1st Global®
RESEARCH & CONSULTING

OUR BELIEFS ABOUT INVESTING

The 1st Global Philosophy for Disciplined, Long-Term Investors

Contents

Introduction and Purpose

It is an undeniable truth that the future is inherently uncertain. None of us can know with certainty what will happen in the next decade, next year, next month, next week, tomorrow or even a minute from now. As people, the reality of our uncertain futures creates feelings of anxiety. To manage these feelings, we take action to bring order, clarity and reason to the future beyond our control. When we think about our families, those around us we care about and the institutions we belong to — like our churches or alma maters — we feel a sense of responsibility to their futures, not only to our own. To create certainty for our loved ones where uncertainty exists, we all take a simple action: we make promises. Promises to live deep into our retirement and never be a burden to our loved ones. Promises to charitably give back to our communities and the institutions important to us. Promises to save for down payments on our first houses. Promises to send our children to the universities of their dreams. These promises are intensely personal to each of us, and they serve as bonds of honor in which our commitment to their reality stands firm in the face of uncertainty.

1st Global's purpose is clear: **to enable intentional living**. We believe that personal responsibility, honoring promises and having the courage to do what's right are the catalysts for a life filled with joy, meaning and significance.

The purpose of this paper is to define our beliefs about investing. Called our philosophy, this paper reflects a system of beliefs, values and tenets. In addition, our beliefs also reach into the classical definition of philosophy, defined as the "rational investigation of the truths and principles of being, knowledge or conduct."

Philosophy

For ages, philosophers have debated the concept of certainty. As Ludwig Wittgenstein said, "No one but a philosopher would say 'I know that I have two hands.'"[1] While we, too, could debate the philosophical concepts of certainty and knowledge, for purposes of this paper, we operate with the belief that investing with certainty is an unattainable goal.

Instead, we're concerned with describing a series of beliefs that guide our actions. These beliefs are important not only because they determine the actions of 1st Global and our investment management decision makers but, more importantly, because we can deliver the greatest results for our clients when we have mutual agreement in these beliefs. We also hold our beliefs in the more traditional sense of a philosophy as we rationally continue to further our understanding of the truths and principles behind investing. Investing is both a science and an art and has a rich history of brilliant ideas that have shaped the past and will influence the future. We believe there is much yet to be learned, and 1st Global is committed to this philosophy as a journey of discovery and intelligence.

Long-term investing is a journey filled with perceptual hurdles, cognitive mistakes, nuance, hard analysis

[1] *Wittgenstein, Ludwig. Zettel, (Berkeley: University of California Press, 1967).*

and constant change. However, knowing what you believe helps to illuminate the path before you more clearly, and your conviction precedes the great action of honoring promises to those you love.

1st Global's Beliefs about Investing

1. Intellectual rigor, discipline, patience and a faith in the future matter.
2. Diversification, asset allocation and efficiency are separate and distinct concepts.
3. Asset allocation matters more than product selection.
4. Disciplined and automated rebalancing improves results.
5. Minimizing losses improves the compounding power of wealth.
6. Investing in stocks has rewarded investors over the long term.
7. Emotions influence investor behavior.
8. Market timing does not work over the long term.
9. Predicting the future is fraught with great uncertainty.
10. Skillful managers can be identified.
11. Listening and advice are the most critical factors when guiding investors.

Intellectual Rigor, Discipline, Patience and a Faith in the Future Matter

Intellectual rigor — Rigor is defined as "strictness in judgment or conduct" or "maths, logic: logical validity or accuracy."[2] Whether economic, mathematical or behavioral, to us, intellectual rigor means being thorough in exploring the science behind investment planning, portfolio construction, asset allocation and investment manager due diligence. Shortcuts and opinions abound; however, it is only those truly committed to the hard work of discovering and understanding the truths behind their actions who maximize their chances of success over the long term.

Discipline — We believe the discipline to budget, plan, save and invest are critical to honoring promises. Reducing short-term temptations and delaying gratification are, and have been, critical factors in helping the emerging affluent and affluent make the uncertain future less uncertain. It is difficult to stay the course when your emotions are trying to overcome your logical thoughts and reasoning abilities. It requires discipline to continue with a comprehensive plan in the face of short-term fears.

Patience — Our invested wealth is predominantly designed to fund long-term future promises. Our

[2] rigor. (n. d.). Collins English Dictionary — Complete & Unabridged 10th Edition. Retrieved Aug.27, 2010, from Dictionary.com website: http://dictionary.reference.com/browse/rigor.

short- term promises are usually funded through stable sources, such as money markets or bank accounts. For many of us, our invested wealth is funding promises 10, 20 or 30 years away. In fact, a 61-year-old couple has a joint life expectancy of 30 years; a 72-year-old couple, 20; and an 86-year-old couple, 10. Surely this highlights the reality that long-term plans are critical for many of us. So why obsess about short-term momentum and noise? Focusing on these often forces us to pay the price of giving up **what has historically worked**.

Faith in the future — Renowned author and speaker Nick Murray describes his faith in the future in the following way: "This is the first characteristic of all successful long-term investors. It is impossible to invest successfully in a future of which one is fundamentally afraid. Thus, the great enemy of investment success isn't ignorance, but fear. All human experience goes to teach us faith in the future, and especially faith in the American economy and its markets. The problem arises when media suggests that some economic or market setback is new and different: terrible in an unprecedented way, and therefore a disaster you'd better jump clear of."[3]

Diversification, Asset Allocation and Efficiency Are Separate and Distinct Concepts

While it is academically correct to consider these a single, comprehensive concept, it is important to eliminate naïveté by understanding the possible distinctions between these concepts to ensure a complete understanding of the power of portfolio efficiency.

Diversification is analogous to the age-old adage "Don't put all your eggs in one basket." Naïve investors often practice diversification by selecting more than one financial advisor, and naïve financial advisors often practice diversification through product proliferation. At its core, diversification allows investors to reduce business-specific risk. This means that the fortunes of any single company will not have a significant impact on an investor's fortune. Many studies have been conducted on random investments in stocks and have found that as the number of securities increases, business-specific risk decreases. Indeed, because diversification can be accomplished easily, business-specific risk is also considered uncompensated risk. This is the basis of index investing, which reduces business-specific risk to a high degree and substantially provides investors with exposure to an overall "market." This solid principle is incomplete when implemented in isolation.

Asset allocation builds on the notion of diversification by looking at security or investment risks in the context of a broad portfolio rather than in isolation. Asset allocation incorporates the idea that correlations — the relationships between investments or asset classes — matter in creating a portfolio. By combining investments that exhibit low correlations to one another, portfolio volatility can be reduced. Volatility refers to "standard deviation," which is simply a mathematical way of referring to the dispersion of outcomes surrounding a portfolio's expected return. By combining asset classes or investments with differing outcomes, the overall dispersion of returns is reduced, and thus, the volatility in the portfolio should be reduced over the long term. However, the process doesn't stop here.

Efficiency is the answer. To produce the best possible asset allocation, given an investor's unique risk

[3] Murray, Nick. "Six Steps to the Ninety-Ninth Percentile." Nick Murray Interactive (subscription required), February 2006.

tolerance, it is necessary to go through the exercise of finding the one "efficient" portfolio (combination of investments or asset classes) that will satisfy the highest level of expected return for the maximum tolerated level of volatility (as measured by standard deviation). More than 60 years ago, Dr. Harry Markowitz, advisor to 1st Global's Investment Committee, set forth what is known as mean-variance optimization in portfolio choice. This technique allows an investor to find the "optimal" portfolio that is right for him or her based on the choice of asset classes and investments.

Mean-variance optimization requires an investor to collect projected returns, standard deviations and correlations of the chosen asset classes. Once that is completed, one can construct a set of portfolios for which there is none that yields a higher likely return and a lower uncertainty of return.4 While portfolios can be naïvely diversified or illogically allocated and still offer some investor benefit, these approaches create "sub-optimal" portfolios. As Dr. Markowitz said in in his Nobel Prize-winning work, "It cannot be said of two efficient portfolios that 'the first is clearly better than the second since it has a larger likely return and less uncertainty.' All such cases have been eliminated."[5]

Asset Allocation Matters More Than Product Selection

In a 2000 study conducted by Ibbotson and Kaplan[6] (defended in 2010 by Xiong, Idzorek, Chen and Ibbotson), the importance of asset allocation policy decisions was explained. In these studies, the researchers asked how much of a portfolio's return variation is determined by the manager's decisions about how to allocate investments among various broad asset classes. Their answer revealed a critical difference from the often-cited 1986 study by Brinson, Hood and Beebower.[7] The 2010 study looked at the three major components of return (the market, asset allocation decisions and active management) and concluded that "taken together, market return and asset allocation policy return in excess of market return dominate active portfolio management."[8]

In fact, "the market movement component accounts for about 80 percent of the total return variations

[4] Markowitz, Harry M. "Portfolio Selection." 1959: p. 6.
[5] Ibid.
[6] Ibbotson, Roger G., and Paul D. Kaplan. "Does Asset Allocation Policy Explain 40, 90, or 100 Percent of Performance?" Financial Analysts Journal Vol. 56. No. 1 (January/February 2000): 26–33.
[7] Brinson, Gary P., L. Randolph Hood, and Gilbert L. Beebower. "Determinants of Portfolio Performance." Financial Analysts Journal Vol. 42. No. 4 (July/August 1986): 39–44.
[8] Xiong, James X., Roger G. Ibbotson, Thomas M. Idzorek, and Peng Chen. "The Equal Importance of Asset Allocation and Active Management." Financial Analysts Journal Vol. 66. No. 2 (March/April 2010): 22–30.

and dominates both detailed asset allocation policy differences and active portfolio management."[9] While this important study did go on to say that "within a peer group, asset allocation policy return in excess of market return and active portfolio management are equally important,"[10] we must further explore the meaning of this statement. First, we recognize that the 2010 study confirms 1st Global's belief that asset allocation decisions matter, as it says that, taken together with the market, these two components can account for 100 percent of return variations.

So, what about the seemingly equal weight of active portfolio management? While active management has the potential to matter meaningfully, as properly indicated by this study, in the aggregate, active management is a zero-sum game — it is highly dependent on the fund(s), the peer group and the period being analyzed.[11] Remember, when active management is used, it is positive for some and negative for others. This highlights the need for an investor to choose his or her proper asset allocation (positive) before considering active management (positive or negative).

For more information on 1st Global's active manager due diligence process, please see our companion paper, "The 1st Global Investment Manager Due Diligence Process: Enabling Promises Through Intellectual Rigor and Institutional Standards."

Disciplined and Automated Rebalancing Improves Results

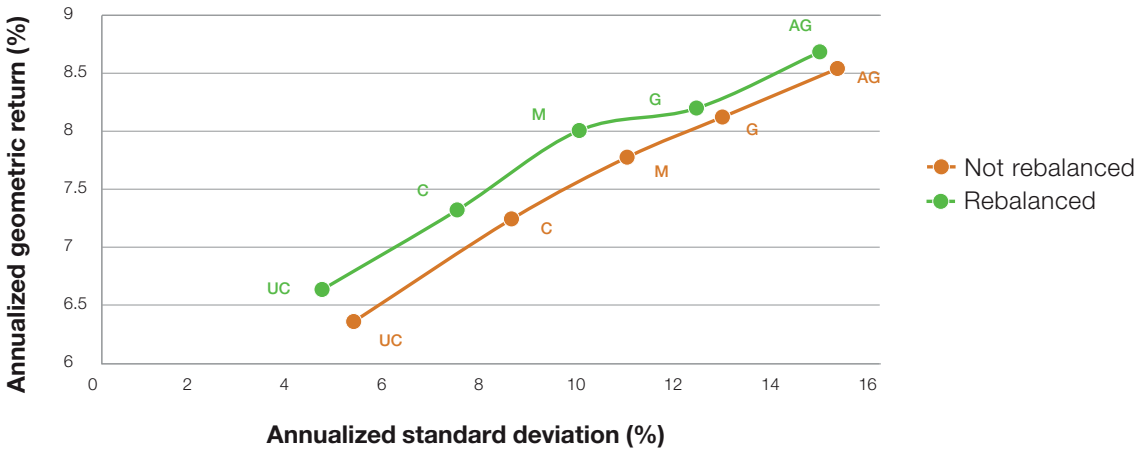
Periodic and automated rebalancing is a recognized way to help control the emotional tendencies of investors to buy high and sell low. Such an approach effectively forces investors to sell high and buy low. Rebalancing strategies are designed to realign a portfolio back to its initially established asset allocation model or the "target" weightings of individual investments within a portfolio. By executing this technique on an automated basis, such as each year or when an asset class drifts beyond a 5-percent tolerance band, emotions are removed from the process, and discipline is introduced. While humans generally suffer from believing that they are in possession of some unique knowledge, typically, deciding when to rebalance is an ineffective strategy, as it introduces emotion back into the process.

On the following page, we present how the power of rebalancing would have impacted 1st Global's strategic asset allocation risk profiles over a long-time horizon. Assuming a 5-percent asset class tolerance band, the results show that a disciplined rebalancing policy increased compounded return, reduced risk or resulted in both across all risk profiles. The graph on the following page shows that rebalanced portfolios (in green), using asset class data going back to 1992, demonstrate both higher geometric (i.e., compounded returns) and lower levels of risk (standard deviation) compared to their un-rebalanced counterparts.

Using compounded returns is critical as it relates to terminal value of a portfolio, but even if arithmetic returns are considered in combination with the reduced standard deviations that one may achieve by rebalancing, a dramatic improvement in risk-adjusted return occurs. Sharpe ratios (which measure a portfolio's excess return over and above the risk-free rate divided by the portfolio's standard deviation) show a notable improvement across each risk profile.

[9] *Ibid.*
[10] *Ibid.*
[11] *Ibid.*

Risk/Return Comparison: Rebalanced vs. Unbalanced Asset Allocations January 1992 through December 2016



Source: 1st Global Advisors, Inc. Past performance is no guarantee of future results. Please see the disclosures at the end of this paper for additional information regarding this analysis and its limitations.

In addition to the direct impact on returns and risk reduction that rebalancing has been shown to provide, there is also the more subtle aspect of keeping the client's risk profile in line with his or her objectives and considerations. As an example of this, the domestic large-cap equity portion of these hypothetical portfolios with moderate risk profiles was extracted and compared on a graph. As of January 2017, the target weighting for this asset class in the moderate risk profile was 31 percent. It is not surprising that the rebalanced portfolio generally stays within plus or minus 5 percent of the target of the total portfolio, as this is built into our rebalancing rules. However, most clients would be stunned to realize that, if left unchecked, the drift of the asset class could effectively migrate the portfolio into another risk profile altogether. For instance, in the example below, the un-rebalanced moderate portfolio drifted to nearly 48 percent in domestic large-cap stocks, an even greater concentration in this asset class than our growth and aggressive growth models.

Deviation from Target Weight — U.S. Large-Cap Stocks: Moderate Risk Profile January 1992 through December 2016

Source: 1st Global Advisors, Inc. Past performance is no guarantee of future results. Please see the disclosures at the end of this paper for additional information regarding this analysis and its limitations.

Minimizing Losses Improves the Compounding Power of Wealth

The principle of compounding of returns is one of the most powerful yet least appreciated forces in investing. However, not all investors and their advisors are aware that return compounding is as much a force multiplier on the upside or a devastator of capital on the downside as it is an incremental component of returns, which many solely regard it as.[12]

Unlike the commonly understood concept of compound interest, compounding of returns works both to reduce wealth as much as increase it. Consider this simple example. Three investors start new portfolios, each with a $10,000 investment. The investor in Portfolio A loses 12 percent during the first year before gaining 20 percent in the second year, for an annual compound return of 2.8 percent. The investor in Portfolio B manages to avoid some of the losses of Portfolio A, losing only 8 percent. This investor does not make as much in his portfolio in year two, only 15 percent, but has achieved a slightly higher ending value and an annual compound return of 2.9 percent. The investor in Portfolio C has the best of both worlds, a smaller loss (only 8 percent) and a bigger gain (20 percent), and ends up with an annualized compound return of 5.1 percent, more than 2 percent higher than Portfolio A or B. By minimizing losses, we keep from having to make up as much ground to get back to where we were. A 20-percent loss requires a 25-percent gain to get back to the starting point, whereas a 10-percent loss only requires an 11.1-percent gain to get back to the start.

The Power of Compounding Returns

	Starting Investment	Return in Year 1	Return in Year 2	Ending Investment	Annualized Return
Portfolio A	$10,000	- 12%	20%	$10,560	2.8%
Portfolio B	$10,000	- 8%	15%	$10,580	2.9%
Portfolio C	$10,000	- 8%	20%	$11,040	5.1%

This is a hypothetical example used for illustrative purposes only and is not meant to represent the returns of any specific investment.

Remember that, at its core, asset allocation seeks to increase the overall return from a portfolio for a given degree of risk or to reduce the overall risk from the portfolio for a targeted level of return. For asset allocation to achieve successful investment results over any meaningful period, an investor must have some sense of long-term perspective and purpose in the execution of such a program in order to maximize the “force multiplier” effects of compounding.

[12] *Ryan, Timothy. “Return Compounding: Essential Insights and Practical Implications.” The Journal of Performance Measurement. Spring 2003: 42.*

Investing in Stocks Has Historically Rewarded Investors Well over the Long Term

The chart on the next page illustrates the calendar returns for each year for the general U.S. stock market over the last 192 years. The horizontal axis shows each year's return in "buckets" of 10-percent returns. Positive returns are displayed to the right of the dotted line, and negative returns are on the left. You can see that, over this very long period of time, the largest "stack" (in terms of numbers of years) is above zero and is in the same bucket as the average arithmetic annual return for the period (9.41 percent). While the history and performance of the U.S. stock market has not necessarily repeated itself in other countries around the world — and a bit of "survivorship bias" shows up in this chart — it is nonetheless quite illustrative of how important ownership of stocks is for the growth of capital for investors.

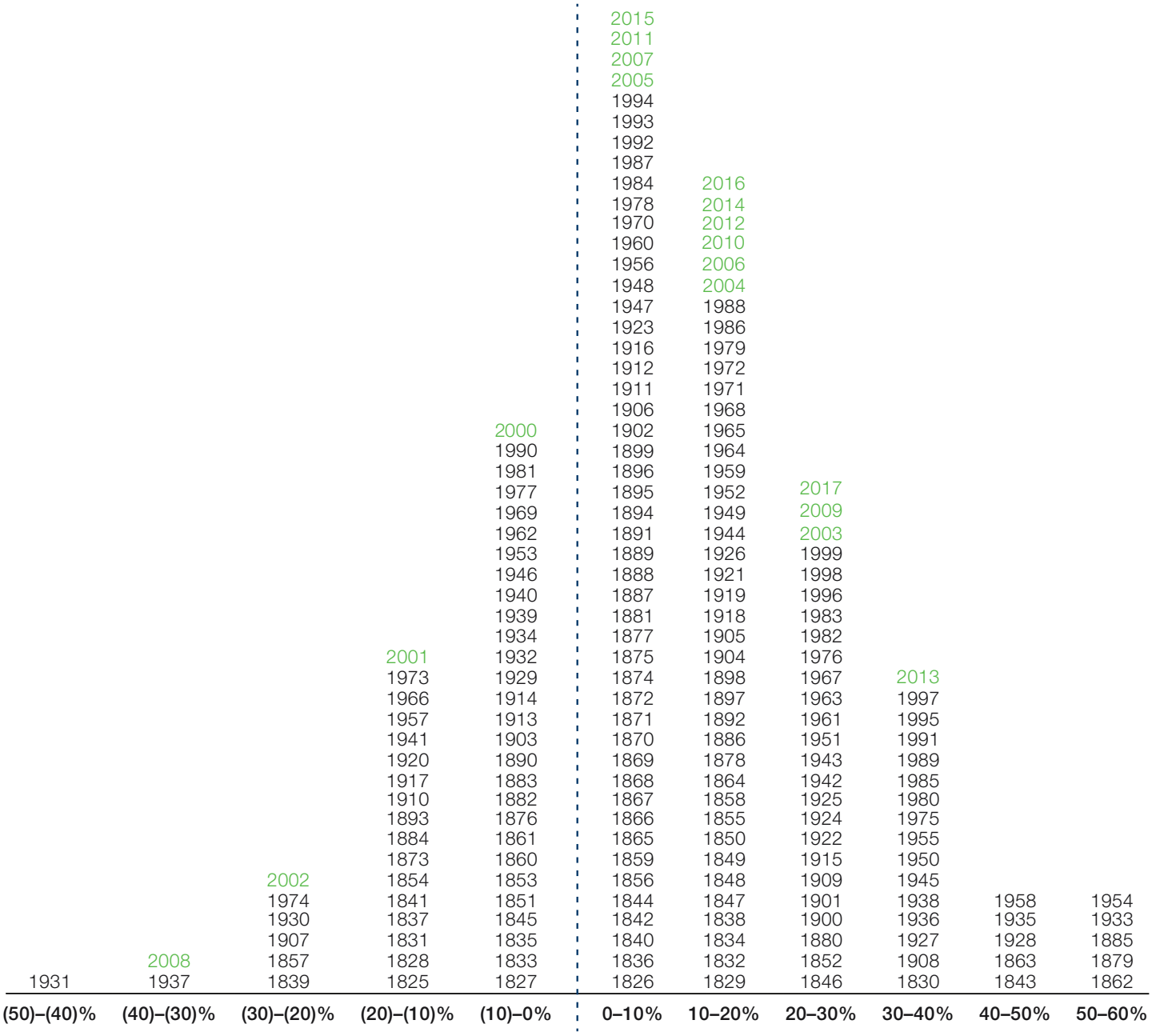
The shape of this "histogram" (the amount of years in each 10-percent bucket) is also important to review when attempting to gain perspective of the frequency of large gains and large losses in the U.S. stock market. Extreme returns (either positive or negative) are not frequent occurrences. While past performance is no guarantee of future results, the U.S. stocks have historically rebounded after periods of negative performance.

Reversion to the mean (average), also called regression to the mean, is the statistical phenomenon stating that the greater a random variable deviates from its mean, the greater the likelihood that the next variable will be closer to the mean. In other words, an extreme event is likely to be followed by a less extreme event.[13]

For investing, the concept of reversion to the mean is more subtlety refined to suggest that prices and returns eventually move back toward a long-term historical mean or average. An intuitive way to think about mean reversion in a time series of an asset class (for example, large-cap U.S. stocks) is to assume that returns react to any deviation from the long-term average. If the return is above the average in one period, it is unsustainable over multiple periods and may likely be followed by a lower return figure, and vice versa. As a result of mean reversion, long-term equity returns are considered to be less risky, which induces an increase in the optimal allocation over shorter periods of time.[14] The concept of long-term mean reversion in stock returns has been widely documented in investment literature.

[13] Weisstein, Eric W. "Reversion to the Mean." From MathWorld — A Wolfram Web resource. http://mathworld.wolfram.com/ReversiontotheMean.html.
[14] Koijen, Ralph S. J., Juan Carlos Rodriguez and Alessandro Sbuelz. "Momentum and Mean-Reversion in Strategic Asset Allocation." EFA 2006 Zurich Meetings. Jan. 27, 2009. Available at SSRN: http://ssrn.com/abstract=687205

Perspective on Long-Term Equity Returns (1825–2017)



Source: Annual U.S. equity returns for the period of 1825 through 1925 are republished from "A new historical database for the NYSE 1815 to 1925: Performance and predictability" by William N. Goetzmann, Roger G. Ibbotson and Liang Peng as published in the Journal of Financial Markets 4(2001) 1–32, pp. 27–30, using the "Total return with low dividends" return series; annual U.S. equities returns for the period of 1926 to the most recent year end are that of the Ibbotson Associates SBBI US Large Stock Total Return Index (USD) obtained from Morningstar Direct.

The implications of this for investors are contained in our belief that emotions negatively impact returns. If investors buy when values are above the mean, they increase the probability of losing money. If they sell below the mean, they also increase the probability of losing money. If cheap investments will probably rise, and expensive investments will probably fall, these factors play a critical role in behavior,

expectations and timing. In a 2009 study by Koijen, Rodriguez and Sbuelz, the researchers concluded that the decision of how much to allocate to stocks was more heavily influenced by the mean-reverting nature of equity returns if an investor has an investing horizon of greater than five or six years. For shorter investing horizons, momentum is more of a factor in explaining equity returns. A well-known prediction of standard strategic asset allocation studies is that the fraction of wealth that an investor allocates to stocks is directly related to his or her investment horizon.

This result typically refers to a problem that usually takes a 15- to 20-year perspective and focuses on mean reversion. This study shows that short-term investors should respond to price momentums, while long-term (more than five years) investors should generally ignore momentum in favor of mean reversion.[15]

Emotions Negatively Influence Investor Behavior

For the 20 years ending Dec. 31, 2017, the average U.S. investor in equity funds realized an annual return of 5.29 percent.[16] For a general — although not perfect — comparison, the average annual return of the popular measure for the U.S. stock market, the S&P 500 Index (Total Return), was 7.20 percent. So what might account for the large difference of 1.91 percent between the return of the S&P 500 stock index and the return of the average investor in equity funds? The answer may simply be irrational investor behavior. The hypothesis is that when stock markets dropped during this 20-year time frame (as they often do), many investors became fearful and sold their equity funds. Studies of investor behavior note that only after the stock markets have recovered a fair amount do investors then get back into stock funds.[17] This missed opportunity to recoup losses appears to account for some of the reason that the average investor's long-term results lag the overall U.S. stock market's returns, particularly if the cycle happens again and again.

Market Timing Does Not Work over the Long Term

The promise of successful market timing holds great appeal for investors. Perhaps you've heard the stories of market prognosticators who can help you sell at the market top and buy at the market bottom, the theory of the market acting as a living organism demonstrating Fibonacci spirals just like seashells, or the late-night advertisements for classroom instruction and trading techniques designed to quickly make you millions.

Forecasting systematic risk factors is extremely difficult, and while success in timing the market is possible, it is not probable. Unknown probabilities and magnitudes of various market risk scenarios added to regime changes can make even the most appealing market timing strategies quickly proven wrong. Even for a mean-reverting process, tracking error can be large and can erase alpha from "catching the turn."[18] Empirical evidence has shown that market timing is fraught with empty promises for both amateur and professional investors.

[15] *Ibid.*
[16] *"Quantitative Analysis of Investor Behavior, 2016" DALBAR, Inc. www.dalbar.com. Please see page 17 for additional disclosure.*
[17] *Ibid.*
[18] *Davis, Joseph H. "The Challenges to Market-Timing Strategies and Tactical Asset Allocation," Presentation, The Vanguard Group Investment Counseling & Research (2009)*

Well-Known Empirical Studies Documenting Unprofitability of Market-Timing Strategies (on average)	
Authors (Year)	**Focus group that fails to successfully time the market, on average**
Treynor and Mazuy (1966)	Mutual funds
Hendricksson and Merton (1981)	Mutual funds
Kon (1983)	Mutual funds
Chang and Lewellen (1984)	Mutual funds
Becker, et al. (1998)	Asset allocation funds
Coggin and Hunter (1993)	Equity pension funds
Barber and Odean (2000)	Investment clubs
Graham and Harvey (1996)	Investment newsletters
Chance and Hemler (2001)	Professional market timers
Goyal and Welch (2005)	Nearly all reported "predictive" variables

Source: Summary by Vanguard Investment Counseling & Research

In a seminal 1966 study on market timing, Treynor and Mazuy found significant market-timing ability in only one of 57 mutual funds.[19] In another mutual fund study, Chang and Lewellen (1984) documented significant market-timing ability in only five out of a sample of 67 mutual funds.[20] The average active manager is more successful at security selection than at market timing.[21]

Another aspect of market timing revolves are humans' problematic tendency toward "confirmation bias," which occurs when one selectively gathers or gives undue weight to evidence that supports his or her pre-conceived notions and beliefs while neglecting to gather or give credence to scholarly evidence that would tell against these notions and beliefs. As humans, we suffer from a natural tendency to look for evidence that is directly supportive of hypotheses we favor.[22] This is particularly relevant in the world of investing, where attractive, unproved schemes abound, railing against the time-tested methods of long-term investing.

Tried-and-true methods may seem boring and dull, and all the while, investors are continuously subjected to get-rich-quick schemes and the beliefs about clairvoyant forecasting. Tufts University professor Raymond Nickerson notes that "the continuing susceptibility of people to too-good-to-be-true promises of quick wealth is but one illustration of the fact that people sometimes demand very little in the way of compelling evidence to drive them to a conclusion that they would like to accept."[23]

[19] *Treynor, J.L. and K. Mazuy. "Can Mutual Funds Outguess the Market?" Harvard Business Review, 1966: 44:131–36.*
[20] *Chang, Eric C. and Wilbur G. Lewellen. "Market Timing and Mutual Fund Investment Performance." Journal of Business, 57 (1984): 57–72.*
[21] *Collins, Bruce and Frank Fabozzi, "Equity Manager Selection and Performance." Review of Quantitative Finance and Accounting, 15 (2000): 81-97.*
[22] *Nickerson, Raymond S. "Confirmation Bias: A Ubiquitous Phenomenon in Many Guises." Review of General Psychology, 1998. Vol. 2, No. 2:175–220.*
[23] *Ibid.*

Predicting the Future Is Fraught with Great Uncertainty

While predicting the future is an age-old temptation, humans have not yet acquired the knowledge to accurately do so. However, as logical and truthful as this statement is, undisciplined investors repeatedly commit the fatal mistake, believing that they know more than others know. Performing a simple Web search on the concept will bring up everything from tarot cards to palm readers to psychics to science fiction and neuroscience. This is not to say that humankind's mathematic and scientific advances have not dramatically improved our ability to understand this past and the causality of events. But that desired certainty about our tomorrows is ultimately still unknown because the events affecting the future are unknown.

This concept is a perpetual temptation in the world of investing, and practitioners of investment "hocus pocus" prey upon the very need by investors for that unattainable certainty described in the introduction. Practical evidence tells that this cannot be, for if these alchemic promises were true, why would someone share them? Wouldn't those who hold this this source of knowledge have access to wealth beyond comprehension? Why would they be inclined to publish it for the world to see?

Skillful Managers Can Be Identified

The belief most relevant to our active investment manager due diligence process is that we believe that, with very hard work, skillful active portfolio managers can be identified. Not with certainty and not with a precise prediction about their future performances, but we can use a disciplined process, applied with consistency, rigor and skill, to find those investment managers with the greatest chances, in our view, of helping clients honor their promises.

We believe that finding active management investment skill has both quantitative and qualitative considerations. In the quantitative realm, consider a season of professional baseball. Do professional baseball players play only three or four games before beginning the World Series? No. To separate luck and skill, they play 162 games before even beginning the playoffs. In separating investment skill from investment luck, the same need for many points of data exists. In fact, to determine with 95-percent confidence that a manager belongs in the top quartile of peers will require 16 years of observations[24] — just more than a baseball season's worth of monthly returns. As the normal life span of an asset

[24] Grinold, Richard C. and Ronald N. Kahn. "Active Portfolio Management — A Quantitative Approach for Producing Superior Returns and Controlling Risk, Second Edition." p. 480.

manager is less than 16 years, a 16-year monitoring period seems rather impractical.[25] Assessing qualitative aspects (investment philosophy, trading savviness, risk management experience, infrastructure, incentive structure, etc.) is the only way around this issue.[26]

In addition, a 1995 study of both equity and fixed-income mutual fund performance by Kahn and Rudd found there is no evidence of persistence in performance for equity funds based on historical performance. Their recommendation was to make sure you have other criteria for choosing future winners (e.g., qualitative), or you should settle for an index investment, if appropriate. For full disclosure, Kahn and Rudd found that there was persistence in performance for fixed-income funds based on historical performance even after accounting for fees, but they still show that other criteria should be used when selecting a fixed-income mutual fund and to settle for an index investment if you chose not to.[27]

Our companion paper, "The 1st Global Investment Manager Due Diligence Process: Enabling Promises through Intellectual Rigor and Institutional Standards," endeavors to enlighten you on our process.

Listening and Advice Are the Most Critical Factors in Developing and Executing a Plan to Honor Promises

It is our belief that the most skilled wealth management professionals in the world will fail to help their clients honor the promises they make unless they listen carefully to understand those promises. Once a wealth management professional understands his or her clients' promises and what matters most to them about money, the next most critical factor is the ability to pair this understanding with comprehensive and competent plans for action. Only when these twin imperatives have been executed to a level of excellence will asset allocation and due diligence to determine product selection ever matter. All of the best listening and advice will enable a client a real chance of honoring promises, even when paired with average due diligence and product selection. However, ineffective listening and poor advice paired with the world's most spectacular due diligence and product selection are unlikely to ever allow a client to honor his or her promises.

Conclusion

In summary, before beginning any journey; before committing any of your money, wealth or time; before taking action that will change your life, know what you believe. A solid foundation will help you possess the clarity you need to persevere in your journey, your investment plan and your promises. At 1st Global, our investment management programs are shaped by our beliefs. Knowing our purpose, we have defined our philosophy.

Equipped with that philosophy, we shape our process and create the actions that define accountability and deliver results. Our philosophy supports our purpose to help the clients of our partner wealth management firms honor the important promises they make and enable intentional living. We are steadfast in our commitment.

[25] Inceichen, Alexander M. "Absolute Returns: The Risk and Opportunities of Hedge Fund Investing." John Wiley & Sons, 2003, p.20.
[26] Ibid.
[27] Kahn, Ronald N. and Andrew Rudd. "Does Historical Performance Predict Future Performance?" Financial Analysts Journal Vol. 51, No. 6 (November – December 1995): p. 43–52.

Definitions

Tracking error (ex-post): A measure of historical divergence between the price behavior of a portfolio and that of a benchmark index. A tracking error is reported as a "standard deviation percentage" difference. A low tracking error signifies that a manager's returns are very similar to a corresponding benchmark.

Alpha (ex-post Jensen's): A measure of performance on a risk-adjusted basis. Alpha takes the volatility (price risk) of a fund or portfolio and compares its risk-adjusted performance to a benchmark index.

Momentum: The rate of acceleration of a security's price or volume. The idea of momentum in securities is that their prices are more likely to keep moving in the same direction than to change directions.

Disclosures

Disclosure on rebalancing analysis: *The information used in the rebalancing study is for hypothetical purposes only and does not predict the future performance of any investment. Hypothetical returns represent a back-tested reconstruction of the returns of 1st Global Advisors' five model portfolio risk profiles over the period from January 1992 through December 2016, using a monthly periodic return frequency. An unrebalanced portfolio for each of these risk profiles over this time frame was compared to a portfolio rebalanced using a 5-percent absolute deviation from target weights as a rebalancing trigger. The study included asset-class-level returns (i.e., representative index returns), as many component mutual funds and ETFs in actual model portfolios do not have substantially long track records to generate any meaningful past comparisons. It is not possible to invest directly in an index. The returns of the actual mutual funds selected as part of your portfolio will vary. The figures do not include advisory fees or transactions costs. These results are not the actual performance figures for any of the firm's clients. The figures above do not take tax effects into consideration. These results do not represent actual trading and do not reflect the impact that material economic and market factors might have had on the firm's decision making if the firm were managing a client's money. The indices used for the asset allocations are the Bloomberg Barclays US Treasury Bill 1-3 Month TR Index, the Bloomberg Barclays US Aggregate Bond*

Index, the S&P 500 TR Index, the Russell 2000 TR Index, the MSCI EAFE GR USD Index, the MSCI EM GR USD Index, the FTSE NAREIT Equity REIT TR Index and the Bloomberg Commodity TR Index. Past performance is no guarantee of future results.

The indices described in this paper are unmanaged indices of common stocks, bonds and other securities. The volatility of the indices may be materially different from the individual performance attained by a specific investor. In addition, the investor's holdings may differ significantly from the securities that constitute the indices. The indices are disclosed to allow for comparison of the investor's performance to that of certain well-known and widely recognized benchmarks of investment performance.

Disclosure for "Quantitative Analysis of Investor Behavior, 2017," DALBAR, Inc. www.dalbar.com: *Equity benchmark performance and systematic equity investing examples are represented by the Standard & Poor's 500 Composite Index, an unmanaged index of 500 common stocks generally considered representative of the U.S. stock market. Indices do not take into account the fees and expenses associated with investing, and individuals cannot invest directly in any index.*

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The returns of the actual investments selected as part of your portfolio will vary. Before investing in any mutual fund, investors should carefully consider a fund's investment objectives, risks, charges and expenses. Fund prospectuses contain this and other information about the funds and may be obtained from your financial advisor.

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