Investment Manager Selection: November 26, 2008

The Multnomah Group utilizes a rigorous, multi-step process to select investment managers for our clients. The purpose of this document is to briefly explain the process as it relates to investment manager selection.

Investment Process

In short, our investment selection process is as follows:

1. ***Define the investment universe-*** We start by looking at the universe of diversified, domestic investment managers. At this point the only screen in place is to identify unique portfolios with a five year minimum track record.
2. ***Define the peer group-*** For domestic equity funds we categorize managers based on their relative exposures to growth vs. value and large cap vs. small cap. While this is similar to a Morningstar Style Box our process looks at a fund's exposure to each of the asset classes rather than placing a fund in one particular asset class. The overall fund classification is determined by employing a returns based analysis.
3. ***Analyze sources of excess performance-*** We break a manager's return down into three parts:
    a. ***Returns against a benchmark-*** We employ an explanatory model composed of several indices that are representative of the asset classes in a global marketplace using statistical regression analysis. This is referred to as style analysis; it provides us with a thorough perspective as to the origin of the manager's returns.
    b. ***Returns attributed to selection and timing-*** Value added (or subtracted) by the manager can be separated into a manager's skill at security selection within the benchmark universe and the manager's ability to time the market by moving in and out of asset classes during the course of a market cycle. We focus on identifying manager's that have an investment process focused on adding valuing through security selection decisions.
    c. ***Consistency of excess returns-*** We employ a metric called the "information ratio" to identify how consistently a manager is able to add value. This aids in identifying if the manager has skills that add value or if the manager's performance is attributable to random luck.
4. ***Review additional quantitative factors-*** Our ultimate goal is to identify funds that not only have done well in the past but will do well going forward. To do this we analyze the following additional factors:
    a. ***Style consistency-*** We are looking for managers that consistently and accurately provide exposure to the asset class while adding value on top of asset class returns through security selection decisions. Style analysis helps us identify a drift in a manager's allocation.
    b. ***Expenses-*** Because a fund's performance is measured net of fees any small difference in fees can significantly impact performance.
        i. ***Expense ratio-*** This is the fee that is charged by the investment manager for managing, marketing, and servicing the fund. While significant, it does not capture the total expenses associated with investing in the fund.
        ii. ***Turnover ratio-*** Besides the explicit expense ratio, fees in the form of brokerage commissions and market impact are also paid by investors when trading is done in the portfolio. While these fees are not disclosed, we use turnover ratio as a proxy for additional costs passed onto shareholders.
5. ***Review qualitative factors-*** We focus not only on how a manager performed but why a manager performed in a certain market.
    a. ***Investment philosophy and process-*** In an effort to better understand why a manager performed the way they did we look to their investment process. "How is the selection process employed?" or "How is the research conducted?" are typical questions we ask to see if the manager's process is repeatable.
    b. ***Manager tenure and experience-*** We want to be confident that the fund's results are from the current manager and not a manager who is no longer with the fund.
    c. ***Firm stability-*** Factors such as employee and executive/leadership turnover, ownership structure, and general organizational stability help to reassure us that the fund will not have to be removed in the near-term due to organizational restructuring.
    d. ***Shareholder friendliness-*** The key issues for the fund companies here are their willingness to close a large or rapidly growing fund, their inclination to limit fast traders, their limitations on using soft dollars, and their philosophy toward fees.
    e. ***Asset Base and asset growth in portfolios***- We evaluate whether the manager has an understanding of the size of the portfolio that they can manage effectively before the portfolio's performance is affected.
6. ***Make recommendations***- Based on our analysis of the quantitative and qualitative factors we ultimately narrow down our recommendation to a manager we deem suitable for inclusion in a client's investment lineup. Our final recommendation is made to the Investment Committee who provides the final approval or declinations of our recommendations.