► **Greycourt White Paper**

White Paper No. 2 – *Money Managers: Greycourt's Criteria and Procedures for Selecting Best In Class Managers*

Background

Clients and money managers often ask us how we select the managers we recommend and how we work with money managers. This white paper describes Greycourt, its characteristic client base, and the procedures we follow before recommending managers or investment products to our clients.

Discussion

Who is Greycourt?

Greycourt is an "open architecture" wealth advisory firm working mainly with ultra-wealthy families nationally. Our typical client is a multigenerational family with investable assets of about $150 million. We also work with a select group of foundations and endowments.

As a true open architecture firm, Greycourt offers no investment products of its own and does not share fees with money managers. We do not charge managers to be in our database, do not offer business services to managers, do not require managers to pay for client entertainment and do not accept soft dollars. Because most of our clients are large taxable families, we are mainly interested in working with tax-aware managers. Strong gross returns that contain significant short-term gains and/or ordinary income are typically of little interest to us. (This does not apply to investment strategies that are inherently tax-inefficient, such as market-neutral hedge strategies.)

Who oversees the manager selection process?

The manager selection process at Greycourt is overseen by the firm's senior principals, not by a separate research staff. Decisions regarding managers to be recommended to our clients are made collectively by the senior principals, with each principal responsible for an asset class. This applies to both traditional marketable securities managers and to alternative managers such a venture, private equity, directional hedge and market-neutral hedge. We believe that this procedure leads to the selection of better managers, but it also limits the amount of time available for manager research. We appreciate money managers' understanding of this limitation on our ability to be responsive to all inquiries.

Do you subscribe to databases of money managers?

We subscribe to several third party manager databases of both marketable securities managers and alternative managers, and hence we are already aware of, or can easily search out, the product lines of most money management firms. Therefore, we cannot accommodate managers who wish to introduce us to their entire product lines. However, if a manager has a specific investment product that it believes to be "best in class," we will be happy to learn more about it.

What criteria and procedures do you use to evaluate managers?

While our manager selection criteria differ somewhat from asset class to asset class, all managers must go through a three-stage evaluation process before they can be recommended to our clients. Those stages, and the criteria associated with each stage, are summarized below.

Level 1 Screening. To meet our Level 1 criteria and pass on to our Level 2 evaluation, investment products must meet or exceed the following performance hurdles:

- Product returns since inception or 10-years, whichever is less, must have an average annual compound return (AACR) better than 66% of its style-adjusted peer group.
- Product annual returns cannot have been in the bottom quartile of the style-adjusted peer group during the past 5 years.
- Product R^2 of at least 85% (will vary by asset class), to the style-adjusted benchmark.
- Product downside returns since inception or 10-years, whichever is less, cannot be greater than 110% of the style-adjusted benchmark.
- Product upside returns since inception or 10-years, whichever is less, cannot not be less than 100% of the style-adjusted benchmark.
- Product Sharpe ratio must be in the top half since inception or 10-years, whichever is less.
- Products that fail any of the Level I criteria, can be evaluated under Level II criteria only upon approval of one the firm's principals.

Level 2 Screening. Our Level 2 evaluation begins with the manager completing a Greycourt electronic questionnaire. To meet our Level 2 criteria and pass on to our Level 3 evaluation, Greycourt must receive and evaluate the following manger and product information:

- Summary of firm's history, ownership and any recent changes.
- Brief description of the product being offered.
- Description of the manager's investment approach and philosophy, including – this is very important – a description of any tax-aware characteristics.
- Background of the relevant investment professionals.
- Firm assets under management (AUM), specifying institutional versus private client assets.
- AUM for the product being evaluated, specifying institutional versus private client assets.
- Review of the product's key characteristics (sector weights, PE, PB, yield, number of holdings, median market cap, duration, credit quality) relative to the appropriate benchmark.
- Total number of investment professionals firm-wide and the number of losses/additions over the past 5 years.
- Number of investment professionals dedicated to the product being evaluated and the number of losses/additions over the past 5 years.
- Summary of the available investment vehicles (separate account, mutual fund, commingled trust, etc.) and the applicable minimum account sizes, indicating if vehicles are open or closed to new investment.
- Summary of applicable fees.
- Manager to provide the firm's SEC ADV Parts I & II.
- Manager to provide after-tax returns if available.
- The Greycourt principal with functional authority for the asset class will develop a conclusion based on his or her review of the Level I and II criteria. The conclusion will include (a) a decision as to whether the product should be moved on to a Level III evaluation, and (b) a brief thesis for that decision.

Level 3 Screening. Level 3 is the most qualitative but most rigorous stage of our evaluation process for managers and investment products. This screening level is conducted by a principal of the firm and will involve a visit to the manager at its headquarters. The principal will inquire into the following issues, among others:

Investment Philosophy. Can the manager articulate its investment philosophy clearly and concisely? For example:

- Is there a well defined investment philosophy?

- Why has the manager's approach worked and why will it continue to do so in the future?
- What is the manager's discernible competitive advantage?
- What changes to the model or process have been made in the past and what changes are being contemplated?
- What is the product's capacity in terms of assets under management?
- Was the product designed specifically for taxable investors? If not, what changes have been made to accommodate tax considerations and how do those changes affect the fundamental investment process?
- Will the manager employ performance-based fees? If not, why not?

Decision Making Process. Consider:

- The selection universe.
- The investment style
- Valuation criteria (quantitative, fundamental, top-down, technical, etc.)
- Portfolio construction:
    - ✓ How many issues are normally held and how are they weighted?
    - ✓ Are all industries and sectors represented in a portfolio? How are they weighted?
    - ✓ What limits are placed on the holding of any one security?
    - ✓ What is the policy for holding cash?
    - ✓ What triggers a buy/sale decision?
    - ✓ Describe how tax sensitivity is incorporated in the portfolio construction process.
- Benchmark issues:
    - ✓ What is the appropriate benchmark for the product?
    - ✓ To outperform the benchmark, what is the manager doing differently (market timing, sector and/or industry bets, bets on volatility, country, currency ,etc.)?
    - ✓ How much does the manager expect to outperform the appropriate benchmark both net of fees and net of fees and taxes?
    - ✓ What does the manager consider the appropriate measurement period and what is the expected annual variability around the targeted out-performance?

Implementation.

- Who is responsible for the product? Are these the same people responsible for the firm's long-tem record?
- Team or star approach?
- Who makes the final decision (buy/sell)?
- For taxable accounts, how are tax considerations of possible trades explicitly addressed?
- How are decisions implemented?
- Describe the trading process and costs. Average Commission? Best execution? Describe by whom and for what soft dollars are allocated (research, capital commitment, IPO allocations , sales and trading coverage). Do you measure the market impact costs of trades?
- How are the security trades allocated among accounts?
- Performance dispersion: what degree of uniformity exists among accounts in the product? How important an issue do you consider performance dispersion to be?

Culture and Stability of the Organization.

- Is money management the sole or primary line of business?
- Ownership structure: have their been any changes, are any anticipated, any plans for generational transfer?
- Are there strong personal incentives both financial and psychological?
- Compensation package available to the firm's professional staff, including incentive plans, specifying how and for what are they awarded.
- What specific incentives are employed to ensure key professionals do not leave the firm either as a group or individually?
- Do the firm invest in the people and business technology to remain cutting edge?
- Is the firm investment driven or sales driven (alpha factory or asset gatherer)?
- What the firm's business objectives with respect to the future growth of assets, products and the resources to service the growth?
- What institutions have hired or fired the firm in the last two years? What are the reasons given for both?

Reporting and Communication Capabilities.

- Describe the firm's ability to provide timely information (i.e. portfolio and performance reports, written analysis, conference calls, etc.)
- Are portfolio managers available to meet with clients?

Risk control.

- Does the firm have a written risk control policy statement? How are these policies enforced?
- Do external auditors test the firm's controls?
- Does the firm have a disaster recovery/business continuation plan? Has it been stress-tested?
- How is the investment performance of client accounts monitored?
- Do persons independent of the trade execution and recording function settle trades?
- How often are accounts reconciled with custodian information?
- Does the firm have a written policy for the use and monitoring of derivatives?

SUMMARY

Although our criteria are numerous and our standards very high, in essence we are looking for managers with the following characteristics: adherence to an articulable investment strategy which is intellectually defensible; demonstrated long-term commitment to and competence in the asset class, sub-class or investment style; demonstrated commitment to keeping investment costs at an optimal level relative to the expected incremental return; investment products which are tax-aware in their design and implementation; long-term manager and management stability; long-term (five and ten-year) performance records in the top quartile; and a commitment to alpha generation rather than asset gathering.

Managers who wish to introduce us to an investment product should contact Patrick Parisi, Director of Manager Research, at our Portland, Maine office at 130 Middle Street, 2nd Floor, Portland, ME 04101, or via email at pparisi@greycourt.com.

GREYCOURT & CO., INC.
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(This paper was written by Gregory Curtis, Chairman of Greycourt.)