INTEROFFICE MEMORANDUM

TO: SCOTT MALPASS, GRAFTON STREET PARTNERS
FROM: JOHN MCCARTHY
SUBJECT: TWENTY GOOD QUESTIONS
DATE: JULY 17, 2024

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1. **"For those who know Notre Dame, no explanation's needed. Those who don't, no explanation will suffice." - Lou Holtz**
   After so many years as part of Notre Dame, what is your perspective on this quote?

   Lou said it perfectly. Notre Dame is an incredibly special place: the students are talented, ambitious, and down-to-earth; the faculty are leading scholars in their field and care deeply about fostering an enriching experience for students; residential life is inclusive and supportive; the administration is focused on educating the full person; the campus is breathtaking; and most are united by their faith and love of sports. The energy on football Saturdays is also unrivaled. I feel very fortunate to have been a part of such a wonderful community for so many years.

2. **As an educator, regardless of specific subject, what do you hope your students come away with?**

   I hope to have positively inflected the arc of my students' lives, be it by influencing their career paths, equipping them with the skills to be successful, creating opportunities for mentorship, or at a minimum, helping them build practices that will serve them well throughout life. There is no singular right path, but I hope that through my teaching, students are better able to find theirs and walk down it with confidence.

3. **Many see the investment business as an "apprentice business". What is your perspective on how people grow as investment professionals?**

   It absolutely is. There is much that can only be learned through experience and being in the 'flow' of opportunities. Junior talent can be in that flow, but with the guardrails of great mentorship, can also avoid (or minimize) the consequences of poor decision making. Furthermore, standing on the shoulders of giants accelerates development meaningfully, particularly in the early to mid-years of one's career.

   That said, I am also a believer in the power of giving investment professionals significant runway and autonomy, so long as they have proven themselves capable of using that responsibly and productively. The most talented and ambitious people crave this and will work incredibly hard to be successful when given the chance. When you combine this motivation with aligned incentives, the result is a powerful driver of innovation, development, and results.

4. **Jean Marie Eveillard, Charlie Munger, Tom Russo, among many others, have stated that a key characteristic of great investors is "the capacity to suffer." Do you agree or disagree and why?**

   Agree; I believe achieving any form of greatness requires suffering. By definition, suffering is hard, particularly for extended periods of time. Generally that which is hard and painful is avoided, but it is also where real learning takes place. Thus, those who are able to endure suffering are likely to emerge the most knowledgeable, experienced, and with the best judgment.

   Furthermore, outlier investors are not merely right, they are both right and non-consensus. To be such, one must have developed and be able to sustain conviction in something that others do not. This requires hard work, insight, a willingness to engage with opposing views, differentiated judgment, and the conviction to maintain that perspective when the going gets tough. Of course, one must ruthlessly pressure-test their beliefs based on the facts that emerge over time, but those who do so and are proven right stand to generate outperformance.

5. **Do you have a view on the long-term debate between asset allocation and security selection?**

   Both are important. I take inspiration from Warren Buffet's quote that "When a management with a reputation for brilliance tackles a business with a reputation for poor fundamental economics, it is the reputation of the business that remains intact." Just as investors must pick the right industries to invest in, so must allocators pick the right asset classes and sectors to invest in. Simply put, great security selection can get you one or maybe two standard deviations above the mean in an asset class, but the portfolio mean is determined by asset allocation.

6. **Do most investors overvalue liquidity?**

   It is hard to generalize as every investor's priorities are different. Liquidity is essential, particularly for endowments or families that must meet annual operating budget needs. Having it when others do not enables one to capture outsized returns. However, the price of liquidity is the opportunity cost of higher returns often available in private equity or venture. So it must be balanced.

7. **Should all investors have an equity bias?**

   This depends on an investor's duration. That said, all investors with a time horizon of over 3 years or more should have an equity bias, yes. When I reflect back on my 32 years at Notre Dame, the lion's share of both absolute performance and alpha came from the equity asset class. That's where the power of compounding can really work magic over a long enough time horizon. This is the reason I started Grafton Street Partners. We're narrowly focused on the equity investing (both private and public) as the ultimate form of long-term compounding, identifying the areas within equities where the alpha is most repeatable and enduring, such as lower middle market buy-out funds, early-stage venture, industry-focused specialists, etc.

8. "It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price." – Warren Buffett
Do you share this view and why?

Yes. I believe the primary characteristic of a wonderful business is that is well positioned to grow cash flows predictably over an extended period of time. The vast majority of long-term equity returns are driven by earnings growth as opposed to yield. Thus, it is better to pay a fair price for a wonderful business than it is to pick up a few extra percentage points of annual yield for a business that is not growing.

Additionally, not so wonderful businesses often require significantly more managerial efforts or oversight, thus reducing one's capacity to find other wonderful businesses. Best to simply focus on high quality businesses in "right side of change" industries where a rising tide is lifting all boats.

9. "The rise of indexation" may be hard to measure but its widely seen as true. Is this a permanent (or very long term) phenomenon?

Unquestionably passive investing has gained in popularity over the last few decades and for good reason. This is a topic near and dear to my heart, given I sit on the board of Vanguard. The reality is that most investors do not possess the skill, temperament, and duration of capital to consistently outperform the market, and thus are best served by accepting the market return and seeking to minimize fees. That said, I believe there will always be a place for fundamental stock pickers. Over my career I've certainly identified some exceptional talent capable of sustainably outperforming the index, but it's incredibly rare, and it often requires long-term, patient capital and a tolerance for concentration and volatility.

10. Notre Dame has a reputation as a long time active and successful venture capitalist. Why does ND have this reputation?

When I became Chief Investment Officer of Notre Dame in 1988, it was very common for university endowments and pension funds to have limited to no exposure to alternatives. Private equity was still relatively niche and venture capital was a cottage industry. Perhaps it was due to my age at the time, but I approached these alternatives with an open mind and I think I appreciated their potential before many others. One of the venture capitalists I met was Don Valentine, whom of course we know today as the

legendary founder of Sequoia. We were one of the earliest institutional investors in Sequoia and partnered with a number of other storied venture firms, such as Accel, Andreessen Horowitz, and others. We stuck with many of these managers for decades and built real relationships and partnerships with them over the years. We tried to be helpful to them and would even invite them out for a football game every year so that they could see how special Notre Dame was and witness first hand the tangible impact that the endowment returns were having on the university. In turn they were helpful to us by allowing us to maintain our allocations after they became oversubscribed and referring us to promising up-and-coming managers. These are some of the factors that helped to build our franchise in venture capital.

11. Do you have standard methods toward Due Diligence, or does every investment need its own Due Diligence method?

There's generally a standard framework we follow for due diligence, although it's often tailored for the specific circumstance. Obviously, one needs to review, understand, and benchmark performance, understand how they evaluate and what they look for in companies. How they source, select, and win in competitive processes. How they add value. What their edge is. We want to ensure we understand what they are uniquely skilled at and how that will drive enduring superior performance. Is the space they are investing in attractive? Are incentives aligned? We also want to deeply understand someone's personal character. What makes them tick? What do they like to do in their free time? Essential in this process is getting character references, ideally from someone trusted in our network who will vouch for them.

Each investment is different though and thus one cannot simply use a checklist to complete diligence. Maybe there's a particular subsector focus that a fund has. In that circumstance, we would want to ensure we deeply understand that subsector, why it's likely to produce winning investments, who the other investors are, how have returns been across the industry historically, etc. Of course, there are additional processes for co-investments and direct investments, but I will spare your readers the details of how those differ at this time.

12. Do you have any frameworks for how you approach trimming or selling liquid investments?

I have always been a long-term investor, and it's hard to really benefit from the power of long-term compounding if you're constantly trading in and out of things. Ultimately earnings growth drives stock prices. As Ben Graham famously said: "In the short run, the market is a voting machine but in the long run, it is a weighing machine." At Grafton Street, we take what could be called a "private approach" to public markets, assembling a portfolio of right side of change businesses capable of predictably growing earnings in the low-to-mid teens consistently for the next five or more years. We also have a mostly tax-sensitive investor base and recognize that buying and holding high quality, growing companies leads to lower turnover, less tax friction, and as a result, much higher post-tax returns over time.[1] Given all of this, the bar for us to trim liquid positions is very high. That said, if the modeled go-forward return is no longer sufficiently attractive either due to a large run-up in the price, or because something has fundamentally changed, we will consider trimming or exiting the position.

13. Why have Private Credit strategies been growing for years in size and scope?

This really goes back to the Great Financial Crisis and the regulatory changes that followed. Among other impacts, these regulations increased the capital requirements on higher risk credit and put limits on the amount of leverage that regulated banks could provide. As a result, banks' appetite to issue public debt decreased, creating a gap that private lenders, who are not subject to the same regulatory requirements, were happy to fill. Demand for credit has only increased along with private equity dry powder, and the attractive returns that private credit strategies have yielded have increased the supply of capital as well. There are other good reasons for private credit to take share, such as there being a better match of capital durations (i.e., when making a 10-year loan, it's better to have a committed fund with a 10-

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[1] We ran some math on this for our last annual meeting, and the power of tax deferral shouldn't be underestimated. If you have two investment portfolios compounding at a 15% annualized rate over a 20-year period and one is held for the full 20-year period and sold in the final year, while the other has 100% annual turnover (a statistic that is not uncommon for active managers!), the annual post-tax return of the low turnover portfolio will be approximately 400bps higher, and result in a multiple of invested capital (13.3x MOIC) that is over twice as large as the hypothetical portfolio with 100% annual turnover paying short-term capital gains taxes (6.4x MOIC).

year lock-up than consumer deposits) and taking on less (or no) leverage compared to banks where 10 times equity capital is often typical. For all these reasons, I would expect private credit to continue to grow over the coming years.

14. How would you compare investing in commercial real estate now to 20 years ago?

Real estate has become much more institutionalized over the last 2-3 decades. Prior to the 1990s, real estate investing was mostly limited to a handful of wealthy families and pension funds, and lending was done mostly by banks and life insurance companies. Today real estate is in an asset class of its own that competes directly with stocks, bonds, and other financial assets. The big innovations that occurred to spur this adoption were (i) the rise of REITs in the 1990s, which allowed investors to allocate into real estate via a liquid, passive wrapper, and (ii) commercial mortgage backed securities (CMBS) issued by investments banks, which facilitated the increasing volume of investment activity.

Today the commercial real estate market is much more competitive (and efficient), but there's still room for good managers to deliver alpha through operational improvements, creative structure, and differentiated sourcing.

15. Infrastructure investing opportunities seem to be growing. Why is this happening and will it continue?

There's been a real shortage of investment in our nation's infrastructure for many years and the downstream effects of this underinvestment can no longer be ignored. We see these effects frequently such as with water contamination, rolling power outages, flight delays, and worsening traffic. These issues seem to have become more acute in recent years, particularly following the migrations that took place during COVID and the resulting stresses placed on local infrastructure. While infrastructure investing isn't a focus of Grafton Street Partners given the lower return profile typically associated with these deals, I would anticipate the opportunity rich environment in infrastructure to continue.

16. Investing in money managers or "GP Stakes" seem to be growing. Why is this happening and will it continue?

I think there are a few drivers for this increase in activity.

First, the founding partners of many money managers are nearing retirement age and recognize that their GP has become very valuable. In fact, their GPs have likely become so valuable in some cases that the junior partners could not afford (or would not like the personal portfolio concentration) to fully buy out their founding partners, thus creating the opportunity for a third-party solution.

Second, as alternatives have matured and become increasingly competitive, the resources and investment required to start a new investment fund have increased. As such, emerging money managers can benefit from an equity investment, or an anchor commitment, in order to get off the ground, professionalize, or build out a new strategy. Often that anchor investor can also make additional introductions that lead to more capital being raised, which helps the emerging manager reach break-even faster.

Third, I believe the market now increasingly appreciates the value of GPs due to their highly predictable annuity-like revenue streams as well as the upside potential from carried interest. There are some nice studies out there on the persistence of strong fund performance as well that further support this view. Given these factors, I think we'll continue to see more GP stake activity.

17. "Tech-enabled" businesses can be in various sectors. What does this term mean to you?

One of my core tenets at Notre Dame – and now at Grafton Street – is to invest behind *innovation*. Broadly defined, innovation enables productivity improvements, which in turn drive efficiency, and in non-perfectly competitive markets, improved profitability. There are many ways to invest behind innovation, the most obvious of which is in technology companies such as through venture capital, but also traditional businesses that are forward thinking in their application of technology. As you know, not all traditional businesses are focused on (or capable of) applying technology to improve their efficiency or to scale. To me, "tech-enabled" distinguishes traditional businesses that are front footed in their usage of technology from those that are not. We believe there is significant value to be created from

technology enablement, particularly for businesses with a moat or scale advantages, given the ever-accelerating pace of innovation, and the resulting potential for margin expansion, revenue growth acceleration, and multiple expansion.

18. Some investors say, "We like to work with founders." Others say, "It is time to professionalize the team." What are the risks of each approach?

As a business grows (or circumstances change), the needs of its leaders evolve. By implicitly promising not to change the CEO, or not having the control to do so, the true potential of a business may never be reached. This is why we think the most constructive role an investor – and particularly a non-control investor – can play is that of a coach. While it's nice to be a cheerleader, it's also important to hold founders accountable and speak clearly about the good, the bad, and the ugly. If they are falling short, particularly as an organization begins to really scale, it's important to have that frank discussion about any capability gaps and ways to address them. We would expect high-performing founders to appreciate such a discussion and be open to considering a variety of paths to best position their company for sustained growth.

Of course, there are risks to the alternative approach of 'professionalizing the team,' particularly with early-stage businesses where the customer understanding, key relationships, and product vision all sit with the founder. Even in more mature businesses, one risks degrading the culture, regrettable turnover, and execution missteps from replacing key leaders too quickly.

The key with either approach, it seems, is to be clear-eyed at the outset as to the capabilities of the team, filter out opportunities that will require changes that an investor is not willing to make, hold leaders accountable, and to be very thoughtful about any transition to mitigate the risks.

19. If you were to empower someone with Fiduciary powers, what type of traits would you look for?

Passion, curiosity, a strong work ethic, and healthy skepticism to relentlessly pursue knowledge and filter out that which is misleading. Attention to detail, structured thought, and confidence to convert that knowledge into convictions rightly held. Humility and a student's mentality to be open to new information and perspectives as they are uncovered. Focus and

discipline to know when to say "no" to opportunities that fall outside of an investor's circle of competence or mandate. Leadership and generosity to build a strong and loyal team. Integrity, gratitude, and a strong sense of purpose to always do right by their clients or trustees.

These are all values I've lived by throughout my career and ones I seek in both my team and partners.

20. If you were designing an Investment Committee for an institution with long term horizons, how would you go about it?

First, there should be a clear alignment of the objectives of the investment office. Is it primarily growth or generating current income? What returns and dividend yield should be targeted annually? This will influence the target asset allocation mix and thus could influence who should be on the Investment Committee.

Second, in terms of member selection, you'd like diversity of expertise of the members, loyalty to your mission (and a commitment to serving for a number of years; continuity is key), and significant real-world investing experience, ideally in the asset classes where you expect to have the most exposure. These members should ideally also have connections within the investing community and be willing to facilitate introductions, such as for back-channel reference checks or to prospective managers. The ideal size of an investment committee will depend on the depth and breadth of talent that a given organization can attract as you don't want to sacrifice quality, but somewhere in the 5 to 8 person range is good.

Third, there should be a clear and documented process for submitting investments, as well as ground rules around approvals, rejections, and potential conflicts. The chairperson should also ideally have experience running an investment committee as a part of their day job. Over time, it's important to develop a high level of trust between the investment committee and the investment team. This should be an intentional point of focus and be cultivated both inside and outside of 'work.'

While there are many aspects of creating an effective and high-functioning investment committee, these three foundational areas will help one build a solid foundation.