



MATARIN CAPITAL MANAGEMENT: INNOVATING IN A CHANGING MARKET

By the National Association of Investment Companies

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In an effort to achieve their actuarial rate of return, which is paramount to sustaining their long-term viability, a number of public pension plans are undergoing major changes to their investment approach by moving towards in-house investment management and passive index investing. These decisions can have a significant impact on many aspects of the plan, including the utilization of diverse managers – even those who are outperforming the plan’s actuarial rate of return.

However, New York City-based Matarin Capital Management is one diverse asset management firm getting ahead of the curve by adopting innovative new products designed to address the risk and cost concerns of pension plans while delivering index-beating performance and contributing to sustainability goals, benchmark diversification and maintaining diversity initiatives.

This trend hasn’t developed overnight. For several years, plans have been gravitating towards lower-cost investment alternatives. According to Morningstar, total assets in U.S. mutual funds and exchange-traded funds grew from \$5.5 trillion to more than \$18 trillion from 2008-2017. “Usually they do it because they’re seeking lower costs and of course the headwind for active management performance has given them the runway to do that. Although it’s quite a short-term focused perspective,” says Nili Gilbert, Co-Founder and Portfolio Manager for Matarin Capital.

As a result, the Matarin team recently launched two sustainable investment indices with S&P Dow Jones Indices and Sustainalytics, the second largest provider of ESG research and data in the world. Asset owners can license data from the Matarin Global Long Term Index and the Matarin International (ex-North America) Long-Term Index to be delivered directly to their trading desks, so that they can be managed internally along with any other benchmarks that the plans are tracking, and at a low cost. The indexes are also offered to clients via separate accounts.

“Two years ago, we came together with S&P to launch two new active indexes that we believed could be a better substitute for clients who are looking to move money from purely active to purely just simple cap-weighted passive beta,” says Gilbert “Where they should be able to get an advantaged return, but still at low cost, and still in the same structures as their other passive indexes.”

The two Matarin indices are designed to address the following concerns precipitating the trend towards passive investing:

- **Low cost, internal management:** As asset owners can license the index data to be delivered directly to their trading desks, they can be managed internally along with any other benchmarks that the plan is tracking at a low cost.
- **Sustainability goals and benchmark diversification:** The indices are designed to allow asset owners to capture a “Patience Premium™” (stocks that exhibit attributes such as fundamentally good businesses, stakeholder-friendly leadership, inexpensive valuations), and positive ESG. The indices have a carbon footprint that is 30% lower than traditional benchmarks.
- **Manager diversity:** A diverse investment management firm, Matarin offers an alternative for plans looking to maintain their diversity objectives.

While it may currently be attractive to the cost-conscious, risk-averse plan, the issues with passive investing are several-fold. For the most part, passive benchmarks give no thought toward the ethical impact of an investment in the equities that it is buying, which runs contrary to asset owners wanting to look good in the public eye by embracing ESG initiatives. Exposure to diverse managers is either significantly reduced or outright eliminated (often regardless of performance), effectively rendering such initiatives meaningless.

And on the performance side, simply cap weighting all of the stocks in the market is not believed to be the most thoughtful approach to gaining equity exposure, particularly now that so much money has flowed into passive indexes. Gilbert and the team at Matarin see their index alternatives as a solution to the downside of passive investing.

The Matarin indices select holdings using a Patience Premium scoring system, which identifies stocks that are expected to offer to offer investors an excess return for long-term holding, in a structure that looks and feels like an index in terms of its construction risk characteristics.=

“We’re thinking not just about how to be great investors, but how to build a great business ourselves,” says Gilbert. “And that means having strategies that will be attractive in varying market environments, and to clients with different needs and approaches. Given what we’ve been seeing, it feels advantageous to have some kind of response to this very prominent trend.”