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Money Management

AJO's Ted Aronson launching new firm with HighVista team

By DOUGLAS APPELL

A year after quant manager AJO LP announced it would shut down and return roughly $11 billion to clients amid a crushing five-year drought for value stocks, Ted Aronson, the Philadelphia-based firm's founder, is launching a new boutique in tandem with Boston-based HighVista Strategies LLC's systematic investment team.

BACK IN PLAY: Ted Aronson's new firm, AJOVista, is set to open with $1 billion in assets under management, anchored by a Missouri pension plan.

Mr. Aronson said in an interview that the new firm — AJOVista — is set to open its doors Oct. 1 with roughly $1 billion in client money, focusing on less efficient market segments such as emerging markets small-cap stocks and U.S. microcap stocks.

The firm is getting off the ground with the backing of a key institutional client, the $10.2 billion Missouri Local Government Employees Retirement System, Jefferson City, which is carrying over roughly $400 million in AJO mandates as well as taking a one-third stake in the venture.

Despite the similarity in names, AJOVista will look radically different from AJO, which at its peak before the global financial crisis had 74 people and $31 billion in assets under management — 90% in the firm's flagship U.S. large-cap value strategy.

This time around, "we're 15 people, all … involved with investing" — roughly equal in size to AJO's investment team. "Everything else is outsourced," Mr. Aronson said.

Jesse Barnes, co-managing partner of HighVista, will become CEO of AJOVista, and Chris Covington — who played a key role in launching AJO's emerging markets small-cap strategy in 2013 before joining HighVista five years later to build out its systematic equity capabilities — will be chief investment officer.

Mr. Aronson and Gina Moore, his co-CEO at AJO, will be co-heads of business development and communication, as well as members of the new firm's investment committee.

The quick turnaround for AJO's founder owed a considerable amount to serendipity, with Mr. Covington playing a key role as go-between. He reached out to Mr. Aronson in October 2020 when news of AJO's looming shut down surfaced to ask about the emerging markets strategy he had helped set up there. "I wanted to be respectful of the situation and not come across as a vulture trying to pick over the carrion … but the emerging market process there has been great since day one (and) it would be a shame to see something like that go away," Mr. Covington said in an interview.

Mr. Aronson said AJO's emerging markets small-cap strategy accounted for $1.2 billion of the firm's $10.6 billion in AUM when he and Ms. Moore decided to close the firm.

Brian K. Collett, CIO of Missouri LAGERS, said that his fund had $155 million allocated to AJO's emerging markets small-cap equities strategy — with annualized returns since inception of 335 basis points above the strategy's benchmark — when news of the firm's decision to close came out.

The pension fund's other mandate with AJO, meanwhile, came at the March 2020 depths of the pandemic sell-off when Mr. Collett — anticipating a short, if wrenching, "down and up" market — asked Mr. Aronson to transform an existing $86 million LAGERS allocation to mega U.S. value stocks into a "COVID fund" of companies with strong balance sheets "that were going to make it through this fine," he said in an interview.

AJO began shifting those funds the first week of April and the portfolio "did exactly what we thought it would do," Mr. Collett said. From the March lows through the end of 2020, the portfolio posted a return of 200% — or double the 100% gain for the benchmark Russell 2000 Value index over that period, Mr. Aronson said.

With that positive experience as a backdrop, Mr. Collett said he wasn't eager to take up Mr. Aronson's offer of a refund. Instead, the pension fund CIO urged the money management veteran to "figure out a way to keep the party going."

Mr. Collett told Mr. Aronson that LAGERS had backed other startup managers and it was prepared to back him if he could get enough people to keep LAGERS' two mandates with AJO going.

Or, as Mr. Aronson recalled it, "They said 'well, we're not leaving. We don't want to leave. You guys figure it out. Keep running our mandates and by the way, we wanna invest in your new firm as an equity partner.'"

That turn of events just opened up possibilities, said Mr. Aronson, adding "our heads were spinning."

For HighVista's part, Mr. Barnes, in a separate interview, said the Boston-based firm's roughly $600 million systematic business was "a little bit of an odd duck" vis-à-vis its more than $4 billion alternatives business and there was a sense that at some point down the line it would do better as a separate business.

The AJO "wind down" proved a catalyst, Mr. Barnes said. With the prospect of AJO's emerging markets baby being thrown out with the bath water, "we called them," initially with the thought of just taking it and running it.

But it soon became clear that the two sides "clicked," Mr. Barnes said, with a shared focus on niche segments like emerging markets small cap, EAFE small cap and U.S. microcap; performance-based fees to achieve better alignment with clients; and a belief that equity in the firm should be distributed broadly across the team.

With Mr. Covington having played a key role in both firms' systematic businesses, they had "the same DNA, a lot of cross pollination," Mr. Barnes noted. As the talks between AJO and HighVista progressed, a whole bunch of things quickly lined up, he said.

It was "kind of like a snowball that kept rolling downhill," getting bigger and bigger, Mr. Covington agreed. But he said for him, it was Missouri's decision, back in December, not only to extend mandates to the new venture but to invest in it as well that convinced him "this thing could really happen."

"Since then, we've been working feverishly" to get all of the new firm's ducks in a row and come the first of October, "we will be fully independent," Mr. Covington said.

The new firm, meanwhile, will keep its distance from the large-cap U.S. equity space that AJO built its franchise on from the firm's founding in 1984.

"Small, inefficient markets — that's where we want to make our money," as opposed to U.S. large cap where the eVestment database counts 1,200 active products, Mr. Covington said.

Mr. Aronson said AJOVista will get off the ground offering four main strategies — emerging markets small cap; EAFE small cap; U.S. microcap; and an opportunistic strategy built on the success AJO enjoyed setting up Missouri's COVID-19 fund — with a $1 billion capacity limit for each.

Messrs. Aronson, Barnes and Covington all agreed that those capacity limits shouldn't prove an obstacle to AJOVista building an attractive business.

The average fee for U.S. microcap, EAFE small cap and emerging markets small cap is about 1%, Mr. Barnes noted. Managing $2.5 billion at 70 or 80 basis points would translate to $20 million of revenues, depending on AJOVista's success in delivering alpha for clients — a formula for building a great business, he said.

Meanwhile, the new firm will put less emphasis on value as a factor than AJO did, Mr. Aronson noted. "Allowing value to go deeper and deeper and deeper in our portfolios as value got cheaper and cheaper and cheaper" was a fundamental mistake, which set the stage for "extended underperformance after the global financial crisis," he said.

"There are many dimensions that are worth pursuing and we will pursue more of them," Mr. Aronson said. "We will never again pursue value into a rat hole."