Institutional Investor

Back to the future at Wertheim Schroder

WERTHEIM SCHRODER
INVESTMENT SERVICES, INC.

Tony's involvement is described on page 3.

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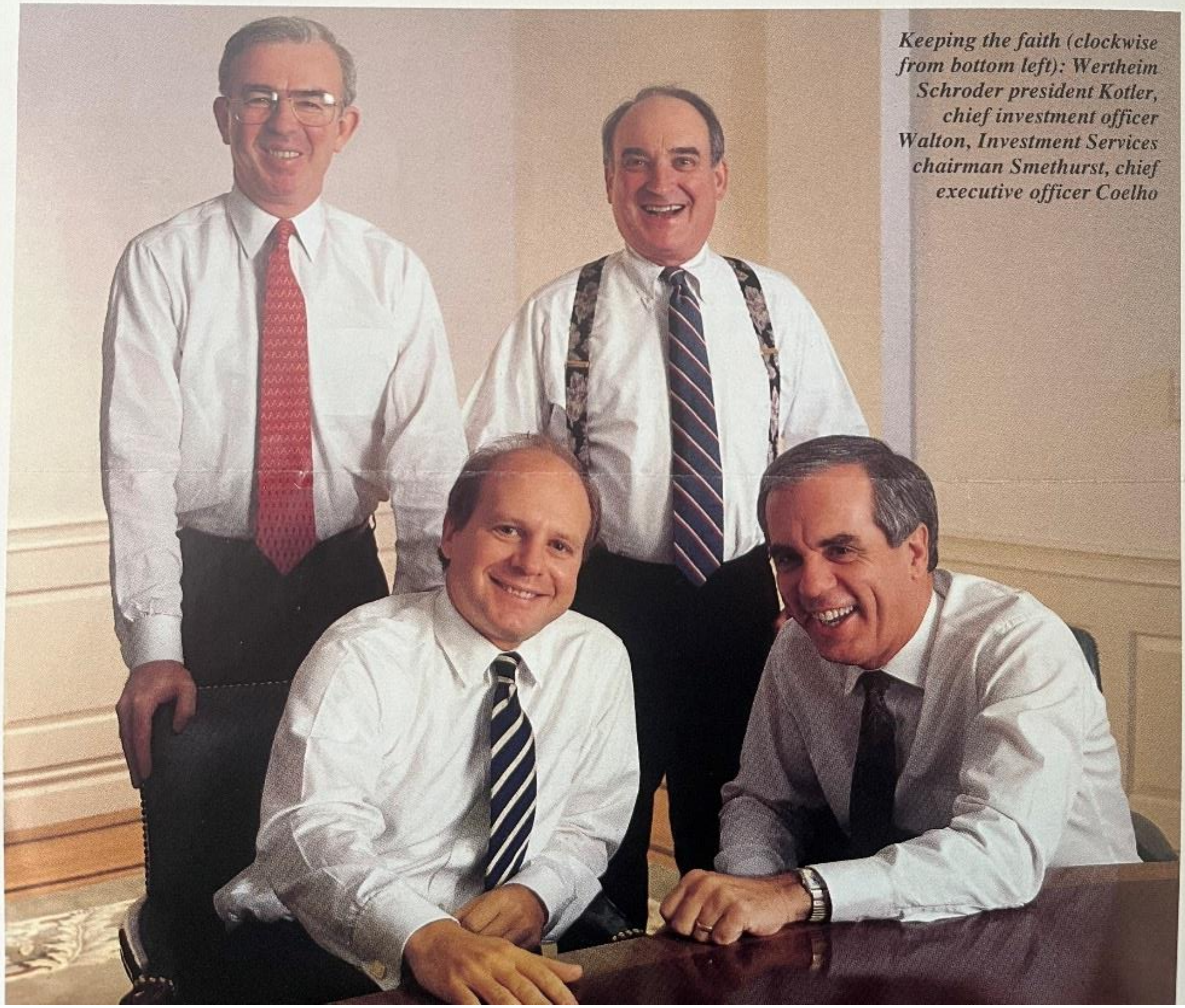
This once-thriving firm fell on hard times and was near the brink just four years ago. In a dazzling rebound, it has since nearly quadrupled its assets and has a five-year plan for further growth.

BY JULIE ROHRER

It wasn't exactly like being on the Titanic, muses E. William Smethurst, chairman of Wertheim Schroder Investment Services. "The Titanic took two hours to go down," he says. At Wertheim the agony was prolonged, lasting most of the 1980s.

At the beginning of that decade, Wertheim Asset Management — as the firm was known until 1989, three years after 50 percent of the voting stock of its parent, Wertheim & Co., was sold to British merchant bank Schroder — was handling some $2.5 billion, had shown up with some regularity as a top account gainer in *Institutional Investor*'s annual Pension Olympics and could justly boast about its performance num-



Keeping the faith (clockwise from bottom left): Wertheim Schroder president Kotler, chief investment officer Walton, Investment Services chairman Smethurst, chief executive officer Coelho

John Abbott

> ***"It would not have been surprising if Wertheim Schroder had decided to let its investment subsidiary go."***

bers. Then the vessel sprang one leak after another. The people who had created the good times debarked, performance plunged and clients abandoned ship. By 1988 the firm was managing just $700 million and sinking fast.

Smethurst can almost joke about it all now because everything seems shipshape again at the firm. Its assets are back up to more than $2.5 billion and are growing rapidly. Turnarounds of this sort, this fast, are rare; once a firm loses its reputation with pension sponsors and consultants, it is usually a long time before it reestablishes its good name, if it ever does. The credit for this remarkable revitalization goes to three key individuals: a new, farsighted and patient president of the parent company, a savvy and experienced investment pro and an ex-congressman from California.

Smethurst became chief investment officer of the firm in 1965. Things probably started coming apart when he left in 1979 to head up investments for a fledgling money management firm, Tallasai Management, and, subsequently, to launch an investment operation for broker C.J. Lawrence Inc. A succession of chief investment officers tampered with Smethurst's successful relative-value approach, in which stocks were screened for a number of value criteria, all relative to their historical norms, then subjected to intensive fundamental analysis. For the period 1980–1988, Wertheim's equity composite ranked in the bottom quartile of consultant data bases.

Other personnel changes shook the firm. Before the 1980s were half over, the firm had seen no fewer than three presidents come and go, including, at the end of 1981, Nicholas Marshall, who had headed up the firm in its heyday. In 1984 Robert Follert, who had so successfully overseen Wertheim Asset Management's marketing, departed (he is now vice president and director of ERISA and tax-exempt marketing at Morgan Stanley Asset Management). The knockout punch came in 1988, when Frederick Klingenstein, co-chairman and son of one of the founders of Wertheim & Co., having sold his interest to Schroder, left to form his own investment firm, Klingenstein, Fields & Co., taking a major portion of the firm's high-net-worth retail clients with him.

It would not have been surprising if parent company Wertheim Schroder & Co. had decided to concentrate on its investment banking and institutional equity businesses and let its investment subsidiary go. The money management group had ceased to be profitable. But in 1988, two years after the Wertheim–Schroder hookup, the parent gained a new president. Steven Kotler, then 40, who had been a Wertheim Schroder managing director, a member of its executive committee and head of investment banking, had other ideas. Believing then and now that money management is "a good business," he set about hiring a team that could resurrect Wertheim's faded glory.

Last to first

Kotler's first coup was to lure Smethurst back to his old role at the investment firm, with a mandate to turn performance around. Smethurst, certainly one of the heroes of this saga, found the situation "hopeless but not serious," he quips, quoting a battlefield remark of a World War I field marshal. One of his first acts — while reinstating the largely dismantled relative-value discipline — was to hit the road, calling on clients still on the books and asking for time. "Give us six months to turn performance around," he told the firm's largest account, one familiar with Smethurst from his previous reign. In the first half of 1989, Wertheim went from being this client's worst-performing manager to being its best, a position the firm still holds today. "I probably made more right decisions then than I have ever made in my life," Smethurst recalls.

In 1990 Wertheim's large-cap stock composite was about even in a down year for the market. In 1991, a disastrous year for value managers, the firm earned a respectable 19.3 percent, and in the nine months through this past September, returns on large-cap stocks were 6.6 percent, versus a gain in the Standard & Poor's 500 index of 2.45 percent. The performance of its small- to medium-cap equities has been similarly impressive.

Though the firm didn't have particularly deep pockets to expand its staff, Wertheim was able to hire a few more investment professionals, most notably senior portfolio manager David Hoener, who had been president of InterFirst Investment Management. It is his record as a value manager with an approach similar to Wertheim's, along with Smethurst's performance at Tallasai and C.J. Lawrence, that consultants use today in building a performance profile for the management team. The Smethurst-Hoener 1981–1989 composite beat the S&P every year but 1989, when the differential was minuscule.

Smethurst had been a known entity; Kotler's next hire was an offbeat, riskier choice, though it proved an exceedingly shrewd one. The year after Smethurst's return, former congressman Tony Coelho came on board. There was no doubt about his charisma and persuasiveness — the 50-year-old Californian, whose hobby is riding western cutting horses, once served as the chief fundraiser for the Democratic Party and as majority House whip. An epileptic, he is a lifetime honorary director of the Epilepsy Foundation of America, for whom he has also proved an effective fundraiser. But he knew nothing about the investment business.

It was in New York in 1987 — the year Coelho quit Congress unexpectedly after acknowledging accounting errors in his financial disclosure reports — that he met co-chairman Klingenstein, who in turn introduced him to Kotler. The two hit it off immediately, and when Kotler became president, he asked Coelho to join the firm, an invitation soon accepted. Coelho subsequently became chief operating officer of the asset management area, and this past August he was given the title of chief executive officer.

Coelho calls Kotler his mentor in a field that was new to him. Kotler, in turn, raves about Coelho's "quick mind" and "superior interpersonal skills." Coelho also brought along his power Rolodex. He has put his estimable networking talents to good use, spreading the word about Wertheim's product. "People had confidence in my ability in other areas and were willing to listen," says Coelho, adding, "I couldn't bring money in the door, but I could make introductions." In addition to being instrumental in adding some wealthy individuals to the client roster, he has helped bring Taft Hartley accounts to the firm. More recently, Wertheim has focused on public fund accounts, adding this past fall a $130 million fixed-income account on behalf of the New Orleans–based Orleans Levee District fund.

Late in 1989 Coelho put a five-year business plan into effect; its goal is to amass $6 billion under management by the end of the five years. "We're ahead of target," says Coelho. A business plan is something Wertheim's money management unit had never had before, but Coelho feels that investment firms should be run like other businesses and says that when this plan matures, another will follow. Another important step was taken earlier this year: To strengthen its fixed-income capability — half of its assets are in that area — Wertheim acquired the West Coast firm Financial Management Advisors, along with its founder and president Kenneth Malamed.

Change at the top

In August of this year, Smethurst stepped aside as chief investment officer, moving up to chairmanship, and J. Richard Walton, 50, was brought on board to fill the CIO role. "When I came back, I was very flattered," says Smethurst, "but I was 58 years old, and I didn't see myself giving a full-court press over the long term of a growing organization. I'd rather be part of the process to provide an orderly succession than be told, at some point, that I'm history and be carried out on a shield. I told Tony over a year ago to start looking for a successor."

Walton arrived with impressive credentials. Between 1986 and 1991 the former All-America Research Team broadcasting analyst was president and chief executive officer of Morgan Grenfell Capital Management, whose assets during his tenure grew from scratch to $2.5 billion. His investment philosophy is very much like Smethurst's. "It would have been too risky to introduce a new player with a different way of managing money," says the latter.

But Walton — like Coelho, an avid equestrian, though he rides hunters and jumpers rather than western cutting horses — will make some changes. He wants to impose new sell disciplines on the relative-value process, and he intends to expand the firm's product line beyond the current core- and small-cap-equity approaches and various fixed-income strategies. On the drawing board, for example, is a short-selling modeling technique that Walton thinks will enable the firm to capitalize on the less-bullish scenario for stocks in the '90s.

Three of those — Hoener, Malamed and Walton — whom Coelho calls his "A-Team" are past presidents of money management organizations, a situation that is almost unique among investment management firms. Walton thinks it says reams about the firm's place in the world today. And he is eager to build on these strengths. Wertheim Schroder Investment Services now has about the same asset base as Morgan Grenfell's when Walton left that firm — "a good size," he says, "to launch from."