

# Do the Right Thing

I love the classic Spike Lee movie, *Do the Right Thing*. It is ahead of its time and is a masterpiece about racial tensions. In the movie, Ossie Davis (Da Mayor) and Spike Lee (Mookie) have a memorable exchange:

Da Mayor: Doctor...  
Mookie: C'mon, what. What?  
Da Mayor: Always do the right thing.  
Mookie: That's it?  
Da Mayor: That's it.  
Mookie: I got it, I'm gone.

In our business, we should always “do the right thing!” To translate, we should always “follow best practices.” Here are a few best practices I suggest for our industry.

## Capital

A successful money manager needs adequate capital. For this reason, we retain some profits every year and have a cash reserve of over \$2 million. The capital allows us to hire good people and to implement new systems. A firm without capital means that management is unwilling or unable to invest in itself, which is a precursor to future troubles.

## Structure

A well-known minority firm recently closed its doors, causing naysayers to ask if minority firms are too risky. They are no more or less risky than large firms: see Merrill Lynch, Bear Stearns, Lehman Brothers and a slew of hedge funds. What they should be asking about is firm structure. We have buy/sell agreements to cover all partners in case of death, divorce, bankruptcy and other unforeseen events. Our buy/sells are at a predetermined valuation to avoid disputes. Furthermore, we have automatic financing to preserve our firm's capital. Lastly, we have key man life insurance on me to protect both the firm and my heirs.

## Pricing

Recent headlines have exposed managers inflating bond prices. We use a third party pricing source (IDC) and do not change/override prices. Pricing services do a great job with high quality, vanilla securities like those we purchase. In contrast, pricing services are regularly too high for CMO's, CMBS and other derivatives, things we do not purchase. Changing prices can easily lead to abuse and manufactured alpha.

## Soft Dollars

We do not utilize soft dollars as commissions belong to our clients! I have never understood how the industry accepted soft dollars, as a normal practice, especially for fixed income managers. The premise behind soft dollars is that managers use client commissions to pay certain manager bills for items that benefit clients. Ask for the evidence! And, ask for the soft dollar liability balance. Utilizing

soft dollars is usually a sign that a manager is undercapitalized. The practice can easily lead to excessive trading (MBS dollar rolls, repurchase agreements, etc.) of client portfolios to generate commissions to pay manager bills.

## Outside Revenue

Our firm derives revenue from one source, managing client assets. It is important to ask if managers/consultants are receiving revenue outside their core competency to expose potential conflicts. Best practices should require consultants to disclose any revenue derived from money managers, especially those brought before clients for potential hire during final presentations.

## Paying It Forward

Our firm has been blessed. That is why we stay humble and always “pay it forward.” We believe in compensating our employees generously. It is the right thing to do. After employees, we give generously in time and money to communities, both ours and those of our clients. We also host a robust summer internship program for minority youngsters.

## Stand Against Injustice

Injustice has no place in 2017. And, we should all stand against it. Last year, we were subjected to an unbelievable, racially charged line of questioning during a due diligence with a major West Coast consulting firm. I wrote their CEO directly. Shockingly, their firm defended its actions. In the end, the market will force them to change their behavior. I stood against injustice so my kids will never be exposed to such treatment and will be allowed to compete fairly.

“Best Practices” means different things to different people. And, one's interpretation of “Best Practices” says a lot about a person and a firm. From this letter, you can see who I am and who we are at Garcia Hamilton. Somewhere, Da Mayor is smiling and saying to me “Doctor, keep doing the right thing.”

To which I reply, “I got it. I'm gone!”

*Gilbert Andrew Garcia, CFA  
Managing Partner  
May 24, 2017*

Quick Update: We recently launched our mutual fund with Nomura for retail investors in Japan. The fund is now \$467 million bringing our total fixed income assets under management to just under \$9 billion. Thank you to all of our employees, families, clients and supporters for making it happen!