Bellwether CONSULTING

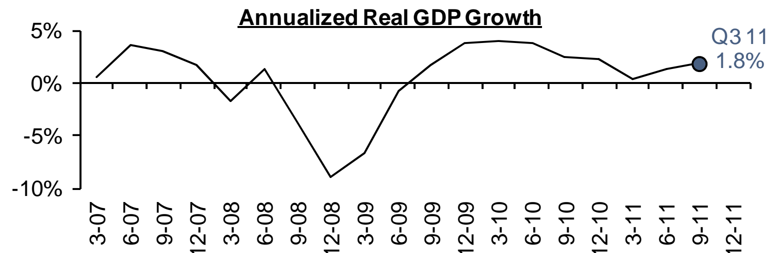
Your Quarterly Update on the Financial Markets
December 31, 2011

4th Quarter

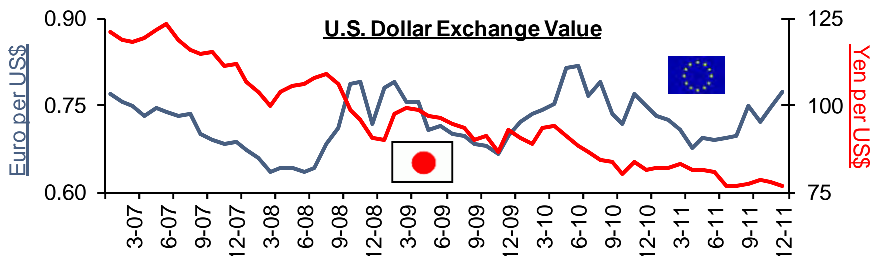
MARKET Recap

The Economy: *"Interest and Currency Currently Interesting"*

The US economy grew at a 1.8% annualized pace for the third quarter, a rate that satisfies neither growth-hounds nor doomsayers. As the latter camp ruled the stock markets in Q3, a year-end rebound in equity prices seems unsurprising. Government spending trends cancelled, with increased federal spending offsetting state and local austerity. Sharply higher non-residential fixed investment buoyed construction and manufacturing. Exports increased at a faster pace than imports, but as we'll soon discuss, we believe this is unlikely to persist.

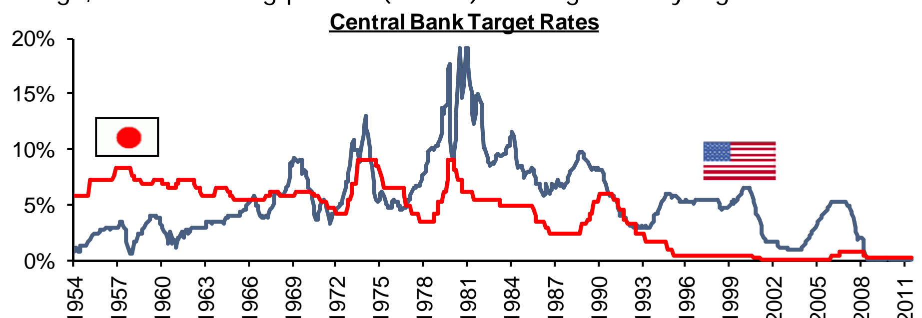


Fed-watching is a manic pastime for any serious student of financial markets. To make the experience more "interesting" this year, the Fed will issue a Playbill of sorts. Starting in February, they will reveal data on the range of forecasts they use for future levels of the Fed Funds rate. Already pundits are debating the outcome – will these forecasts ease concerns of inflation hawks by showing an intended path away from 0% rates? Will they soothe market jitters by providing greater certainty on continued near-term stimulus? Or, will they just confuse everybody? We say "hats off" to Mr. Bernanke for transparency, regardless of the outcome. For what it's worth, we see nothing at this point to suggest the Fed will back away from stimulus in 2012. Commodity prices fell another 4.5% in the fourth quarter, the CPI moderated, existing home prices declined nationally, and growth is not yet near the 3% target pace we've discussed in recent issues.



We remain very concerned over the unintended consequences of chronic low rates – deterioration of pension funding, solvency risk in money market funds, and erosion of long-term personal savings to name a few. Curious though is the lack (so far) of the *intended* consequence, stimulus of real growth. Why is the engine sputtering with the gas pedal mashed to the floor? One reason is the dollar's surging value since the Eurozone crisis truly began to blossom last summer. With US rates pegged at zero one would normally expect a dollar carry trade to develop, weakening our currency as investors borrow dollars cheaply and lend euro dearly. This in turn should promote domestic manufacturing and exports, boost employment, and support increased domestic spending. In other words, it should generate nominal growth and (eventually) inflation. However, the carry trade only develops if investors have confidence in the solvency of their investments – and clearly, no one has confidence in the euro at this point. Until the Eurozone situation stabilizes, we are skeptical that net exports (and therefore manufacturing) can drive US growth.

Not that the yen carry trade worked out so well for Japan, the modern-era master of low rates. The financial requirements of the carry trade worked – they had a large, solvent trading partner (the US) with significantly higher rates. However, their manufacturing base was ill-prepared for the emergence of China as an industrial giant. The result has been a lost decade (or two) of stagnation.



Lessons for us? First, Europe's problems do matter to us, in ways that are not always clear at a glance. Second, monetary stimulus alone does not guarantee growth. Having a sound banking system,

a competitive private sector, and reasonable fiscal policies are also critical. As citizens, we should watch these areas more closely – but as stock and bond market investors, we'll still watch the Fed!

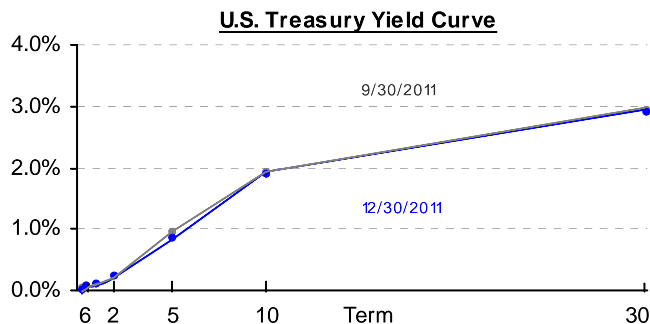
The US Bond Market

The fourth quarter of 2011 produced a bond market that seemed quite subdued. With volatility subsiding and the European financial crises averted (at least for the quarter), investors returned to riskier assets. High yield and emerging markets debt led for the quarter, returning 6.5% and 4.9% respectively, but no bond sector came close to the returns posted in the US stock markets. The story for the full-year was quite different. Low yields proved more appealing to investors than equity volatility, and the ensuing rally in US Treasuries (largely in Q3) drove credit markets, dragging yields lower in both investment-grade and high yield debt. This meant solid returns for investors that easily outstripped full-year equity returns in the US and abroad, as well as incentive for corporate borrowers to issue bonds.

Bond Indices - Total Return	4Q2011	2011
BarCap Aggregate	1.12%	7.84%
BarCap Interm. Gov't	0.68%	6.08%
BarCap Long Gov't	1.80%	29.15%
BarCap Interm. Credit	1.13%	5.37%
BarCap Long Credit	3.21%	17.13%
BarCap High Yield	6.46%	4.98%

However, good news for bond investors meant bad news for most US corporate pension plan sponsors, which use corporate bond yields to discount plan liabilities. With discount rates falling, pension liabilities increased. In addition, low-to-negative equity returns across the board only made it more difficult for unmatched portfolios to cover the widening gap between assets and liabilities. According to Credit Suisse, pension plan assets of S&P 500 companies now cover only 74% of estimated liabilities, representing a $450 billion deficit. To cover the required pension funding, some highly-rated companies are predicted to take advantage of low borrowing rates by issuing corporate bonds. However, eventual recognition of asset losses could also be a drag on some company earnings.

The quarter ended with US Treasury yields virtually unchanged from the beginning of the quarter. The benchmark 10-year yield ended the year at 1.88%, down 3 basis points from the close of Q3 2011 and down 141 basis points from the end of 2010. The yield curve flattened over the year with the spread between the 2-year and 10-year notes narrowing about 100 basis points, from 270 basis points at the close of 2010 to 165 basis points at the close of 2011. A flattening yield curve is often viewed as a signal of a coming recession. But when it is the result of direct Fed action instead of free market movement, we would argue it loses predictive value.



Source: Bloomberg LP

The big surprise for 2011 turned out to be the municipal bond market. The sector returned 10.7% in 2011 as measured by the BarCap Muni Bond Index, second only to TIPS (which returned 13.6% as measured by the BarCap US TIPS Index). At the end of 2010, many predicted 2011 would see substantial defaults on debt issued by municipalities, which includes local governments and other affiliated entities like school districts. With tax revenues falling, the federal government's fiscal stimulus coming to a close, and pension obligations increasing, the sector seemed more than challenged. And investors agreed. In the fourth quarter of 2010 and early 2011, investors liquidated municipal bond holdings, causing prices to fall and yields to surge. However, the wave of defaults never materialized. While the aggregate dollar amount of 2011 defaults was about twice that in 2010, about half of the $6 billion of debt that went into default was due to bonds connected with AMR Corp., the parent of American Airlines. (Corporate-backed muni debt, a small part of the sector, is typically issued through specially created local-government or airport authorities.) Only 1% of the 2011 defaults are related to tax-backed bonds from local governments and debt tied to essential services, such as power or water-and-sewer utilities. With yields in the first half of the year rising, issuance was scaled back in 2011. According to Thomson Reuters, municipalities sold $281 billion of bonds through the third week in December, the lowest annual total in a decade and 35% less than 2010.

The US Stock Market

While all major indices finished in the black for the fourth quarter of 2011 the yearly results were not as strong. The Dow Jones Industrial Average was the only major index to experience a slight price gain for the year; all others were relatively flat or down in 2011. The S&P 500 finished flat for the year experiencing its smallest annual price change in history (down 0.003%), with dividends chipping in about 2%. With the volatile third quarter still in recent memory, a flat finish does not seem so horrible. The year began with optimism about an improving US economy which drove stocks to a peak at the end of April. The US stock market's positive fundamentals helped it through the geopolitical strife in the Middle East and

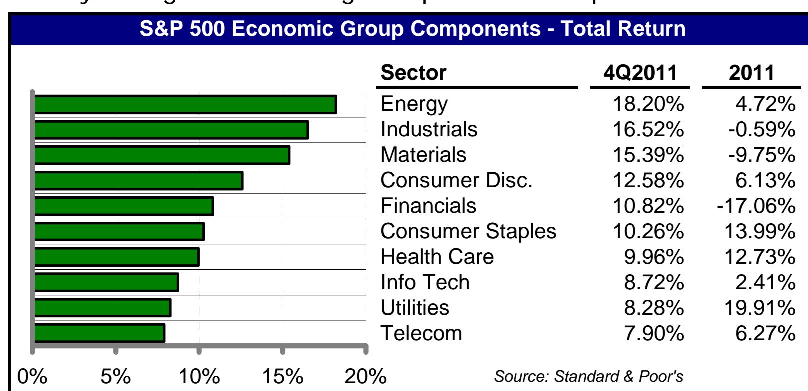
North Africa as well as Japan's earthquake, tsunami, and resulting nuclear crisis, but the market stuttered amid a torrent of headlines about Europe's debt crisis. Gridlock in Washington as a result of the debt ceiling extension debate followed by Standard & Poor's downgrade of the US credit rating in August added fuel to the already blazing financial markets, setting off another three months of uncertainty. The fourth quarter experienced its fair share of ups and downs as well. But some positive news in the US, specifically a decrease in the unemployment rate (8.6% in November) and an increase in retail sales during the holiday season, as well as some encouraging signs from Europe regarding their debt crisis helped the major indices finish in positive territory for the period.

Stock Indices - Total Return

	4Q11	2011		4Q11	2011
Largecap Stocks			**Midcap Stocks**		
S&P 500	11.82%	2.11%	S&P Midcap 400	12.98%	-1.73%
Russell 1000	11.84%	1.50%	Russell Midcap	12.31%	-1.55%
Growth	10.61%	2.64%	Growth	11.24%	-1.65%
Value	13.11%	0.39%	Value	13.37%	-1.38%
Broad Markets			**Smallcap Stocks**		
Russell 3000	12.12%	1.03%	S&P Smallcap 600	17.17%	1.02%
Wilshire 5000	11.95%	0.59%	Russell 2000	15.47%	-4.18%
			Growth	14.99%	-2.91%
			Value	15.97%	-5.50%

Smallcap and midcap stocks outperformed largecap offerings for the quarter as investors positioned for growth. This smallcap rally could be a sign that a broader market recovery is on its way as smaller, more nimble firms historically outpace larger companies in the early part of most rallies. Small and midcap stocks underperformed for the year as investors flocked to the safety of large, well established firms with the balance sheets to ride out the downturn.

Given investor risk aversion, defensive sectors fared best for 2011. Utilities, consumer staples and health care saw the strongest gains while the more cyclical sectors such as financials, materials and industrials were hardest hit. Financials took a beating with big banks fairing the worst as concerns over European bond market exposure resurfaced. However, with optimism growing during the fourth quarter the more cyclical sectors turned around. The energy sector experienced notably strong returns during the quarter as the price of oil rose amid fears of an Iranian oil blockade. Closing the Strait of Hormuz (waterway that borders Iran) would disrupt about a third of the world's tanker traffic and send oil prices soaring. The consumer discretionary sector was another top performer during the quarter. US retail sales were up during the holiday season and auto sales experienced a strong December as well, rising 11% from the previous year.


S&P 500 Economic Group Components - Total Return

Sector	4Q2011	2011
Energy	18.20%	4.72%
Industrials	16.52%	-0.59%
Materials	15.39%	-9.75%
Consumer Disc.	12.58%	6.13%
Financials	10.82%	-17.06%
Consumer Staples	10.26%	13.99%
Health Care	9.96%	12.73%
Info Tech	8.72%	2.41%
Utilities	8.28%	19.91%
Telecom	7.90%	6.27%

Source: Standard & Poor's

US IPOs declined this year, raising $36.3 billion in 2011, almost 10% less than in 2010, according to Renaissance Capital's Global IPO Review. Renaissance's report comments that these new US offerings significantly underperformed the broader market with an average loss of 12% and about two-thirds of all the stocks falling below their offer price. Internet IPOs filled the headlines this year with 24 internet companies going public, the most to do so in over a decade, but still well below the bubbly levels of 1999 which saw 212 offerings in the space. Overall these internet stocks did not fare very well with the average new issue in the sector down 18% for the year.

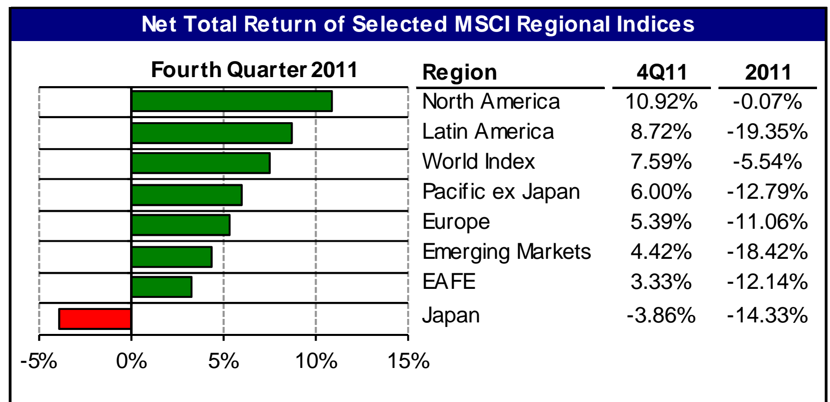
Overseas Markets

Global markets bounced back during the final quarter of the year, recovering some of the returns lost over Q3. Eyes remained on the Eurozone as sovereign debt concerns spread past the peripheral countries and threatened French and German banks. Skittish investors sought the safety of North American developed markets and while the quarter ended on a positive note with hopes of a better 2012, most regions closed the year with double-digit losses.

In the Eurozone markets were mixed, with impressive strength out of Ireland (+22.4%) due to successful implementation of harsh austerity while recommitting to its favorable 12.5% corporate tax rate. Notable weak performers included Portugal (-9.5%) and Spain (-2.2%). Euro countries must make a choice. Stand together, with the weaker countries imposing harsh austerity on the populace and giving up a portion of their government's sovereignty; or dissolve the union, with the struggling nations leaving the euro and implementing some form of default, either outright or through inflation, to get their national debts down to manageable levels. European central bankers are insistent that a unified Europe with a common currency is the only way. Not to let a crisis go to waste, the IMF stands ready to expand its power and influence with bailout funds. The European Union's critical summit in early December offered an opportunity for member nations to make headway towards a debt crisis resolution, but left investors with little confidence of a favorable outcome. At the summit, EU leaders worked on a potential agreement that would call for more fiscal unity among the 17 Eurozone gov-

ernments, including penalties for violating budgetary restrictions. Déjà vu to investors who remain skeptical of the tough talk with little action.

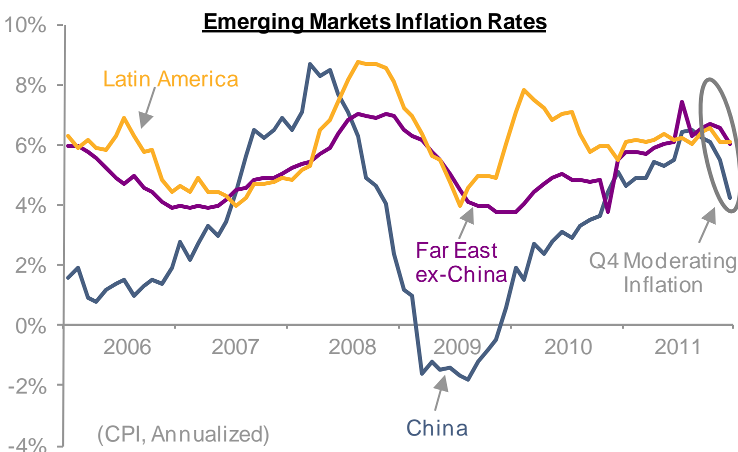
The European Central Bank made multiple moves over the quarter to shore up its fragile banking system, including a significant emergency loan and a loosening of capital requirements to member banks. Hundreds of European banks rushed to take out €489 billion ($640 billion) worth of low-interest loans from the European Central Bank in late December. ECB officials had hoped the lifeline would calm illiquidity fears within the banking system. Concerns resurfaced a week later as investors quickly realized the size of the ECB loan was dwarfed by bank liquidity issues. In addition, banks face collateral pressures as more lenders now require troubled banks to post assets as insurance against default. To ease concerns, the ECB loosened rules on the types of assets banks could use as collateral.



Region	4Q11	2011
North America	10.92%	-0.07%
Latin America	8.72%	-19.35%
World Index	7.59%	-5.54%
Pacific ex Japan	6.00%	-12.79%
Europe	5.39%	-11.06%
Emerging Markets	4.42%	-18.42%
EAFE	3.33%	-12.14%
Japan	-3.86%	-14.33%

In Japan, a potential record budget deficit, negative balance of trade, and stagnant economic growth made for a lackluster fourth quarter. In an attempt to stimulate its slumping economy, Japan's cabinet approved a 2012 budget that includes record-high spending of ¥90 trillion ($1.15 trillion). With a looming debt-to-GDP ratio of 250%, Japan's economy is as gridlocked as a city morning rush hour. And more debt seems not the cure for insurmountable debt. Another sign of economic troubles, Japan reported a ¥685 billion trade deficit in November. Traditionally a strong exporting nation, Japan has faced multiple natural disasters that affected the country's strong infrastructure and supply chains. In addition, massive flooding in a key trade partner, Thailand, and fears of a global economic slowdown have added pressures to Japan's exports. Downgrading its assessment of the economy, Japan's central bank held its target rate at 0%. Rates have been held at ultra-low levels since the early 1990's when Japanese stock and housing bubbles came to an abrupt halt, causing anemic growth for nearly two decades.

In an attempt to weaken its currency during the quarter, Japan's central bank intervened in markets for the third time this year with the largest single-day unilateral intervention, selling about ¥10 trillion ($128 billion) in order to weaken the yen against the dollar and euro. A weaker yen would bolster the country's export driven economy by making Japanese products more competitive abroad. Although temporarily halting the yen's strength, many analysts say the yen's role as a safe haven amid the European crisis will cause further unwanted upside pressure.



Over the first three quarters of 2011, inflation worries have been front and center of any discussion on the sustainability of China's growth. Easing concerns in December, China's Consumer Price Index dropped 200 basis points from last quarter to 4.2% year over year. The reading is the lowest level of the year, and underscores a recurrent theme in many emerging markets: moderating inflation. Allowed to go unchecked, China's Central Bank officials know slowing inflation can quickly turn into a deflationary spiral, undermining the entire economy and banking system. As a result, China kept interest rates unchanged during the quarter and stimulated its economy using its preferred monetary policy tool, cutting bank reserve requirements for the first time in nearly three years. Growth is clearly a focal point of Chinese central planners, who also saw the country's official purchasing managers' index drop from 50.4 in October to 49.0 in November. Readings below 50 signal a contracting economy. As part of an ongoing story of bringing the yuan onto the world stage, China and Japan announced a series of deals that promotes the use of the yuan in trade between the two countries. Bouncing back from last quarter's selloff, the MSCI China Index added 8.1%.

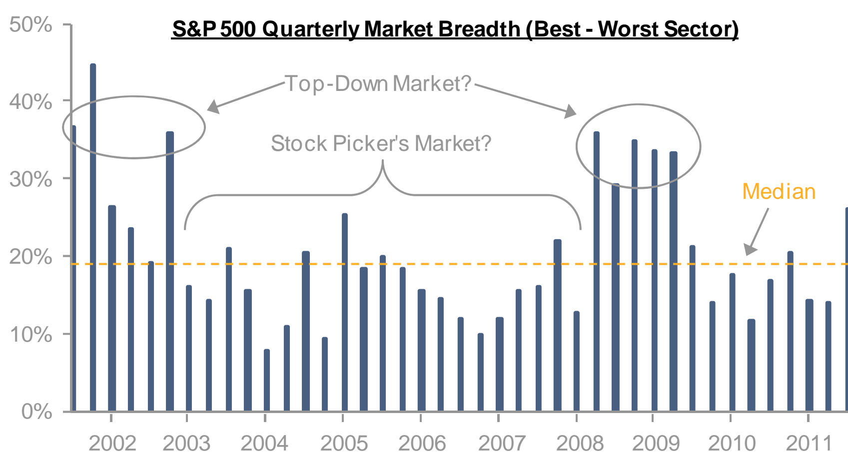
The MSCI EM Latin American Index rebounded 8.7% over the fourth quarter. In the region, the story of moderating growth and inflation has caused central banks to loosen their monetary policy levers. Brazil's GDP growth slowed to a crawl in Q3. From a height of 9.3% in Q1 2010, Brazil's annual GDP growth has fallen precipitously to 2.1%, prompting central bank officials to reduce interest rates twice over the quarter to 11.00%. While inflation remains elevated at 6.64% as of December, Brazil's monetary policy officials are betting that a slowing economy is more of a threat than inflation.

Argentina's markets have been volatile as investors try to gauge what the re-election of President Cristina Kirchner in October means for the markets. Mixed government policy decisions and internal struggles among Mrs. Kirchner's team have compounded uncertainty and are causing capital flight from the country. The weakest Latin American performer, Argentina's markets shed 2.7%.

Generally mirroring the rest of the world, Far East inflation rates moderated during the quarter in all countries of the region except one. Thailand's inflation rate remained unchanged as the major monsoon flooding that started in July has led to upward price pressures. Highlighting the global nature of the European debt crisis, the central banks of Indonesia, South Korea and New Zealand held key interest rates unchanged in December, awaiting more clarity of how the situation will play out among Eurozone leaders and bankers. Underscoring the uncertainty, Indonesia's central bank is preparing for counter-cyclical policy measures as it expects a global economic slowdown. During the quarter, Indonesia's parliament approved a law to speed up the building of much needed new infrastructure, including roads, ports and power plants. Overall, Far East markets improved in Q4, with notable boosts in Thailand and Malaysia of 11.5% and 11.7% respectively.

Focus On: *Top-Down vs. Bottom-Up Approach*

Global financial market turmoil has created a risk environment driven predominantly by macro events such as global debt concerns and a fragile world banking system. Like a tennis match, all stocks regardless of merits or proximity to international events bounce rapidly back and forth based on headlines out of Europe. Greek Prime Minister Papandreou calls for a referendum vote on an EU debt rescue package: the Dow Jones Industrial Index jolts lower 200 points. Papandreou calls off the referendum: the index serves up a 250 point gain. Italy's borrowing costs hit an all time high: the Dow smashes down 200 points in sympathy. While many of us may enjoy a good tennis match, we'd rather see it played on the main courts of Wimbledon than in the financial markets with our retirement savings.



Managers frequently distinguish themselves as "bottom-up" stock pickers or "top-down" macro managers and will describe each quarter's trading environment as favorable to one approach or the other. If stock pickers underperform their benchmark in a quarter and claim top-down market momentum drove quarterly performance, not superior company fundamentals, should we lend an understanding ear to their claims?

With macro events clearly in the driver's seat, headlines out of Europe pressuring global financial markets can be frustrating for those seeking stable investment returns within the United States. "Why do we care about Greece and Italy?" plan-participants ruminate. Herein, we take a statistical approach to answer the question: is there a significant difference in returns between bottom-up stock pickers (relying exclusively on security selection) and top-down managers (relying on asset class, style, or sector selection)? Furthermore, are there categories (i.e. largecap growth, high yield) where one approach consistently outperforms?

Top-Down and Bottom-Up Defined

Within actively-managed funds, we categorized investment approaches into two broad groups: those fund managers that focus mainly on security selection to drive performance (bottom-up) and other fund managers that give consideration to the macro environment when making investment decisions (top-down).

Bottom-up managers assert that their analysis is at the security level *only*. They consider company financials, advantages among competitors, management expertise, relative valuations, and look to invest in the best companies regardless of their sector or industry. A sector overweight or underweight may occur in their portfolio, but it is strictly because they have found more attractive opportunities in a specific sector. Contrarily, top-down managers incorporate sector selection and style tilts (i.e. growth vs. value bias) based on their evaluation of the broader economy. Essentially, they adjust the fund risk and sector positioning to be more aggressive if they are bullish and more conservative if they are bearish on the economy. For example, a bearish high yield bond fund manager may shift the portfolio credit quality to overweight BBs and underweight the riskier CCCs. Likewise, a bearish largecap equity manager may rotate holdings into traditionally defensive sectors like utilities and consumer staples.

In summary, bottom-up managers look at the world through a microscope while top-down managers prefer the view from 30,000 feet. Since financial markets in the US are heavily influenced by global events, we will explore and expect to find a difference in returns achieved by top-down and bottom-up managers.

Using eVestment Alliance as our data source, we examined 14 specific investment categories, including the nine US equity style boxes (i.e., large, mid, and smallcap each for value, core and growth strategies), three US allcap equity categories, emerging markets equity, and high yield bond funds. To ensure consistency within each category, we only examined funds that shared the same benchmark. Funds with less than a 5-year track record and fund managers that gave no guidance on the source of their value-added alpha (bottom-up vs. top-down) were eliminated.

Bottom-up funds were defined as those where the manager claims security selection drove 90% to 100% of alpha. Top-down managers, on the other hand, attributed at least 20% of alpha from a combination of sector selection, style tilt, country/region selection (for international funds), or duration and yield curve positioning (for fixed income funds). We then compared the mean returns of the two groups for 3- and 5-year total returns, and 2006 through 2010 annual returns, and tested the difference in returns for statistical significance.

Few Findings of Significance

A typical choice for statistical hypothesis tests, we ran each test at a 5% level of significance. This simply means if we find a difference in average returns between the bottom-up and top-down approach, we can be 95% confident the difference in means is truly representative of the entire investment category.

Within the nine US equity style boxes, we found no statistical significance within most categories and return periods. In other words, we can not have confidence the returns between bottom-up and top-down managers are meaningfully different. The one exception is the 2006 annual returns for large-cap value, indicated by a green box in the table "Statistical Significance of Investment Returns". When considering allcap funds, we found a statistically significant difference in allcap core 5-year returns and allcap growth 2006 annual returns. Finally, we found a distinction in returns among the high yield category 5-year returns.

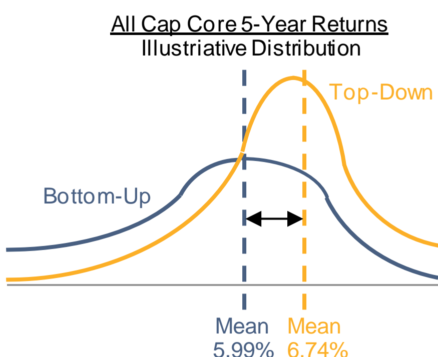
Statistical Significance of Investment Returns

Fund Categories	3-Year	5-Year	2006	2007	2008	2009	2010
Large Cap Core	0.34	0.29	-1.25	0.22	1.17	0.05	-0.61
Large Cap Growth	-0.42	-0.93	-1.21	-1.57	1.01	-0.81	-0.13
Large Cap Value	0.59	1.09	2.05	0.21	1.64	-0.99	-0.17
Mid Cap Core	-0.74	-1.45	0.45	-0.99	-0.79	-0.29	-0.01
Mid Cap Growth	-0.15	-0.39	-1.59	0.36	-0.96	0.18	0.14
Mid Cap Value	0.10	-1.06	0.16	-1.05	-0.89	0.27	0.67
Small Cap Core	0.01	-0.05	1.19	0.84	-1.10	0.86	1.00
Small Cap Growth	-0.59	-0.70	-0.68	0.32	-1.00	0.06	-0.55
Small Cap Value	-1.36	-1.06	0.92	0.39	-0.50	-1.04	-0.35
All Cap Core	1.38	2.73	-1.12	1.28	1.38	0.09	0.76
All Cap Growth	1.41	0.87	-2.56	-0.27	-0.34	1.14	0.98
All Cap Value	0.99	1.15	1.65	0.80	-0.10	0.98	0.94
EM Equity	-1.28	-1.29	0.31	0.54	-1.12	-0.45	-0.90
High Yield	1.39	2.23	-0.30	1.38	1.68	-1.08	-0.79

A t-statistic of +/- 2.00 indicates statistical significance at 95% confidence

Interestingly, top-down managers outperformed over 5-year total return periods in market categories that allowed for more freedom to move within a broader set of investment options as opposed to being constrained by a specific style box (i.e. largecap growth). For instance, an allcap core fund can shift between small-to-large cap and growth-to-value biases based on top-down macro views, whereas largecap growth funds are constrained to only largecap securities. Taking advantage of these additional strategy levers, top-down managers seemed to gain an edge over fund managers that focused more acutely on bottom-up security selection.

Similarly, the 5-year returns of high yield bond top-down managers outperformed bottom-up managers. A shift in portfolio credit quality is a main lever top-down high yield fund managers can use to express a bullish or bearish market view. In trying times, shifting portfolio credit quality out of riskier CCCs could help avoid defaults, thereby boosting returns of the savvy top-down manager.



As they are over only a 1-year period, the differences in 2006 annual returns within largecap value and allcap growth have less meaning because full market cycles have not played out. We view the statistically significant differences in returns within the investment categories as anomalies since (1) no pattern of significance was identified in any other annual returns and (2) the significant 2006 results could just be a short-lived period of time where one approach had an advantageous portfolio positioning mid-market cycle.

Top-Down vs. Bottom-Up Analysis – Not a Holy Grail to Superior Returns

Overall, the data suggest that neither approach is systematically better than the other. In most categories, the results delivered are not meaningfully different. Therefore from a policy perspective, there is little reason to prefer one approach to the other. When searching for an active manager, we would not create "top-down" or "bottom-up" mandates, nor would we screen for a specific approach. We would also not seek to construct multi-manager portfolios with an expectation that a certain blend of these approaches would generate better expected outcomes.

It is tempting to believe that the approach matters in a small number of very broad categories, like allcap equities or high yield. Indeed we found statistical significance in four specific fund categories/timeframes, but we view these results with a critical eye with two main reservations. First, market cycles take years to play out. Over a 5-year window, there may be 3 – 4 economic inflection points or sustained changes of sector leadership where a top-down manager has the opportunity to differentiate fund returns on a macro level. For statistical purposes, the sample of decision points is small; however, extending to a longer timeframe of observation reduces the number of available managers for observation, and increases the risk that a significant number of managers will have changed their approach during the observation window.

Secondly, a fund manager's perceived investment approach may not represent reality. In other words, a bottom-up manager may actually incorporate more top-down analysis than they acknowledge. If a manager compares, for instance, investments based on Porter's five competitive forces, they make top-down investment decisions based on the relative attractiveness of several sectors without necessarily acknowledging it as an alpha driver.

To swipe a large brush over the entire fund universe and assert top-down funds are better than bottom-up funds (or vice-versa) would be a mistake, as markets are complex ever-changing landscapes. While macro-factors may be driving markets today, it is no holy grail to superior investment returns.

The Right Time to Care

If the manager's approach is not meaningful from a policy perspective, should we care at all when a manager proclaims a bias? Absolutely! It would be a mistake to apply aggregate market observations to a specific manager – just because the average person is 1.6 meters tall doesn't mean that you are. For a specific manager, their approach may explain a great deal of their performance, or not – it is up to the analyst to determine that. However, since there is no policy-level reason to prefer a specific approach, the consideration of approach should occur after the screening process, during the selection and evaluation of individual finalists. It should also be part of the ongoing evaluation process for current managers.

When considering fund managers we place emphasis in evaluating the clarity of their decision making-process, soundness and sustainability of their investment thesis, depth and stability of the investment team, and the process and risk controls employed as potential drivers of fund performance. The manager's stated approach is important, in our view, in evaluating the decision-making process. Regardless of the manager's approach, we believe it is important that strategy, portfolio positioning, and historical results be consistent. For example, if a manager claims that their top-down views are a driver of results, we look to see that their current portfolio has meaningful overweights and underweights that are consistent with their current view – and that their performance history shows evidence of added value through sector allocation as opposed to security selection.

So while we don't prefer one approach to the other, we believe strongly that a manager's stated strategy and execution should be aligned. Absent that, we can't develop confidence that the manager has a chance of delivering superior results. In other words, if the manager cares, we care – but only in the context of evaluating the manager.

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