

# THE PILLAR

Fourth Quarter 2010

Beacon Wealth Management

Issue XXIII

## Manager Selection

You can't make a decision without knowing all the facts. As Advisors we can either make all the investment decisions ourselves or utilize other managers that excel in their respective areas. Reality is that one person alone cannot possibly decide to buy, sell or hold with 100 percent success rate across every position. At Beacon, we believe portfolio management is dynamic and invest across multiple managers, each with a proven historical track record of success and depth of understanding in the particular asset class they manage. Our firm's number one client objective has always been that of principal protection and preservation; however, we continually strive to enhance portfolio performance utilizing a proactive management selection process.

Generally speaking, our investment managers have expertise in specific markets, asset classes, sectors, geographies and strategies. We conduct proper due diligence and follow a systematic process for manager selection that is both qualitative and quantitative. Some of the factors we consider include investment philosophy, use of fiduciary best practices, alignment of client objectives, approach to risk, and calculation of past performance over a significant period of time. The firm's selection allows Beacon not just to pick great managers; but it also provides a guideline for the dismissal of a manager if they cannot sustain performance as compared to the appropriate benchmark for that asset class.

## Beacon characterizes the 6 major areas of assets as follows:

1. **Equities**- This is the stock portion of the portfolio. Beacon will break this category down to include value and growth as well as foreign, emerging markets and the size of stocks either large or small.
2. **Bonds**- This class will include high quality, high yield, and convertible bonds as well as foreign bond, and emerging market bonds.
3. **Commodities**- Commodities includes grains, gold, silver, oil and natural gas. Clearly it has become an asset class that deserves specific attention and allocation.
4. **Alternatives**- This tactical portion of a client portfolio is a dynamic asset class built on domestic and global macroeconomic conditions and is designed to capture opportunities in the market.
5. **Equivalent**s- This class is a strategic position that increases or decreases depending on the allocation to equities. When the equity allocation goes down this class will increase in size and vice versa.
6. **Cash**- All accounts need to have a liquid portion and some clients need more cash than others. In many cases, it is usually in a money market fund.

## Manager Statistics and Selection

All managers publish statistics and a number of independent sources including Morningstar, Thomson, and Reuters provide the data we need to perform a complete analysis. Beacon recognizes that performance is not just simply a flat number — it is composed of risk, variability, and a total correlation with the market. For example, if a fund returns 10 % and the market returns 8 % the initial consensus is that 10% is preferred. However, we may find the risk level on that same fund is two times as risky as the market and hence might not select that specific manager. To also assist in the selection, we will evaluate:

1. Performance over time
2. Correlation with the market
3. Worse time periods
4. Best time periods
5. Comparison to peers that invest with the same thesis

*(Continued on reverse side)*



6. Comparison to the stated objectives of the fund
7. Losses - If there is a loss what time does it take to recover from a loss
8. Performance during bull markets (up markets)
9. Performance during bear markets (down markets)
10. Alpha- the performance excess over simply investing in the index
11. Sharpe ratio and information index comparison or more specifically how much return variability and what caused it.

In order to excel in today's difficult financial environment, we have found multi-year performance comparison is essential to manager selection. This multi-year evaluation compares all the statistics and works to eliminate managers that are hot for a short period of time and then underperform. No manager will be the top manager every year. A manager may be stellar for 10 years and then have a bad year that is significantly worse than the market. At Beacon we try to focus on managers that do better in negative years. This characteristic tends to keep the manager in the top 25% (quartile) of managers over a ten year period, which is an enviable position. This process is built on the numbers but also on my personal experience of over 25 years and witnessing how managers react to the market ups and downs. The statistics are the initial separators but the philosophy of principal protection first is always at the forefront of our review of managers.

Beacon believes that manager selection is an art as well as a science. Finding that manager is only the beginning, you then need to keep them on your radar and under continuous review. Our firm prides itself on an open architecture to find the best manager in that asset class and adheres to the guiding philosophy of managing our client's money as if it was our own. In our view, it is the only way to invest.

Sincerely yours,



Mark S. Germain, CFP®, MBA  
Founder and CEO

