EPISODE TRANSCRIPT

OCIO Pioneer Jonathan Hirtle on Building a $20B RIA the Organic Way

A conversation with Louis Diamond and Jonathan Hirtle, Executive Chairman of Hirtle, Callaghan & Co.

Mindy Diamond:

Welcome to the latest episode of our podcast series for financial advisors. Today's episode is OCIO Pioneer Jonathan Hirtle on Building a $20 Billion RIA the Organic Way. It's a conversation with the executive chairman of Hirtle, Callaghan & Company. I'm Mindy Diamond, and this is Mindy Diamond on Independence.

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When it comes to innovations that fundamentally alter the wealth management world, many pundits will cite the OCIO or Outsource Chief Investment Officer model. The concept of outsourcing investment management changed the way that investment decisions were made and implemented for institutional investors and high net worth families moving the decisions from product driven sales folk to a fiduciary minded comprehensive investment office. It was a game changer for the industry, creating a more streamlined, comprehensive and cohesive approach for clients while driving growth for firms that adopted this methodology, yet the OCIO model's impact was most transformative to the firm. Co-founded by the pioneer of the model, Jon Hirtle. This former Marine started out in the wealth management industry in the trainee program at Goldman Sachs in the early '80s. It was through that experience that he was immersed in a culture unlike any other, yet he ultimately felt philosophically cornered in a transactional based role at the firm.

That is Jon was conflicted. He saw an opportunity to serve clients' investment needs in a more comprehensive manner, in a way he just couldn't at Goldman. So, in 1988, Jon co-founded RIA, Hirtle, Callaghan & Company with Donald Callaghan, another Goldman Sachs vice president, to serve solely as an Outsourced Chief Investment Officer and investment department to family groups and institutions that chose not to develop and pay for a full staffed internal investment department. And they made the leap to independence at a time when few would consider it and when the resources to do so just didn't exist, that is they did it from the ground up without a blueprint or the support that is available to present day prospective independent business owners. Today, Hirtle Callaghan is a $20 billion RIA growth solely driven by organic means and without the aid of outside capital. Jon is a true legend with an incredible journey and many valuable lessons which he shares with my partner Louis Diamond. There's a lot to discuss, so let's get to it.

Louis Diamond:

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Jon, thank you so much for joining us today.

Jon Hirtle:

It's my pleasure to be here, Louis.

Louis Diamond:

Very good. Let's get to it. Can you tell us about your background prior to joining Goldman Sachs?

Jon Hirtle:

Well, I grew up in Pittsburgh and I went to Penn State and before joining the Marines, joining Goldman, I spent seven years on active duty in the Marine Corps. And after I returned from overseas, I began dating my wife. We were married a couple of years and had our first child three years after that. And although I loved the Marine Corps, it was really transformational for me, and I absolutely still loved being a Marine. But as a young father, the idea of being a first guy on the beach seemed to be less exciting than it once had. So my last tour was recruiting officers at back at Penn State, and I was going to grad school at the same time, and somebody told me you could make a $100,000 a year working on Wall Street, but you couldn't get a job. And I remember thinking to myself, I don't really know what they do on Wall Street, but I'll bet I can get a job. And marines tend toward confidence. So that was what started it all.

Louis Diamond:

Amazing. So it was the drive, and thank you very much for your service, of course.

Jon Hirtle:

My pleasure.

Louis Diamond:

So you joined Goldman in the '80s when it was still a private partnership, the Wild West Wall Street of the '80s. Definitely predates me, but very curious just to know, what was it like to work there at that time?

Jon Hirtle:

Well, I've always thought that I've been relentlessly pursued by good fortune. And working at Goldman in those bygone days was once again really transformational. The firm was a small, exciting, diverse meritocracy, and the general partnership structure meant that the partners who we work with every day took everything about the firm, personally, people, capital, and of course most of all reputation. And the training in both a formal sense and in an apprenticeship sense was amazing, but being immersed in that culture was the real blessing. For example, last year we celebrated the 40th anniversary of our

training class and almost everyone returned. They came from all over the world just to really recall the time and the people who we were with when we launched our careers.

Louis Diamond:

Amazing. And so when you joined Goldman, you were now the role as a private wealth advisor. Was it a somewhat similar capacity then, or was it a little bit different?

Jon Hirtle:

It was different. There was no investment management at Goldman in those days, and there was no wealth management, there was no PCS. There were just, as I recall it, three big divisions. There was trading, there was investment banking, and there were sales. So the security sales division, which is really securities brokers, was the division I was in. And it was terrific because I had both families and institutional clients, so taxable and tax-exempt clients, and I got to do everything from options, strategies to limited partnerships to municipal bonds to stock picking. And so it was one of those old classic opportunities where you got broad training across lots of different disciplines. So that was a very different structure. It's a long time ago, as I just mentioned.

Louis Diamond:

So was all the revenue commission based or transactional or were you allowed to serve private clients on the advisory side at that time?

Jon Hirtle:

Nope, it was all transactional. No one had discretion. We did serve as advisors, but the compensation model was different. So it is all transactional. Actually, Goldman had a big business where they were serving as brokers to many of the money managers in the world. And at that time, the notion was that we didn't want to compete with our clients who were investment managers. So we, specifically, the firm, made a decision not to be in the investment management business in those days. I'm not sure when it changed, but obviously it did.

Louis Diamond:

Interesting. It's very interesting to track the history of the industry through even an experience like yours, and you went full life cycle going from a transactional based role at Goldman to being product focused, to eventually launching Hirtle Callaghan, which is a strict conflict free advisory firm, a consulting firm. So very interesting just to track the history of the industry through your eyes, which we'll get to.

Jon Hirtle:

That's for sure.

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Louis Diamond:

So what were your drivers to even consider leaving Goldman in the '80s? I have to imagine that back then, well, even now, very, very few people would leave a job as VP at a company like Goldman, especially back in the partnership days, even especially when it meant that your exit option was founding a nascent firm back before the RIA channel even picked up steam. So can you talk a little bit about what was going on at Goldman or what your thought process was to take that time a massive, massive leap?

Jon Hirtle:

Yeah, well, I'm happy to. Well, Goldman was and is one of the very investment banks in the world, we all know that. But interestingly, the purpose of an investment bank is to raise capital for Corporate America, for example, by creating and selling securities, which is, and that's how they raised the money for corporations. And it's an essential element of free enterprise, but it's the wrong structure for managing money. I learned all that at Goldman when I really combined that fact with the passion for clients and my personal idealism. I really found that I had been philosophically cornered. So, in other words, we knew that we had to look serve clients. The first day I was at Goldman, my mentor who was a terrific professional and still a great friend, I asked what the noble cause was just coming out of the service.

He said, the client is a noble cause. And so that was really what drove me. And through time, through those seven years of training, I really understood that there was a better way to manage money, but it really couldn't be there, we couldn't do it at Goldman Sachs. So I knew this notion of a pure play independent investment office was the ideal structure for serious investment management, but for several very sound reasons, we really couldn't do it at Goldman Sachs. So I was philosophically cornered and had to start a new firm.

Louis Diamond:

At that time because again, now we take for granted that most firms are advisory only, or most of the revenue comes from advisory. Back then, who were the competitors that were acting in this noble way that you looked at and said, wow, there must be a better way?

Jon Hirtle:

There were a lot of great professionals in the marketplace and there still are. What did not exist was an independent investment office for hire. So I had been looking at the best investors in the world, people probably mention these again because I tend to mention them again and again, but the Yale Endowment Office and the R.K. Mellon family. So they're large multi-billion dollar investors. I was fortunate enough to cover R.K. Mellon. They had three and a half billion dollars in the '80s and they had own their own independent investment office managed by a guy named Arthur Miltenberger who was

the CIO, and they were consistently outperforming Goldman Sachs. So if that structure, the more I looked at it, the more I realized it was structurally advantaged, but we couldn't execute it at a brokerage firm at an investment bank.

And I would make the case that they still can't execute it at the banks and brokers. But once I figured out that that was the best model, then we really looked around and I didn't want to go to a different bank or broker because I always felt like I already felt I was at the best. So the option was really to create a new firm.

Louis Diamond:

That's not the first time we've heard that on this show, that a lot of advisors get to a point where they feel like they have the best in platform and technology, they're at an amazing company, but what's missing is that entrepreneurialism, it's the freedom, it's the control, and it's in their mind a breakdown of the business model rather than, okay, there's another company that's already doing it. And that's often what drives folks to break away and go independent. Granted, you did it long, long before, I guess they'll say it was cool back before the custodians provided all this amazing technology before this ecosystem of tech vendors and capital providers and outsourcing partners and platforms, and also just the momentum and the narrative around the independent space had really taken form. So what was it like to start and operate an RIA then and coming out of company like Goldman, you hadn't operated a business and we're going into the great unknown. Can you just talk about what it was like then and how you did it?

Jon Hirtle:

Sure. Think of it this way, we started with a clear and largely complete vision because we were not creating something new, we were emulating the large independent investment offices. So we had a model in our mind, as I say, Yale, R.K. Mellon. Today, you would look at the Microsoft Office, things like that. How do we create that and make it broadly available? But we had this clear vision of a never before seen, I don't know, think of a performance automobile. And we were certain that we would and we could create it, but to get started, we had to use the components that were available in the system but assemble them in a different way. So we were constantly explaining to prospective clients and colleagues why our design was superior. And while we were racing the car, we were designing and creating and inserting new components.

That's how it worked. But importantly, the basics were provided through a joint venture that we were able to create with SEI, that's a long story, but it was a moment in time before SEI was an investment firm. They were looking for interesting businesses to complement their core business, which was trust department processing. And they were not yet an investment firm, but working with them, we were able to pull together the basics as we went along. So custody asset allocation manager search, operations support and so forth. We actually hand printed our own statements, but they were

tremendously supportive and starting at the top, Al West believed in our concept and was all in really assembled a wonderful team for our project, including guys like Fred Hammer and Herb McPherson, Murray Lewis. And then SEI had acquired a few years earlier, A.G. Becker and A.G. Becker was really the leading pension consulting firm in those days.

And SEI bought them and there were two former Becker stars, Gil Beebower and Bill Madden who gave us the intellectual comradery that we needed. Gil B. Bauer was one of the authors of the famous Beebower Hood and Randy Hood, Gary Brinson and Gil Beebower wrote the original piece on the determinants of portfolio performance, which is the big asset allocation study that really got people thinking about the significance of asset allocation. So these guys were real luminaries and they gave us the intellectual comradery that we needed. So that got us started. We're all learning as we went along. We were so loyal to Goldman that we brought along no former clients, so we went almost two years without any revenue, but it eventually worked. I think it was Eddie Cantor said that the average overnight success takes 20 years. So building a real firm, not just a practice, but a real firm is a struggle. It takes capability, commitment, and time, but it worked and we feel fortunate to be where we are today.

Louis Diamond:

And just for perspective, when you launched Hirtle, Callaghan or the company that became Hirtle, Callaghan, what year was that, if you remember?

Jon Hirtle:

1988.

Louis Diamond:

So 1988. So let's talk about where you are today just to really, I think, build up the credibility of the rest of the episode. Can you describe the makeup of the business, the size, and the overall value proposition that Hirtle, Callaghan goes to market with?

Jon Hirtle:

Well, we've got $20 billion dollars under discretion, but when I'm asked to describe our business, I always like to start with our why do we do what we do? And our purpose really is to strengthen the families and the institutions who positively impact our world. So we see ourselves as a force multiplier for them, and while they fuel free enterprise and create opportunity and solve societal problems and educate the next generation and just make our world a better place, we want to multiply their effort by managing their money in a way that is custom for them and that leads to their further success with a high degree of certainty. So we manage that $20 billion dollars with discretion, complete global solutions, custom design for each client, everything from cash management to public stocks, to bonds to

private markets, including private credit, private equity, and venture capital. So we're investors, not consultants.

This is a key differentiation. We are not a consulting firm, we are people that have discretion. We design and implement investment programs. So if you think about the stock picker, a bond picker, a venture capital firm, they are component investment managers. We are the overarching investment manager and we're point accountable for results. That's a big differentiation. Everyone in our strategy group, almost every significant person in our strategy group has been a trigger puller, somebody who's made decisions and lived with the returns that he created in their career. So that's what we do. We're responsible really for this notion of complete success. So what we do, one of the key concepts is that we start even with the largest institutions, defining what success means for them so that we can achieve it with a high degree of certainty. And that's really our value proposition using our collective purchasing power and collective expertise and collective access to deliver success with certainty.

Louis Diamond:

Can you explain that a little bit more? What would be an example?

Jon Hirtle:

Well, for example, if a college, we want to look at their operating and risk and their financial risk. Years ago, there was a prominent consultant running around the country telling everybody to invest like Yale, which is interesting because Yale, when you think about it from an operating standpoint, their quadruple subscribe by qualified full pay applicants and they've got a AAA rated balance sheet, so their financial risk is low. So their operating and financial risks are quite low. It's not the size of their endowment that allows them to be aggressive, it's their fact pattern. So the investment process needs to be complimentary to the financial risk and the operating risk. There are other things, for example, when we're working with a finance department, and this is true with families as well, a lot of people think they need more liquidity than they actually do. And so by working with them to define processes for managing liquidity, we can free up assets to be in private markets and achieve higher returns.

Louis Diamond:

It makes enough sense. I'm not the one that has to understand that that's why people hire you. I think for the advisors listening, it makes sense to them. So I want to talk about the OCIO model, which you pioneered. But before then, can you just talk a little bit about the split of your business between family and institutions? So what's the breakdown between the two? How did that evolve and why do you think serving families and institutions is complimentary and not conflicting?

Jon Hirtle:

Yeah, I'm happy to. So we started out managing only family business. So what today would be called wealth management. But it wasn't too long before our clients asked us to help them at their alma mater or at their community hospital because those programs were struggling. So we did that and today our business is about 50/50. We have more clients who are families and we have slightly more assets that are institutional, but the revenue from the two is about even. And we love that because every one of our families is philanthropic, and so the institutions that inspire them are prospects for our business. Conversely, when we are introduced to that institution, everyone on the investment committee is a high net worth prospect. So it's a virtuous cycle and people who see us working with families want to introduce them to the institutions that they love.

And on the other side, people who see us working at institutions are curious about how we might work with them personally. So we love that business. We think it's complimentary because the families really teach us how to serve clients and the institutions frankly keep us on our toes because the way committees work. In other words, if you've been going, if you're working with a family and you're going to bar mitzvahs and christenings, you don't generally get crushed when you go to an investment meeting, somebody's not really ready to go after you, but investment committees is different. The dynamic is somebody on the committee sort of takes it upon themselves to be the most aggressive question answerer. So we like it that way too because the institutions keep us on our toes and the families help us keep it personal.

Louis Diamond:

I like that, that's a funny analogy. So let's talk about the OCIO model or the Outsourced Chief Investment Officer model. Even just using the acronym it, I'm doing it because it's commonplace in today's lexicon of the industry, but I think you're accredited with really founding or pioneering this concept. So can you talk a little bit about the way you thought of this and just the evolution of it?

Jon Hirtle:

Sure. Well, when I started in the business, really serious investors only had to decide among a few things. And first of all, they were heavily conflicted. They were dealing with heavily conflicted sell side, product oriented shops like banks, brokerage houses, and other product shops, but was also much a simpler world. Most investments were restricted to stocks, bonds, and cash U.S. So this is a buyer beware world. So these product vendors, like the banks and the brokers and the product shops were conflicted. Everybody knew they were conflicted, but because the world was so simple, the sophisticated user, the sophisticated layman who tends to be on a committee or tends to be a successful business person, could differentiate or protect themselves from these conflicts in that simple, what I think of as a three sell matrix stocks, bonds cash, US. Today, the complexity and noise in the investment marketplace has exploded.

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On one axis, you've got every type of investment there is, private markets, alternatives, option strategies, every form of derivative and so forth. On one axis, on the other axis, you've got all the countries in the world. So it went from a three cell matrix to a 50 cell matrix. Complexity is skyrocketed, and this is one of the most important reasons the old buyer beware. Sell side structures have become inappropriate for serious investors because the complexities exploded. So we just decided, we said, look, why can't we replicate what the most sophisticated, most successful investors in the world do? And if you look at Yale, for example, which is really the poster child for terrific investment departments. The people who work there do not get paid more based on asset allocation, they get paid more when they perform well only, and that's just a salary and bonus. So they really work for the university.

They don't work for Goldman Sachs or JP Morgan or Fidelity or anybody, they work for the firm. So you see this happening more in family offices around the country where CIOs are being hired by our family offices. But our notion is that you got to have enough collective purchasing power and you have to have enough growth to attract and retain great talent, that's the only way you get great results. So the idea was to create this independent office with enough purchasing power that you were unconstrained by access to talent and by access to vehicles. And that became called the Outsource Chief Investment Officer. From the day we started, we referred to ourselves as Chief Investment Officers. And so this notion of outsourcing the CIO function took off and today it's a large market.

Louis Diamond:

So just to take that one step deeper, just to think about or rewind what it was like back when you created this model, back then, who would've been your biggest competitor and how were they going about recommending investments? And aside from the term, it's caught fire, what was the fundamental difference you think, between you and your competition at that time?

Jon Hirtle:

Well, the competition was all at these product shops. They were at banks and brokers, and so forth, and most people didn't understand what a CIO does. So for example, I would lay out a model and I'd talk about CIOs, and there's an interesting cognitive fact that people can hear what they're prepared to hear. In other words, if they don't know what a CIO is, then they will put you in the box of a broker or a banker or something. So a trust office person. So I would go through the whole story about how 93% of the variability among diversified portfolio performance is determined by asset allocation and Markowitz theory and how you collapse the dispersion around a high return, how you use portfolio engineering to create high returns with low risk. And at the end, the prospect would listen quite carefully. In the end it'd say, so what is your favorite stock?

So the notion of building the box, people think today, well, it must have been easier when you started because there weren't any other OCIOs, but nobody knew what an OCIO was. And periodically people would say, well, if this is such a good idea, why isn't Goldman doing it? So today, everybody's doing it.

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The idea of an OCIO is better understood. It's not fully understood because there are lots of people out there that say they do OCIO, which and they don't. But at the beginning, the competitors were everyone who managed money. And I still think this is true actually, because people do business with you for three reasons. They do business with you because they like you, because they trust you, and because they think you're a money maker in that order. So if we're in a town somewhere in the United States and there's a great team at a brokerage firm there, they tend to be the competition because the people are terrific.

If we're in another town and there's a great trust department there, and this was more true in those days, but it's still true today, that great trust department, that great trust office might be our competition. If we're calling on a college endowment in the south, there would be a local firm that does OCIO that is probably our biggest competition. So the competition is geographically specific and it's really driven by the people. Our notion is that of course, we want compelling people and we believe our structure and our culture is the most trustworthy in the world, but we also want to deliver second to none investment performance. And that's where we hang our hat and we believe the structure helps us do that. It's not just the capability. There are very smart people at Goldman Sachs and JP Morgan, but the structure gets in their way.

Louis Diamond:

In your view, what are the challenges faced by OCIO firms and independent RIAs today? Maybe just name a few.

Jon Hirtle:

Yeah. First of all, if you look at the growth in the OCIO business, it's largely in pension space. And it's largely going to big consulting firms who now say that they do OCIO, which I disagree with, but that's what they say. So anyway, you need to grow. So a lot of the small OCIO firms aren't growing, and you got to grow to hold talent to attract and hold talent. And if you can't attract and hold talent, things are not going to go well. The handwriting's on the wall. So the growth for most OCIO firms has been a challenge. The other thing I would say on the RIA space, the last 10 years have been unusual before the bear market here, the last 10 years prior to '22, were a straight-up market. And people who have been in the business 10 years think that, and they've been working for 10 years.

So in most cases you say how long you've been at this say 10 years, oh, you're an experienced person. But they've really experienced only one kind of market, which is zero interest rates, straight up tech stocks leading the way. So the most simplistic thing you can do and make money is buy more of what worked last year, but that worked for 10 years. That's very unusual. If you look through history, usually the leading asset classes rotate year to year. So I think a lot of people don't realize how hard it is, how complex the world is, and everyone made money during that 10 year period. And so the big challenge

for RIAs going forward is how do they muster the capability to manage a market, which likely to be much more complex and challenging than the one we experienced over the last 10 years.

Louis Diamond:

And how do you think that would manifest itself? Why does that matter?

Jon Hirtle:

Well, first of all, I think if somebody's really an investment professional, it's going to matter to them. They're not going to see the results that they hoped for their clients. This is one of the things that caused us to start our firm years ago when I saw that R.K. Mellon was consistently outperforming Goldman Sachs, I said, what? I mean, my clients are counting on me. I've got to be able to deliver the best results I can. So real professionals are going to be disturbed by that, but clients are also going to be disturbed by it. And so I think that as the market becomes more complex and more difficult and performance is harder to come by, organizations without large capability and resources are going to be challenged. Conversely, if the large capability and resources are housed within a conflicted structure, that's a problem as well.

So the large independent office, it won't surprise you, is what I think is the future of the serious investment management industry. I worked at Goldman with Jim Kramer, and about five years ago I said to him, I was going to start a TV show called Serious Money to Counter Mad Money. And he said, that's great, that's great Hirtle, but nobody's going to listen to you. Nobody's going to watch your show because it's true. I mean, serious money is different than what you see in the popular press every day. It's not trading, it's not gambling, it's using engineering and real due diligence to deliver terrific returns with certainty.

Louis Diamond:

And your firm does that, it's a manager of managers approach. So instead of picking stocks, it's doing diligence on many different money managers and alternatives providers?

Jon Hirtle:

Right. If you think about it, you're allocating capital among managers. People think about capital allocators as just among asset classes, but it's really among styles as well and among managers and trying to find managers with true skill, which is very hard. The vast majority of long only managers if they're analyzed properly, really can't earn their fees. So finding managers who have true skill in a public space is very difficult. In private space it's very difficult if you don't have access to the right people, that's another conversation. But allocating money among these managers is this is going to determine the vast majority of the performance variability in a program. And so we really feel like people think of us as

money managers, we say, well, wait, your capital allocators I say said, well, that's true. We only impact 93% of the performance. Everybody else impacts the 7%.

Louis Diamond:

Love that. And I think what you're saying too is the challenge with the way the market has been going up before 2022 is that it hides some of the challenges that firms face. So if things are going up, growth looks good, revenue's increasing, but if you don't have the right people and systems and processes in place, when you have a situation like the regional banking crisis that happened recently or interest rates going up, it starts to expose some real gaps in organizations. Did I get that right?

Jon Hirtle:

Yeah, you did. And Warren Buffet says, when the tide goes out, we find out who's swimming naked. And so bull markets hide a lot of flaws. And when you get into a more stressful situation, you realize what a set of challenges it is, it's really a Rubik's cube. You've got to do everything. For example, why does anybody have any money on deposit at a bank unless it's operating cash that you need to write checks against? Who would do that? So a CIO wouldn't let that happen. So we're not only looking, I mean, we're certainly managing the money, but what about managing risk? How about we talk to the bank custodians and we say, where are you sweeping cash?

And they say, well, we're sweeping in a money market fund. Said, is it on your balance sheet? They said, well, we're not sure, send us to CUSIP. So we find out what security they're using and is it money that our client's money going to be at risk if something happens to the bank? So we've always done that. And so it takes a lot of expertise and a lot of client centricity to deliver a great outcome for clients consistently.

Louis Diamond:

Yeah, I'd say so. One of the things I was most excited to talk with you about was just the journey of the firm. So can you talk about the journey or the expedition of getting from zero? You said you didn't bring over any clients from Goldman, so going from legitimately zero to one billion in assets and then from a billion to five billion and now from five billion to 20 billion, can you just talk about how you did it and what was the hardest of those leaps?

Jon Hirtle:

It's an interesting question. I mean, it's all hard, but the first one or two billion was sort of straightforward because we could achieve it with just a few people. We were young, hardworking team players, all believers, you can accomplish a great deal with idealism, aspiration, and just a lot of hustle. And so we were able to create that first billion or two that way, and after that, it became harder that next getting from, I would say from four billion to eight billion, something like that through the five

billion threshold. Because you get to a point where you have something like four billion and you go, this is really hard work. We've been at this for a long time, it's just every day a grind. The markets the next challenge serving clients, it's hard work, and here we are, what next? And what you realize is to break through to the next level, you have to make a new commitment.

You have to have more talent, you have to reinvest. So a lot of you get to a place where people feel like they're at four billion or something, though I don't know, maybe it's time for me to sell this because we've worked so hard and to get to seven billion, I'm going to have to double down on the market. And I remember one of the things that was a big deal for us was right at that moment in time, we found one of our clients asked us to come to their alma mater and we spoke to them about the science of investing and conflict-free models and the Ivy Leagues and how they manage their money. And so the family client had heard that all before, but wanted us to say it to the alma mater. And they said, we'll hire you if you develop private equity capability.

The number and sticks to my mind was $465 million was the account. And today that account's been with us for 25 years, it's $1,000,000,004. But at the time they said, if you will develop private equity capability, we'll join you. Well, I said we would and by default, in other words, once I had made that commitment, then we had to invest and it took us over the hump. The next thing we know, we were past that point where we were now at $5 billion and continuing to grow. So getting through that next phase where you realize you've worked, you've given it everything you have, and you've worked really hard and you have a decent business, but to make it a great business, you got to double down. And that I think is really hard. But interestingly, the hardest thing I think I did for me personally was about 10 years ago, I decided that it was time to really focus on continuity planning because I wanted the firm to be an organization that was existence for a long time.

I felt like our clients, our multi-generational family clients and certainly our institutions have almost a perpetual horizon. So if we could create an organization that stayed with them through time, that would be terrifically valuable. So we had been in business 25 years, and I thought, how do we get in business? How do we stay in business the next 25 years? And so we had a very good business, but we decided to force the firm into a self-reflecting J-curve to say, how do we get a lot better? And so that was even harder, I think, because it risked everything that it didn't risk everything, but it basically said, why would you want to work that hard? Why not just continue to do what you're doing? But I felt like we needed to be stronger from an investment standpoint, stronger from an operations and IT standpoint if we were going to become the institution we wanted to be.

So that was another hard step, and that was about 10 years ago. But today we have the fruits of all that effort and we've become the firm that we hoped we would become. So all of that was hard, but it was also fun. And every client, terrific psychic income out of the clients and working with people and seeing

careers blossom and seeing their dedication to the clients and see the clients appreciate that dedication is really a virtuous cycle.

Louis Diamond:

It's pretty remarkable, congratulations on that. And what we'll talk about next is how I think you've avoided some of the, we'll say the industry cheat codes, which is growing to $20 billion through M&A. Not that M&A is cheating, but it certainly gets you somewhere inorganically much faster. And also by taking a large check or capital infusion from an external investor, both of which you buck the trend on and double down on what you were doing personally. So we'll definitely talk about that. But before then, can you talk a little bit about how your firm accesses alternatives and other types of managers in a different fashion than RIAs, let's say smaller RIAs and also the brokerages and wire houses that you're competing against?

Jon Hirtle:

Sure. This is a big topic. I mean, one of the things that's interesting to me and alternatives is a wide title. So it refers to people it generally thinks of as hedge funds, which are Howard Marks says hedge funds is not an asset class, it's a compensation strategy. So it's really hard to call any of this stuff an asset class. And private equity certainly is an asset class, but when we think about it on making comments about anything that has to do with the average, they're almost meaningless because when you look at the distribution of outcomes in private markets, a good manager in public markets might outperform the mean by 2%. A good manager in private equity might outperform the mean by 25%. So there's not a bell curve in private equity, it's more like a symbol. This is very broad distribution. So what happens when you have that kind of an asset class?

The manager's skill is way more important than any average comment about the asset class unless you are constrained to be in average or sub average managers. So private markets are really as much of a who you know game as a what game, and the more you know, the more you know what you know have, the more you realize how critical access is. So we've been investing in alternatives for 25 years. And when I say that, I mean, I think when I'm thinking about private equity, we've been investing in hedge funds just as long, but for the minute I'm talking about private equity, but it does include looking for compelling strategies in public markets, but also private markets including credit and private equity and venture capital. So five years ago, so we've been doing this for 25 years and we've always had a strong program. For example, in private equity space, our philosophy has always been that client that we wanted to go with managers who are great operators because private equity managers will tell you that they can make money three ways.

They buy it right, they make it better, they sell it well. Well, the problem is that the buy it right and the sell it well is often beyond their control. They're usually things that are determined by the market, but if they can take that company and make it better, do a roll-up, add IT, restructure their financing, have

expertise to sit on the board, then those are the guys who really add value. And we've always felt that way for 25 years. So we had a very good program, but five years ago we brought Dan McCollum from Brown University who was the deputy CIO there, and Brown had been leading the Ivy League, and Steven Vaccaro joined us from the University of Pennsylvania endowment. So we know that the Ivy's have been leading the world on endowment management results, and we knew that we had a strong private equity area, but we wanted to make it second to none.

So we brought in these guys and they're terrific, and they augmented our knowledge and network with theirs. And so we were able to convert a great program into a second to none program world, really world-class. And so today we have access to managers that are closed. We rarely respond to an incoming solicitation from a manager. We're really using our network, going to the great managers and saying, who do you respect? Who spun out who you think is terrific? So using our network among this exclusive group that these guys have earned access to over many years to find better managers. So we try to do things in the best possible way. We don't use, for example, the big publicly traded private equity firms because we believe that they have a conflict of interest because their shareholders, their public shareholders, should be their first fiduciary responsibility rather than their limited partners.

So we don't like that structure. And we also know that many managers, many banks and brokers require, the big banks and brokers require alternatives, managers, private equity and venture to give up part of their compensation to be on the bank's platform. Well, no great manager needs to do that, nor would do it. So we think once again, the clients of the banks and brokers are at a disadvantage because they're not getting access to those very best private markets managers.

Louis Diamond:

So it sounds like you're saying if you were employed by a brokerage firm or you're on a brokerage platform, you might be the most talented manager researcher in the world who has a really good knack for private equity similar to you, but if they're picking from a more limited shelf of products, that's where the conflict or the challenges arise, and that's what you think is your difference, is the fact that you have a much broader access to the market because you're not focusing just on managers that are paying for shelf space or have to raise a certain amount of capital to be on the platform. Is that accurate?

Jon Hirtle:

Well, yeah, but except also we're using with manage, not just, I mean, it's not broader than the big banks. The big banks have lots of money and they could talk to anybody if they want it, but if they require the manager to give up part of their fee to be on the platform, the best managers won't do that. Why would they do that? They don't have to do it, they wouldn't do it. So it's not the breadth, it's the access to the very best and how do you get them and how do you spend the time? Our job and private

equity is to be the best limited partner in the world, and if for the best limited partner in the world, then we get access to the best general partners in the world.

Louis Diamond:

Like I mentioned earlier, given the size of Hirtle at $20 billion and growing, it's very rare that you're still a hundred percent independent and do not have an external capital backer, whether it's a family office that owns equity or it's a private equity fund or anything in between. Can you explain why this is and how do you think clients benefit with the setup?

Jon Hirtle:

We've been approached by dozens of very substantial firms over the years, and we've learned from every conversation, but we've never found a firm that had our time horizon that would actually help us do better for clients. Warren Buffet says, "If you have a great business, never sell it." So when you sell a business, you get one time piece of cash in your pocket, but if you have a great business that business pays you and everybody in the community, everybody in the business for years and years and years to come, and it also serves clients along the way. The value that pure independence and long-term focus of private ownership really aligns our interests and timeframe with those of our clients. And it's the absolute opposite of what you see in this sort of hair on fire tempo in the quarter to quarter focus of the popular media.

These multi-generational families and institutions have a perpetual horizon. So the key is how do you create this institution that can serve them for decades and decades to come? So we've never really been tempted to sell the business because we believed in it and we believed in its future. That doesn't mean we won't take a capital partner at some point. As you've mentioned, Louis, and I think we've mentioned that we are beginning to augment our organic growth with acquisitions. So that doesn't mean we won't have a capital partner at some point, but we will remain independent and privately owned.

Louis Diamond:

And I think probably most firm CEOs would say, I want to remain independent and completely agree with everything you said about different time horizons of their capital backers. But whether it's because of acquisitions which you just hinted at or for personal liquidity, it's just very challenging to remain independent. How have you personally reconciled the fact that you haven't been able to monetize a major part of your personal balance sheet as far as the equity you own in Hirtle to an external investor? How have you been able to get comfortable with that?

Jon Hirtle:

Yeah, I like having that net worth in the business. I believe in the business, I know it's growing. I think we're doing important work. When I think about what people do, what happiness is this, Arthur Brooks

does a lot of writing on happiness, and one of the first requirements is work that matters, meaningful work. And as I said before, we're really acting as a force multiplier for these philanthropic families and mission driven institutions that make the world a better place. So to do that and to be fairly compensated while you do it and to be building equity is terrific. I would say one other thing I should mention, and that is that after Don Callaghan retired and we bought out his stock, we really became a family controlled business. So it was just a course of time when we started the business, Don and I were equal partners, we had a silent partner, and as time went by and I was the youngest of the group, I ended up controlling the business.

So this was part of my 10-year plan on continuity structures and so forth, and how are we going to manage the firm going forward? Today we're managed by a five person management committee and two of the five, and I'm not on that committee anymore, I've stepped off, I'm now the executive chairman, but two of the five members of that management committee are family members. So my oldest daughter and my second daughter's husband who are on that management committee, they've been at the firm for, Susan's been there 17 years, I think Garrett's been there 15 years, and they've really earned their spurs and are highly regarded within the organization. The chairs of the committee are not family members, so we want the business to be family controlled, but not necessarily family managed. We've been in business 35 years, that's G2, that's second generation involvement means we have another 35 years to go, and we think that timeframe is a huge advantage for us in the marketplace because clients see us as the closest thing they know to perpetual.

Louis Diamond:

That's terrific. A lot of firms talk about perpetual, but it doesn't really work that way in practice for one reason or another. So, again, another part of your journey that's been pretty remarkable is that you've gotten from zero to $20 billion and rising without really doing any acquisitions. I believe what you can talk about, you've done maybe a lift out or two, but that hasn't really been a focus of the business. Can you talk about why you did not go inorganic sooner given the scale of the platform?

Jon Hirtle:

Yeah, where to start? One thing I haven't mentioned is that first and foremost, we are investment professionals. So we're not financiers or a buyout shop who happen to come up with an idea for consolidation, we're investment professionals in our bones. I mean, we're all people who are investment professionals first. So our vision since the beginning is to create this new powerful, enlightened, global, durable investment management institution with incentives that are completely aligned with our clients. So that meant you had to build this office and figure out how to manage it in perpetuity. So that took a lot of time. So we weren't saying, how do we get big fast? We were saying, how do we get great as fast as we can? And then once we got to this place where the operations of the firm, the investment strategy group, everything about it is really we think exceptionally strong.

Now it's time to go out and look for like-minded professionals who want to become part of this journey. So that's really why our priority has always been on the investment side, not on the business side. When I was at Goldman just before I got there, the famous CEO chairman of Goldman was a guy named Gus Levy. He talked about being long-term greedy, and the idea is that if you really, the way to make the most money over the long run is to take care of clients. If you really take care of clients, the whole situation will work out. So we take care of our clients first, our colleagues second, and the shareholders will benefit from that. So that kind of an orientation meant we were never in a hurry to do a financial consolidation. We're not financial consolidators, we are perhaps strategic integrators.

When people sell businesses, they say, is it a financial buyer or is it a strategic buyer? We're strategic buyers. And these lift outs that we did, one in Minneapolis and one in Scottsdale have been terrific. I mean, they're just people that they can complete our sentences, we can complete theirs. They're completely client-centric, they're real pros, and I know we are ecstatic about that and I think they are as well. So we're looking for more people like that. We think what we do is very valuable. We know every city in America, every market needs what we do, and we'd like to have a team in each one of those, in each one of those markets, and we want to do it one at a time. We're not in a race, and I think that's going to serve us well over the long run.

Louis Diamond:

Do you think the formula from $20 to $30 billion, aside from hopefully a lot of market appreciation, is going to be adding acquisitions and team lift outs to the fold?

Jon Hirtle:

In addition to our organic growth, so we're always primarily organic because that's what we know. And if we're doing things right, the business will grow beyond just market appreciation. But once again, one of my things I do right now since I'm an executive chairman is I like to go out and meet new teams and say, what's it like in Tulsa? What's it like in Indianapolis? What's it like in Birmingham? Tell me about your practice. I love to talk to people about how they build their business. When you see that and you see somebody and you say, and a lot of these guys, their business is entirely wealth management, and they don't realize that the minute they affiliate with us, they become credible with a local university, they can add hundred million dollar clients, $300 million clients because of this complimentary nature of the family business and the institutional business. So I love to do that, and there's no reason we can't do it. And we've suspected that, and then with these two teams we've created in Minneapolis and Scottsdale really confirms that it's a great idea.

Louis Diamond:

Interesting. And what's your view on consolidation taking place in the investment management and RIA market today here just briefly, your pure thoughts on it?

Jon Hirtle:

Yeah. Well, first of all, lots of people have built big businesses doing that, and God bless them and congratulations. Commercially it's done well, so good for them. One of the things that perplexes me is that some of the consolidators aren't even RIAs. So when I think about us, I think about if I use medicine as a metaphor, we're doctors and we're out meeting other doctors and say, join us and we can deliver better results for patients. A lot of the consolidators are just finance people. We're not finance people, we're an investment people, it's a very different thing. So some of them don't have a hub. They don't have access to terrific managers that we're willing to share. They don't have compliance and operations and research department that is world-class. So there's no hub there. No. So the whole thing is just about financial consolidation, and I've never really quite understood that.

But that once again goes back to the point that I start from the standpoint of being an investment professional first. That's basically what I think. I think that over time, the cream rises to the top, and what happens is the people that are true professionals who are truly client client-centric and have better tools and a long-term orientation will win because they're adding the most value to their clients. It starts with the client. And so I don't know that the consolidators know that. I think what the consolidators do know is that RIAs are amazing in their relationship with their clients. The compelling nature of their personalities and the trust factor that they have with clients is extremely valuable, and we just want to empower that with second and non-investment capability.

Louis Diamond:

Yeah, I'm with you there. Very interesting perspective. Last couple questions here just about the, I mean the really hard thing you did, which was an internal succession plan, taking off the CEO hat five years ago to become the executive chairman, you hinted at some of this about the executive committee you set up about keeping the business private, not bringing on external capital, but a lot of folks that are listening likely struggle a little bit with when do I start the succession process? How do you do it? So using you as a live case study, maybe take those two questions. When did the succession and continuity planning start, and what was the first action you took to really start it?

Jon Hirtle:

Well, first of all, I think there's a recognition of the fact that Harvard Business School, I think wrote or somebody wrote a thing called Level Five Leadership came up with that term. And level four leaders are people who do everything right. Level five leaders do everything right and then prepare the organization to flourish after their departure. I was with an estate attorney recently who told me about a client who said, if I die, and the attorney said, let's rephrase that question. It's not a question of if, it's a question of when. So if you want your firm to continue and prosper, if you care about your colleagues and you want them to continue to prosper, if you want your clients to know they can count on you, then you have to think about continuity. And it is a different set of skills. So, in other words, somebody who's a great

client person may not be great at transitioning into an organization that has perpetuity and can provide the next set of great client people so that client, that family, that institution continues to be served.

But I think it starts with a recognition that level five leadership is a worthy quest. Let's get there and what does it mean? And being self-reflective. One of the things we did years ago, it was probably about seven, eight years ago, we were being pursued by big well-known shops that wanted to buy us, and we didn't want to sell it, but we said, well, why don't you come in and do your due diligence? Because we thought it would be like a consulting project would be like hiring McKenzie, except these guys were not pulling any punches because they were trying to formulate a bid. And we went along with it, we showed them everything we had, and they came back with a series of reasons that we should sell to them. We can increase your access to talent, we can strengthen your investment team, we can do this, we can do that.

And we collectively said, well, that was terrific. Thank you so much for your interest in our firm, and we're not selling, but you've given us a list of six things to get working on, and so we did. And so this idea of being reflective and being willing to have somebody from the outside criticize you, I think is part of that succession plan or what we like to think of as continuity planning. It's not what's next, it's how do we continue to do what we've been doing in getting better every year?

Louis Diamond:

Wow. That was a pretty compelling set of reasons there. I love that example. You took really the reasons why a potential investor/buyer would make us better. Instead of taking them at their word and going along with it, we said, okay, these are the areas that we have to improve ourselves. So it sounds like the first step was self-reflection, understanding what the gaps were, and then figuring out how to close it. But how about from a leadership standpoint, the physical act of removing that title from your business card and no longer being the CEO, how did you get comfortable doing that? And I mean, was it hard, and today is it hard to look and think about what life was like before that happened?

Jon Hirtle:

Everyone's different, and I feel like I get tremendous emotional satisfaction out of seeing the firm succeed. And I really love seeing people that I hired, prospering, and making great decisions. We spent a huge amount of time working on defining our culture. A lot of entrepreneurs say that the successor people just don't get it, well, they just don't get it. Well, it's the entrepreneur or the CEO's leader to figure out how they can explain it so they do get it, and that's not easy. So we had consultants and helpers and hired out outside experts to come in and really define what are the core values that make us click? So we took the, they just don't get it, and we wrote it down so that they did get it. So, that organization, that effort to make sure that the culture and not all the culture, you have to decide what's causal and what's coincidental.

So what are just customs that you do that don't have anything to do with actually the essence of why clients love you, but what are the things that if we changed, the clients would hate it? And within the organization, what makes it a sense of a community, like our first value is that we make it personal. We don't write in the passive tense. We don't say it was decided. We say, Dave, look this over and we have decided. So we speak to people personally. Everything we do is personal. This is personal money, it's matters to the people involved and we want to make it personal. So we did that whole effort of defining our culture in a way that we could pass on. That was a big project. Louis, what I'm thinking is, at this point in my life, I'm getting more satisfaction out of seeing people succeed, knowing that I could do that.

I remember when I was in the Marine Corps the first day I was overseas and I was still in Okinawa and my company commander said, if we were in Vietnam, you'd be dead by now. And I said, really? That's discouraging. And he said, yeah, you were trying to do everybody's job for them. And anybody that was watching could tell you were in charge and you would've gotten shot. So your job is not to do their job for them, your job is to get them to do their job. And so that stuck with me. And I think to at this point in my life, I get even more satisfaction out of seeing them do well than I did when I was doing well in their roles.

So it hasn't been that hard for me, and I think it's been a long process, that's one of the issues. It wasn't an overnight switch, but I enjoy what I'm doing now. I actually get to do exactly what I like best about work, and that is working with clients through client teams, working with these client teams and therefore clients, meeting new client teams, networking to find compelling ideas, compelling managers, compelling commercial opportunities, and talking about investing with you.

Louis Diamond:

There we go. Yeah, no, I think that's the best. When you have good people, the rest can take care of itself. It lets you focus on your passions, your unique ability. I would assume too, it's probably given you a much longer time period that you're still enjoying work. Because if it was still the grind and you felt like you had to do it, it holds a different meaning than right now, which is you're doing it because you like it and because you get to do what sparks you and helps get you out of bed in the morning. So this has been extremely, extremely interesting, Jon, I wish we had another hour.

I might ask you a bunch of questions offline just to understand your perspectives a little bit more because you've really seen it all. You've been at the epicenter of this RIA movement before it was cool to now being on the leading edge and perhaps being the next strategic acquirer. Note, I didn't say aggregator or financial buyer, and very, very excited to see where Hirtle goes from here and also just to see how your personal journey unfolds. So thanks again for joining us, Jon.

Jon Hirtle:

Thank you very much, Louis. It was a pleasure to be with you.

OCIO Pioneer Jonathan Hirtle on Building a $20B RIA the Organic Way

A conversation with Louis Diamond and Jonathan Hirtle, Executive Chairman of Hirtle, Callaghan & Co.

Mindy Diamond:

Jon painted an amazing picture of how innovation drove change, not just for Hirtle Callaghan's clients, but for the wealth management industry at large. From recognizing the limitations in the brokerage environment to making an early leap to independence and on to the value of delivering a comprehensive investment model, Jon paved a new path that now serves as the backbone of the institutional consulting space as it stands today while sparking a flow of independent firms as a result. I thank you for listening, and I encourage you to visit our website diamond-consultants.com and click on the tools and resources link for valuable content.

You'll also find a link to subscribe for regular updates to the series. And if you're not a recipient of our weekly email, Perspectives for Advisors, click on the articles link to browse recent topics. These written pieces are an ideal way of staying informed about what's going on in the wealth management space without expending the energy that full on exploration requires. You can feel free to email or call me if you have specific questions. I can be reached at 973-476-8578, which is my cell or my email, mdiamond@diamond-consultants.com. Please note that all requests are handled with complete discretion and confidentiality, and keep in mind that our services are available without cost to the advisor. You can see our website for more information. And again, if you enjoyed this episode, please feel free to share it with a colleague who might benefit from its content. If you're listening on the Apple Podcast app, I'd be grateful if you gave it a star rating and a review. It will let other advisors know it's a show worth their time to listen to. This is Mindy Diamond on Independence.