Investment Philosophy Statement

This document and the proprietary analysis is the property of A&I Financial Services LLC. Review of this material constitutes an acceptance of the specific request not to disclose any information contained herein to any third party without the advance, written permission of A&I Financial Services LLC.
Table of Contents

Executive Summary ......................................................................................................................... 1
What We Believe ............................................................................................................................. 1
Definitions ....................................................................................................................................... 2
THE WORLD OF INVESTING ............................................................................................................. 2
Goal-based Investing ....................................................................................................................... 2
Goal-based Investing at a Glance .................................................................................................. 2
Step One: the Discovery Process ................................................................................................. 3
Step Two: Liquidity and Income ................................................................................................. 3
Step Three: Long-term Objectives ............................................................................................... 4
Step Four: Asset Allocation .......................................................................................................... 4
Step Five: Investment Strategies ................................................................................................. 4
Step Six: Build Your Portfolio ....................................................................................................... 4
What We Know About Stocks and Bonds ..................................................................................... 5
How We Diversify Risk ................................................................................................................ 7
Rebalance Your Investments ........................................................................................................ 7
Stay Invested ................................................................................................................................ 7
Avoid the Big Mistake .................................................................................................................. 8
The Miracle of Compound Growth .............................................................................................. 9
Time Smooths Out Returns ........................................................................................................ 10
Importance of Excess Returns ................................................................................................... 12
YOU—OUR CLIENTS ....................................................................................................................... 15
<table>
<thead>
<tr>
<th>Topic</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Important Investor Behavior</td>
<td>15</td>
</tr>
<tr>
<td>“Volaphobia”</td>
<td>15</td>
</tr>
<tr>
<td>Vulnerability to Risk of Loss</td>
<td>16</td>
</tr>
<tr>
<td>Bounciness</td>
<td>17</td>
</tr>
<tr>
<td>Murphy’s Law and Your Money</td>
<td>18</td>
</tr>
<tr>
<td>Your Ability to Own a Portfolio That Looks Different from Indices</td>
<td>20</td>
</tr>
<tr>
<td>YOUR INVESTMENT ADVISOR—A&amp;I FINANCIAL SERVICES</td>
<td>21</td>
</tr>
<tr>
<td>The Strategic Portfolio Management Process</td>
<td>21</td>
</tr>
<tr>
<td>Gap Analysis</td>
<td>21</td>
</tr>
<tr>
<td>Tactical Asset Allocation</td>
<td>22</td>
</tr>
<tr>
<td>Ongoing Performance</td>
<td>22</td>
</tr>
<tr>
<td>Rebalancing and Reporting Progress</td>
<td>22</td>
</tr>
<tr>
<td>The Investment Policy Committee</td>
<td>22</td>
</tr>
<tr>
<td>Foundation Income</td>
<td>23</td>
</tr>
<tr>
<td>World Growth</td>
<td>24</td>
</tr>
<tr>
<td>Pure Valuation/Profitability</td>
<td>25</td>
</tr>
<tr>
<td>Global Tactical</td>
<td>26</td>
</tr>
<tr>
<td>Secular Bear/Bull Market Allocation (SBMA):</td>
<td>27</td>
</tr>
<tr>
<td>Appendix 1: Our Research Team at Litman Gregory</td>
<td>30</td>
</tr>
<tr>
<td>Step One: Performance Screens</td>
<td>30</td>
</tr>
<tr>
<td>Step Two: Due Diligence Questionnaire and Document Review</td>
<td>31</td>
</tr>
<tr>
<td>Step Three: Initial Portfolio Manager Interview</td>
<td>31</td>
</tr>
<tr>
<td>Step Four: The Site Visit</td>
<td>32</td>
</tr>
<tr>
<td>Step Five: Final Follow-up and Third-party Contacts</td>
<td>33</td>
</tr>
<tr>
<td>Step Six: Litman Gregory Research Team Approval</td>
<td>33</td>
</tr>
</tbody>
</table>
Executive Summary
We follow a goal-based investing process, meaning that we align the investments with your goals, values, relationships, interests, and other things that are most important to you. Your wealth manager carefully and thoroughly learns these important factors about you and then follows a six-step process to choose the investments and to create your plan for the future.

Our investment committee uses the perspective of two research firms, Litman Gregory and Athena Invest. Our investment strategies are called: Foundation Income, World Growth, Secular Bear/Bull Market Allocation (SBMA), Athena Global Tactical, Athena Pure Valuation/Profitability, and possibly others as well. You may see the names of these strategies on your investment statements and we will refer to them at your regular progress reviews. Each strategy may include individual stocks, mutual funds, Exchange Traded Funds (ETFs), and other investments.

We follow a strict belief system in making all these decisions and consistently test our beliefs. This document describes these processes in detail and concludes with an in-depth look at each of your investment research teams and the academic basis of our beliefs.

What We Believe
We believe quality inputs generate quality results over time. We believe that investor behavior is the single greatest determinant of an investor’s financial success. We believe that asset allocation between stocks and other investments, including bonds and alternatives, is more important than selection and timing of particular investments. We believe stocks will yield better returns over time than other assets. We believe that a patented investment process, combining time-tested strategies, with high conviction and consistency, generates superior investment returns.

When building our client’s portfolios, we believe in utilizing a combination of active investing (experts employing diligent research when picking specific investments) and passive investing (investing in overall market indices, such as the S&P 500 or the Dow Jones). This combination allows the investor to benefit from the expertise of several of the best money managers in the industry, while controlling the costs of their portfolio by mixing in the less expensive index holdings.

Finally, we believe in ongoing, rigorous due diligence and the testing of our beliefs.
Definitions
Acronyms, terms, and abbreviations used in this document include:

- Athena: A research partner
- CFP: Certified Financial Planner
- CFA: Chartered Financial Analyst
- ETF: Exchange Traded Fund
- ETN: Exchange Traded Note
- Fi: Foundation Income, an investment strategy
- LG: Litman Gregory, A research partner
- Pure: Pure Valuation/Profitability, an investment strategy
- SBMA: Secular Bear/Bull Market Allocation, an investment strategy
- WG: World Growth, an investment strategy

THE WORLD OF INVESTING

Goal-based Investing
To honor the uniqueness of each of our clients, we utilize goal-based investing. Your wealth manager follows a discovery process to learn about your particular situation. This includes the relationships in your life that mean the most to you: your values, fears, ambitions, and dreams. Your wealth manager then selects the right investment ingredients to help you achieve what is most important to you.

Today’s stock market may look like a scary place to invest. Historically, it’s hard to know when an ideal time to invest might be. Our fear comes partially from our natural instincts to avoid pain. We are also fearful due to recent history. Recall the dot.com and “great recession” stock market crashes of the first decade of the 21st century. The financial press reinforces our fears (and may cause even more fear) by telling us the “hot stocks to buy now” and all the reasons why “this bull market may not last.” But fear and entertainment clearly aren’t professional, diligent, or repeatable investment approaches.

While acknowledging your feelings about the economy and the short-term prospects for the markets, we want to invest according to your goals. We call this goal-based investing.

Goal-based Investing at a Glance
Our investing process centers around six steps:

1. **Step One: the Discovery Process.** Our investment plan process begins with a thorough conversation about your financial values and goals, as well as your key relationships, existing assets, other professional advisors, preferred communication style, and personal interests.
2. **Step Two: Liquidity and Income.** We separate your short-term needs for income and liquidity from long-term needs for financial security. Short-term needs require liquidity. Money for these goals should be managed with a short-term investment horizon.

3. **Step Three: Long-term Objectives.** Taking into account the long-term nature of successful investing, we set objectives for your portfolio that are appropriate for your risk profile and for the investment horizon(s) you identify.

4. **Step Four: Asset Allocation.** Asset allocation is the first investment decision. We decide how much of your portfolio to invest in asset classes, such as stocks, bonds, alternatives, and short-term investments.

5. **Step Five: Investment Strategies.** With an asset allocation in place, we select the investment vehicles you will use to implement your portfolio strategy. Several key investing principles guide these selections: the importance of asset class decisions, the time value of money, and the quality of investment management.

6. **Step Six: Build Your Portfolio.** Building on the first five steps, we construct a portfolio suited to your needs, goals, time horizon, and risk profile. The building blocks for your portfolio are institutional investment managers and investment products.

This process results in a diagnostic report of your current situation, with our recommendations for positioning your portfolio to maximize your probability for success. These recommendations take into account portfolio costs, as well as potential tax impacts, which are unique to each client.

Let’s look at each step in greater detail now.

**Step One: the Discovery Process**
Long-term investment success means different things to different people. The best investment plan for you depends on your specific circumstances and objectives. That is why we begin the investment planning process with a discussion of your values, goals, relationships, assets, advisors, preferred process, and interests.

While everyone’s situation is unique, certain factors matter in creating an investment plan. These factors include the purpose of the investment, its size, sources, planned uses of the funds, and the amount of volatility you are comfortable experiencing. By thinking clearly about your specific goals and overall circumstances, we build the foundation of an investment plan that best matches your needs and the realities of the financial markets.

**Step Two: Liquidity and Income**
Your wealth manager constructs your portfolio to meet both short-term liquidity and income needs as well as your long-term growth needs. We want to make sure that a portion of your portfolio provides you the peace of mind that you can cover important short-term needs. The
remainder of your portfolio will be dedicated to meeting long-term goals, like making sure you stay ahead of inflation and that your money outlasts you.

**Step Three: Long-term Objectives**
Investors know they should be long-term investors. This often gives rise to the question “How long is long-term?” The answer for many investors is often surprising—your long-term horizon should be as far into the future as possible. One of the many enduring facts about investing is that having a long horizon is a powerful advantage. You want your time horizon to include as many decades as possible, because as an investor, time is your best friend.

Many investors aspire to achieve financial freedom for the long term. But most investors also have intermediate-term goals: funding college educations for children or grandchildren, buying vacation homes, and founding charitable foundations, for instance. You may also have goals that reach far into the future, and even outlive you. For example, you may wish to leave a legacy for your great-grandchildren or for your community.

**Step Four: Asset Allocation**
If we are careful in setting your long-term investment objectives, then we will be successful in planning your investments. Once we have worked with you to determine your time horizon and risk approach, we begin the task of building your investment portfolio. The first step in this process is asset allocation.

Asset allocation is the process of deciding how much of your portfolio to invest in different investment types, or asset classes. The most basic asset allocation choice is between equities and fixed income, also known as stocks and bonds. Stocks allow you to participate in the long-term growth of companies and the economy. Bonds are fixed obligations of governments and corporations. Stocks are partial ownership units of a company, whereas bonds are loans made by a company or government with a promise to repay the principal plus interest. The asset allocation may include short-term investments, foreign stocks and bonds, and alternative assets. These have a large effect on your long-term, total return.

**Step Five: Investment Strategies**
Once you have determined your asset allocation, the next step is to select the investment strategies. This document describes how those investment management decisions are made, the processes, and the people behind the scenes. Your investment team will manage the risk and return, periodically rebalance these investments, and keep your money invested in alignment with your goals and values.

**Step Six: Build Your Portfolio**
We are now ready to build a diversified, high-conviction portfolio based on your individual goals and needs. To do this, we use the latest in academic investment research and the work of two research teams, Litman/Gregory and Athena Invest. We describe both in detail in Appendices I and II in this document.
What We Know About Stocks and Bonds

Historically, stocks are partial ownership shares in a company. Bonds are loans made (by an investor like you) to a company or government.

We often ask, “Would you rather be an owner or a loaner?” While there is no right answer to this question, stocks offer superior long-term growth potential, while bonds offer more stability. It is also true that owners take greater risk than loaners. Naturally, we expect to be rewarded for being a partial owner of a diverse portfolio of companies.

Would you rather be an owner or a loaner?

Stocks deliver much higher returns than bonds over time. For example, $100 invested in stocks (as represented by the S&P 500 Index) at the beginning of 1928 would have been worth $399,885 by the end of 2017. Bonds had a difficult time keeping up with inflation. U.S. Treasury Bills turned into $2,015 and Treasury Bonds became $7,309. Simply to maintain purchasing power (stay even with inflation) you would have required an increase in value to $1,431.1

1 Roger G. Ibbotson and Rex Sinquefield, Stocks, Bonds, Bills, and Inflation. Dow Jones Irwin, Homewood, IL. 1986. Updated annually by Ibbotson Associates. See also U.S. Inflation Calculator for a quick and easy way to get the same information, as of April, 2018: http://www.usinflationcalculator.com/
Stocks, Treasury Bonds, Treasury Bills, January 1928-December, 2017

The return from stocks dwarfs other options over time. $100 invested in 1928 turns into nearly $400,000 by the end of 2017, including all of the stock market crashes, dividends, and rallies.

Although it may bring up emotions or feel unpleasant, the bounciness of stocks is the very reason stocks produce higher returns than bonds. Volatility is of greatest concern to those who will have to liquidate their investments in a short time horizon. However, for long-term investment horizons, wise investors seek a high rate of return on long-term money.

That said, there is often a place for both stocks and bonds in a prudently designed portfolio. In a strongly rising stock market, some investors are tempted to move to an all-stock portfolio to chase those gains. However, such a move can result in dramatic swings in the portfolio’s value, and may leave the portfolio vulnerable to a substantial drop in value once the market reverses. Your wealth manager will help you find the right mix for your unique situation.

---

2 Stern NYU website for a quick and easy way to get the same information, as of March, 2018:
http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html
How We Diversify Risk
We manage risk by diversifying within U.S. and international equity markets. We look for investments that zig while others zag; if all the investments have a long-term, high rate of return, then a portfolio’s overall bounciness is less than any single investment and delivers a comparable long-term rate of returns.

Correlation is the way two or more investments move together. The higher the correlation, the more these investments are likely to rise and fall together.

_The lower the correlation, the smoother the ride._

A common practice in the industry is to use Morningstar or other tools to diversify a portfolio, however, traditional style boxes (large cap, small cap, growth, and value) provide no improvement in correlation. For more information about this, refer to the Academic Research at the end of the document.

Another common error is over-diversification: holding a large number of small investments, which does not reduce risk nor produce excess returns. Instead, we diversify by investment strategy, choosing concentrated portfolios, and remaining consistent. These concepts are also discussed under Academic Research.

Rebalance Your Investments
Periodically we rebalance the portfolio to make sure it maintains its strategic allocation. Certain conditions can make entire asset classes more or less risky. We assess the structural risk and make tactical adjustments to over- or under-weight assets. We may increase or decrease the weighting to an asset class by 1–20% after much thought and careful research.

In response to changing market conditions, we use investment models/strategies like Global Tactical and SBMA. These strategies potentially reduce risk and increase returns. In a down market, as much as 25% of the portfolio may be hedged, or placed in cash. We may give up a small amount of performance in exchange for downside protection. In the converse, as much as 25% of the portfolio can be leveraged to potentially get additional returns in strong growth periods. Refer to the Strategies section of this document for more information.

Stay Invested
Investors often ask, “When is the right time to enter the market?” For a long-term investor, the answer is today. Even though there is always a possibility that the market will go down tomorrow, today is the right day to start investing.

The aforementioned chart, Stocks, Treasury Bonds, Treasury Bills, January 1928-December, 2017, shows this dynamic well.

A large portion of the long-term gain in investment in the stock market comes from sharp upward bursts. Just missing the best day out of each calendar year results in dramatically lower
returns than staying invested throughout the period. A $10,000 investment in equities started on June 30, 1926 would have accumulated to $45,310,852 by December 31, 2017. If you missed the one best day each year your investment would have grown to $1,879,984.

<table>
<thead>
<tr>
<th>Missing 1 Best Day</th>
<th>$ 1,879,984</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staying Invested</td>
<td>$ 45,310,852</td>
</tr>
<tr>
<td><strong>Difference</strong></td>
<td>$(43,430,868)</td>
</tr>
<tr>
<td><strong>Cost of Missing Out</strong></td>
<td><strong>-96%</strong></td>
</tr>
</tbody>
</table>

A downward day, week, month or year is both unpredictable and immeasurably small over our investment lifetimes. Staying invested gives us the best chance of success.

*The one best day of each year accounted for 96% of the total returns over the years between 1926 and 2017.*

**Avoid the Big Mistake**

Our research partners at Athena Invest studied the recent history of the stock market, 1974 to 2015, and found that the big mistake was to be out of the market. This 30-year period of time covered significant swings in equity markets, dramatic news events, and incredible changes in quality of life. Surprisingly, missing only the three best days in the market would have caused an investor’s returns to go negative!

“The investor that stays fully invested over this period benefitted by reaping an annual compound return of 11.0% and ends up with $800,000 on an initial $10,000 investment. On the other hand, missing just the three best days each year during that period actually produces a negative 1.2% annual compound return, decreasing the initial investment to a final value of $6,000.”

---

1 Athena Invest, Behavioral Advisor, June, 2016. Used with permission.
Behavioral research reveals that investors may feel like we should move with the herd, and take action, at exactly the wrong time.

### The Miracle of Compound Growth

Compound growth operates on a simple principle: when you put money aside to earn returns, and then reinvest those returns, you have both your original investment and the returns working for you. The longer this process continues, the greater your accumulation will likely be.

Imagine putting $1 million into an investment that consistently earns 8% every year. The table below shows how the compounding process works.

---


4. Although the “Miracle of Compound Growth or Compound Interest” is sometimes attributed as a quote made by Mark Twain or Albert Einstein, we cannot verify the source.

5. Figures are for illustrative purposes only and are not a guarantee of future performance. Figures do not reflect the effect of fees or taxes.
Miracle of Compounding

<table>
<thead>
<tr>
<th>Year</th>
<th>Starting Amount</th>
<th>+ Earnings</th>
<th>= Ending Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$1,000,000</td>
<td>$80,000</td>
<td>$1,080,000</td>
</tr>
<tr>
<td>2</td>
<td>$1,080,000</td>
<td>$86,400</td>
<td>$1,166,400</td>
</tr>
<tr>
<td>3</td>
<td>$1,166,400</td>
<td>$93,312</td>
<td>$1,259,712</td>
</tr>
</tbody>
</table>

...time passes...

| 10   | $1,999,005      | $159,920   | $2,158,925      |
| 20   | $4,315,701      | $345,256   | $4,660,957      |

At 8%, your investment grows to more than 4½ times its original size in 20 years. To see the effect of compounding, notice that you would earn $1,158,925 in returns in the first 10 years, but even more in the second 10 years—$2,502,032.

**Time Smooths Out Returns**

Time reduces investment risk, especially in diversified portfolios of stocks. It’s natural to worry that if you invest in the stock market today, it may go down tomorrow. But if you have a long investment horizon, tomorrow is just one of the thousands of market days during which you will be investing. Over decades, many of the daily and monthly ups and downs in the market are cancelled out, leaving the broad upward-market trend.

The stock market has produced a wide range of outcomes. An investor holding stocks for just one calendar year could have had returns ranging from a high of 52.6% to a low of -43.8%. An investor with a 10-year horizon could have experienced annualized returns ranging from a high of 21.5% to a low of -2%. During all of these time periods, the average rate of return is high—between 10% and 11%. The patient investor can earn that average rate of return.
The following graph shows how the range of annualized outcomes for stocks narrows as your horizon becomes longer. Look at various periods of time, from 1928 to 2017, with the annual performance of a popular benchmark index, Standard & Poor’s 500.\(^6\)

<table>
<thead>
<tr>
<th>Timeframe</th>
<th>Highest</th>
<th>Average</th>
<th>Lowest</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Year</td>
<td>52.6%</td>
<td>11.3%</td>
<td>-43.8%</td>
</tr>
<tr>
<td>5 Year</td>
<td>28.3%</td>
<td>10.06%</td>
<td>-12.71%</td>
</tr>
<tr>
<td>10 Year</td>
<td>21.5%</td>
<td>11.4%</td>
<td>-2.0%</td>
</tr>
</tbody>
</table>

As time passes, the odds increase that we will earn average stock market returns. Patience rewards the prudent stock investor with a greater likelihood of a significant increase in his/her investments.

\(^6\) U.S. large capitalized stock performance calculations are based on annual performance of the Standard and Poor’s 500 Index, an unmanaged index intended to represent the performance of a diversified portfolio of large cap U.S. stocks. Investors cannot invest in an index and past performance is not a guarantee of future results.

\(^7\) Stern NYU
Time can reduce your risk, but many investors looking at this chart may still feel that the stock market by itself is too volatile. In designing your portfolio, we will make use of asset allocation to help reduce volatility to a level acceptable to you.

That said, maintaining your long-term perspective drives the success of your portfolio. The minimum expected investment period should be five years for any portfolio containing stocks. One-year volatility can be significant for certain asset classes. However, over a five-year period, volatility is greatly reduced. A time horizon of 10 years or longer will increase the likelihood of achieving your financial goals. And, over decades, no other asset class has come historically close to delivering the returns provided by stocks.

**Importance of Excess Returns**

Investing in high-quality, active managers and investments may produce returns that exceed average long-term market returns. This approach is supported by a stream of academic research, quoted at the end of this document. The academics teach us to search for high-quality, high-conviction portfolio managers to deliver superior performance.

We will invest your portfolio to take advantage of the long-term positive returns available in the stock market. Portions will be managed by those partner investment firms who consistently pursue a well-defined investment strategy and are willing to take high-conviction positions. Using this approach, you may benefit from potentially superior returns.

The additional amount gained by investing in successful active management can be substantial. Using the same S&P 500 return data from before and assuming a 2%, 4%, or 6% excess return, the expected amount earned for $1,000,000 invested over various investment horizons is shown below.

**Miracle of Compounding Excess Returns**

<table>
<thead>
<tr>
<th>Excess Return</th>
<th>10 years</th>
<th>20 Years</th>
<th>30 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
<td>$2,158,925</td>
<td>$4,660,957</td>
<td>$10,062,657</td>
</tr>
<tr>
<td>2%</td>
<td>$2,593,742</td>
<td>$6,727,500</td>
<td>$17,449,402</td>
</tr>
<tr>
<td>4%</td>
<td>$3,105,848</td>
<td>$9,646,293</td>
<td>$29,959,922</td>
</tr>
<tr>
<td>6%</td>
<td>$3,707,221</td>
<td>$13,743,490</td>
<td>$50,950,159</td>
</tr>
</tbody>
</table>

The power of compounding is in full force: excess returns build additional wealth. The most dramatic case is a stock portfolio that earns an excess return of 6% over a 30-year investment horizon, producing $40 million in additional wealth.
Excess returns have a positive effect on an average annualized return value as well. Compare the following chart to the one shown earlier, Average Annual Returns for the S&P 500 in Various Timeframes from 1928-2017. An investor in the S&P 500 did well, but with excess returns that could potentially reach 6% or more per year, as the academic research at the end of this paper suggests is possible—do very well indeed!

![Average Annual Returns for the S&P 500 with Excess Returns in Various Timeframes from 1928-2017](chart-image)

Give it time. The average returns are approximately the same in all periods, but the range of possible results becomes more predictable as time passes.

<table>
<thead>
<tr>
<th></th>
<th>1 Year</th>
<th>5 Year</th>
<th>10 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Highest</strong></td>
<td>65.7%</td>
<td>35.3%</td>
<td>26.5%</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td>14.1%</td>
<td>12.09%</td>
<td>13.7%</td>
</tr>
<tr>
<td><strong>Lowest</strong></td>
<td>-54.8%</td>
<td>-17.44%</td>
<td>-4.4%</td>
</tr>
</tbody>
</table>

---

*(Howard, 2010) and Stern NYU*
Keep in mind that these are expected values and that actual results can vary substantially. As demonstrated in the previous section, the longer the time horizon, the narrower (and more favorable) the range.

Successful active management has the potential to get you to your goals quickly and, over time, safely. The reward for raising the bar with excess returns is that, over long periods of time, the amount of additional returns exceeds the amount of additional risk, as shown in the following chart.

Significantly higher returns with modestly higher short-term bounciness substantially improves the return/risk ratio over long periods of time.

<table>
<thead>
<tr>
<th></th>
<th>1 Year</th>
<th>5 Year</th>
<th>10 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Excess Portfolio</strong></td>
<td>66%</td>
<td>35%</td>
<td>27%</td>
</tr>
<tr>
<td></td>
<td>-55%</td>
<td>-17%</td>
<td>-4%</td>
</tr>
<tr>
<td><strong>S&amp;P 500</strong></td>
<td>53%</td>
<td>28%</td>
<td>21%</td>
</tr>
<tr>
<td></td>
<td>-44%</td>
<td>-13%</td>
<td>-2%</td>
</tr>
</tbody>
</table>

Time improves the odds in favor of the patient investor. As shown in the chart above, an investor might take on additional investment risk in proportion with her potential additional returns. As time passes, the potential additional return outweighs the commensurate additional risk.
Time reduces the investor’s risk. The first year, an additional potential gain of 13% accompanies a potential additional loss of 11%. By the tenth year, an additional 6% potential gain is offset by an additional potential 2% loss. Investment risk declines substantially over time.

*We believe our investment philosophy increases your chance of success through:*

1. the miracle of compound growth,
2. risk reduction over time, and
3. the opportunity to earn excess return.

In summary, goal-based investing focuses on the inputs, not the outputs, of your investment plan. You benefit from the miracle of compounding returns, from risk reduction over time, and from the opportunity to earn excess returns. These fundamental truths give you the opportunity to afford and enjoy a long and healthy life. The greatest threat to a portfolio constructed this way is discussed next, and that is investor behavior.

**YOU—OUR CLIENTS**

**Important Investor Behavior**

The single greatest determinant of your investment success is your behavior. Research is good. Asset allocation is powerful. But your ability to stick with investments that align with your goals—not over the short term but the long term—will determine your success.

Here are several important considerations:

1. “Volaphobia”
2. Vulnerability to Risk of Loss
3. Bounciness
4. Murphy’s Law and Your Money
5. Your Ability to Own a Portfolio That Looks Different from Indices

Let’s look at each of them in more detail.

**“Volaphobia”**

Over the course of your investment life, the value of your portfolio will rise and fall. While we would always rather see our portfolio value rise, an astute investor knows that any investment will have some periods in which the value will fall. Stock markets, in particular, are volatile and investors should expect that there will be regular periods of rising prices and frequent periods of falling prices. These fluctuations can be painful.
Dr. Thomas Howard coined the term “volaphobia” to describe our emotional response to high-returning portfolios. The more our investments bounce around, the more our account values decline, and the more emotional we become. The more emotional we become, the more likely we are to make poor investment decisions. Volatility tolerance is emotional tolerance. If we can manage our emotions, then we can manage our volatile investments, and give ourselves the best chance of incredible success.

Volatility in our investments is like turbulence in an airplane. Turbulence very rarely (if ever) causes a crash. Instead of landing the plane every time we experience air turbulence, a pilot calmly asks the passengers to buckle up and take precautionary measures. We arrive at our destination much faster than we would any other way. Furthermore, as the statistics often show, flying a (faster) plane is actually safer than driving a (slower) car. Seasoned travelers overcome fear of turbulence just like experienced investors overcome volaphobia.

Our investments are like a fast-flying plane. As shown in the chart “Stocks, Treasury Bonds, Treasury Bills, January 1928-December, 2017”, the turbulent investment delivers higher returns and takes less time to do so, compared to other vehicles. Stock market gains are very fast. They happen over a short, completely unpredictable period of time. If we overcome our volaphobia, we may earn higher returns.

Vulnerability to Risk of Loss

You may have a conflict of interest with yourself. Your short-term fears may be in direct conflict with your long-term goals. Your wealth manager might advise you to invest more than you would like in high-returning but bouncy stocks. You may feel like you cannot afford to lose the money you have saved and still feel like you need those high returns to achieve your goals.
What can you do?

As a prudent investor, you should consider your ability to withstand short-term financial losses. Market downturns are unpredictable. You and your wealth manager must assess the real financial harm you might face if your portfolio seriously declines in value. If your portfolio fails to provide the returns you had planned, will you be able to adjust your goals?

You have two tools at your disposal: your cash reserves and your perspective.

Your cash reserves, with little-to-no short-term risk, help you avoid selling your long-term investments to pay for short-term needs. Academic research shows that six months of cash reserves are adequate. Two years of spending money in cash is more than sufficient.

Your perspective is critical to your long-term success. The chart below shows the best and worst one-year, five-year and ten-year returns of a 60% equity, 40% fixed income portfolio. As you can see, the longer your time horizon, the greater your short-term risk capacity.
Give a diversified investment portfolio time and it is likely to generate smooth returns, close to historical averages.

<table>
<thead>
<tr>
<th></th>
<th>1 Year</th>
<th>5 Year</th>
<th>10 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highest</td>
<td>32.9%</td>
<td>20.4%</td>
<td>17.0%</td>
</tr>
<tr>
<td>Average</td>
<td>9.0%</td>
<td>10.44%</td>
<td>9.6%</td>
</tr>
<tr>
<td>Lowest</td>
<td>-27.3%</td>
<td>-4.29%</td>
<td>1.8%</td>
</tr>
</tbody>
</table>

In this “balanced” portfolio, the lowest return generated over any ten-year period in the past was approximately 1.8% per year. The best return was 17% per year. In all cases, the average was 9% per year or more. Time and diversification dramatically reduce the risks of a worst-case scenario happening to you.

**Bounciness**

Most investors would not choose to take more risk than necessary. While this is a simple statement, investors often fail to build this concept into their investment plan. *Your need to take risk is directly tied to your rate-of-return objective.*

---

9 (Siegel, 2007) and Finance.yahoo.com
If you want your portfolio to grow more quickly over your time horizon, you will want a higher rate of return. Some people call this “catching up.” An increase in your rate-of-return objective, however, will generally mean experiencing more bounciness in the short term. If your return objective is higher than your willingness to take risk or your vulnerability to losses, then something must give. This could mean, for example, retiring later, trimming expenditures, and/or needing to take on even more risk later in life.

On the other hand, if your rate-of-return objective can be lowered because your assets can support your income goals, then your need to take risk is reduced and you can afford less bounciness. As your portfolio grows over time, your wealth manager will reassess your need to take risk and adjust your investment strategy accordingly.

**Murphy’s Law and Your Money**

You might feel like your investments follow “Murphy’s Law,” or that whatever can go wrong, will go wrong. For example, you may think that if you invest in stocks then the market is likely to decline shortly thereafter. Or if you invest in bonds, that Murphy’s Law will come around and you’ll lose money in bonds. You may look at that long-term graph of investment returns and say something like, “But that’s the past. What about my future?” Rest assured, you’re in good company. These feelings are very common!

We don’t know what the market will do, so we invest in a way that gives us the best chance of success. Like picking a chocolate from a box, we may pull out a winner or pull out something distasteful. In the stock market chocolate box, the flavors are usually delightful; most of the years are winners. The size of the winners is significantly larger than the size of the losers, so keep on investing, year after year. If you choose enough chocolates, the good ones are much better (than the bad ones are bad), and the good ones much more plentiful.

The following chart shows the returns, by year, for the S&P 500 stock market for the past century. The better the returns for the year, the further that year moves to the right side. Years with losses are on the left side of the chart, to the left of the green line near the middle of the chart. Notice the shape of this chart: a bell-curve, or standard distribution, with the most plentiful number of years stacking up with an approximate 10% return.

It is a grab-bag of returns, with the vast majority of them being positive—significant both in the size of their returns and the number of years with positive returns.
A Grab Bag of Returns

<table>
<thead>
<tr>
<th>&lt; -40%</th>
<th>&lt; -30%</th>
<th>&lt; -20%</th>
<th>&lt; -10%</th>
<th>&lt; 0%</th>
<th>&lt;10%</th>
<th>&lt;20%</th>
<th>&lt;30%</th>
<th>&lt;40%</th>
<th>&lt;50%</th>
<th>&gt; 50%</th>
</tr>
</thead>
</table>

What will next year bring for the stock market? More than two out of three years are positive and a good year’s return is historically much larger than a bad year’s losses. Statisticians call this a positive skew—the odds favor the investor.10

Since the 1920s, the stock market has had more than two good years for every one negative year and the gains from the good years are significantly larger than the losses. If you could flip a coin, knowing that ⅔ of the time heads would win, how would you bet? You would want to bet on heads. The same is true with stocks: the odds significantly favor the long-term stock market investor.

Investors who are near or in retirement often wish to remain financially safe—to protect themselves from stock market swings—by holding an all-fixed income portfolio. However, such a portfolio will tend to achieve returns only approximately equal to the rate of inflation. The typical couple retiring at age 62 has a joint life expectancy of 30 years.11 Without the inflation-beating potential of stocks, a retirement portfolio is subject to a gradual erosion of its value over time and may not meet this 30-year retirement income need.

Building a prudent portfolio requires careful consideration of stocks, bonds, and alternative investments.

10 (Siegel, 2007) and Finance.yahoo.com. See also Stern NYU website for a quick and easy way to get the same information, as of May, 2014: http://www.stern.nyu.edu/~adamodar/pc/datasets/histretSP.xls

The true risk is not the temporary loss of principal common in the stock market, but the permanent loss of purchasing power assured by inflation.

What will your money buy at age 85? Age 95? Age 100?

**Your Ability to Own a Portfolio That Looks Different from Indices**

Many investors are more comfortable when they know they are doing as well, or as poorly, as most other investors. A portfolio that tracks the returns of a popular index such as the S&P 500 can provide that comfort, but it is unlikely to deliver excess returns. The broad indices do little to help us evaluate what is the right investment for you.

Portfolios at A&I Financial Services may look substantially different than market indices, depending upon the research we’ve done at a particular point in time. As discussed later in this document, investments that differ from common benchmarks have the best opportunity to outperform those benchmarks.

*To potentially outperform a benchmark index, an investment must differ from the benchmark index.*

**Appendix 2: Our Research Team at Athena Invest** discusses at some length the key research findings that lead us to this conclusion: benchmarking a portfolio against any index leads to short-term bounciness and long-term underperformance.

Your ability to hold a portfolio that looks and behaves differently than the stock market indices frequently quoted by financial news sources is a key determinant of your long-term investment success.
The Strategic Portfolio Management Process

The financial goals and values you shared with your wealth manager at your Discovery Meeting have become the basis for your investment plan. This is not a one-time event, however. The Strategic Portfolio Management Process ensures that you are on track to achieve your goals. It is vital in managing the investment component of your overall wealth management plan.

The process has four distinct parts, as illustrated below:

**Gap Analysis**

This is an ongoing evaluation of your current situation. We reassess where you are now, where you want to go, and consider any actions or changes that may be necessary to maximize the probability of achieving what is important to you.

We may have experienced better returns than we expected, and then you and your wealth manager have a pleasant conversation about whether you want to keep it going or if you can afford to take some money “off the table.”
Sometimes, recent performance is negative. The stock market makes its gains in sudden bursts but often has periods of low growth or losses. A candid conversation with your wealth management advisor helps you determine if recent performance has caused a gap in your financial plan, or if it is perfectly normal, and whether you need to take action to reach your goals.

**Tactical Asset Allocation**
We may adjust your underlying holdings into the assets that will meet your financial goals. Change is one thing of which we are certain, and because proper asset allocation is so important, we periodically review each asset class to determine if it is still appropriate for your overall plan.

**Ongoing Performance**
Our Investment Policy Committee evaluates managers and investments on an ongoing basis. In particular, we look for their ability to consistently pursue an investment strategy and take high-conviction positions. We evaluate new investments, most of which never make it into the portfolio. We test our hypotheses and decisions to make sure we are on-target with the ingredients our wealth managers use to build your personal investment plan.

**Rebalancing and Reporting Progress**
During regular progress meetings, your wealth management advisor will ask you about any events in your life that may call for a change in your portfolio. These events might include, for example, the birth of a child or grandchild, changing your job or career, buying or selling property, the death of a parent, or a change in your marital status. When changes in your personal situation warrant adjustments/rebalancing within your portfolio, we make these changes as needed. We will also report on how your portfolio has performed, as well as specific activity in the portfolio, at our regular progress meetings.

**The Investment Policy Committee**
The A&I Investment team meets weekly to monitor all investment holdings and, if necessary, make changes. Because the assets in each strategy move differently from each other and a portfolio may be moving differently than the overall stock or bond markets at any point in time, the strategies are typically not traded often, potentially saving you from excessive short-term taxes. The committee reviews each holding, holds teleconferences and in-person due diligence meetings with investment managers, and challenges our own assumptions. The committee is the final layer of due diligence for your investments within A&I Financial Services.

The right way to manage money is to put together a team of the best investments available, whose managers behave differently from each other, and measure the consistency and conviction of the investment decisions. The portfolios we recommend for you are a customized, calculated collection of solid, time-tested money management philosophies. You may have money invested using some, or all, of the following strategies:
1. **Foundation Income:** Foundation Income is a wide-ranging and diverse set of investments that provide a steady total return in addition to delivering a competitive fixed income. For many investors, Foundation Income is the main substance of their retirement portfolio.

2. **World Growth:** World Growth is the most diverse stock portfolio we recommend and invests in a large number of the best run companies in the U.S. and the world.

   World Growth and Foundation Income both use the research of Chartered Financial Analysts (CFAs) at Litman Gregory.

3. **“Pure” Valuation/Profitability:** This portfolio of stocks provides high potential returns and the stocks held by this portfolio may or may not be companies you have heard about. The factors that make Pure a historically top performer among all the investment managers in the world are the unique strategy, consistency, and high-conviction investment decisions.

4. **Global Tactical:** As a general rule, the holy grail of stock market investing is being in the right investment at the right time. Global Tactical catches the underlying currents of the market and invests accordingly.

   Athena Invest provides the research for both Global Tactical and Pure Valuation/Profitability.

5. **Secular Bear/Bull Market Allocation (SBMA):** Beyond stocks and bonds, alternative investment mutual funds and ETFs (exchange traded funds) include commodities, precious metals, and currencies. SBMA is designed to move differently than the rest of your portfolio and is designed to smooth the ride for our clients.

Each of these strategies is described in greater detail next.

### Foundation Income

Some of your money may be invested in Foundation Income, a diverse pool of fixed income and total return investments in mutual funds and ETFs. Foundation Income uses the research of the Chartered Financial Analysts (CFAs) at Litman Gregory, discussed in Appendix 1.

Foundation Income is diverse. It may invest in U.S. Treasuries, corporate bonds (and other debt investments), foreign companies’ debt, sovereign foreign debt, foreign currencies, floating rate, fixed rate, inflation protected securities, real estate investment trusts (REITs), master limited partnerships (MLPs), and/or absolute return, among other investments.

The Litman Gregory investment process provides insight into the way the decisions are being made by the various mutual fund and/or ETF and/or ETN investment managers. Again, we believe in a diversity of opinions from the best, highest conviction, most consistent investment...
minds in the world. Our independence gives us the ability to move quickly, without a conflict of interest, in the best interest of our clients.

Implement sophisticated decisions simply.

While Litman Gregory’s due diligence and investment selection process is sophisticated, for our investment policy committee, the decision to act or not to act is simple: we follow the time-tested Foundation Income process. And for our clients, it’s even easier: just watch and communicate with your wealth manager.

World Growth
World Growth invests in a diverse array of the best companies in the U.S. and the world. World Growth may be invested in U.S., foreign, or multinational companies through stocks, mutual funds, and exchange traded funds (ETFs). The research team at Litman Gregory performs quantitative research, qualitative research, and then an onsite visit with fund managers before making their recommendations to us. Refer to Appendix 1: Our Research Team at Litman Gregory for more details on their renowned in-depth research.

Invest in a diverse choice of the best companies in the U.S. and the world.

International Risks and Rewards
One reason for investing overseas is the potential for increased diversification. By diversifying, we intend to increase the investment returns relative to the risks we take. International equities and U.S. stocks may move differently; they have a lower correlation than between different U.S. stocks. This tilts the odds toward achieving our intentions.

Investors all over the world prefer to invest in their own home markets. If we do not invest in overseas equities, then we miss two important benefits. First, overseas investments allow us to participate in the growth of the global economy. Second, international equities are a powerful diversifier, allowing us the opportunity to potentially reduce volatility without sacrificing potential growth.

Asset Allocation
Diversification through different regions around the world can provide additional opportunity. Our initial asset allocation approximately mimics the market capitalization of international stock exchanges.
Within each region, the market capitalization of the individual stocks will vary. We may choose smaller companies or larger companies. Additionally, we may find ourselves in more emerging markets and less developed markets, or the opposite, depending upon the best funds available through our research.

**Three Fundamental Beliefs for World Growth**

First, know the mutual fund/ETF manager. The research process at Litman Gregory puts the investment manager through an extensive due diligence process, including in-person interviews, to make sure we are confident they have a sustainable edge.

Second, World Growth is strategic and slow. World Growth portfolio trades infrequently, remaining tax-friendly and delivering long-term performance.

Third, stay diverse. Make sure the portfolio never makes a large enough bet that it will neither make a killing, nor be killed.

*No single investment is large enough for you to make a killing, nor be killed, financially speaking.*

These three features of World Growth make it different from other strategies. World Growth is the most broad, diverse stock portfolio at A&I Financial Services and is different from the other methods, described next.

**Pure Valuation/Profitability**

Some of your investments may be made in the Athena Pure Valuation/Profitability investment strategy, or Pure. Pure invests directly in stocks, not mutual funds or ETFs.
Pure takes advantage of behavioral investment mistakes made by other investors. Pure invests in companies overlooked by most investment managers, choosing stocks that have fallen out of favor. The screening process includes looking at a company’s leverage, net worth, dividends, and the research from sell-side analysts. Pure invests in companies with high expected cash flows and high potential growth prospects. The most attractive companies pay a dividend, have a considerable amount of leverage, and high expected future earnings expectations relative to their current price.

*We take advantage of thousand-year-old human nature. Thus we are confident we will maintain our edge for many years to come.*

Pure does not own a large number of stocks—likely around 8–12 different companies. The companies are sector-diverse, avoiding too much dependence upon any one area of our economy. Pure is not bound by the size of a company (avoiding only the smallest of companies) and it does not limit itself to a Morningstar (or any other) “style box”. Refer to “Appendix 2: Our Research Team at Athena Invest,” to learn about the research behind Pure. Over the years, Pure has won numerous awards for delivering superior returns.

**Global Tactical**

Some of your investments may be made in the Athena Global Tactical ETF portfolio. Global Tactical taps into the deep underlying currents of the market and then chooses an investment accordingly.

*We use a patented method to identify stock market trends.*

Global Tactical uses the patented “Market Barometer” from Athena Invest. As discussed under Academic Research elsewhere in this document, Athena has identified 10 different investment strategies for picking stocks. In “normal” markets, certain strategies perform, on average, the best. When the relative performance of the strategies changes, and other strategies start to outperform, then Athena makes a change to the “Market Barometer” and Global Tactical may take action.

Global Tactical forecasts the likely returns of various markets, including large U.S. companies, small U.S. companies, and international companies. Global Tactical makes an investment in the market with the highest expected return. In certain cases, the portfolio may invest using an ETF that moves twice as fast as the market (leveraged ETF). And, in severe downturns, Global Tactical may move to cash.
Global Tactical Anticipates Likely Market Returns

Odds of Success

Loss

Gain

When the market barometer predicts better-than-average returns, as shown in the blue line above, Global Tactical moves into an ETF that goes up more quickly than the market. If the barometer predicts low or negative returns, as shown in the yellow line above, Global Tactical may go into cash.

Global Tactical has the same characteristics as the stock market, shifted to the right or the left, depending upon whether the expected returns are high or low. Global Tactical increases equity exposure depending upon whether the expected returns are high or low. The characteristics of equity exposure are still there. If the expected returns from the stock market are negative, then the portfolio moves into cash.

Global Tactical taps into the large market currents and helps investors stay invested, knowing that their investments won’t just “buy and hope.” Instead, you can put your mind at ease.

Secular Bear/Bull Market Allocation (SBMA):
Some of your money may be invested in alternative assets in a portfolio called SBMA: Secular Bear/Bull Market Allocation. There are four components to the SBMA investment portfolio:

1. Relationships
2. Performance
3. Allocations
4. Weekly Maintenance

Relationships
First, SBMA only invests in publicly traded, marketable mutual funds or ETFs. This enables us to both purchase and sell investments, as necessary. Flexibility is a key element to SBMA.

From a rapidly growing universe of alternative investments, our investment committee researches the historical correlations between investments. We want assets that have little
relationship to stocks or to each other. In today's volatile investment environment, these are often hard to find. Some of the asset classes we may consider:

### Possible Assets in SBMA

<table>
<thead>
<tr>
<th>Precious Minerals (like gold)</th>
<th>Targeted International Equities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Natural Resources (like oil)</td>
<td>Real Estate</td>
</tr>
<tr>
<td>Currencies</td>
<td>Managed Futures</td>
</tr>
<tr>
<td>Commodities</td>
<td>Arbitrage and Private Equity</td>
</tr>
</tbody>
</table>

**Performance**

After finding a series of investments, the A&I Financial Services Investment Committee ranks them by their relative performance. Using a proprietary methodology, we choose the investments likely to deliver consistent positive performance and to maintain a low correlation with each other and with stocks and bonds.

**Allocations**

After determining the ideal investments for the asset allocations, and determining the technical trends are desirable, the investment committee layers the investments into a portfolio. We take great care to reduce the bounciness of your overall portfolio. Modern portfolio theory plays a key part in the asset allocation of SBMA.

**SBMA reduces bounciness**

SBMA uses modern portfolio theory to increase the likely returns for the amount of bounciness that a portfolio experiences.

As shown in the picture, SBMA reduces the overall bounciness of a portfolio and helps increase the chances of higher average long-term returns. Again, because the investments inside SBMA
each have an average rate of return that is historically independent of stocks and bonds, this may help you sleep better at night.

For investments that don’t easily fit into equities, bonds or other asset categories, which have a compelling potential value proposition, SBMA is our way to invest and test and benefit. Each investment stands on its own. And you benefit from just a little of the state-of-the art developments in the investment universe.
Appendix 1: Our Research Team at Litman Gregory

Litman Gregory (LG) is the investment manager for Foundation Income and World Growth portfolios. The disciplined multistep investment process is outlined below:

1. Step One: Performance Screens
2. Step Two: Due Diligence Questionnaire and Document Review
3. Step Three: Initial Portfolio Manager Interview
4. Step Four: The Site Visit
5. Step Five: Final Follow-up and Third-party Contacts
6. Step Six: Litman Gregory Research Team Approval

Step One: Performance Screens
There is no evidence for the persistency of performance. History may not be the best guide, but it is the only guide we have. As Winston Churchill once said about democracy, it is the worst form of government except for all the others. The same can be said for performance—it is the worst way to judge an investment, except for every other (at least at first glance). Thus, choosing an investment that will perform in the future requires much more than just a picture of the past.

To overcome these habits and challenges, past performance is considered at the outset of the six steps in the LG research process. First, the LG research team considers funds that have outperformed their peer group and benchmarks over a reasonably long period of time (five years or more). Past performance is useful only as a tool for identifying managers that may be worthy of further qualitative research.

Occasionally, the research team will consider newer funds with a shorter record. LG is also willing to take into account a manager’s institutional separate account record prior to the mutual fund’s inception if they believe such a record is meaningfully related.

Second, LG inputs the past performance information into their own proprietary database of manager returns, which incorporates separate account and mutual fund track records. In addition to absolute performance, LG takes into account:

1. Performance consistency, volatility, and downside risk relative to the fund’s peer group and benchmarks over a wide variety of time periods.
2. Special factors that impacted performance that may not be repeatable.
3. The dollar amount the manager was investing during the performance period.
4. Operating expenses. LG has low expense thresholds.

Comparative results determine whether the fund manager proceeds to the second stage: due diligence questionnaire and document review.

**Step Two: Due Diligence Questionnaire and Document Review**

Step one ranks the *quantitative* value of an investment manager. The second step of the due diligence process builds our understanding of the *quality* of the investment manager.

LG requires the investment manager to complete a 50-question due diligence application. LG then begins research into all of the fund’s literature.

> *Your mutual fund manager has to “apply for the job” to be entrusted with a portion of your investments.*

LG’s questions delve into the investment philosophy and process, portfolio management and risk control policies, team members and roles, their compensation practices and incentives, and growth plans. LG researchers read the fund’s shareholder reports and manager commentaries. They dig up media articles and interviews that may provide additional insights into the thinking, culture, and decision-making process at a fund or fund family.

Most investment managers, mutual funds, and ETFs fail the screens developed by Litman Gregory and do not make it past Step Two. If they do, they move on to Step Three.

**Step Three: Initial Portfolio Manager Interview**

LG conducts a detailed follow-up interview. In this process, LG researchers begin to qualitatively assess the manager’s discipline and skill. LG verifies that the manager’s actual practices are in line with the investment process articulated in the questionnaire and other documents.

> *We verify the consistency with prior decisions, written and verbal answers to build our trust.*

Litman Gregory measures the fund’s consistency across prior investment decisions, written answers, and interview answers. LG researchers want to understand the reasoning behind the manager’s investment philosophy and process. LG researchers interview members of the analyst team to assess their quality and contribution to the investment process.

After this initial contact, LG may eliminate the manager from further consideration (despite strong historical performance) due to major *qualitative* red flags. For example, LG may find the manager to be an empire builder and overconfident, not worried about excessive asset growth or spreading themselves too thin. LG may not be comfortable with the managers’ philosophy or research process, or may not see how their past success can be repeated and sustained.
If after the initial interviews LG is sufficiently confident with the manager’s investment process, discipline in executing that process, and plans for managing growth, then LG schedules a visit to the offices of the investment manager.

**Step Four: The Site Visit**

An LG research analyst schedules an onsite visit to money managers to spend time face-to-face with the analyst team and other key investment team members.

The agenda for the Litman Gregory researcher is to:

1. **Determine if there is consistency between the way the manager describes his/her investment process and the stock/bonds they actually own.** LG wants to know if the way that each stock/bond was researched and the justification for the buy decision are in line with the investment philosophy. LG researchers question the manager about holdings in the portfolio. LG does the same thing to assess their sell discipline, discussing why assets have been sold. If LG finds inconsistencies, either the manager is not disciplined in executing the strategy or their description of the investment process was inaccurate, and that money manager will not make the cut.

2. **Determine if there is consistency among all team members.** By talking to members of the analyst team, LG determines if everyone is on the same page and adhering to the stated process.

3. **Evaluate the quality of the team.** LG evaluates how educated, driven, focused, passionate, experienced, humble, confident, and performance-oriented the analysts are.

4. **Evaluate the culture and the compensation incentive systems.** LG determines if the team is likely to stick together. LG believes stability is critical to the ability of an investment organization to stay focused. LG looks for firms that have healthy work environments and where everyone is passionate about what they are doing. If personnel turnover has been an issue in the past, LG seeks to understand the reasons behind it.

5. **Understand management’s vision for their business.** LG wants to know how they see the firm changing over time, how the team might change, what other products they might launch, how big they want to get, etc. LG understands that all businesses want to grow and LG wants to see the desire for growth balanced against a clear understanding of the firm’s fiduciary responsibility to its current shareholders.

After completing the onsite visit, the LG researcher prepares a report and written recommendations to continue or discontinue pursuing and evaluating with that manager.
**Step Five: Final Follow-up and Third-party Contacts**

After Litman Gregory digests the information acquired during the site visit, they have additional questions that require follow-up. If there are further questions or issues that can’t be resolved from talking to the manager, LG uses their extensive industry contacts to do more detective work. Sometimes LG knows people in the industry who worked with key members of the team at another job or who used to work at the firm they are investigating. At times these contacts are invaluable. They also check firm references in situations when they think it will add value.

By the end of this stage, the LG researcher knows whether they will recommend the investment manager for approval to the rest of the LG team.

**Step Six: Litman Gregory Research Team Approval**

Finally, the lead analyst responsible for covering the fund presents his analysis and opinion at a Litman Gregory research team meeting.

*Before any fund recommendation is approved, the analyst must pass her thesis through a thorough, peer-review process.*

The analyst must convince the rest of the LG team via lively discussions and debates. Various people play the role of devil’s advocate, challenging the analyst to defend one point or another. This meeting typically lasts several hours, and in many cases it generates additional questions and issues for the analyst to go back and resolve before a final decision is made.

The research team meeting is an important final step in the Litman Gregory investment discipline. The analyst knows he will have to present his case before the entire research team and that his peers will be on the lookout for any analytical errors, cognitive biases, or shortcuts in research.

**Ongoing Monitoring**

After a fund joins the Litman Gregory Recommended List, LG continues to monitor it. The most important aspect of the monitoring process is a regularly scheduled “fund update” phone interview with the fund’s manager. In these calls, LG covers significant developments and changes in the portfolio, the team, the firm, etc., and LG continues to test their original thesis for recommending the manager. Any time there is a significant event, such as the departure of a team member, LG contacts the manager immediately to follow-up. In addition, fund managers and analysts often visit the Litman Gregory offices to meet with the research team.
Appendix 2: Our Research Team at Athena Invest

Some of your money may be invested using the research of Athena Invest, based in Denver, Colorado. Dr. Thomas Howard of the University of Denver, Reimann School of Finance, founded Athena Invest in 2006.

Athena is the key stock research partner for A&I Financial Services clients. Much of the academic research cited in this document comes from Dr. Thomas Howard. Our clients have the unique opportunity to meet the manager, upon occasion, at events in our offices, at Athena offices, or in other areas around Denver, Colorado.

Athena manages high-conviction portfolios designed to generate excess returns. Athena has patented a process to measure consistency and conviction, which Athena believes are leading behavioral indicators of performance. The process allows Athena to identify the best investment ideas and best managers, which in turn may outperform the market.

The best ideas from the best managers may give us excess returns.

Athena identifies the top managers in each strategy based on two factors: first, how consistently the manager pursues their stated strategy and second, the extent to which the manager takes high-conviction positions within their portfolio.

Athena patented the Strategy Based Investing methodology. Every month, they rank more than 7,500 active equity mutual funds and 5,000 stocks using data provided by various databases in combination with information from Athena’s carefully researched strategy database. This warehouse contains about 300,000 pieces of active equity holdings data.

Five Diamond Investments

Athena Investment portfolios are constructed in a disciplined process as depicted in the following diagram.
The monthly strategy-based research process is conducted.

A universe of high-quality investment opportunities is identified and ranked using a Five Diamond Scale.

Additional filters are applied to meet specific portfolio objectives (U.S., International, Income, etc.).

Specific investment criteria are applied. (Rating, strategy, sector, elements, etc.).

Risks are managed using ratings, sector diversification, strategy diversification, and other criteria.

Best available investments are selected.

Investments are monitored and sold when they no longer meet the specific investment criteria.

**Keys to the Patented Investment Process**

Athena Portfolios have the following characteristics:

- Rigorous academic foundation
- Patented research methodology
• Behavior-based leading indicators of consistency and conviction
• Disciplined portfolio and risk management
• High-quality, high-conviction portfolios
• Potential excess returns, low correlations and potentially lower downside risk

**Academic Research**
We use the latest in academic research to identify superior equity fund managers. Investment research shows that most mutual funds do not outperform their benchmarks. Surprisingly, the latest research shows that superior stock-picking skill is common among money managers. How could both of these statements be true?  

Stock-picking skill is not detected by many performance studies because many money managers over-diversify to match a benchmark. This dilutes the superior performance of their best ideas (biggest holdings). The typical fund starts out life underperforming after fees and gets worse with age. Declining performance is most likely the result of powerful industry incentives to benchmark to a popular market index.  

The reverse is also true: if a fund manager is allowed to concentrate on best ideas and avoid over-diversifying, then performance starts out strong and gets stronger with age. Such fund managers are strong enough stock pickers to more than cover their fees, and stock-picking skill improves with manager experience. The average 26 to 30-year-old fund that continues to concentrate on best ideas generates an excess net of fees return exceeding 1% monthly while beating the market an astonishing 84% of the time. Even less-experienced active managers who do not over-diversify outperform by an astonishing 6% to 12% annually.  

Three critical factors identify the best equity fund managers:

1. Investment strategy
2. Investment conviction
3. Investment consistency

We discuss the research on these three factors below:

---

12 (Siegel, 2007) and (Baker, 2004)

13 (Hunter, 2009, March) and (Wermers R., A Matter of Style: The Causes and Consequences of Style Drift in Institutional Portfolios., 2002 (July) working paper)

14 (Howard, March 2, 2010) and (Cremers, 2009)
Invest in Different Strategies
Money managers declare their investment strategy in the prospectus of their investments. One of the key tenets of portfolio management is diversification: we want investments that move differently from each other.

*Investment strategy: how a money manager goes about generating investment returns by analyzing, buying, and selling stocks.*

Morningstar Inc. of Chicago makes several claims that may not help investors truly diversify. First, Morningstar believes that small companies move differently than large companies and over time, small companies outperform. Second, some companies are “value” and some are “growth.” Third, investors can identify these “return factors.” Numerous academic research studies debunk these Morningstar style-box myths.

Fama and French, Nobel Prize-winning researchers, show that small companies did not perform any better from 1962–2006 and the “small company effect” was significant only from 1962–1983, which makes them of little use to investors today. Regarding value and growth companies, Oxford Professor Ludwig Phalippou proved that the “value premium is driven by only 7% of the market and 93% of market capitalization held most by institutional investors is value premium free.” We provide a full list of academic research studies at the end of this document. The collective conclusions of the academic studies are:

1. Popular tools, including style boxes, do not help when making investment decisions.
2. Skilled stock pickers do not stay in a style box and thus have style drift.
3. The existence of the small-firm effect and value premium are questionable.

To make prudent investment decisions, investors need better and different tools. Dr. Thomas Howard, University of Denver, finds that money managers gravitate toward one of approximately 10 different investment strategies. These strategies are shown below.
<table>
<thead>
<tr>
<th>STRATEGY</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitive Position:</td>
<td>Business principles, including quality of management, market power, product reputation, and competitive advantage. Consider the sustainability of the business model and history of adapting to market changes.</td>
</tr>
<tr>
<td>Economic Conditions:</td>
<td>Top-down approach based on economic fundamentals; can include employment, productivity, inflation, and industrial output. Gauges overall health of economy, resulting supply-and-demand situations in various industries, and best stocks to purchase.</td>
</tr>
<tr>
<td>Future Growth:</td>
<td>Companies poised to grow rapidly relative to others. The Future Growth and Valuation strategies are not mutually exclusive and can both be deemed important in the investment process.</td>
</tr>
<tr>
<td>Market Conditions:</td>
<td>Consideration of stock's recent price and volume history relative to the market and similar stocks as well as overall stock market conditions.</td>
</tr>
<tr>
<td>Opportunity:</td>
<td>Unique opportunities that may exist for a small number of stocks or at different points in time. May involve combining stocks and derivatives and use of leverage. Many hedge fund managers follow this strategy, but a mutual fund manager may also be so classified.</td>
</tr>
<tr>
<td>Profitability:</td>
<td>Company profitability, such as gross margin, operating margin, net margin, and return on equity.</td>
</tr>
<tr>
<td>Quantitative:</td>
<td>Mathematical and statistical inefficiencies in market and individual stock pricing. Involves mathematical and statistical modeling with little or no regard to company and market fundamentals.</td>
</tr>
<tr>
<td>Risk:</td>
<td>Control overall risk, with increasing returns a secondary consideration. Risk measures considered may include beta, volatility, company financials, industry and sector exposures, country exposures, and economic and market risk factors.</td>
</tr>
<tr>
<td>Social Considerations:</td>
<td>Company's ethical, environmental, and business practices as well as an evaluation of the company's business lines in light of the current social and political climate.</td>
</tr>
<tr>
<td>Valuation:</td>
<td>Stocks selling cheaply compared to peer stocks based on accounting ratios and valuation techniques. The Valuation and Future Growth strategies are not mutually exclusive and can both be deemed an opportunity strategy, but a mutual fund manager may also be so classified.</td>
</tr>
</tbody>
</table>
These **10 strategies** have correlation characteristics that aid in the construction of high conviction portfolios and reduction of risk. Some strategies work better than others and some of them move differently than others. Our equity researchers make recommendations based on this analysis. (Howard, 2010)

This strategy-based approach to equity selection measures the quality of money management separately from the manager’s past performance. The money managers are judged on their consistency and conviction to stated investment objectives.

**Invest with Conviction**

Investment managers who limit their investment holdings to their best ideas outperform investment managers who must compete with a benchmark. The table below shows the excess returns obtained by skilled active equity managers. The managers who have a long track record of investing the least like a benchmark index are the managers who have done best over time. In other words, the more experienced the manager, the better.

<table>
<thead>
<tr>
<th>Fund Years</th>
<th>Average Active R²-R Annual Net Fund Return in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-5</td>
<td>6.00</td>
</tr>
<tr>
<td>6-10</td>
<td>6.81</td>
</tr>
<tr>
<td>11-15</td>
<td>9.92</td>
</tr>
<tr>
<td>16-20</td>
<td>9.58</td>
</tr>
<tr>
<td>21-25</td>
<td>12.55</td>
</tr>
<tr>
<td>26-30</td>
<td>14.21</td>
</tr>
</tbody>
</table>

*Includes all active U.S. equity open-end mutual funds over the period from February 1980–February 2009. Index, lifecycle, target date, allocation, balanced, and 529 funds are excluded. This results in a sample of 4070 funds, with half still in existence in February 2009, for a total of 403,577 fund-month observations. The sample is survivor bias-free since it includes all active U.S. equity funds that existed in any month during this sample period. Excess monthly returns are net of the monthly S&P 500 return as well as automatically deducted management, trading, 12B-1, and other fees. Reported results are simple averages across funds. From this sample, the active RS1 - R1 funds are selected at the beginning of each month as those ranked in the bottom trailing one year S&P 500 R-squared quintile and the top trailing one year return quintile. Study methodology based on Amihud and Goyenko "Mutual Fund R² as Predictor of Performance" December 2008 NYU Working Paper. Study conducted by C. Thomas Howard, PhD, AthenaInvest, Inc. Data source: Thomson Financial*
Market and media forces compel many money managers to invest like popular benchmarks. However, as the following table shows, managers have only a few good investment ideas. Across all equity mutual funds (good and bad), a manager’s best ideas outperform the market. The investment in which the money manager is most confident is the investment that most often outperforms the comparable index by a significant amount. In this study, the “alpha,” or additional return, is greater than 6% per year for the “best idea.”

Based on Graph 3 in Cohen, Randy, Christopher Polk, and Bernhard Silli, 2009. Best Ideas, Harvard Business School working paper, (March 18). Graph shows the average, over the subsequent quarter, six factor risk adjusted annual alpha for the most overweighted stock in a mutual fund portfolio, the next most overweighted, and so forth. Based on all active U.S. equity mutual funds from 1991–2005.

Randy Cohen of Harvard Business School reveals that skilled equity portfolios managers can rank their best ideas. Their best idea outperforms their next best idea, and so forth. If we construct a portfolio of stocks with the best ideas of the best managers, we believe we can deliver excess return in your stock portfolio.

**Invest Consistently**

In another study conducted by Dr. Thomas Howard, managers who consistently buy stocks that fit their investment style generate excess returns. In other words, managers who stick to their knitting consistently outperform managers who buy stocks to match a benchmark index.
Based on 3065 strategy identified U.S. and international equity mutual funds, resulting in 335,751 fund-month observations over the March 1997 to May 2009 time period. Strategy consistency is based on the proportion of own strategy stocks held by the fund and is scaled to range from 0 (fewest own strategy stocks held) to 100 (most own strategy stocks held) within each strategy. Updated monthly. The reported returns are the average subsequent month fund return net of automatically deducted fees and the return on the S&P 500.

These studies independently confirm the skilled active equity managers are in fact capable of producing 4–6% excess returns. This is contrary to conventional wisdom citing the performance of all mutual funds as a whole. We separate the skilled manager from the average manager by:

1. Identifying the strategy
2. Measuring consistency
3. Measuring conviction

The result, we believe, will be significantly improved investment performance for your portfolio.

Works Cited


Important Disclosures

This material is provided for general information only and is subject to change without notice. Every effort has been made to compile this material from reliable sources; however no warranty can be made as to its accuracy or completeness. The information is provided for illustrative purposes only and does not represent, warranty, or imply that services, strategies, or methods of analysis offered can or will predict future results, identify market tops or bottoms, or insulate investors from losses. The material is neither an offer to sell nor a solicitation of an offer to buy any securities, or participate in any investment or trading strategy. Before acting on any of the information, please consult your financial advisor for individual financial advice based on your personal circumstances. The opinions expressed are solely those of the author.

The above portfolios are being managed through a fee-based account or agreement. The returns of the portfolios may be reduced by the applicable advisory fees. The portfolios may use funds that involve certain risks, which include increased volatility due to the fund’s possible use of short sales of securities and derivatives such as options, futures, and swap agreements. The use of leverage by a fund increases the risk to the fund. The more a fund invests in leveraged instruments, the more the leverage will magnify any gains or losses on those investments. The fund's use of derivatives, such as futures, options, and swap agreements may expose the fund to additional risks that it would not be subject to if it invested directly in the security underlying those derivatives. Investors should carefully consider the investment objectives, risks, and expenses of each mutual fund, including management fees and brokerage commissions. There are no assurances that any fund will achieve its objective and/or strategy. The mutual fund prospectus should be read carefully before investing.

Equity investments are subject to market fluctuations. It is possible to lose money by investing in equities. The principal value and investment return of the fund will fluctuate with market conditions.

Investors should carefully consider the investment objectives, risks, and expenses of each mutual fund, including management fees and brokerage commissions. There are no assurances that any fund will achieve its objective and/or strategy. Important information regarding each mutual fund is contained in the prospectus, which can be obtained from your financial advisor. The prospectus should be read carefully before investing.

Alternative investments may contain special risks to the underlying investment class such as currency fluctuations, political and economic instability, differing SEC regulations, and periods of illiquidity.

Past performance does not guarantee future results.

*Investment advisory services offered through A&I Financial Services LLC, a Registered Investment Advisor.*