



MANAGING THE MONEY MANAGERS

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WATERSTREET
FAMILY WEALTH COUNSEL

What is it that clients expect from their advisors when it comes to their investment portfolios? While the answer can differ from one family to the next, families that are served by WaterStreet Family Wealth Counsel have expressed a few key expectations.

As you might expect, WaterStreet's client expectations are fair and reasonable, and are consistent with the expectations of most ultra-affluent families. Specifically, the top three expectations expressed by the firm's clients are simply these:

- **Preserve my capital.** "I've worked hard to create this wealth, so I don't want to lose it."
- **Grow my capital.** "I want to grow my capital at a rate of return that allows me to achieve my long term goals regardless of the performance of my biggest asset – my business."
- **Minimize my taxes.** "I don't want to pay more income tax on my investment earnings than necessary."

The professionals at WaterStreet have listened carefully to the expectations of the families they serve. One of the most critical functions to ensuring these expectations are met is the task of selecting and monitoring the money managers that WaterStreet believes will provide appropriate returns over the long run. "We employ a 'multi-manager' or 'open architecture' approach to constructing our families' investment portfolios," says Audrey L. Robinson, Chief Investment Officer at WaterStreet. "By carefully selecting and monitoring 'top

tier' investment managers, we're able to effectively assist our clients in achieving what's most important to them," she continues. WaterStreet's approach is designed to recognize the following beliefs:

- Active portfolio management can add significant value relative to market benchmark indices, both in additional returns and reduced risk.
- Both the odds of active management success and its magnitude vary widely between the most "efficient markets" and the least. Costs are also meaningful and likewise vary significantly with the result that in some markets and asset classes, passive investing may be more appropriate.
- No single investment manager, however expert, can excel :
 - *in all asset classes, nor in all regions of the world, nor*
 - *in all "styles" (e.g. growth, value or core), nor*
 - *in all market environments.*
- No manager can or should be conclusively identified as "the best," even in their own

specialty, but it's possible to identify those with significantly higher (or lower) than average odds of future success.

- Where size of assets and costs permit, it can be prudent to engage more than one manager in an asset class. This manager diversification will mitigate the risk of future manager “lack of success,” whether due to the limitations of the selection process, a material organizational change in the manager or the unpredictability of markets.
- With globalization on the rise, WaterStreet believes that globally diversified portfolios have become a prerequisite for long-term investment success; accordingly, the firm's selection process takes a world-wide view of world-class managers.

“Our beliefs are framed by our desire to know a manageable number of investment management firms in depth, rather than a large number superficially,” Robinson says. Accordingly, WaterStreet does not believe in maintaining several manager choices within each asset class; the firm would not, for example, be inclined to have relationships with three U.S. Large Cap growth managers. “Our investment manager selection and monitoring processes are quite intensive, and allow us to know a few managers very well, which we believe helps to increase the odds of investment success for our families,” says Robinson.

MANAGER SELECTION PRINCIPLES

Academic studies have repeatedly shown that past performance does not predict future success, except possibly for very short periods of one or two years where a momentum effect appears. At the same time, as managers tend not to change their investment approach radically, or frequently, past performance can be a good indicator of their “style” and the risk factors

associated with their style.

WaterStreet focuses its process, therefore, on what the firm perceives to be the more permanent factors that have given rise to a manager's prior results and which may be expected to be important in generating future success. Identifying and assessing these factors has as much to do with WaterStreet's experienced judgment of investment businesses and investment practices as it does with entirely objective criteria. “Clearly, even the most rigorous selection process carries no guarantees – rather we strive to maximize the odds of success for our families,” Robinson suggests.

Key principles employed by WaterStreet include:

- A sound, researched and distinctive investment philosophy (the “why”) is a prerequisite. In practice this is also a remarkably effective characteristic that distinguishes between those managers who truly understand their business and those who are largely repeating what has worked before.
- Three investment process factors (the “how”) are the key to the likelihood of sustainable outperformance:
 - *Unique insights (research),*
 - *Rigorous analysis, and*
 - *Disciplined execution*
- The “best” investment managers are never satisfied. They constantly re-examine their beliefs and processes as the capital markets evolve and, critically, they acknowledge and learn from their mistakes. They relish being challenged on their investment processes and beliefs and recognize that successful investment processes are not static.
- Preferred managers also recognize that the management of private client assets is quite different from that of institutional assets

(pension funds or corporations), carrying much greater emphasis on:

- *Limiting absolute losses, rather than benchmark tracking*
- *Use of concentrated portfolios (“I just want your best ideas”)*
- *Minimization of turnover (“buy and hold”)*
- *Awareness of tax impacts (“net, net performance”).*

HOW WATERSTREET’S PROCESS DIFFERS

The principles outlined above, and WaterStreet’s lengthy experience, lead to five distinguishing emphases in the firm’s manager selection and review process:

1. Qualitative analysis is at the heart of WaterStreet’s decision-making: “We view each manager both as a business to be invested in and as an approach more likely to add value for our families than others,” Robinson explains.
2. Quantitative analysis must be comprehensive and rigorous, but it remains a guide, not a prescription.
3. Regular, on-site due diligence visits are critical, by experienced analysts taking sufficient time to probe effectively without endangering the relationship with the investment manager.
4. Small but significant differentiators among managers have been found to be:
 - *The quality of their written responses and demonstrations*
 - *Their enthusiasm and attention to detail*
 - *The articulation of an investment philosophy that translates directly into an investment process.*
5. The management of private client assets

must be distinctly different from institutional assets to meet the very real behavioural characteristics of individuals. “As specialists in wealth management for private families, we clearly recognize this distinction in the experience and processes of our preferred managers,” says Tim Cestnick, President and CEO of WaterStreet.

“We believe our focus and our process will materially increase the odds of enhanced returns and controlled risks in our families’ portfolios,” Robinson says in closing.

WORKING WITH WATERSTREET

WaterStreet brings a unique and disciplined approach to the architecture of portfolios for the families they serve. Investment manager selection and monitoring is just one component of the effective advisory role WaterStreet assumes for its families. WaterStreet welcomes the opportunity to discuss more fully the asset consulting capability that it offers. For more information, or to arrange a consultation, contact the firm:

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WaterStreet Family Wealth Counsel is a Multi Family Office™ advisory firm, providing strategic advice to wealthy families.

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