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Institutional Investor

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Makeover at Mitchell Hutchins

Mitchell Hutchins CEO
Margo Alexander

JANUARY 1997

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Turning point

Curing a sick money manager takes strong medicine and ample time. Margo Alexander may yet nurse Mitchell Hutchins off the critical list.

By Alyssa A. Lappen

“Once a broker came to me with a letter from a client whose husband had died. She had invested in a number of stocks I had recommended and made a lot of money. She felt she did not have to worry about her future. I cried, I was so thrilled.”

Sappy? No doubt. But something about the way Mitchell Hutchins Asset Management chief executive Margo Alexander tells this story from her days as a securities analyst conveys conviction. Here is someone who does what all money management bosses purport to do but often don't: care about the well-being of their firms' clients. It's a good start, but only a start.

For the past two years, Alexander has been struggling to repair the damage done to Mitchell Hutchins by years of turmoil. MHAM, which might as well be

Mitchell Hutchins's Alexander: "We are trying to build a long-term, high-quality asset management firm, and that requires team orientation, which is not the description of the prior organization"

pronounced "mayhem," has suffered from lousy performance, extensive turnover, sundry expensive investment-related snafus and fast-ebbing institutional assets. Since 1992 alone, the subsidiary has torn through a chief executive and two presidents, expended at least 30 portfolio managers and forfeited the faith of parent PaineWebber's brokers, customers and potential clients. Any number of observers have dryly noted that the firm would make a good case study for Alexander's alma mater, Harvard Business School.

The most apt title: "Turnaround in (slow) progress." Alexander has consolidated fractious operations, improved spotty internal communications, instituted strict risk management tools and shaken up fund management, naming three new chief investment officers (of equity, of bonds and of quant management). The firm's 20 long-term mutual funds show early signs of performance gains (see charts, pages 58-59).

Yet assets, now at \$43 billion, are still not growing at anything like market rates. Mitchell Hutchins remains much too dependent on none-too-remunerative cash products. And the firm has lost at least a dozen portfolio managers and key marketing people in the past year alone.

Most pension consultants remain skeptical of Mitchell Hutchins's turnaround efforts. "None of the major investment banking-brokerage houses have been successful getting into the separate-account institutional business," contends David Eager, head of management consulting firm Eager & Associates. "There's a transaction mentality rather than a relationship mentality."

When PaineWebber chairman and chief executive Donald Marron, then-president Paul Guenther and then-retail head Joseph Grano parachuted Alexander into Mitchell Hutchins from her position as director of institutional equities at the brokerage firm, many observers termed the appointment "brilliant." But doubts linger as to whether even an accomplished manager like Alexander can revitalize Mitchell Hutchins's mutual fund and institutional operations — and whether she has the long-term com-



Steve Stoll

Mitchell Hutchins CIOs Barneby, McCauley and Tincher (left to right): Brought in for one purpose — to improve performance without, as Tincher says, being "hostage to a star system"

mitment of top management to keep trying. "From the outside they are doing the right things," says Avi Nachmany, an analyst at the New York mutual fund consulting firm Strategic Insight. "But the bigger the mess, the longer it takes to clean it up."

"My normal personality is rather analytical," says Alexander, a former retail-sector analyst. "But the 1994 [mutual fund] performance was nothing to be proud of. We had to focus on delivering performance and overcoming the turmoil of the past. Honestly, I started faster in this job than I ever have. I didn't spend six

MHAM: Pronounce it 'mayhem'

The past decade at Mitchell Hutchins has been fraught with change, little of it beneficial. Here's a quick guide.

1987 — Mitchell Hutchins Asset Management chief Jonathan Smith departs, replaced by Edward Allinson from Chase Manhattan Bank.

FEBRUARY 1988 — Allinson closes the \$35 million purchase of Manufacturers Hanover Investment Corp. Institutional assets peak at \$22 billion.

Joseph Grano joins parent PaineWebber as head of retail operations from Merrill Lynch & Co.

APRIL 1988 — Stephen Canter hired from Chase Investors Management Corp. to run the institutional business.

LATE 1988 — Mitchell Hutchins

management discovers huge real estate losses in several Arizona. Taft-Hartley accounts acquired from Manny Hanny only days after the option to return the liabilities to the bank expires.

Allinson leaves the firm in the wake of Phoenix losses. Joyce Fensterstock promoted from managing director of mutual fund sales to president of mutual funds, reporting to PaineWebber president Paul Guenther.


1989 — Canter hires Gyanendra (Joe) Joshi from State House Capital Management to manage the Core Value equity portfolio.

1991 — More fallout from Manny Hanny deal: Marketing head Sheryl Gruetz-macher Gordon leaves firm.

APRIL 1993 — Canter bails out to U.S. asset management arm of Kleinwort Benson with fixed-income portfolio manager Emad Zikry and 14 members of the fixed-income management team.

1993 — Institutional assets dip to \$10.4 billion, despite bull market.

JUNE 1993 — Frank Minard hired from Oppenheimer Capital as executive vice president of institutional marketing then asked to run MHAM as its CEO. Fensterstock named president.



months analyzing the past and industry trends and trying to think of a grand strategy. I began quickly to focus on what we knew. What do our clients need? How are we going to deliver it? And let's go."

Looking resolutely forward comports with the party line at both PaineWebber and Mitchell Hutchins. Marron and Grano, now president of PaineWebber, speak expansively of almost doubling MHAM's assets, to \$80 billion, by 2000. "You may know more about the [firm's] history than I do," quips Alexander, plainly anxious to bury its messy past. But the past, in this case, is very much prologue: Mitchell Hutchins's old problems continue to plague Alexander's efforts to retain and recruit clients and to rejuvenate the firm.

Mitchell Hutchins was founded in 1919 in Chicago as a brokerage firm serving top-drawer clients. In 1966 it absorbed Marron's investment bank, D.B. Marron & Co., and shifted its focus to research and trading support for institutional clients. By 1977, when PaineWebber bought the firm for \$6 million, it began to switch gears again, this time to asset management, but Mitchell Hutchins did not launch its first mutual funds until 1984.

Then in 1988 Mitchell Hutchins ventured into institutional asset management, buying \$22 billion in assets from Manufacturers Hanover Trust Co. for what seemed a bargain-basement \$35 million. The newly acquired assets were promptly segregated from the mutual fund and private-client businesses, on the theory that they would do better with separate portfolio managers and research. Fund sales were headed by PaineWebber veteran Joyce Fensterstock. Stephen Canter was hired from Chase Investors Management Corp. to head the institutional effort. He reported to Edward Allinson, then Mitchell Hutchins's CEO, and later to PaineWebber pres-

ident Paul Guenther, while Fensterstock reported separately to Guenther and, later, to Joe Grano.

Says one well-placed former insider, "The decision to split up money management that way almost guaranteed that the operation would not get synergies or economies of scale."

Politicking widened the breach between the two divisions. For five years after he joined the firm in 1988, Canter reportedly jockeyed to become CEO of Mitchell Hutchins; the post remained vacant after Allinson left the asset management firm that year for State Street Bank & Trust Co.

At Chase Investors Canter had promoted the "shop within a shop" concept. At Mitchell Hutchins, numerous sources say, he all but refused to cooperate with Fensterstock — or, for that matter, with PaineWebber. "Stephen Canter is not a people person," says someone who worked with him. "He never got along with Guenther or Grano. They were always at each others' throats. So there was no success." Canter, who left the firm in a messy "lift-out" of key bond professionals in 1993, is now CIO at Mellon Bank's Dreyfus Corp. and refuses to discuss events at Mitchell Hutchins.

As the division of the mutual funds, private-client and institutional businesses became ingrained, confusion over management authority became rampant. "Reporting lines changed four times in one and a half years," grouses one former money manager. "Neither Canter nor Fensterstock had the power to approve a budget. So neither side of the business got any resources." Counters Grano: "If you look back, you'll see that some of the best growth that Mitchell Hutchins ever had in its history was in the late '80s and early '90s. So that [comment] is hard to fathom."

In fact, though, the PaineWebber mutual funds run by Mitchell Hutchins were growing sluggishly compared with those of most other proprietary fund families and with the mutual fund market as a whole. Historical data from Lipper Analytical Services indicate that PaineWebber-brand fund assets grew 28 percent from December 1987 through 1992. By con-

EARLY 1994 — Minard effectively kicked upstairs, but stays until his contract expires in late 1995.

APRIL 1994 — PaineWebber infuses mortgage-backed-laden Short Term U.S. Government Income Fund with \$57 million pretax, buys back interest- and principal-only paper for \$55 million. In July the parent applies to the Securities and Exchange Commission to buy back two illiquid structured floating-rate securities for \$180 million.

JUNE 1994 — Several fixed-income managers, including Ellen Griggs, leave the firm in connection with the bond fund debacle.

AUGUST 1994 — Fensterstock resigns. Firm reports to PaineWebber's Guenther on interim basis.

SEPTEMBER 1994 — Mitchell Hutchins hit by layoffs. By year-end acting co-heads of fixed income Edward Rosenzweig and Mark Fishman leave the firm.

OCTOBER 1994 — PaineWebber purchases Kidder, Peabody & Co. from General Electric Co. Mitchell Hutchins later merges in Kidder's remaining \$4.3 billion in mutual funds plus \$600 million in institutional accounts.

JANUARY 1995 — Margo Alexander shifted from head of institutional equity at PaineWebber to become Mitchell Hutchins CEO.

JUNE 1995 — Mitchell Hutchins agrees to sell \$350 million in venture capital assets to managing director George Siguler. Deal closes late 1995.

1995 — Small-cap manager Dorik Rozanski leaves to join Rothschild Asset Management.

JUNE 1996 — Joshi resigns to start his own asset management firm. By November he has \$750 million in assets, nearly half from former Mitchell Hutchins clients.

SEPTEMBER 1996 — Mitchell Hutchins's institutional business has shrunk to \$5.9 billion.

trast, Shearson Lehman Brothers' house funds increased 135 percent; Prudential Mutual Fund Management's, 61 percent; Merrill Lynch & Co.'s, 60 percent; Dean Witter InterCapital's, 53 percent; and Smith Barney's, 128 percent. From the end of 1987 through 1993, PaineWebber's fund assets grew just 1.5 times, even as the fund marketplace as a whole nearly tripled.

The situation on the institutional side was a good deal grimmer. Having taken on \$22 billion in institutional assets in the Manny Hanny deal, Mitchell Hutchins had by 1992 suffered an \$11 billion drop in those same assets. To be sure, \$6 billion of the loss was anticipated and had been priced into the deal: Manny Hanny had a huge California State Teachers' Retirement System account that it was handling on a temporary basis until the client could make the transition from active to passive management. Yet that still left the firm out \$5 billion — at a time when healthy markets arguably should have enabled it to both recoup the \$6 billion deficit and add to its original trove.

Canter, meanwhile, had begun to maneuver to buy the institutional asset management business himself. In 1991 he structured a deal to purchase the entire institutional arm in a partnership with the U.S. money management subsidiary of Britain's Robert Maxwell, the late, disgraced publisher. The deal fell apart at the 11th hour.

In April 1993 Canter bailed out of Mitchell Hutchins to join the U.S. asset management arm of Kleinwort Benson, taking with him virtually the entire MHAM institutional long-term fixed-income team — its chief, Emad Zikry, and some 14 other managers. PaineWebber sued Kleinwort, which settled on undisclosed terms.

Had PaineWebber glanced around the money management scene, it might have picked up some clues as to what had gone awry at Mitchell Hutchins. "People from a lot of firms that blow up would perceive that they didn't get the support they wanted," says one former insider. The brokerage firm's leaders wanted Mitchell Hutchins to succeed — but on their terms. Some time ago, the former insider says, "Donald Marron told Mitchell Hutchins managers, 'Margins stink, and if you fix them I will leave you alone.'" Yet the brokerage firm made the same mistake as do so many others new to money management, he says: Either Marron or his deputies assumed that simply by clamping down on Mitchell Hutchins's costs, they could enhance its value. "You can't manage revenue," this former insider notes, "but you can manage costs. So problems usually relate to capital investments. It's conflicting greed."

Two months after Canter fled the firm, Mitchell Hutchins hired as his replacement Frank Minard, managing director of sales and client service for Oppenheimer Capital. Soon afterward the seasoned marketer was installed in the long-vacant CEO post and given a three-year contract at a reported \$1 million-plus per year. Joyce Fensterstock was named president.

Their straightforward mandate was to turn around the business. But true to form, PaineWebber was remiss in providing the wherewithal to do so. "The firm didn't have compliance and was just beginning to network computers in mid-1994," notes one former manager. "Some portfolio managers kept track of trades on index cards, since there was no centralized system. And they had only eight mutual fund wholesalers to



Steven Boljoni

Risk chief Byers: "Institutional firms have used customized benchmark portfolios for years, but I would guess not many retail funds use the technique" — as Mitchell Hutchins now does for its funds

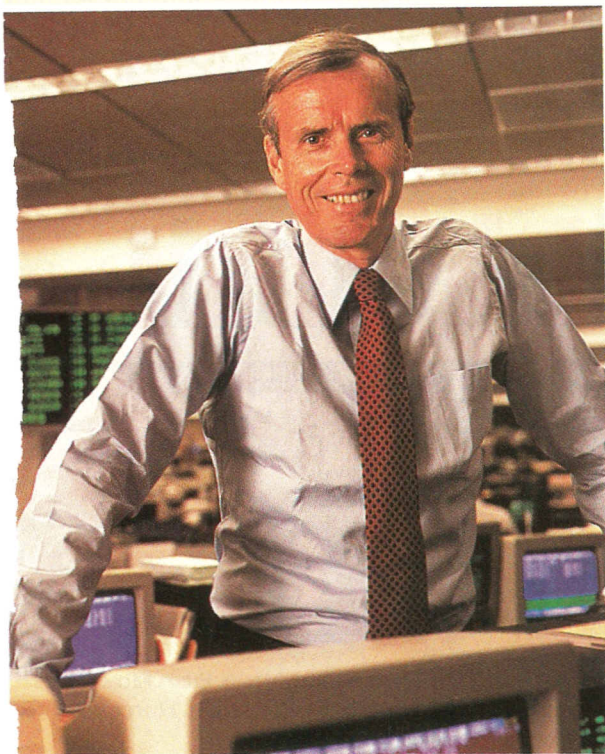
cover the whole U.S." Says a former Mitchell Hutchins marketer, "PaineWebber tied the purse strings tightly in a business where you have to spend money to make money."

Minard's marketing bent, moreover, did not readily clue him in to changes that needed to be made in portfolio management and business structure. Though he did lobby to merge the mutual fund and institutional operations, complicated legal considerations now required that they be kept separate (and so they remained until early '95). Even where Minard could have made a difference, he often failed to act decisively.

Take the institutional fixed-income team. Zikry's hasty exit had left it chiefless. Six months after Zikry's departure, Minard hired an Aetna Life and Casualty Co. money manager, John Kim, to head the group. But within months Kim had returned to Hartford, ultimately to become CIO of Aetna's Aeltus Capital Management. So bond portfolio manager Ellen Griggs was appointed head of fixed-income management for mutual funds and head of oversight for institutional portfolios. But in the wake of a bond fund blow up, she left and was replaced by co-heads Mark Fishman and Edward Rosenzweig, portfolio managers who'd joined the firm a few years before. Ultimately, they, too, exited. "It was the manager du jour," recalls a former employee.

Marketer Minard was blindsided by management troubles that mostly predated his arrival. "Minard was not experientially equipped to handle the magnitude and multiplicity of problems with which he was presented," confides a former associate. Minard, now managing director of global investment at Bankers Trust Co., refuses to comment. Among the miseries he found at Mitchell Hutchins:

PaineWebber CEO Marron: Will he be more patient with longtime PaineWebberite Alexander than he has been with other Mitchell Hutchins bosses?



Catherine Gibbons



Shonna Valeska

PaineWebber president Grano: How realistic is the goal of nearly doubling Mitchell Hutchins's assets by 2000? "It had better be," he says. "It has my name on it"

- Some 85 percent of the company's accounts and funds were out of compliance, and many were not fully invested.

- The firm faced several huge claims from Arizona union pension funds — accounts acquired along with the Manny Hanny business in 1988 — that had been overallocated to speculative southwestern real estate. Mitchell Hutchins failed to discover the extent of losses until days after the firm's right to "put" the associated liabilities back to Manufacturers Hanover had expired.

Settlements reached in November 1994 were among the biggest ever for a pension dispute in Department of Labor annals. They cost Mitchell Hutchins \$29.2 million (and assorted other parties an additional \$64 million). Sources say the firm spent at least a further \$5 million on legal bills.

- Another onslaught of lawsuits, filed in 1993 and 1995, alleged that in the late '80s, 32 large clients of Mitchell Hutchins Investment Advisors manager William Reik Jr. had lost more than \$18 million on suspect investments. Among the plaintiffs: the Houston City Employees Pension Fund and Missouri Senator Christopher (Kit) Bond. Allegedly, Reik had attempted to corner and manipulate a few thinly traded stocks, in part through a Mitchell Hutchins closed-end vehicle called the Cypress Fund (which was ultimately liquidated). Grano dismisses the Reik affair as "the cost of business in a litigious society." Yet there was apparently some substance to the charges, for public records show that PaineWebber and Mitchell Hutchins paid at least \$11 million to settle numerous claims related to Reik, who was reportedly forced to resign in September 1990. "[Reik] did not contribute to the settlements," says his attorney, Richard Martens of West Palm Beach, who contends that

had the cases gone to trial, they would have been thrown out.

- In 1994's bond bloodbath PaineWebber-brand retail fixed-income funds suffered an especially massive hemorrhage. Says Morningstar president Don Phillips, "I've never seen an investment management firm implode like PaineWebber did in 1994. A stunning number of the brokerage's Mitchell Hutchins-managed funds ranked in the bottom half of their investment objectives."

The most conspicuous casualty: the Short Term U. S. Government Income Fund, which was crammed with mortgage derivatives. A huge sales push had pumped up the fund's assets to \$1.7 billion within its first year of operation. When the Federal Reserve Board caught markets off guard in March by jacking up interest rates, panicked fund investors scrambled to redeem their shares. By summer the fund's value had fallen so sharply, and investors had redeemed so many shares, that irate PaineWebber brokers forced the brokerage house to give the fund a \$57 million cash transfusion and buy back several

interest-only and principal-only mortgage securities for a further \$55 million. Assets sank to \$730 million, resulting in two illiquid structured floating-rate securities accounting for a quarter of the fund's value. PaineWebber then applied to the Securities and Exchange Commission for permission to buy back those securities for an additional \$180 million, promising to eat further losses but to use any gains to benefit fund shareholders.

PaineWebber suffered no more than any other firm on Wall Street that year and reacted better, Grano now maintains. "We were one of the few firms that stepped up and righted the situation," he says. Nevertheless, the bad news proved hard to shake. By mid-1996 investors had redeemed all but \$238 million of the hapless government fund, according to Lipper Analytical, even though Mitchell Hutchins had in 1994 outsourced its management.

PaineWebber brokers progressively lost faith in Mitchell Hutchins. Sales of the asset firm's PaineWebber-brand funds plunged from 65 percent of all funds sold by the brokers in 1993 to 7 percent in mid-'95, according to one former insider. (The proportion had recovered to 20 percent as of last fall, says Schroder Wertheim & Co. analyst James Hanbury.) PaineWebber, like other Wall Street houses, had of course provided special sales incentives to encourage its brokers to sell house-brand funds, a practice for which the entire brokerage community came under fire — and which PaineWebber ceased in late 1994. Even so, the proportion of own-brand funds sold by brokers at other major firms averages 50 percent, Hanbury says.

At a fundamental level the government-fund debacle stems

from flaws inherent in the structure of the PaineWebber-Mitchell Hutchins relationship. "We had promised returns of 4.5 percent in a 3 percent environment from a fund with a 1.5 percent expense ratio and a short duration," recalls one former MHAM portfolio manager. "Managers needed to make 6 percent returns just to keep even." Adds another ex-MHAM manager, "When anyone complained, which several people did, they were told that brokers had to be paid and to just go manage the money."

In effect, the fund's pricing required managers to take huge risks. Says Morningstar's Phillips: "The Short Term U.S. Government Fund was being pitched as a money market fund alternative. So all of the sales charge came out of the yield. And the managers were hung out to dry."

Grano objects strenuously to this characterization of events. "[That is] absolutely not true," he retorts. "The fact that the fund did so well in raising a lot of assets is contrary . . . to wherever you're hearing that." PaineWebber was admittedly among the first to sell funds with multiple share classes and pricing schedules. Grano continues: "That fund had one of the more innovative pricing schedules, with class-D [shares sold for] a flat 1 percent a year rather than a heavy up-front load. With a 1 percent level load, the client was certainly better off for six years. It was an issue of the impact of those derivatives, not an issue of the expense ratio."

In 1994 PaineWebber purchased the carcass of Kidder, Peabody & Co., acquiring a \$4.9 billion mutual fund family and a \$600 million institutional business. But before Mitchell Hutchins could absorb the Kidder funds into its fold, their assets had dwindled to \$4.3 billion, according to Lipper Analytical. Moreover, at least five of the firm's key fixed-income managers quit to join Cowen & Co. Others scattered elsewhere. "They lost every institutional person who came with Kidder," says one former insider. "Some brokerage people even left their bonuses on the table just because they did not want to work at PaineWebber."

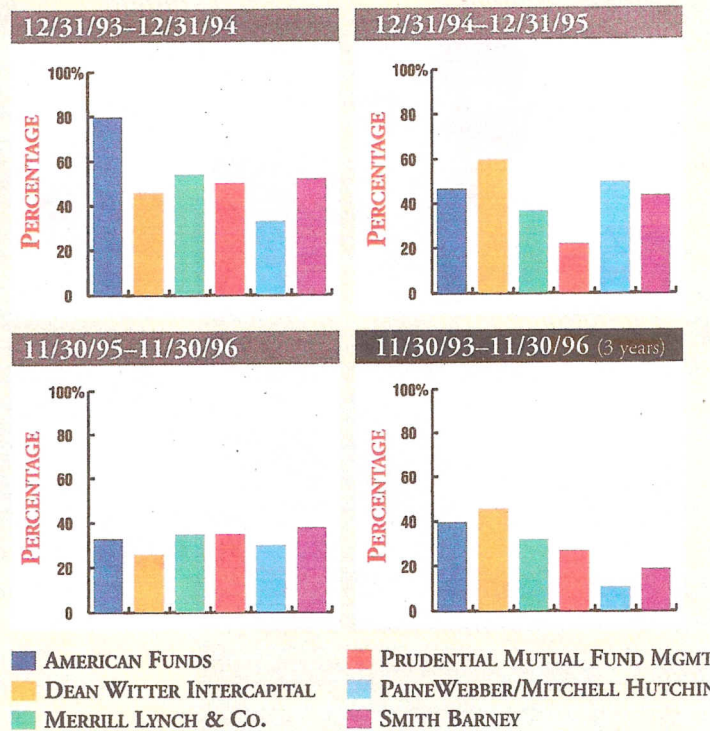
Some attrition was anticipated. Sources say severance packages had been priced into General Electric Co.'s sale of Kidder to Mitchell Hutchins, and the firm's employees suffered through three demoralizing rounds of layoffs in late 1994 and early 1995 in which dozens of Mitchell Hutchins and Kidder people were let go.

Within a year of Frank Minard's arrival at Mitchell Hutchins, his authority had been eviscerated. "PaineWebber lost patience," says one of his former colleagues. "Their definition of long term is different from that of the institutional community." Former employees say the sharpest blow to Minard came in December 1994: Chief marketer Paul Legvold was fired without Minard's knowledge, after which two other institutional sales staffers were also sacked. PaineWebber "made a strategic decision to get out of the institutional business when they fired the institutional sales staff," says one source.

Minard offered, like Canter before him, to buy the business himself. He reportedly also brought PaineWebber an opening bid from United Asset Management chairman Norton Reamer, though it was apparently never seriously considered. At about the same time, in early 1995, Mitchell Hutchins reportedly brought in McKinsey & Co. to determine whether all or part

Trying to break par: How Mitchell

Below are the proportions of funds in a number of families of funds whose long-term equity funds were ranked by Lipper Analytical Services in the top half of their respective objectives for the stated periods.



of MHAM should be sold. "That is ridiculous, it's almost comical," Grano says, denying that McKinsey was employed by Mitchell Hutchins or that the firm ever considered exiting the institutional business. "Mitchell Hutchins was then one of our core businesses [at PaineWebber], one of our higher-margin businesses, and our strategies have always been to grow." McKinsey was hired, say PaineWebber spokespeople, but only to conduct "a narrow review of selected MHAM financials."

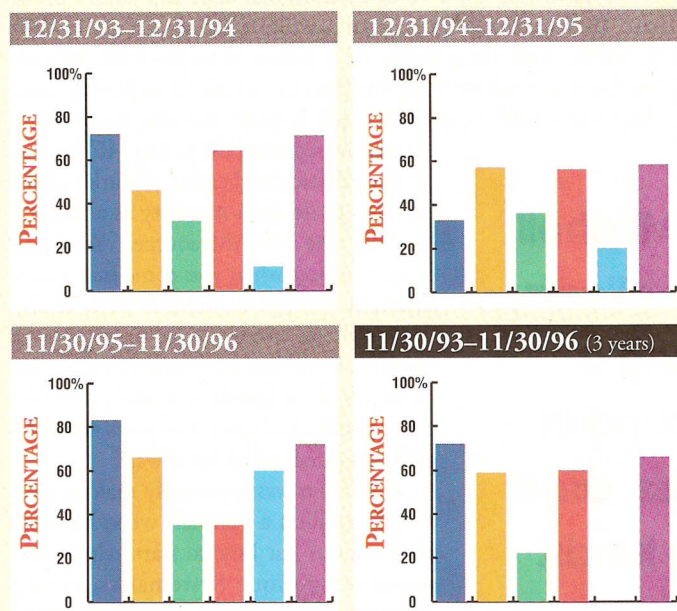
Named chairman of Mitchell Hutchins but forfeiting his CEO title, Minard was effectively kicked upstairs in early 1994, say sources. (Guenther was named temporary head of Mitchell Hutchins in mid-1994, and Minard remained at the firm only until his contract ran out at the end of '95.)

Into the Mitchell Hutchins maelstrom stepped a new CEO, Margo Alexander. Her PaineWebber background had made her a favorite over outside contenders, notably Stephen Treadway, then chairman of Smith Barney's mutual funds.

Born in California and educated at the University of California at Berkeley before Harvard B-school, Alexander had worked with Marron ever since starting as a Mitchell Hutchins analyst in 1973. Her long hours and hard work had paid off when he awarded her senior positions of the sort that no other woman on Wall Street had achieved before: head of equity research and, later, co-head of the firm's equity division. Alexander demonstrated intense loyalty — rejecting proffered plum research jobs, including a top spot at Shearson in the mid-1980s. And she toughed it out after losses on the convertible bond desk prompted her de facto demotion in 1990 from co-

Hutchins funds have fared

Below are the proportions of long-term bond funds in each family that were in the top half of their performance objective, as ranked by Lipper Analytical, for the periods shown.



Source: Lipper Analytical Services.

head of equity to head of institutional equity.

"[PaineWebber] is a fairly toxic environment," says one source. "She suffered horrendously [in '90], but for some reason she chose to stay. She survived because of her natural resilience." And perhaps, too, because of her knack for corporate diplomacy. Says Alexander today when asked about the episode: "I have been given lots of opportunity at PaineWebber, and I have never felt constrained. I have always had a lot of people I think a lot about [here]. Family is too mushy, but it's an extended community that I feel part of and I value."

Alexander's survival skills, though, probably owe more to her acknowledged knack for managing people. "Margo is absolutely the right person at the right time," swears her former boss Guenther. Notes Montgomery Securities research head Kent Logan, who worked for Alexander for seven years, "She is one of the consummate professionals in the business." Former PaineWebber analyst Rod Schwartz (now an investment banker at Paribas Capital Markets) calls her "the best boss one could ever hope to have. She is almost pathologically fair." Her erstwhile chief rival for the Mitchell Hutchins job, Treadway (now chairman of Pimco Funds Distribution Co.), describes Alexander as "smart and easy to work with." Similarly glowing reports come from, among others, American Van Kampen chief Don Powell and Alliance Capital Management head Dave Williams, who has known her for 23 years.

Once in charge of Mitchell Hutchins, Alexander wasted no time fretting about who had done what to whom. "I had an organization that was delivering, particularly in mutual funds, subpar performance and had a lot of personnel turnover," she

points out. "We needed some stronger people. That's what we changed to make Mitchell Hutchins an integrated organization."

The firm urgently needed better risk management, better performance and better organization. Some pieces of the puzzle were waiting to be dropped into place. The southwestern real estate and the government fund disasters were behind it. In August 1994 Guenther had plucked PaineWebber risk manager Stephen Byers from the trading desk to head compliance, administration and risk management at Mitchell Hutchins. Later that year Minard had rehired Kirkham Barneby, a quantitative manager who'd left Mitchell Hutchins in mid-'93 to head Vantage Global Advisors' quantitative work. And Minard had also recruited Dennis McCauley, who boasted 30 years of running fixed-income portfolios at IBM Corp. As one of her first moves, Alexander hired Mark Tincher, the stand-out Vista Growth & Income manager for Chase Investors.

Alexander then forthrightly addressed Mitchell Hutchins's split personality by merging institutional and mutual fund research and portfolio management. She appointed McCauley CIO for all fixed income, Tincher CIO for all equities and Barneby CIO for quantitative management and benchmark support. Next she cut the number of long-term open-end mutual funds from 33 to 20, ridding the fund lineup of esoterica and overlapping objectives.

Being thoroughly conversant with the PaineWebber culture, Alexander crucially was able to wangle fresh funding for Mitchell Hutchins. (Neither she nor Grano will say how much: "I gave her a lot of rope," he says with a laugh.) "PaineWebber has been incredibly supportive of this division," Alexander says, sounding her usual positive corporate note. "You don't pick up the phone and say, 'I'd like a whole new computer system.' You actually have to work on it."

Given that length of rope, Alexander must now rely on Mitchell Hutchins's commitment to sophisticated risk management to keep from hanging herself. A significant chunk of the new resources has gone into technology, including at least \$1 million for a network of PCs.

"We developed a system two and a half years ago to measure the performance of every fund relative to its own historical standard deviation and the historical standard deviation of its peers," says risk boss Byers. "Every day we get a report four pages long on equity, fixed income, global and municipal funds, and if any fund has a deviation from its historical standard deviation, there is a big bold X — it's very clear."

Byers also maintains daily pricing on individual securities, identifying the ten or 15 most volatile in each portfolio. And he tracks each fund's performance weekly, month-to-date and on a rolling 30- and 90-day basis relative both to its Lipper Analytical peer group of funds and to its own customized benchmark portfolio (devised by quant Barneby). "Institutional firms have used customized benchmark portfolios for years," says Byers, "but I would guess not many retail funds use the technique."

The risk watcher also monitors securities lending, which Byers notes can either limit returns or significantly ramp up risk. "It's wonderful," says McCauley. "The checks keep coming and the clients smile about it."

Computing power is, naturally, critical to Barneby's quant

group. "We can get intangibles quantified," he says. "For a number of portfolios, we look at liquidity and likely trading costs, including the market impact of trades and the execution cost." Barneby's systems also help the CIOs assess portfolio characteristics and isolate areas of underperformance. "In high yield we were not happy with performance," says equity CIO Tincher of the \$450 million segment. "We all got together and talked to the manager and found that he had underweighted some sectors that did well and had slightly lower credit quality than the broad market. Now he is in the top 15 to 20 percent of his benchmark."

Barneby has helped his colleagues obtain such data and analysis tools as TeleRate, Barra, Bloomberg and the Merrin trading system. Exults ex-IBMer McCauley, "I came from the buy side, and coming here was like coming to heaven."

Alexander has also parceled out money for applied R&D. Last April PaineWebber put up \$10 million to seed a market-neutral product run by Barneby and Tincher. "It is truly market-neutral," says Tincher. "The beta is zero, so we have eliminated the systematic, or market, risk. Longs are offset by shorts in each industry group, giving us zero weighting in each sector, with Kirk's quantitative model helping us to pick higher alpha [stocks]." The portfolio is ahead of its performance standard by about 200 basis points, says Barneby, but Mitchell Hutchins is waiting for more-sustained results before marketing the product.

In authorizing a number of new hires, Alexander set down a strict standard: They must be team players. "When I came," she recalls, "a friend said, 'Mitchell Hutchins is like a condominium of investment groups.' People didn't talk to each other. One worked on this fund, another worked at that fund, and I don't think that is the way to build a successful, ongoing organization." Says Tincher: "We have focused on the team for the past 18 months. Most of the big successful firms have had a discipline and a process. People can come and go, they get sick, and we did not want to be hostage to a star system." Two notable recent additions to the MHAM team are Joanna Migdal, a 13-year veteran of Oppenheimer Capital, where she managed \$500 million worth of separate institutional equity accounts, and Peter McCarthy, a chartered financial analyst who managed \$1 billion in mid-cap value stocks at Valenzuela Capital Management. The pair co-manage Mitchell Hutchins's Core Value institutional product.

Mitchell Hutchins's staff generally seems to like the changes so far. Says one insider: "Mitchell Hutchins is definitely more organized about running money. We all work together, and it wasn't always like that."

But not everyone has taken to the new collegial regime. In 1994 PaineWebber boasted of Mitchell Hutchins's in-house venture capitalist, managing director George Siguler, whose "ground-breaking" and "oversubscribed" Russia Partners Co. was the first private equity fund to invest in Russia. But Siguler says he couldn't get funding for a Moscow office or hire more people through MHAM, which was cutting expenses. So in late 1995 he arranged

to buy out his \$350 million-in-assets business from PaineWebber and Mitchell Hutchins for what he calls a "fair price, considering that their managers were leaving with the business."

Another dropout was portfolio manager Gyanendra (Joe) Joshi, a managing director who joined Mitchell Hutchins in 1989 to run its Core Value institutional large-cap equity product. In five years he'd bolstered lackluster performance and built Core Value to a respectable \$2.3 billion in assets. Joshi, however, did not relish working for Tincher, no doubt in part because he'd wanted the equity CIO's job himself, but also purportedly

because he regarded his young (40) boss as egotistical and bullheaded. "Mark's problem had to do with maturity as a leader," confides one MHAM source. "You have to earn respect when you come into a new situation, not just demand it. [The equity CIO job] was wrong for Joshi, but he was important to the business because his numbers were good, and the sales and client people had spent five years trying to get his product to where it was."

Joshi, who was reportedly making well over \$1 million a year, left when his contract ran out last June to start value management boutique Systematics, taking along his partner, Kevin McCreesh. Several

PaineWebber brokers soon followed. Within six months Joshi's new firm had more than \$750 million under management, nearly half from former Mitchell Hutchins clients.

Other institutional players appeared to chafe at equity CIO Tincher's snug bit. Two were Dorik Rozanski, a seasoned though eccentric small-cap manager, and his associate, Morris Ajzenman. Rozanski ran the firm's successful \$1.5 billion Uncommon Value product, and when he and Ajzenman departed for Rothschild Asset Management in late 1995, Mitchell Hutchins lost most of Rozanski's clients. Among them: the Massachusetts Bay Transportation Authority, a \$45 million account for MHAM, and the Arkansas Public Employees Retirement System, a \$107 million account.

Within one year — from mid-1995 through mid-1996 — Mitchell Hutchins experienced nearly 100 percent turnover among managing directors of its institutional equity business.

The portfolio manager shuffle wasn't confined to the equity side. "We'd had it," says Florida director of treasury Henry Cain, explaining why he terminated a \$135 million intermediate fixed-income account with MHAM in early 1995 after less than two years. "Our portfolio manager did a good job, but Mitchell Hutchins let him go without telling us. We had to find out through the grapevine, and this was the third time this had happened to us [at MHAM] within one and a half years."

New fixed-income CIO McCauley confronted both a performance and a personnel challenge. At IBM he'd handled about \$8 billion in active U.S. fixed income. "He is a great combination of a person who uses fundamentals and technicals," testifies McCauley's former boss at IBM, Carter Wolfe, who also moved on when the computer company transferred virtually all of its pension fund management to outsiders.

Yet at Mitchell Hutchins McCauley's fixed-income operation has turned in a solid but unspectacular performance, re-

A few Mitchell Hutchins clients, sensing a turnaround in progress, are adding funds.

turning just 18.56 percent in 1995 on the U.S. active fixed-income composite, according to Nelson's Investment Management, 57 basis points behind the Lehman Brothers aggregate bond index. Clients say bond portfolios returned 0.58 percent for the first ten months of 1996, substantially behind the Lehman benchmark.

Nor has McCauley stanching attrition in fixed income. Managing director Albert Meyer, a 14-year veteran cash manager who came over to Mitchell Hutchins in the Manny Hanny deal, flew the coop to William D. Witter, Inc. last August with his longtime assistant, Barry McNell. Soon afterward Mitchell Hutchins lost a \$1 billion cash and insurance portfolio — a large piece of its total cash and insurance business — when United Cos. Life Insurance was acquired by Penn Corp. Financial Group, which plans to manage the money internally. The loss tops a long list of fixed-income clients that departed over the past two years, reportedly including the Archdiocese of Rockville, the Cement Masons of Southern California, Entenmann's, Banco Popular and Chemical Bank.

Other clients have been more patient — up to a point. Long Island Lighting Co. has left \$68 million of its \$93 million fixed-income account with the firm, although the portfolio was up only 0.8 percent through last October, compared with a 2.8 percent gain for the comparable Lehman Brothers aggregate bond index. Says Lilco capital markets supervisor Michael Senicola, "We are impressed with McCauley."

Yasuda Fire and Marine, a Mitchell Hutchins client for 30 years, halved the firm's share of its equity and bond portfolio a few years ago. Now Yasuda keeps 85 percent of its \$100 million account in bonds. "[In 1995] they were a little behind the index," notes Yasuda treasurer Richard Tafro. "But the measure that's really important to me is how they do against Brinson [Partners, Yasuda's other fixed-income manager], and last year they did better."

Other clients have been a lot less loyal. By September Mitchell Hutchins's institutional business had slumped to \$5.9 billion. Throw in private-client accounts, as Mitchell Hutchins now does, and its total "institutional" business is still only \$12.6 billion, a hair less than at the end of 1990.

Several former staffers fault Alexander's insistence on forming portfolio management "teams." "If you take a horse and paint stripes on it to make it look like a zebra, it is still a horse," says one. "Every institution wants to build a team, but without a leader you have a crowd, and the leaders of each team left and took good team members with them."

Alexander adamantly refutes that assessment. "We are trying to build a long-term, high-quality asset management firm," she emphasizes, "and that requires team orientation, which is not the description of the prior organization. When we [changed], some people didn't like that, they didn't fit. Just assume that some of these people made a choice, some didn't. In some cases, the decision was mutual. Let's be adults about that. I would lose sleep if I hadn't been able to attract terrific new people. But I have not had a conversation with our managers

saying, 'Let's just settle for this person.'"

Certainly, Alexander has been able to woo some talent. For chief of marketing, she recruited Brendan Boyle, the former head of Prudential's marketing effort and a veteran of Smith Barney. And to serve as head of institutional sales and client services, she hired William Gordon from PaineWebber International; he had previously spent 14 years marketing to institutions at Merrill Lynch. "This is a turnaround," says Boyle. "Did it cause me to do due diligence? Yes, it did. But it also gave me an opportunity to come here."

Boyle's "point of demarcation" in fund marketing is PaineWebber's 6,150 brokers in 300 branch offices. He's got eight mutual fund wholesalers and three "institutional" salespeople, the latter handling small companies and large individual accounts. The brokers' clients, PaineWebber president Grano likes to point out, have \$234 billion in assets at the firm — a goodly chunk of which he'd like to see squirreled away in "recurring fee" Mitchell Hutchins mutual funds.

Boyle has other salespeople focusing on Taft-Hartley accounts and will soon hire someone to focus on pension fund consultants. "We've had a number of consultants come in here on reviews," he adds, "and they like what they see. They want to see more." Conversations with consultants, however, suggest that they've not all been enthralled.

With performance records still being repaired or built from scratch in long-term bonds and equities, Boyle's big push has been in cash products, a mainstay of PaineWebber-brand funds. The Liquid Institutional Reserves money fund grew from \$369 million to \$1.2 billion in the first 11 months of 1996. "Price in any institutional cash offering is key," the marketing chief says, "but so are relationships. The number of companies that do not [yet] take advantage of short-duration and cash products is surprising. It's a great account opener."

A few Mitchell Hutchins clients, sensing a turnaround in progress, are adding funds. The San Antonio Fire and Police Fund recently tapped Mitchell Hutchins for a \$45 million allocation to the Russell 1,000 value index, adding to \$43 million in a Standard & Poor's 500 index and \$75 million in a Lehman Brothers aggregate bond index account. "We put more in based on performance and price," says fund executive director Weir Labatt. (Mitchell Hutchins is reportedly charging less than 16 basis points, just to hang on to business.)

"Yes, we lost some accounts," grants one PaineWebber source. "But sometimes a firm is decimated when even one key manager leaves. That we kept as much business as we did, to be honest, is a credit to marketing and client services." Notes CIO Tinch, "We kept about 80 percent of the [equity] assets."

Taken together Alexander's moves at Mitchell Hutchins have accomplished one absolutely critical goal: improving performance — if only in the short term. In the 12 months ended November 1996, 30 percent of the firm's equity mutual funds ranked in the top half of their Lipper categories, and 60 percent of fixed-income funds ranked in their top half. In bonds, at least, this was a marked improvement over 1994, when only 11 per-

Most pension consultants remain skeptical of Mitchell Hutchins's turnaround efforts.

cent of the group's long-term fixed-income funds ranked in the top half, and in equities it is no worse than its 1994 showing. Moreover, whereas in 1994 Mitchell Hutchins significantly underperformed its peers, it is more or less now on a par. (Mitchell Hutchins will not divulge its institutional fund performance.)

One year of good numbers do not a turnaround make, however, as myriad skeptics quickly point out. "They have changed the way they control things, with a risk officer," notes A. Michael Lipper, president of Lipper Analytical. "While the improvement is not total, it is broad-based. But you can't tell how much of this is because of the bull market. You never know until you have reversed the [market] cycle."

Alexander understands that changing the perception of Mitchell Hutchins will take time. "When I go out and say, 'Here's what we've done, here's our performance,'" she says, "there has to be proof of our people, our process and our philosophy. People take time to recognize change. They do not make casual choices with their money."

Yet Alexander, no doubt feeling pressure from her bosses at PaineWebber, is itchy to see results. "We're at \$43 billion, and our goal is to double assets," she states without flinching. Is this \$80 billion-by-2000-or-bust mandate at all realistic? "It had better be," says Grano, laughing. "It has my name on it."

For Grano and Marron, as well as for Alexander, the goal is urgent. PaineWebber lags its Wall Street competitors in money management: Last year the firm generated fund management fees of only about \$440 million, up some 10 percent from the year before but equal to only about 12 percent of PaineWebber's \$3.6 billion in net revenues, says Schroder Wertheim's Hanbury. By comparison, Smith Barney derives 21 percent of its revenues from money management, Merrill Lynch 19 percent and Dean Witter 30 percent. "They have to fix it, period," says Hanbury. "This will be even more important if the market rolls over."

Any downturn will hit a still-wobbly Mitchell Hutchins. Most of PaineWebber's growth in money management now comes not from new assets but from increased fees and from \$13.5 billion in wrap accounts, with the funds managed predominantly outside. Internally managed assets are at best flat — an ominous sign in this era of stupendous market growth. And considering that at least 56 percent of Mitchell Hutchins's business consists of cash products, the money manager's margins are probably respectable but far from lofty. Nor can PaineWebber jack up fees indefinitely, particularly in mutual funds. Its 198-basis-point average expense ratio on general equity funds is the highest of any major retail brokerage house, according to Lipper Analytical data.

What might it take to double Mitchell Hutchins's assets? "They need very cooperative markets, given that Mitchell Hutchins is coming off a lost decade, whereas so much of their competitors' growth was market appreciation," says one former insider. "They also need a star system — the mutual funds that have been successful have stars that brokers could get excited

about. And they need distribution, which is about the only thing they actually may have."

Mundane cash products could conceivably offer one avenue for growth. "There is a misperception that cash is a horrible business," says one Wall Street analyst. "It is not. The returns are okay." A firm can make a nice living off cash, provided there's enough of it and the money is sticky. PaineWebber gets an estimated \$150 million in gross revenues just from its \$24 billion in money market funds, a small fraction of which is in institutional cash accounts. But running cash is still a commodity

business. And if PaineWebber mounts a major foray into the institutional cash market, it will run up against huge players, such as Goldman, Sachs & Co., Federated Investors and Fidelity Investments, whose institutional money fund fees average a paltry 20 basis points or so, versus 63-basis-point expense ratios for the predominantly retail cash funds of Mitchell Hutchins. Barring a prolonged bear market, it's also a no-growth business.

Another option: grow long-term assets. "Everyone wants to grow to some higher level," says one major investment executive. "But Mitchell Hutchins cannot grow internally very rapidly, yet."

So what gambit could enable the firm to reach the magic \$80 billion? Buy assets

outright. Marron, Grano and Alexander seem quite prepared to go shopping for another money management firm. But deals are dear now — purchasers paid near-record average prices of 2.4 percent of assets in the 111 money manager deals struck in the first 11 months of 1996 (see Deals of the Year). Buying the \$37 billion in assets that Mitchell Hutchins would need to reach \$80 billion right away would hypothetically cost it almost \$900 million (on top of the at least \$411 million, in present dollars, that PaineWebber has spent on the existing Mitchell Hutchins business) and would probably take at least six years to pay for out of earnings. PaineWebber, however, had only \$199 million in cash on its balance sheet at the end of September. And its stock, at 28¹/₄, trades at nine times trailing earnings — a steep discount to the market. "If they want to grow by acquisition," concludes one money management guru, "it will be very expensive for shareholders, because money management firms sell for more than PaineWebber in the marketplace."

Nevertheless, no one at Mitchell Hutchins is backing off the firm's stated growth objective. "We are not done with this transition yet," Alexander asserts. "We've made fabulous progress in most asset [classes]. But we've got a tremendous amount to do to take that performance, take the organization, and market it. I have spent almost no time with clients, and that's something I want to do. Periodically, we want to have new products, we'll get into different distribution channels, such as 401(k). We will market to the brokers because, obviously, regaining their trust and confidence is critical. We'll market to institutions. Next year will be very critical in telling our story." One way or another — cautionary tale or turnaround triumph — the unfolding Mitchell Hutchins story is a money management fable whose moral won't be lost on the money management industry. Or on Wall Street. ■