



Investment Philosophy



INVESTMENT PHILOSOPHY

We believe it is crucially important for investment decisions to be made within the framework of a clearly defined investment philosophy using a highly disciplined and consistently applied investment management process. Our conservative investment philosophy is based upon Strategic Asset Allocation. Each client's return requirement, risk tolerance and investment time horizon are assessed in the planning process to determine the appropriate asset allocation. Our primary objective is to minimize risk first, then to achieve a reasonable rate of return within the given risk parameters.



1. OUR INVESTMENT PROCESS STARTS WITH YOU, THE CLIENT.

YOUR GOALS, TIME HORIZON, REQUIRED RETURNS, RISK TOLERANCE, AND LIQUIDITY NEEDS.

We then apply modern portfolio theory and design an appropriate portfolio for you based upon the principles of asset allocation.

2. IMPLEMENT PORTFOLIO DESIGN

After we have determined the proper asset classes and their weightings, we seek investments to implement our strategy. We have a rigorous screening process. We filter over 10,000 mutual funds by:

- Appropriateness of investment philosophy
- Asset class and style
- Buy and sell discipline
- Manager tenure
- Performance
- Style consistency
- Investment process
- Fees
- Access to portfolio manager for frequent fund updates
- Comparison of holdings vs. philosophy

3. ONGOING MONITORING AND EVALUATION

We continually monitor and evaluate your portfolio on three levels: asset class weightings, style management, and security selection. We follow a strict process that is overseen by our Investment Policy Committee of senior planners and is executed by our Chief Investment Officer and his team on a daily basis.

Asset Class and Style Weightings - We closely monitor the valuation of each of your asset classes. This valuation analysis is a two-part process. The first step is to compare the relative valuation between the various classes in the portfolio. The second step is to then look to the longer-term historical valuation within each asset class. If we perceive that a particular asset class looks under or over-valued we will change the weighting of



that class in your portfolio. Relative valuation is very important to us—we always look for assets that are under-valued to one another today and by historical standards:

- Stocks vs. Bonds
- Domestic vs. Foreign
- Large vs. Mid vs. Small
- High Grade vs. High Yield
- Investment Style
 - Growth vs. Value
 - Long vs. Short

Our investment policy dictates that we will only overweight or underweight an asset class by up to a maximum of 10%. The primary objective of the asset class weighting changes is to add value by reducing risk. Any further over- or underweight may actually increase risk by decreasing diversification.

Monitoring of Investment Securities - We monitor your holdings and will change them based on:

- Strategic reasons
 - Strategic asset class or style weighting changes as above
- Specific reasons
 - Investment philosophy change on the part of the manager
 - Manager change
 - Style drift
 - Performance

ASSET ALLOCATION

Asset allocation is the primary factor in explaining the variation in the rate of return between different investment portfolios. According to a landmark study by Brinson, Beebower and Singer (and subsequently validated by several others), more than 90% of the total return of a portfolio is derived from the way in which the assets are allocated among the various asset classes. Market timing and actual security selection each contribute less than 5% to the overall investment return on a portfolio.

When designing a portfolio based upon asset allocation principles, there are three primary elements to consider: asset class returns, the volatility of each asset class (standard deviation), and the relative price movement between the various asset classes (correlation).

When analyzing asset class returns, we first calculate the long-term historical rates of return. Additionally, it is very important to understand the relative return between the various asset classes over long periods of time. Understanding this relationship allows greater predictability on how each asset class will contribute to the rate of return on the portfolio.

Measuring and understanding the volatility of each asset class is critical. Generally speaking, the rate of return on an asset class relates directly to the volatility (risk) of the asset class. When measured over long time periods it is generally true - the higher the rate of return, the higher the risk.

The relative price movement (correlation) between the asset classes is the last crucial element in building a portfolio. Combining different asset classes with low correlations with one another will reduce risk in portfolio. This is the heart of diversifying a portfolio.

By considering these three elements and testing them by utilizing sophisticated software, we are able to combine the different asset classes to design an efficient portfolio, one that balances an acceptable level of risk with a statistically predictable range of returns.



THREE PRIMARY LEVELS OF PORTFOLIO MANAGEMENT

After the basic asset allocation is determined we employ a disciplined process of strategic management to the portfolio. We continually monitor and evaluate the portfolio on three levels: asset class weightings, style management, and security selection.

ASSET CLASS WEIGHTINGS

We closely monitor the valuation of each asset class. Our valuation analysis is a two-part process. First we compare the relative valuation between the various classes in the portfolio. The second step is to then look to the longer-term historical valuation within each asset class.

When we identify a significant valuation differential between assets classes on a relative basis, we then look to the historical range of valuations for each asset class. If we find the relatively overvalued asset class is also in the high range of historical valuations, then we will underweight that asset class in favor of the most undervalued asset class. The primary consideration in making this change is risk reduction. The more overvalued an asset class, the more likely it will eventually revert back to a more normal valuation. Generally, the undervalued asset class also will perform quite well because it too reverts back to its more normal higher valuation.

An overvalued asset class is often the most popular at the moment. The overvaluation plus the popularity generally mean this asset has the highest risk going forward. Our disciplined process is designed to avoid being caught in the herd mentality. This discipline is paramount since our primary objective is to minimize risk.

Our investment policy dictates that we will only overweight or underweight an asset class by up to a maximum of 10%. The primary objective of the asset class weighting changes is to add value by reducing risk. Any further over- or underweight may actually increase risk by decreasing diversification. This is an extremely important consideration. We do not make large bets on any single asset class or attempt to predict the direction of the market. And above all; we do not believe in, nor do we attempt to, 'time the market' by moving in and out of the market. Our philosophy is to be fully invested at all times.



ASSET CLASS WEIGHTINGS

Investment managers utilize many techniques to evaluate stocks. However, in the simplest form there are two basic styles of equity investing: growth and value. Buying stocks of companies where the earnings are increasing rapidly is called growth investing. The most common type of value investing is buying companies at low price-to-earnings ratios or at low price-to-book value ratios. There are many variations of these styles. A combination of the two styles is commonly referred to as a blend style and has some elements of both.

Within each equity asset class we carefully monitor the earnings. The level of earnings and the growth rate of earnings will vary in each asset class. If the earnings outlook within a particular asset class is positive, we may elect to skew the security selection toward the growth style. If the earnings prospects overall for the class are not strong, we will emphasize value. Each asset class may have differing earnings and earnings growth prospects. Therefore, the style emphasis may be different between the asset classes.

We consider bond style based upon the average maturity of the bonds, or specifically, the duration. Investment managers generally classify duration on bonds into short, intermediate or long duration. The duration or average maturity of bonds reflects their sensitivity to changes in interest rates. Our interest rate outlook will determine whether we opt for a longer or shorter average maturity across the bond asset classes. If we feel it is likely interest rates will go down, we will slide toward longer duration bonds. If we believe rates may increase, we will skew more toward the shorter duration bonds.

In equities, our investment policy allows us to take a maximum of a 75% style bias in any single asset class. If we do not have a strong conviction on a style within a particular asset class, we will structure a neutral or blend position within the class. In bonds we will generally use a 100% allocation to the chosen duration within each asset class. We do not consider Real Estate or Commodities to have distinct styles within the asset class.



SECURITY SELECTION

Our investment vehicle of choice is open-end mutual funds. We can, and occasionally do, use virtually any other publicly traded security. However, our preference for mutual funds is based upon some important criteria; first and foremost is safety. The safety is a function of the very broad diversification offered by mutual funds. An individual fund's holdings may range from dozens of individual securities up to literally hundreds. This allows us to build portfolios with the kind of diversification that generally accrues only to the largest institutional investors. Intensive research, professional management, liquidity, and style purity are a few of the other important considerations.

For a fund to qualify for inclusion in our portfolios it must possess certain quantitative and qualitative criteria. On the quantitative side, we start with a database of over ten thousand funds. We have developed a set of specific screens for each of the different asset classes and styles of funds. These screens are applied initially to select a core group of funds for more intensive evaluation, and then utilized regularly to monitor the continued acceptability of the fund. The most important of the qualitative criteria are: a well conceived, logical and persistently applied investment philosophy consistent with the asset class and investment style used; strong and deep analytical capabilities; long manager tenure; appropriate buy and sell disciplines for the asset and style managed; above average long-term performance; and perhaps above all, direct access to the portfolio manager.



OTHER CONSIDERATIONS

Socially Responsible Investments - Many people try to do good while they are trying to do well with their investments. We find there are many definitions of socially responsible investing. We encourage our clients to support the socially responsible causes of their choice and work with us on specifics. We support a socially responsible portfolio that encompasses many of the most common socially responsible causes: clean environment, no tobacco, no alcohol, no gambling, no nuclear power and no weapons manufacture.

Industry Weightings - Industry sector weightings are consistently monitored across all asset classes and portfolios. We are careful to make sure that the other portfolio decisions have not inadvertently allowed too high a concentration in any single industry or group. Having too many investments in narrowly defined industries or sectors defeats the benefits of broad diversification and risk reduction that underpin our investment philosophy. We utilize sector specific funds within the specialty asset classes to balance our industry positions.

Taxable portfolios - Tax considerations in taxable portfolios are very important. We go to great lengths to harvest losses, manage timing of gains and losses, avoid distributions, and to generally manage the portfolio as tax efficiently as possible. However, it is our policy that the investment decision must come first. The tax consideration will be the secondary factor in investment decisions.

Decision Making Process - This clearly defined, and highly disciplined investment management process is guided by our Chief Investment Officer. As he leads the research team through this rigorous daily analysis, he closely monitors and reviews all aspects of the process to assure compliance with our investment philosophy. All research findings and recommendations are presented to our investment committee. This committee, which is composed of all senior advisors in the firm, makes the final investment decisions.