady dealings, what other kind of due diligence should be done by clients before hiring a manager?**

It's time to look beyond statistics and reams of data. Not that a close examination of intra-period trades isn't called for to make sure that the manager isn't indulging in investment sins, from window dressing to saying one thing and doing another. Because quantification is at the heart of investing, and because ours is a highly analytical profession, **it is easy to overlook that which cannot be expressed numerically, such as character, temperament and motivation.**

### **Three steps to take:**

1. **Ask personal questions.** Portfolio managers are by and large a hyperanalytical and nerdy lot, so I am not suggesting that you judge us solely on our social skills. That said, **I don't know where in the rulebook it's written that you can't ask personal questions.**

Knowing a manager's pet charities (where are all those millions in donations coming from?), board commitments (too many?), hobbies (expensive ones?), and where they spend their time says a lot about them. **Our analysis of small-cap stocks always includes a close look at the CEO and his or her team.** Your selection of a fund manager should be no different.

For example, I recently met with the CEO of a company during a one-on-one breakout session at a research conference. His body language screamed "I don't want to be here" and he met our desire to understand his business with the barest modicum of civility, fleeing when time was up as though we'd exposed him to the Ebola virus. This behavior continued



throughout the day with all other investors, so it clearly was nothing personal. While I can understand that meeting Wall Street is any self-respecting CEO's least favorite part of the job, shilling your company is a fact of life and pissing off prospective investors is at best, self-indulgent and at worst, puts a lid on the stock. Sure enough, a few weeks later this CEO announced his retirement.

1. **Meet them on their own turf.** A nice suit, a new pair of shoes and a polished presentation can go a long way towards making a positive impression, and in the process, mask important red flags. That's why an onsite visit should be part of your due diligence.

**We have a client that used to make its managers trek to their offices twice a year, but then decided to hit the road themselves.** Not because of the delights of modern day travel, mind you, but to observe said managers in their natural habitat. An extra step that they've since found to be worth the effort.

Similarly, a consultant friend told me that he learned the importance of qualitative due diligence after he decided to drop in on a firm that had been marketing to him assiduously. The portfolio manager refused to come out of his office to meet with him (certainly a black mark), but the pièce de résistance was the wall of beer cans in the office. This was no collection of travel souvenirs or the beginning of a recycling drive either, simply Budweiser cans presumably emptied on the premises.

1. **Push beyond first impressions.** I'm convinced that some of the reluctance to look beyond the numbers and at the investment managers themselves is due to our societal deference towards the rich and/or successful. (Many money managers have become very wealthy over the decades.)

**I was struck recently by how much of a defensive shield money, power and success can be** while in a meeting at the office of a well-known money manager who graciously allowed me to sit in with the management of a health-care company. The view from his aerie was priceless. The art in his office was priceless. And the deference with which he was treated by management and everyone else in the room was priceless. I'm certain he doesn't get asked all sorts of nosy, probing questions to figure out where his head is at with respect to his business. But he should be. We all should be.



Sound investment has always been about the people behind the numbers. **And while past performance may not be a guarantee of future returns, past behavior - good or bad - usually is.** So go ahead... ask what your manager eats for breakfast. It may be the best investment decision you make.

*\* Mariko O. Gordon is founder, CEO and CIO of Daruma Asset Management, a NY-based small cap investment management firm. Subscribe to her free monthly e-newsletter On Daruma's Watch [here](#).*

[www.advisorperspectives.com](http://www.advisorperspectives.com)

For a free subscription to the Advisor Perspectives newsletter, visit:  
<http://www.advisorperspectives.com/subscribers/subscribe.php>