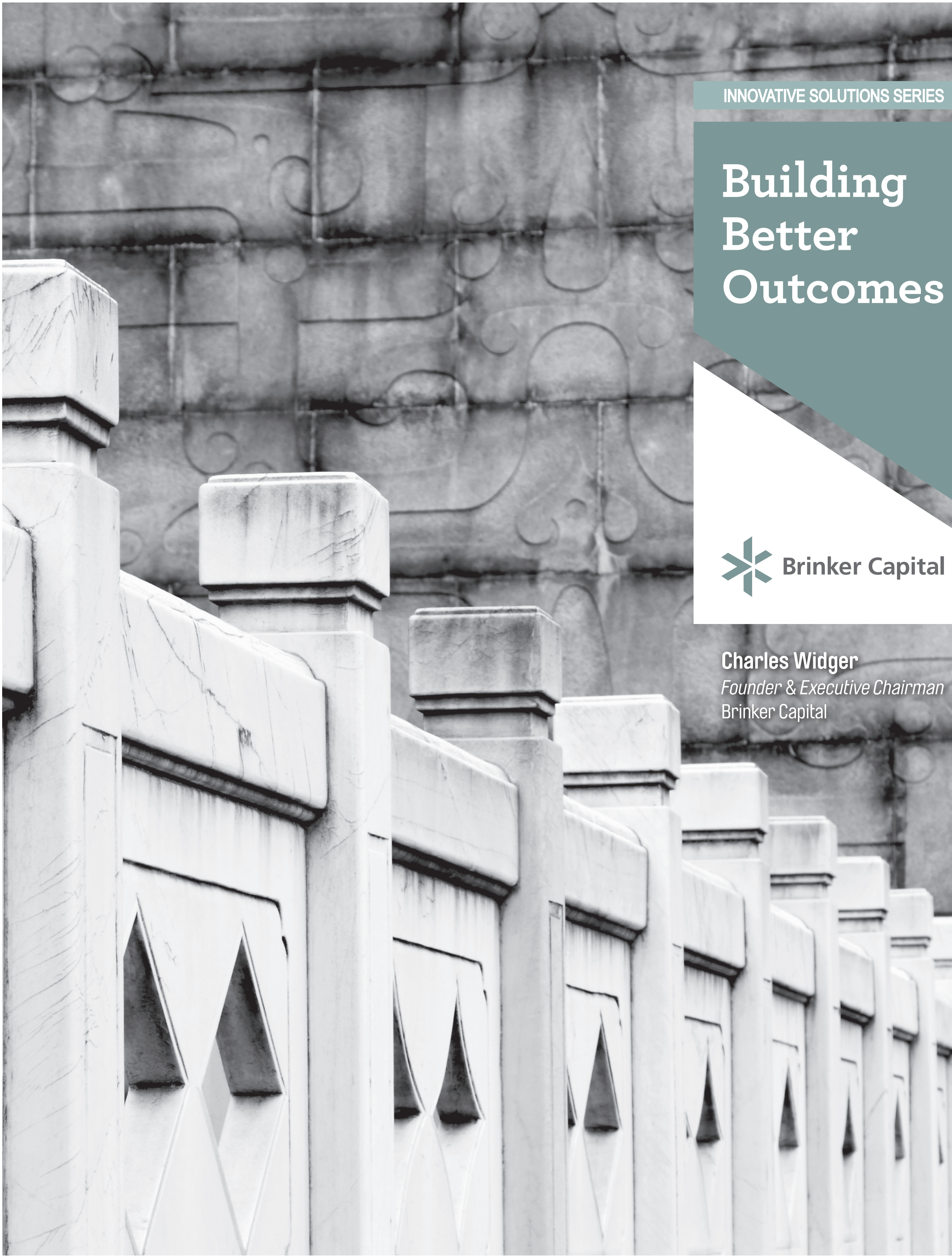

INNOVATIVE SOLUTIONS SERIES

Building Better Outcomes

Brinker Capital

Charles Widger
Founder & Executive Chairman
Brinker Capital

EXECUTIVE SUMMARY

The outcome investors typically seek when investing is the generation of a return to meet a real-world goal. Investors seek to grow their money and this money is used to pay for college, take a trip, pay for retirement, or achieve any other tangible goal they may have. *Building Better Outcomes* outlines the process Brinker Capital takes to help advisors and investors build better portfolios through multi-asset class investing. Sensible investors build portfolios with the broadest group of asset classes available to them. To that end, compounding return to successfully meet a goal takes an investment partner who is knowledgeable in investing theory and skilled in its application and implementation.

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1A - Creating Value for People

A comprehensive statement or listing of the principles that make up an investor's theory can be said to be the investor's investment philosophy. An investment philosophy is an articulated, intentional approach to generating returns. It is made up of a body of studied, tested, and formalized principles in which the investor's belief is so strong it rises to the level of professional conviction.[1] An investment philosophy that works creates real value for real people with real goals. "Nothing is so useless as an academic theory that goes unused, and nothing is so practical as a theory which works."[2]

Brinker Capital's investment philosophy is multi-asset class investing. Sensible investors build portfolios with the broadest group of asset classes available to them. Multi-asset class investing is the next evolution of balanced fund investing. While balanced funds invest in stocks and bonds, multi-asset class portfolios invest in real estate, commodities, absolute return strategies, venture capital, and private equity, as well as stocks and bonds. Three cherished principles – diversification, innovation, and active management – are the foundation of our multi-asset class investing philosophy. We will discuss our philosophy and principles in the three-step framework of theory, application, and implementation. As a predicate to the three-step explanatory framework, a brief history of multi-asset class investing is offered.

1B - A Journey Through History

It is plainly an ancient concept to diversify your investments. Investors have been diversifying or allocating their capital into different investments for centuries, but the challenges of the 1930s and World War II discouraged equity investing. When World War II ended in 1945, institutional investors, like endowments, and retail investors tended to emphasize bonds in their portfolios. Endowments were guided by the then-current version of the prudent man rule, which mandated an emphasis on fixed income in endowment portfolios. Scarred by the 1929 stock market crash and the Depression, individual retail investors avoided equities and embraced bonds. Bonds were made popular in retail markets because of the sale of government bonds to finance the successful war effort.

After the war, insightful business leaders like Charlie Merrill of Merrill Lynch recognized two important things. The successful offerings of government bonds broadly throughout the American public meant that millions of individual Americans had experienced successful investing. The second important premise in Charlie Merrill's corporate strategy to bring Wall Street to Main Street was his belief that as the dominant economic and military power after the war, America would experience a significant economic boom. This view did not reflect the conventional wisdom. As a result of Charlie Merrill's leadership, Merrill Lynch played a significant role in persuading and helping the American public embrace equity investing. The 1950s and 1960s were a time of great prosperity and success for talented equity investors. The 1970s were not. Burdened by excessive deficits financed by expansive money printing to finance war and huge increases in domestic spending, the 1970s were economically damaged by significant inflation and poor economic growth. This economic environment was called stagflation. Equities do poorly in a slow-growth economy characterized by inflation.

In 1981, Federal Reserve Chairman Paul Volcker led the assault on stagflation. Federal Reserve monetary policy pushed short-term interest rates to over 12% and squashed inflation by creating a severe recession during 1981-1982. With the inflation genie returned to the bottle, the economy returned to robust growth and equity markets soared. Retail investors, served by a large nationwide network of financial service firms, again embraced equity investing.

Pensions and endowments also embraced equity investing to meet the return goals needed to provide pension retirees with distributions and to satisfy the established endowment spending rates to support university and college operations. These institutions, pensions, and endowments were guided in shaping their investment policies by consultants like AG Becker. Consultants relying on decades of data providing risk and return information counseled institutional investors in the diversification of their portfolios into bonds, stocks, and other asset classes.

For retail investors in the 1980s, diversification meant portfolios made up of cash, stocks, and bonds, or so-called balanced portfolios. Until the mid-1990s, this was the basic diversification model for retail investors, but not for many sophisticated institutional investors. In the 1980s, many sophisticated institutional investors began to embrace a more sophisticated approach to diversification. These institutional investors, pensions and endowments, began to develop multi-asset class diversification. For these investors, sound investment policies included allocations to stocks, bonds, real estate, and commodities on a global basis through public and private vehicles. The most prominent institutional investor in developing the multi-asset class investment model was and remains David Swensen, chief investment officer of the Yale Endowment Office.

Multi-asset class investing has been more widely adopted by institutional investors from the 1980s to the present, and beginning in the mid-1990s by retail investors, because multi-asset class investing produces equity-like returns while managing volatility. While institutional investors benefited

[1] Swensen, David F. "Pioneering Portfolio Management." Free Press, 2009.
[2] Ellis, Charles D. "Winning the Loser's Game, 6th edition: Timeless Strategies for Successful Investors." McGraw-Hill, 2013.

from equity-like returns with managed volatility, retail investors did not until after the 2008-2009 financial panic and Great Recession. Unfortunately, many providers of investments to retail investors from the 1980s through 2008-2009 emphasized index-oriented or relative return investing. These providers encouraged advisors to benchmark retail investors to the S&P 500 or benchmarks that blended the applicable indexes such as the S&P 500, Barclay's aggregate bond index, EAFE, and other well-known indexes. Unfortunately, providers, advisors, and investors did not fully grasp the risk in index-oriented or relative return investing. If you design your portfolio to compete with or beat the S&P 500, you take on the risk in the S&P 500. Few investors, institutional or retail, actually want or can handle the -32% decline in their portfolios that occurred in March 2009. Since then, the outcome-oriented investing achieved through multi-asset class investment philosophies and absolute return investment strategies has become increasingly popular. Investment strategies focused on achieving attractive equity-like returns with minimum volatility have for many investors become preferable to relative return investment strategies.

Today, multi-asset class investing means different things to different people. Bloomberg's most recent *Fund Classifications*, published on September 2, 2013, describe eight asset classes: equity, fixed income, mixed allocation, specialty, real estate, money market, commodity, and alternative, as shown in Figure 1. This report was the first to include the alternative classification for mutual funds, clear evidence of a recent phenomenon.

Morningstar Inc. added "alternative" as a classification on July 31, 2008, and "multialternative" as a classification on April 30, 2011. Both of these are within the last six years.

Yale University uses seven distinct asset classes: domestic equity, foreign equity, fixed income, absolute return, natural resources, real estate, and private equity. David Swensen (2009) said the following about asset classifications in his book, *Pioneering Portfolio Management:*

> Purity of asset class composition represents a rarely achieved ideal. Carried to an extreme, the search for purity results in dozens of asset classes, creating an unmanageable multiplicity of alternatives. While market participants disagree on the appropriate number of asset classes, the number should be large enough so that portfolio commitments make a difference, yet small enough so that portfolio commitments do not make too much of a difference. Committing less than 5 percent or 10 percent of a fund to a particular type of investment makes little sense; the small allocation holds no potential to influence overall portfolio results. Committing more than 25 percent or 30 percent to an asset class poses danger of overconcentration. Most portfolios work well with around a half a dozen of asset classes.[p101]

Brinker Capital leverages David Swensen's original six asset classes: domestic equity, international equity, fixed income, absolute return, real assets, and private equity. From its founding more than 27 years ago, Brinker Capital's purpose has been to deliver an institutional quality investment experience to its investor clients. From its earliest days, Brinker Capital recognized that multi-asset class investing was and still is practiced on a global basis by most institutional investors. Pension plans, insurance companies, banks, and endowments are all multi-asset class investors. They invest in absolute return strategies, real assets, and private equity in addition to stocks and bonds.

FIGURE 1

Asset Class Focus

Equity	Fixed Income	Mixed Allocation	Specialty	Real Estate	Commodity	Money Market	Alternative
Invests in stocks	Exposure to fixed-income securities with maturity >1 year	Invests in a combination of variable- and fixed-income securities	Invests in non-traditional investments, specifically life policy, currencies, and derivatives	Focused on tangible real estate assets; real estate investment trusts (REITS) are not included	Either tangible or through the use of derivatives strategies to invest in commodities	Invests in fixed income instruments with a mean residual life to maturity of <1 year	Funds using hedge / derivative strategies

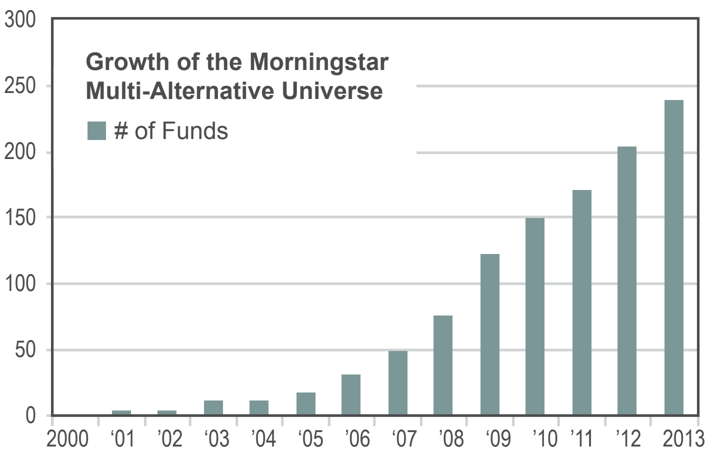
Source: Bloomberg. "Fund Classifications." September 2, 2013.

SECTION 2: DEVELOPMENT OF AN INVESTMENT THEORY

2A - The Future is Bright

Until recently, the investment management industry has offered retail investors few investment products that implement multi-asset class investing philosophies. That changed with the 2008-2009 financial crisis and the Great Recession. Since then, the number of investment products based on a multi-asset class philosophy available to the individual market has been greatly expanded both domestically and internationally. Based on the strength of this idea, we expect the popularity only to grow. One recent research study indicated that in Europe 43% of investment management firm capital investment is going into the development of multi-asset class products.[3] Also indicative of greater growth in retail multi-asset class products, Figure 2 shows the rapid growth in the number of mutual funds in Morningstar's multi-alternative universe.

FIGURE 2



Source: Morningstar, Inc., 2014

The continued embrace of multi-asset class investing by institutional investors and the ongoing expansion of retail multi-asset class and absolute return offerings we believe constitutes proof that it works. Multi-asset class investing does deliver equity-like returns and manage volatility. It is a theory that works and is therefore a practical solution for achieving the outcomes many investors seek.

2B - Don't Take Your Hand Off the Wheel

To be a successful investor, you have to have a theory. Successful multi-asset class investing is based on a theory, or a body of investment principles that have been studied, tested, and formalized over long periods of time. These principles have their empirical roots in observations and insights made, in some cases, hundreds of years ago. And, in many instances, these principles have been refined and enhanced through academic studies in recent decades.

Brinker Capital's multi-asset class investment theory is framed by three core principles: diversification, innovation, and active management. Three schools of academic thought have long validated the study, testing, and formalized statement of these principles as important guides to successful investing. The three schools of academic thought are investment theory, risk theory, and economic theory.

Investment theory, risk theory, and economic theory support diversification. Diversification has been a hallmark of investment theory since Harry Markowitz's paper "Portfolio Selection" was published in 1952. Diversification is key to the risk statistic tools and law of large numbers presented by Jacob Bernoulli in 1703, both important parts of risk theory. Even economic theory, which calls for specialization production, advocates diversity in your trading partners to allow the maximum overall utility for the group as a whole.

Similarly, innovation can be seen clearly across the disciplines as each theory presented improves our understanding of the subject matter. Fibonacci's innovation of bringing Arabic numerals to Italy in 1202 changed the way calculations were performed and allowed for further innovations in mathematics and risk theory. The advent of the Black-Scholes model in investment theory provided the ability to better price options and hedge portfolios. However, the greatest advocates of innovation are found in economic theory, led by Joseph Schumpeter's creative destruction and the Solow-Swan model of economic growth that use technology advances/innovation as one of the three major variables of growth.

The call for active management and specifically the ability to adjust probabilities to new information in risk theory is the focus of Thomas Bayes' "An Essay Toward Solving a Problem in the Doctrine of Chances" of 1763. Investment theory, despite findings of reasonable efficiencies in markets, continues to note the benefits of active management. Whether it be Graham and Dodd's "Security Analysis" in 1934 that discussed how to conduct fundamental analysis and make gains when the market offers mispriced securities or more recently Fama-French's 1992 three-factor model that notes the advantages of investing in high book-to-price and small cap equities, active management in investments continues to make sense. Finally, economic thought has been dominated by theories

[3] Cerulli Research Report, 2013.

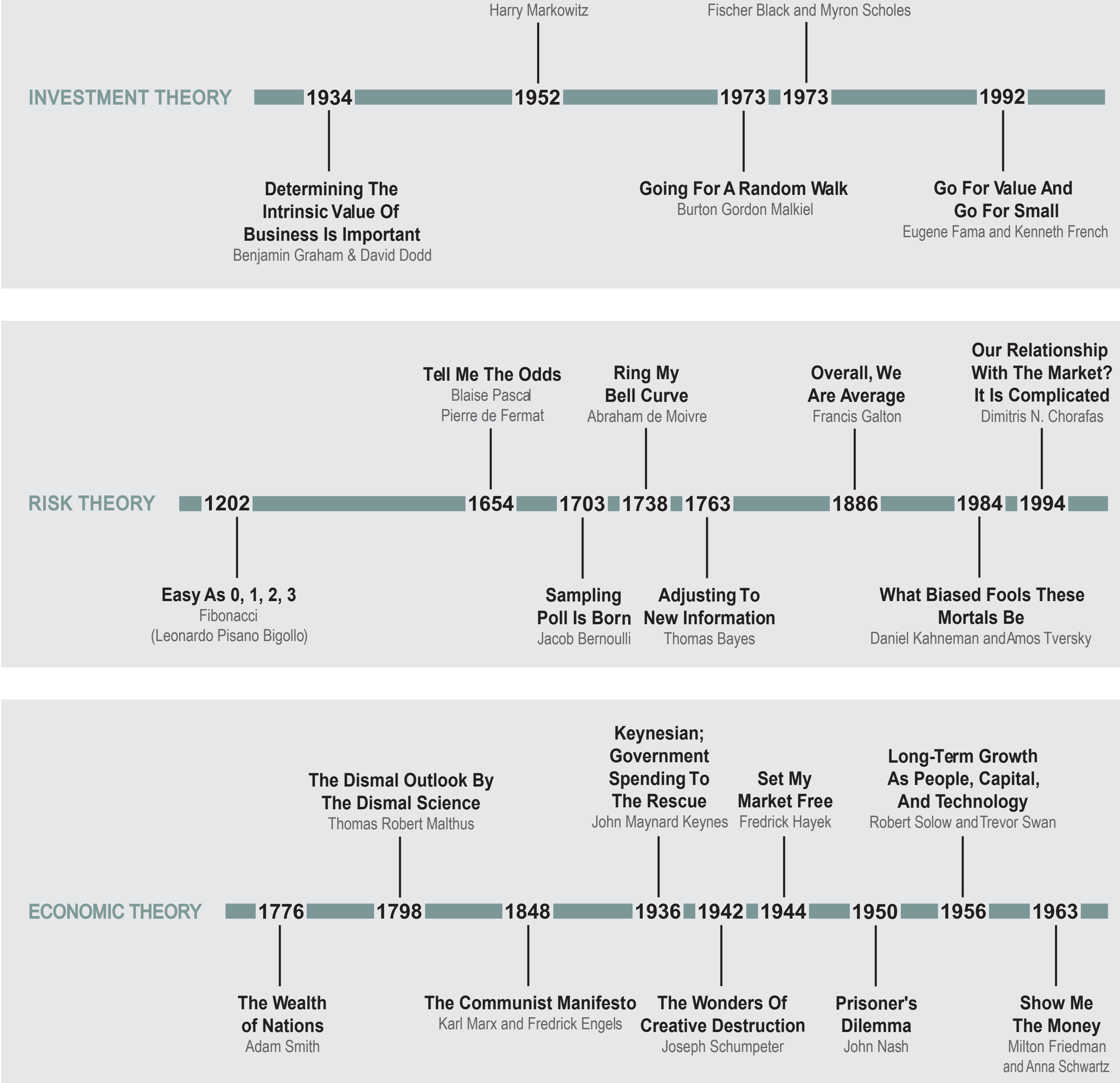
on how to better manage economies. Marx argued for full active control. Keynes argued for government intervention to help during periods of demand shortages. Friedman's government intervention is through money supply. Even the economic liberalism of Hayek calls for the government to help manage externalities in the markets. The message across the disciplines is clear; don't take your hand off the wheel.

2C - Investment, Risk and Economic Theory

Figure 3 plots key developments in investment theory, risk theory, and economic theory.

Clearly, principles of diversification, innovation, and active management are each supported by rich bodies of academic history and thought.

FIGURE 3



Source: Brinker Capital, 2014

2D - Equities Prevail

Another key principle Brinker Capital includes in its approach to multi-asset class investing is, except for its most conservative investor clients, an equity bias. People invest to fund current and future activities. Financing future activities requires increased purchasing power. Equity ownership provides greater returns than bonds; bonds offer nominal returns. See Table 1, which shows the differences in the historical returns for these two asset classes.

TABLE 1

Equities Generate Superior Returns in the Long Run
Wealth Multiples for U.S. Asset Classes and Inflation
(December 1925-December 2005)

Asset Class	Multiple
Inflation	11 times
Treasury bills	18 times
Treasury bonds	71 times
Corporate bonds	100 times
Large capitalization stocks	2,658 times
Small capitalization stocks	13,706 times

Source: Ibbotson Associates, Stocks, Bonds, Bills, and Inflation, 2006 Year Book.

Table 1, which presents the historical return data for stocks and bonds, shows that the annualized return for stocks is +5.7% more than bonds. This difference is the "premium" return paid to investors in equities for taking more risk. Because equity investors hold a residual claim on corporate assets (they get paid last when things go bad), they have taken more risk. This premium is called the equity risk premium. Without the equity risk premium, capital markets would not function. Stocks must return more than bonds to attract equity investors. Without the equity cushion there would be few debt investments.[4]

Finance theory holds that if an investor takes more risk, the investor should get more return. Table 1 demonstrates that historical experience matches the theory. The focus of serious long-term investors is use of the principles of equity ownership and non-correlated diversification.

2E - A Free Lunch

The 1950s and 1960s brought a profound change to the world of investments. Harry Markowitz, an unknown 25-year-old graduate student at the University of Chicago, led the charge when he submitted his paper titled "Portfolio Selection" for publication in the *Journal of Finance*. As Peter L. Bernstein wrote in his book, *Against the Gods: The Remarkable Story of Risk*, "That paper was innovative on so many levels, that it earned Markowitz a Nobel Prize in Economic Science in 1990."[5]

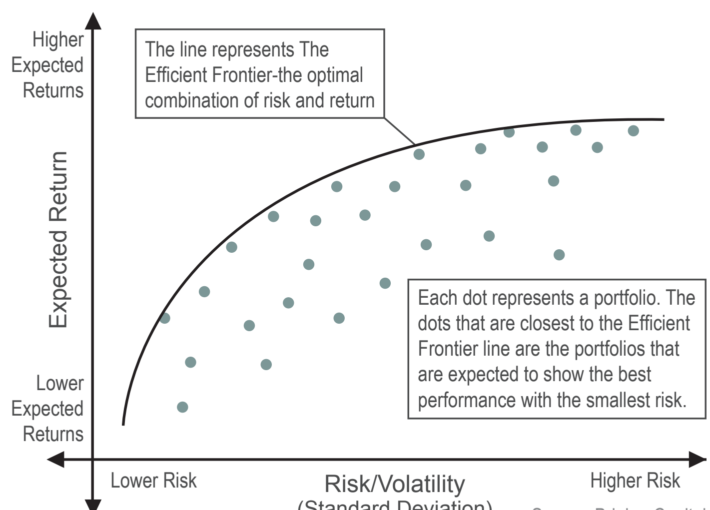
Quite simply, Markowitz defined risk mathematically for the first time. It is hard to believe but before Markowitz, risk was gut, experience, or instinct. "Throughout most of the history of stock markets—about 200 years in the United States and even longer in some European countries—it never occurred to anyone to define risk with a number." Markowitz did, and that idea quickly produced a dominant theory.

Once Markowitz measured risk mathematically, he extended his work and established two extremely important considerations for investors. First, investors can achieve an equivalent level of return with lower risk through diversification. Again, Bernstein (2008):

> The mathematics of diversification helps explain the attraction. While the return on a diversified portfolio will be equal to the average of the rates of return on its individual holdings, its volatility (Markowitz's mathematical term for risk) will be less than the average volatility of its individual holdings. This means that diversification is kind of a free lunch at which you can combine a group of risky securities with high expected returns into a relatively low-risk portfolio, so long as you minimize the covariances, or correlations, among the returns of the individual securities.

By incorporating different investments that are not highly correlated, investors can lower volatility while also preserving expected returns. Second, investors' will attempt to create an "efficient portfolio." An efficient portfolio is deemed to be the portfolio that yields the highest expected return for a given level of risk, as measured by the standard deviation (see Figure 4). By plotting all combinations of efficient portfolios whose return is the highest per unit of risk, one can construct an efficient frontier. Said differently, efficient portfolios use risk in the most effective way possible.

FIGURE 4



Source: Brinker Capital

When Markowitz developed his mean-variance framework in the early 1950s, a lack of computing power greatly limited practical use of his ideas. However, cheap computing has allowed for empirical testing of mean-variance analysis and other concepts of modern portfolio theory (MPT). Mean-variance analysis (the theory) has thus, over time, transformed into mean-variance optimization (the implementation), whereby computer algorithms solve for the efficient portfolio given estimated returns, standard deviations, and correlations. Since the original framework was

[4] Swensen, David F. "Pioneering Portfolio Management." Free Press, 2009. p.155.
[5] Bernstein, Peter L. "Against the Gods: The Remarkable Story of Risk." Wiley, 1998.

developed, investors have had nearly three decades and a financial crisis to better understand the effectiveness and limitations of MPT. Before reviewing the limitations of MPT,[6] let us first better understand some of its assumptions:

1) Transaction costs and other illiquidities can be ignored.
2) All investors hold mean-variance efficient portfolios (i.e., portfolios with the highest expected return for a given level of risk).
3) All investors hold the same (correct) beliefs about means, variances, and covariances of securities.
4) Every investor can lend or borrow any desired amount at the risk-free rate.
5) Investors can sell short without limit and use the proceeds of the sale to buy long positions.

While many of these assumptions may be appropriate for modeling purposes, a variety of empirical studies suggests that they do not likely hold for practical purposes. Harry Markowitz's quotation from a 1998 Money Magazine article is most illustrative when he says, "I should have computed the historical covariances of the asset classes and drawn an efficient frontier. Instead, I visualized my grief if the stock market went way up and I wasn't in it – or if it went way down and I was completely in it. My intention was to minimize my future regret. So I split my contribution fifty-fifty between bonds and equities" (Zweig, 1998, 118)[7]. More broadly speaking, MPT assumes that both investors and markets are largely efficient and that investor decisions are well informed and rational. Empirically, we know that not all segments of the capital markets are efficient and that not all investor decisions are well informed and rational. Moreover, the just-identified assumptions work for modeling but do not generally obtain results in practice.

Brinker Capital recognizes these limitations in applying its multi-asset class investing philosophy. Markets are difficult to forecast and not perfectly efficient; thus, the recent 2008 financial crisis also highlights that assumptions of "normal distributions" of volatility and constant correlations may also be flawed. Rather, experience suggests that fat tails and ever changing correlations are more likely to be experienced. Recognizing the uncertainties around input variables and flawed assumptions of the model has led to investors placing heavy constraints on MPT models. As David Swensen wrote, "unconstrained mean-variance [optimization] usually provide[s] solutions unrecognizable as reasonable portfolios…Because the process involves material simplifying assumptions, adopting the unconstrained asset allocation point estimates provided by mean-variance optimization makes little sense."[8]

Table 2 shows an example of an optimizer's unreasonable output. Twice annually, in January and July, Brinker Capital's investment team gathers to make forecasts for each of the six asset classes in our client allocations. In early January 2014, Brinker Capital's investment team agreed on the forecasts in the two columns labeled "2014 Expected Return" and "2014 Expected Risk." Furthermore, we agreed to use historical correlations. That column is not shown in the table. The output of the optimizer is shown in the column titled, "Optimized Recommendation." When compared to the "Current Allocation" column, it is perhaps surprising to see large differences. For example, current client allocations include percentage weight in each asset class. The optimized recommendation has zero in three of the six asset classes; it vacates international equity, fixed income, and real assets. Such an exit is not rational for four important reasons: trading costs, taxes, humility, and diversification. Investors are taxpayers, unless the assets are held in a qualified account such as a retirement plan. Wholesale movements in and out of assets produce unwanted trading costs and premature capital gains taxes. They are arrogant as well. It is wise to be humble in the face of uncertainty because our forecasts are not always correct. Finally, multi-asset class investing commits both the investment professional and the client to the principles of diversification.

TABLE 2

Asset Class	2014 Expected Return*	2014 Expected Risk*	Current Allocation	Optimized Recommendation
Domestic Equity	9.06%	13.99%	32.90%	14.00%
International Equity	8.86%	17.50%	14.10%	0.00%
Fixed Income	-1.10%	4.02%	30.00%	0.00%
Absolute Return	4.05%	6.07%	15.00%	55.98%
Real Assets	2.91%	14.55%	2.50%	0.00%

Source: Brinker Capital, 2014

Rather, Brinker Capital views mean-variance analysis and other tools of MPT as part of the overall mix of our investment process. Whereas a pure MPT framework would rely entirely on precise estimates of returns, standard deviations, and correlations, our diversified approach places greater emphasis on relative areas of outperformance, asset classes with higher risks, and a strong understanding of links among asset classes and strategies. However, perhaps the greatest contribution that MPT has made to benefit investors is that the benefits of diversification are without question. Regardless of model assumptions or efficient versus inefficient markets, a diversified portfolio should help smooth investor returns and create a better path for clients to obtain their financial goals. "The future is uncertain, so we can never know what will happen. Indeed, risk would not exist if we could correctly anticipate the future."[9]

The impact of Markowitz was far reaching on portfolio management. For example, in the area of fiduciary duty of trustees, the prudent man rule had been in place since 1830 and had required that investments be judged in isolation on their own merits and with a strong bias toward safety of capital. Directly because of the impact of Markowitz, this rule was updated in 1992 (just two years before Brinker Capital began to offer multi-asset products) as the Uniform Prudent Investor Act with an emphasis on modern portfolio theory and total return.

[6] "A Note on Harry M. Markowitz's Market Efficiency: A Theoretical Distinction and So What?" CFA Institute (Vol. 61, No. 5, 2005). [7] Shefrin, Hersh. "Beyond Greed and Fear: Understanding Behavioral Finance and the Psychology of Investing." Oxford University Press, 2000. [8] Swensen, David F. "Pioneering Portfolio Management." Free Press, 2009
[9] Markowitz, Harry. "The Efficient Diversification of Multi-Asset Class Portfolios." 1st Global (p. 3, 2010).

3A - Process Overview

To apply investment principles is to use the principles that make up your theory to create a strategic (long-term) plan for achieving the outcomes sought. In multi-asset class investing, Brinker Capital applies, or uses, the principles of diversification, innovation, active management, and equity bias to create models or strategic (long-term) plans for achieving investor goals.

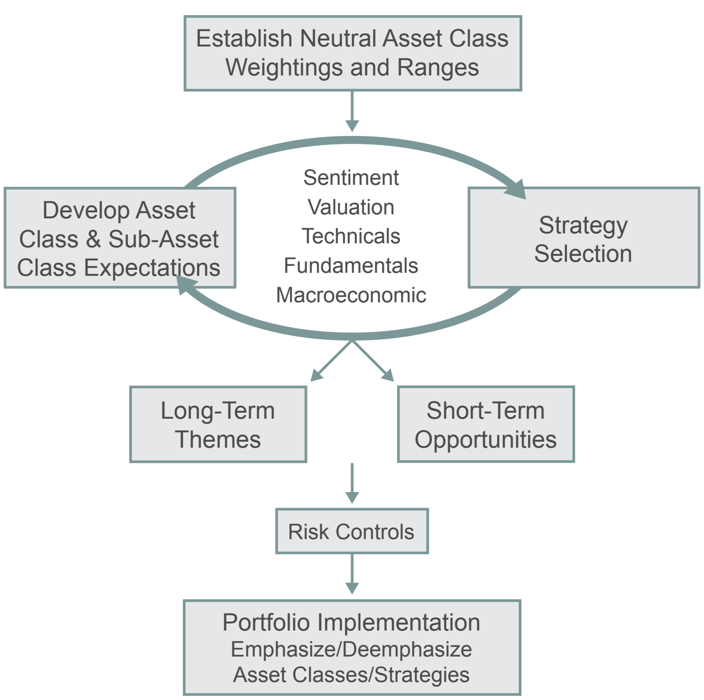
Today, using our investment philosophy as our foundation, we build broadly diversified strategies that span the risk-return spectrum. As we move further out on the risk spectrum, greater emphasis is placed on equity-oriented asset classes that possess a higher expected return, but also higher levels of volatility. This gives clients the ability to select a strategy that best fits their risk tolerance and time horizon. An investor's risk tolerance can be measured as the level of variability in returns an investor is willing to accept in his or her portfolio or as an acceptable level of capital loss, or drawdown, an investor is willing to withstand. The longer an investor's time horizon, the more willing he or she should be to take on additional risk to maximize returns over the long term.

3B - Establish Neutral Weighting

Our application process is strategic, meaning long-term in nature (see Figure 5). In it we establish neutral asset class or model weightings and ranges for the asset classes. We complement this strategic asset allocation with active management—shorter term tactical asset allocation decisions to take advantage of specific market opportunities—later, in the implementation phase. Tactical asset allocation decisions can be long term (expressed for 12+ months) or short term (expressed for less than 12 months).

FIGURE 5

Application Process for Brinker Capital's Multi-Asset Class Theory



Source: Brinker Capital

Brinker Capital offers portfolios across the risk-return spectrum, and each of these portfolios is managed to a desired risk or volatility level. To reach that desired risk level, we build the portfolios using an appropriate blend of our six major asset classes, combining lower volatility asset classes like fixed income with equity-oriented asset classes that offer a greater expected return, but with a higher level of volatility. This asset mix is our neutral, or policy, weight for each portfolio.

For simplicity, integrity, and familiarity, we represent our neutral asset mix using domestic equity, international equity, and fixed income, the three traditional asset classes. The traditional asset classes have longer historical return and risk data than the three non-traditional asset classes. As shown in Table 3, domestic stocks, international stocks, and fixed income have return and risk data going back 20 years. While the past is not always a prologue, it is common practice for professional investors to seek the longest streams of historical data when building neutral models along the risk-return continuum. Each asset class is represented by a broad market index, as shown in Table 3. We believe these market indexes best represent the asset class from a long-term risk and return perspective; however, they are not inclusive of all of the sub-asset classes in our opportunity set.

TABLE 3

Asset Class	Representative Market Index	20-Year Ann. Return**	20-Year Ann. Standard Deviation**
Domestic Equity	Russell 3000	9.3%	15.5%
International Equity	MSCI All Country World ex USA	6.7%	17.3%
Fixed Income	Barclays Aggregate	5.8%	3.7%

**20-year period ending November 30, 2013. Source: FactSet.

Using the long-term risk and return characteristics for these market indexes, we determine the appropriate asset mix that results in the desired risk level, measured by standard deviation, for each of the portfolios. A conservative investor is more sensitive to short-term losses and is willing to accept a lower return to better protect on the downside. A moderate investor can accept more risk than a conservative investor but balances the importance of both safety and return. An aggressive investor is willing to accept large fluctuations in value in exchange for a higher return.

Our six target risk portfolios presented in Table 4 and Figure 6 have neutral equity exposures ranging from 30% to 98% and standard deviation targets that range from 5% to 15%. We space our portfolios along the risk-return spectrum to ensure that each portfolio possesses its own unique set of risk characteristics.

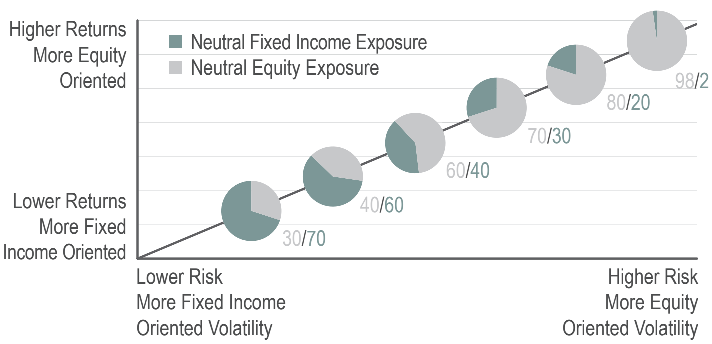
TABLE 4

Neutral Weight Models

Neutral Target Risk Portfolio	Neutral Equity Exposure	Neutral Fixed Income Exposure	20-Year Ann. Return**	20-Year Ann. Standard Deviation**
Conservative	30%	70%	6.7%	5.2%
Moderately Conservative	40%	60%	7.0%	6.5%
Moderate	60%	40%	7.7%	9.4%
Moderately Aggressive	70%	30%	8.0%	10.9%
Aggressive	80%	20%	8.2%	12.4%

**20-year period ending November 30, 2013. Source: FactSet.

FIGURE 6



Source: Brinker Capital

When determining the appropriate split of our equity allocation between domestic equity and international equity, several factors come into play. International equity markets are gaining a greater percentage of global equity market capitalization, and international markets offer diversification benefits, both of which argue for a higher allocation. However, we believe our investors prefer a home country bias, as they need to spend U.S. dollars, so we have settled on a neutral global equity allocation of 70% U.S. and 30% non-U.S. We increased this allocation from 20% to 30% of total equity in 2008 and will continue to monitor the appropriate mix going forward.

While our neutral asset class weightings are represented only by traditional asset classes, in practice we also allocate to non-traditional, or alternative, asset classes in all of our portfolios. We add the non-traditional, or alternative, asset classes (including absolute return, real assets, and private equity) to the neutral weight models in the implementation step.

In addition to determining neutral asset class weightings, we also determine asset class minimum and maximum allocation ranges for each of our portfolios. Our ranges provide flexibility for active management, but also ensure that our portfolios remain true to their target risk level and objective. The neutral allocations and ranges for our moderate portfolio are provided in Table 5. Compliance within these ranges is continually monitored, as is the reasonableness of the ranges.

TABLE 5

Asset Class	Neutral Weight	Range
Domestic Equity	42%	30-55%
International Equity	18%	11-27%
Fixed Income	40%	25-45%
Absolute Return	0%	0-20%
Real Assets	0%	0-10%
Private Equity	0%	0-10%

Source: Brinker Capital

SECTION 4: IMPLEMENTATION OF AN INVESTMENT THEORY

4A - Crossroads

Implementation is the busy crossroads where theory and application meet practice. At this important intersection, a financial advisor knowledgeable in theory and skilled in its application helps clients meet their goals, such as generating income for spending requirements and protecting the purchasing power of their savings. Clients expect their financial advisor to act as a fiduciary with independence and objectivity. Six asset classes provide portfolio managers with a large opportunity set and robust functionality. Multi-asset class investing offers clients the best chance to achieve their goals.

4B - The Power of Six

The foundation of our investment approach is broad diversification across and within six major asset classes, including traditional asset classes (domestic equity, international equity, fixed income) and non-traditional, or alternative, asset classes (absolute return, real assets, private equity). Each of these asset classes plays a role within a client's portfolio, such as growth, inflation protection, and uncorrelated returns or stability. Our sophisticated diversification approach provides us with great flexibility in building portfolios using combinations of the various major and sub-asset classes, resulting in a suite of investment solutions that can meet a multitude of investor goals and objectives.

Domestic Equity

Domestic equities represent ownership of a piece of a U.S.-based corporation and provide a direct link to growth of the economy. Over the long term, the driver of domestic equity returns is growth in company earnings. An equity investor can participate in the growth in company earnings and cash flow over time. However, over the short term, investor sentiment, as well as the market multiple, or how much investors are willing to pay for the company's earnings, can affect the price of an equity security.

The domestic equity asset class can be sliced by market capitalization. Market capitalization is a measure of the size of the company and is calculated by multiplying the share price by the number of outstanding shares. Larger capitalization companies are more liquid and have more research coverage, and therefore the sub-asset class tends to be more efficient. The opposite is true for those that are smaller and, as a result, the small cap space is less efficient. However, small cap companies can also have higher price volatility and therefore higher risk.

Equity investors can also target a specific type of company. Investors in growth-oriented companies are seeking a higher growth rate for a company's earnings stream than the overall market would deliver. A growth investor may seek companies that are growing earnings at a level of 15% or higher. Investors in value-oriented companies are looking for companies trading at discounts to their intrinsic value. Companies may trade at a discount for various reasons, such as membership in an out-of-favor industry. Investors can also target companies that pay a dividend. Historically, dividend-paying stocks have offered attractive downside protection to equity investors.

The higher expected return characteristics of equity-oriented assets fit with the need to generate substantial portfolio growth over time. However, these higher expected returns come with a higher level of risk, or volatility, from the asset class.

International Equity

The characteristics of domestic equities described above also apply to international equities, the only difference being where the company is domiciled. As with domestic equities, the long-term driver of international equity returns is growth in company earnings. However, during short periods of time, investor sentiment and factors influencing the price an investor is willing to pay for the company's earnings stream can affect equity prices.

The international equity asset class can be further broken down into developed economies and emerging economies. Developed international equities include companies based in developed economies like Japan, Western Europe, Canada, and Australia. Developed economies are comparable to the U.S. in terms of economic infrastructure and they will have common drivers of economic performance; however, markets in different regions can respond to different economic forces, causing differentiated returns.

For the period 1976-2007, MSCI (the foreign developed markets) indicates an annualized return of +10.8% for North America, Europe, and Asia. The S&P 500 was up +11.2% for the same period. However, investors in foreign developed markets must be mindful of two important characteristics – periodic structural changes and changes in national policies. These are differentiating characteristics.

Emerging economies, such as those in Asia, Latin America, and Eastern Europe, offer attractive growth prospects but can also be less stable as their economies and capital markets are still developing. Emerging economies continue to represent a growing share of the global economy. Emerging market equities can provide higher expected returns than developed equities, but with higher levels of risk.

Because these faster growing economies have become more like developed markets and participate in the global economy through world-class companies, they should play a more central role in a portfolio. However, because of immature regulatory environments, investors need to proceed with caution.

The key takeaway is that equity investments in different regions have different economic exposures and thus generate differing return patterns, thereby creating greater diversification. Additionally, international equity investment creates exposure to foreign currencies. Currency exposure is a generally accepted risk. Realistic investors understand that over time currency fluctuations offset one another and therefore do not speculate in currencies. Moreover, finance theory argues that currency exposure increases portfolio diversification, provided foreign currency exposure is no more than 20-25% of portfolio assets.

Fixed Income

Fixed income securities, which represent loans to other entities that are paid back over time, can generate stable cash flows for investors and offer low volatility compared to other asset classes. Additionally, they offer the opportunity for price appreciation as bond prices and interest rates have an inverse relationship; when interest rates fall, bond prices rise, and when interest rates rise, bond prices fall. To capture this price sensitivity, duration is a measure of the price sensitivity of a bond to changes in interest rates. Longer duration bonds exhibit greater price sensitivity to interest rate moves than shorter duration bonds. If an investor holds a bond until it matures, he or she will have received coupon payments over the life of the bond and the principal would have been returned at par value. However, over the short term, movements in interest rates and credit spreads can have a significant impact on bond prices.

Related to this, a key role for U.S. Treasury securities is as deflationary protection. Given the lack of credit risk due to the implicit guarantee of the U.S. government and the fixed payment present in the majority of debt instruments, Treasuries should increase in value as rates drop in response to an economy in decline.

Investors in the fixed income market can target multiple sectors, some of which offer significant depth and liquidity, and others that are less efficient and offer less liquidity. Debt issued by the U.S. government (U.S. Treasury securities) or debt that offers an implicit guarantee of the U.S. government, like government agency debt and agency mortgage-backed securities, are large, highly liquid sectors of the fixed income market. Investors can also allocate to debt issued by corporations, debt issued by international and emerging market sovereigns, and debt issued by U.S. state and local municipalities that currently enjoy tax-exempt status.

In addition to allocation to specific sectors of the market, fixed income investors can target allocations to securities with a specific duration mandate (short, intermediate, or long) or with a specific credit quality mandate (high quality or high yield). Brinker Capital employs a core satellite approach when constructing our allocations to the fixed income asset class, where allocations to passive and/or active broad market strategies are bolstered by meaningful allocations to various fixed income sectors. This approach provides maximum flexibility to use our active management style to capture market opportunities across and within sectors.

Absolute Return

Absolute return strategies are actively managed strategies that seek to exploit market inefficiencies to generate attractive risk-adjusted returns. Absolute return strategies typically rely on manager skill to deliver alpha, or outperformance versus traditional asset classes. Strategies considered absolute return may have little or no beta, or market sensitivity, to traditional asset classes or may simply have a key driver of performance that is independent of traditional equity and fixed income strategies. Because their return stream is wholly or partially independent of overall market returns, absolute return strategies provide meaningful diversification benefits.

Types of absolute return strategies include but are not limited to long/short equity, market neutral, relative value, event driven, and global macro. Investors can allocate to specific absolute return strategies that complement their overall portfolio. Over the long term, the return of absolute return strategies should be alpha driven by active manager skill since these strategies should have low correlation to traditional asset classes. Over the short term, returns can be driven by market fluctuations and asset cross-correlations.

Historically, absolute return strategies have been offered in a limited partnership structure. However, today there is an expanding universe of absolute return strategies structured as mutual funds. Brinker Capital prefers accessing absolute return strategies through mutual fund vehicles because of the attractiveness of daily liquidity, daily pricing, and greater transparency. Absolute return strategies accessed through separate account vehicles are also attractive for those reasons.

The selection of absolute return managers requires significant resources and expertise. Casual manager selection will almost certainly lead to disappointment given that absolute return manager success is all about skill in selecting individual securities based on serious, in-depth research and expertise.

Real Assets

Real assets exhibit a higher correlation to inflation, most notably unexpected short-term inflation spikes, and thus help protect against a loss of purchasing power. Inflation erodes an investor's purchasing power over time. A decrease in purchasing power means that it takes more dollars to purchase the same basket of goods and services; clients will need more money to maintain their standard of living. Investors can combat this loss of purchasing power with an allocation to real assets. Allocations to real assets can be shifted over time in response to the economic environment. For example, the allocation to real assets may be higher in a high-inflation environment but lower during periods of falling inflation.

Real assets typically include a variety of strategies such as real estate, commodities, natural resources, and Treasury Inflation Protected Securities (TIPS). Because individual real assets strategies can react differently to changes in inflation, it is important to diversify within the asset class. Supply and demand factors are key drivers of value for real assets.

Real estate investments provide exposure to the benefits and risks of owning office properties, apartment complexes, industrial warehouses, and retail establishments across the globe. Real estate investments also provide a cash flow component. Investors can access real estate through private investments or through publicly traded real estate investment trusts (REITs). Typically, all but large, sophisticated institutional and large family wealth offices prefer public investment vehicles. Our experience indicates that during periods of financial system stress or economic duress, accredited investors do not want to own illiquid investments. In other words, private investments sound good at the outset. However, the inevitable bumps during the holding period trigger an uncomfortable awareness of risk and a demand for unavailable liquidity. Thus, Brinker Capital does not offer private investments. Rather, it provides access to these asset class strategies through public vehicles.

Real estate is highly correlated to inflation because the labor and materials used to construct buildings rise in cost with inflation. Key to a positive correlation is equilibrium in supply and demand. Additionally, investment properties that can adjust their rents in response to inflation can pass these increases directly on to their investors.

Commodities are basic goods of value, of uniform quality, produced in large numbers by many producers. In addition to protection against rising inflation, historically, commodities have offered diversification benefits because of their lower correlations to traditional asset classes.

Natural resources equities provide exposure to commodity prices, but also can benefit from the operating leverage of the company. Through equities, an investor can also gain exposure to certain commodities that are not traded on futures exchanges.

TIPS are securities issued by the U.S. government that are indexed to inflation. In addition to coupon payments, investors in TIPS will receive a semi-annual adjustment in their principal value depending on the level of the consumer price index (CPI). Investors in TIPS will directly participate in periods of rising inflation; if the CPI increases, the principal of the bond will increase. Because TIPS are a fixed income instrument, they do have duration risk and will be affected by movements in interest rates.

Private Equity

Private equity is equity capital that is not quoted on a public exchange. Private equity investors make investments directly into private companies or conduct buyouts of public companies. Private equity funds, which raise capital from investors, will then try to improve the financial and operational results of a company with the intent to sell the company at a later date for a profit. Private equity strategies are often categorized as leveraged buyouts, venture capital, and special situations, such as mezzanine and distressed deals.

Private equity is most commonly accessed through limited partnerships, where a long holding period is required and investor access is limited. Investors can also gain exposure to private equity through publicly traded companies that have underlying private equity investments. These listed private equity companies are relatively new in the U.S., but global markets have broadly accepted the vehicles for decades. The public markets serve as a constant investment pool for private equity managers and, in most structures, public investors can gain access to the same deals as investors in the limited partnership. While limited partnerships require long lock-up periods, listed private equity companies offer daily valuation and liquidity.

Private equity investments seek to generate higher returns relative to other equity strategies, but with greater levels of risk. Private equity is viewed as less of a diversifier and more as a way to enhance overall portfolio returns. While over the short term, prices of listed private equity companies are affected by market sentiment and the credit markets, over the long term, investors should benefit from higher exit values due to operating improvements in underlying portfolio companies.

Brinker Capital has found ways to access the expected higher returns from private equity through the careful selection of specific "liquid private equity" opportunities.

Brinker Capital's skills and research resources dedicated to thorough due diligence identify and select for inclusion in certain client portfolios small capitalization securities where managements are focused on enhancing operations and growing the business. In addition, active management of investment in publicly traded affiliates of large private equity firms presents meaningful opportunities to augment the equity returns in client portfolios. Brinker Capital has identified such a strategy and included it in client portfolios.

Because access to top-tier active managers is difficult, private equity makes little sense for most investors. However, for investors like Brinker Capital, with the resources and expertise to conduct careful due diligence, "liquid private equity" opportunities can enhance return.

Asset Class Summary

In Table 6 we summarize the basic characteristics of these six asset classes.

TABLE 6

Asset Class	Return	Risk	Key Portfolio Role
Domestic Equity	High	High	Mature economic growth exposure
International Equity	High	High	International economic growth exposure
Fixed Income	Low	Low	Stability and Income
Absolute Return	Various	Various	Returns with low correlation to the markets
Real Assets	High	High	Short-term inflation hedge
Private Equity	Very High	Very High	Young business growth exposure

Source: Brinker Capital

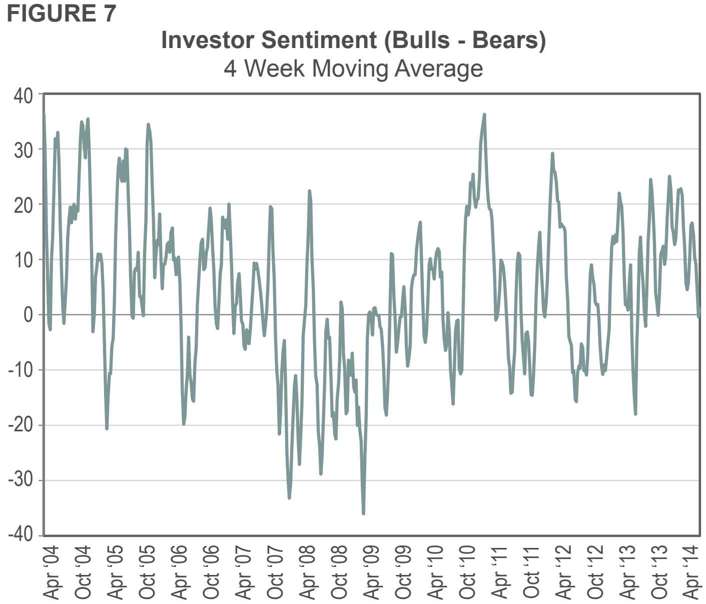
4C - The New Mosaic

We implement our active management from an asset class, strategy, and manager selection perspective. Importantly, this is an iterative process best done by generalists. A specialist in manager due diligence and selection is often blind to asset allocation considerations such as which asset class is favored. Instead, the specialist knows only best manager performance and capability. On the other hand, an asset allocation specialist is familiar with trends in each asset class but unfamiliar with the best managers in each asset class. Brinker Capital's investment managers are skilled in both asset allocation and manager selection. We have developed a framework to assist in developing return, risk, and correlation expectations for major asset classes and sub-asset classes. The basis of this framework is building and then interpreting a mosaic of a number of market and economic-related factors. The mosaic allows us to determine the relative favorableness or unfavorableness of the various asset classes and sub-asset classes. The components of the mosaic – sentiment, valuation, technicals, and the macroeconomic environment – are described in greater detail next.

Sentiment

Investor sentiment measures how positive (bullish) or negative (bearish) groups of investors are about the equity markets at any given point in time. Sentiment is a contrarian indicator, so when sentiment is negative, meaning investors are extremely pessimistic about the equity markets, it is often a great entry point. And when sentiment is elevated and investors are exhibiting excessive optimism in equity market prospects, it often signals a market top. Sentiment is typically measured by survey, as shown in Figure 7, but it can also be measured by examining flows into various asset classes of mutual funds. If investors are moving significant amounts of capital into domestic equity funds, for example, this could be a sign that sentiment is elevated. However, sentiment can remain elevated for some time, so it is important to consider sentiment in the context of the other factors in the mosaic.

FIGURE 7

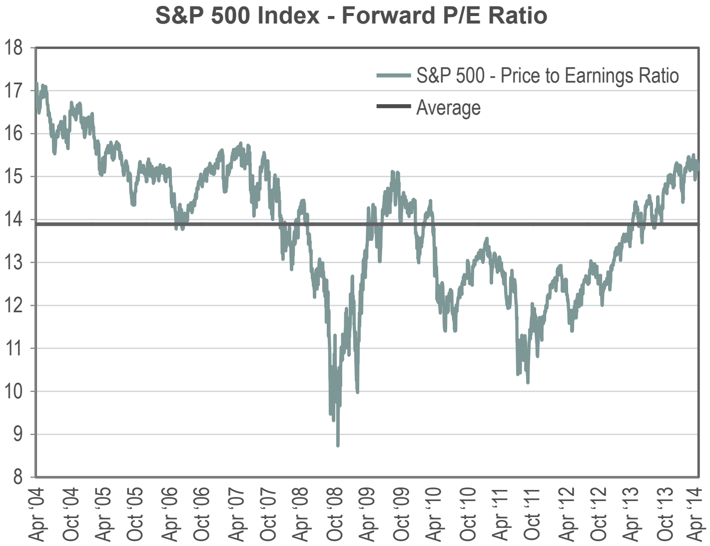


Source: FactSet

Valuation

Valuation measures the worth of an asset. Financial assets can be valued using absolute measures that determine the present value of the asset's future cash flows or relative measures that determine value based on similar assets or history. A number of commonly used relative valuation metrics exists, including price to earnings (using both historical and expected future earnings), price to book value, price to cash flow, enterprise value to earnings before interest, taxes, depreciation, and amortization (EBITDA), enterprise value to sales, price/earnings (P/E) to growth, and the Shiller cyclically adjusted PE ratio (see Figure 8). It is important to incorporate a number of different valuation metrics into the mix and compare current valuation to historical valuations for context. Similar to sentiment, both elevated and compressed valuations can persist for an extended period. With that said, elevated valuations relative to history should prompt caution when determining a view on an asset class; however, low valuations are good entry points for investors as we saw in the equity markets following the 2008 financial crisis.

FIGURE 8

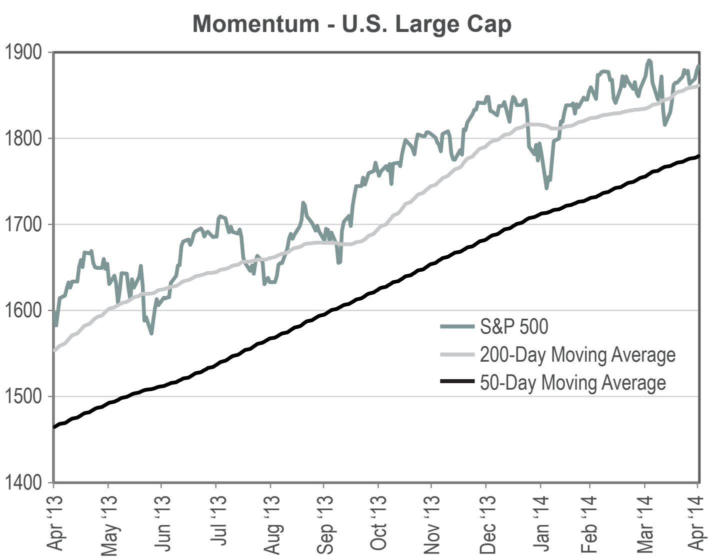


Source: FactSet

Technicals

Technical analysis is a security analysis discipline for forecasting the direction of prices through the study of past market data, primarily price and volume. Technical analysis relies on the basic dynamic of supply and demand. Momentum can be a very strong factor driving asset prices (see Figure 9). We look at the price trends of various asset classes and sub-asset classes compared to their shorter term (50-day) and longer term (200-day) moving averages. Should an asset class fall below its 200-day moving average, this may be cause for concern.

FIGURE 9

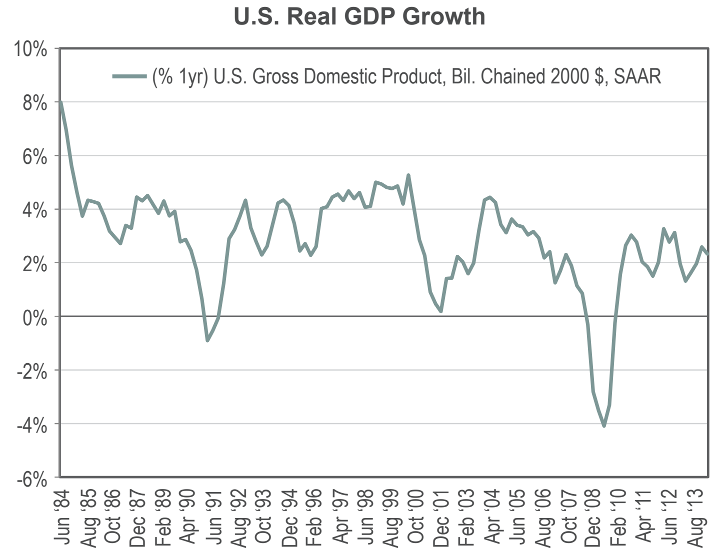


Source: FactSet

Macroeconomic Environment

The macroeconomic environment can affect all asset classes and strategies in various ways, so it is important to understand the sensitivity of those asset classes to changes in the macro environment (see Figure 10). The macroeconomic environment includes an assessment of the global economy, including growth and inflation measures, interest rates, and global monetary and fiscal policy, which can have a significant effect on economic growth and confidence as we saw following the 2008 financial crisis. For example, a weaker global growth profile will weigh on company earnings and could push valuation metrics lower.

FIGURE 10



Source: FactSet, Bureau of Economic Analysis

When determining our short-term (<12 months) and longer term (>12 months) views on major and sub-asset classes, we interpret the mosaic created by sentiment, valuation, technical, and macroeconomic factors. We determine both a short-term and a longer term view on the asset classes, determining return and risk expectations, as well on how an asset class will behave relative to other asset classes given the mix. The resulting portfolio allocations will be weighted based on how favorably or unfavorably we view the asset classes.

Implementation: Strategy Selection

Once we have determined our views on the major and sub-asset classes, we decide how best to implement those views, which is where we begin our strategy selection. Strategy selection discussions are often concurrent with asset allocation discussions. We often receive input from our underlying managers that helps in building the mosaic for the asset classes.

SECTION 5: ACTIVE MANAGER SELECTION

5A - Why Active?
5B - Quest for the Best
5C - Time to Build

5A - Why Active?

A major decision for strategy selection is whether to express the asset class view passively, allocating to a beta-oriented position, or express the view through the use of an actively managed strategy. If we are seeking pure asset class exposure, we will opt to express that view using a passive exchange-traded product or index fund. A passive vehicle will deliver the exposure in a cost-effective manner and without the worry of style drift. In addition, using passive vehicles also allows for more specificity in implementing the asset class view as these vehicles, primarily exchange-traded funds (ETFs), can offer very granular exposures.

We prefer active management in a number of situations, including when we are targeting inefficient segments of the market; an active manager can add significant value when that manager has a significant competitive advantage or when a desired exposure cannot effectively be replicated passively.

Another way to determine where active management is appropriate is to look at the dispersion of the returns of active managers across asset classes. In asset classes where there is a high level of dispersion between the returns of a first quartile manager and a third quartile manager, active management makes sense. See Table 7 and Figure 11. An investor will be rewarded for selecting a top-performing manager.

TABLE 7

Dispersion of Active Manager Returns (%)

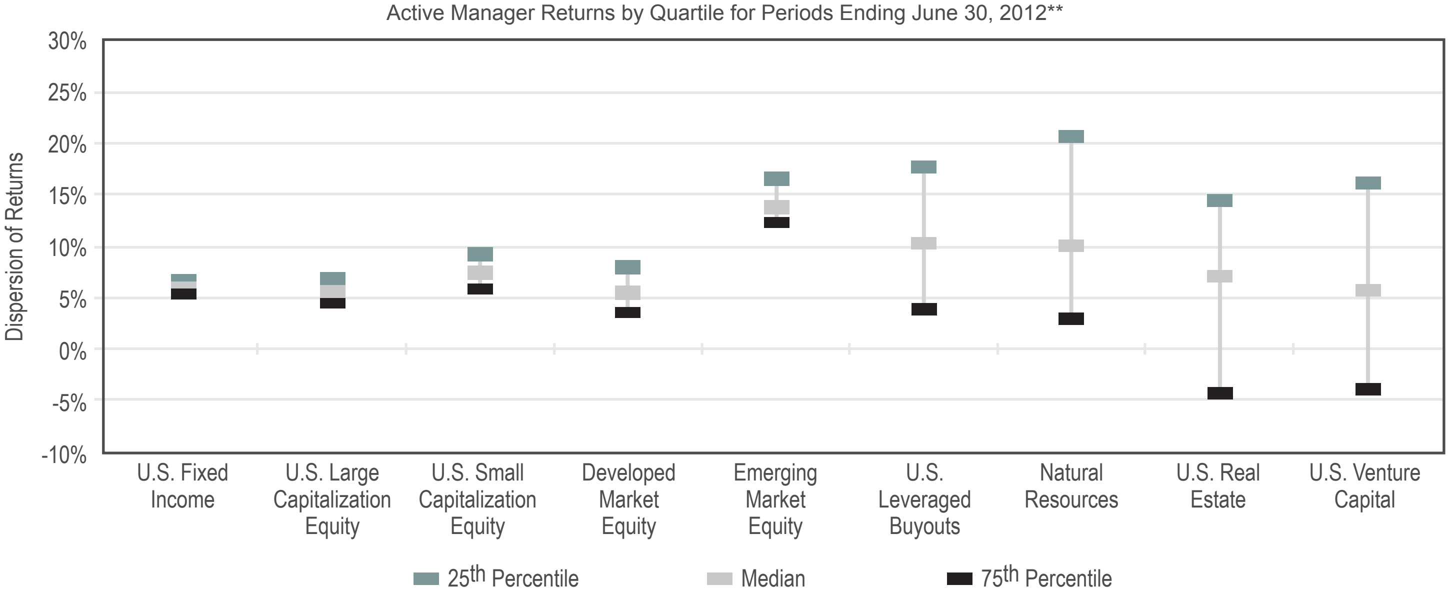
Asset Class	First Quartile	Median	Third Quartile	Range
International Equity	10.5	9.0	4.0	6.5
Fixed Income	7.4	7.1	0.5	6.9
Real Estate	17.6	12.0	9.2	8.4
Absolute Return	15.6	12.5	7.1	8.5
U.S. Equity	12.1	11.2	1.9	10.2
U.S. Small Cap Equity	16.1	14.0	4.8	11.3
Leveraged Buyouts	13.3	8.0	-0.4	13.7
Venture Capital	28.7	-1.4	-14.5	43.2

10-year period ending June 30, 2005.
Source: Pioneering Portfolio Management, David Swensen.

FIGURE 11

Active Manager Selection Process: Alternative Asset Returns Exhibit Significant Dispersion

Active Manager Returns by Quartile for Periods Ending June 30, 2012**



***Fixed income and marketable equity performance based on annualized ten-year returns of BNY Mellon manager universes, adjusted for fees. Venture capital, LBO, real estate, and natural resources returns based on annualized since-inception IRRs of Cambridge Associates manager universes.
Source: Cambridge Associates, 2012.

5B - Quest for the Best

A manager search may be conducted for a number of reasons: to gain exposure to a new asset class or investment strategy, to gain additional manager depth, or to replace an existing manager. The first step in our manager selection process is to identify a group of candidates to include in the search process. Managers to be included in the search process are typically sourced from manager databases, industry contacts, existing manager contacts, referrals, and publications.

Fund screening in a database allows us to narrow down a list of funds to a workable group of candidates. The quantitative screening process varies depending on specific investment strategy. The screening process is more uniform when looking at traditional asset classes with a well-developed opportunity set, such as U.S. equity funds. Some factors used in a more traditional screening may include, among others, performance rankings within a peer group, expense ratio, assets under management, and manager tenure. However, with more esoteric sub-asset classes, the screening process may be less formalized as the opportunity set is often smaller.

The result of a screening is combined with any additional investment managers found through other sources (industry contacts, existing manager contacts, fund company meetings, and publications).

After a workable group of search candidates is identified, the number of which will depend on the asset class and purpose of the search, as well as the available opportunity set, further due diligence is performed. The candidates are evaluated using both quantitative and qualitative factors. Quantitative factors may include, among others, total returns, risk-adjusted returns, peer universe comparisons, downside risk, performance consistency, up- and down-market capture ratios, and number of holdings. More qualitative factors may include, among others, expense ratio, portfolio manager tenure, and strategy assets under management.

Each of the candidates is then interviewed, typically by phone, to get a better understanding of the investment philosophy, team, and process. After the interviews are completed, the candidates are narrowed down further to a group of finalists.

Finalists are required to complete a detailed new manager questionnaire. We also then complete on-site visits to finalists. Through the on-site visits, we are better able to understand the key drivers of the strategy, including people, process, and philosophy. We seek to gain a good understanding of what drives the strategy, whether it is a key portfolio manager or a team of analysts, a sound and repeatable process, or the passion of the team to unite under a single philosophy. This understanding will help in setting expectations for the strategy and monitoring the strategy once it has been added to our portfolios.

Once the on-site visit is completed and the questionnaire is reviewed, we complete a quantitative manager scorecard as well as a more qualitative investment summary memo that describes the key aspects of the strategy. The portfolio managers will discuss the merits of each strategy and make the final manager selection decision. Just as Markowitz urged us to focus on the portfolios in aggregate and not consider assets in isolation, when making a final decision, we are always looking for the best manager to complement our existing portfolio, not the best manager in isolation. The goal of our investment philosophy is to generate consistent returns over time, and we are looking to build a portfolio of managers and strategies that accomplishes that goal. Before adding a manager to our portfolio, we determine the drivers of performance and set expectations for that strategy's behavior in various market environments. While we understand that a manager's strategy can fall in and out of favor, we do not want all of our managers in a specific asset class to have similar performance characteristics across all market environments. We seek a group of managers that complement each other during various market environments, which as a whole delivers consistent returns over time.

We typically remove managers from our portfolios if there has been a fundamental change in personnel, investment philosophy, or process that we believe will negatively affect future performance, result in performance that does not meet our expectations, indicating the team is not executing as we would like, or change significantly the fund characteristics or structure, including excessive growth in assets under management.

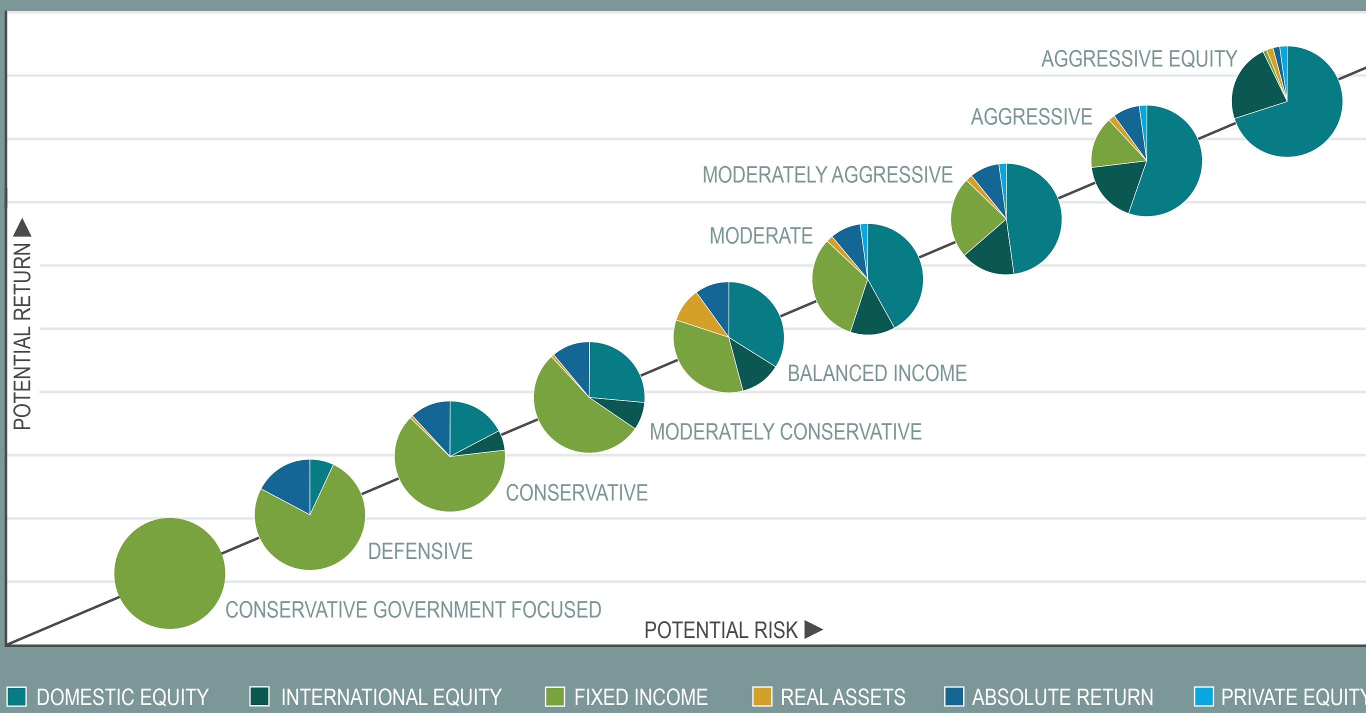
We believe our extensive manager due diligence process enables us to select superior managers. Through our manager interview and questionnaire process, we can identify the most important characteristics that have made the strategy work in the past. By monitoring those characteristics, we can identify when fundamental changes should result in a termination before it shows up in poor manager performance. In addition, we have found that many mutual fund investors don't have the knowledge or resources to analyze fund data that we think gives us an edge, including tracking fund flows, using linked track records to secure more complete data, and analyzing how fund candidates interact with other funds in our portfolio. Finally, our flexible selection process allows us to consider smaller and newer funds, which in turn allows us to take advantage of attractive opportunities before they are recognized by the broader universe of mutual fund investors.

5C - Time to Build

After developing views on the major and sub-asset classes, as well as choosing specific strategies to use to implement those views, we construct our portfolios. Our views can be implemented as longer term themes, which are typically longer than 12 months in duration, or shorter term opportunities, which are typically less than 12 months in duration. The asset class views are framed relative to our neutral asset class weightings, and to express our views we will over- or underweight specific major and sub-asset classes.

Our portfolio construction process is bolstered by a number of risk controls, the most important of which is our very broad diversification across and within asset classes and sub-asset classes. In addition, we size positions to mitigate specific manager or strategy risk. Finally, even after implementing our tactical views, our asset class exposures for each portfolio must remain within their stated ranges, as depicted in Figure 12.

FIGURE 12



Source: Brinker Capital

SUMMARY

To compound return, an investment firm must know investment theory and be skilled in its application and implementation; the firm must be creative in discovering enhancements to its theory and committed to ongoing improvements in its implementation.

An investor's philosophy is a comprehensive statement of the principles that make up the investor's investment theory. The philosophy is an articulated, intentional approach to generating returns. It is made up of a body of studied, tested, and formalized principles in which the investor's belief is so strong it rises to the level of professional conviction.

Brinker Capital's investment philosophy establishes a broad opportunity set for achieving return and manages risk by constructing diversified portfolio investment strategies that allocate assets across and within six asset classes. Each portfolio investment strategy establishes a specific objective that is achieved by seeking the most consistent risk-adjusted returns possible. This philosophy is guided by these three fundamental tenants: diversification, innovation, and active management.

Brinker Capital's multi-asset class investment philosophy has been tested over long periods of time. Independent capital market data and the documented track records of many Brinker Capital strategies constitute empirical proof of success in achieving investor objectives by generating consistent risk-adjusted returns.

Application of Brinker Capital's investment philosophy begins by identifying six clearly defined asset classes to establish probability beliefs about future risk, return, and correlations for the selected individual asset classes and, in turn, once the six asset classes are assembled as a whole portfolio, to form probability beliefs about the portfolio's risk and return characteristics. Initially, the portfolio's risk and return characteristics are determined by establishing neutral weightings for allocations to the three traditional asset classes – domestic equities, foreign equities, and fixed income. These risk and return characteristics are further enhanced by allocations to the alternative or non-traditional asset classes (absolute return, real assets, and private equity) on an opportunistic basis. Neutral weightings and ranges are set for all selected asset classes. Ranges are established to provide the flexibility required for active management of asset class allocations.

Another important step in application of the investment philosophy is the establishment of separate target risk portfolios (generally six taxable and six tax-exempt) for each Brinker Capital investment offering. Each target risk portfolio has the appropriate mix of risk and return characteristics needed to achieve an individual investor's objective. A conservative investor who is sensitive to short-term losses and willing to accept lower returns will choose a target portfolio that has a smaller allocation to risky assets like equities and a higher allocation to less risky assets like fixed income and absolute return. Conversely, a more aggressive investor with a longer time horizon who can accept volatility will choose a target portfolio with a greater allocation to risky assets like equities and a smaller allocation to less risky assets like fixed income

After applying its investment philosophy in constructing target portfolios, Brinker Capital implements its philosophy through active management. Brinker Capital's approach includes active management of the weightings to the selected asset classes and sub-asset classes and the selection of active management strategies to execute the selected asset classes and sub-asset classes.

Active management of the weightings to asset classes and sub-asset classes is guided by historical risk, return, and correlation data and a mosaic made up of a number of market and economic-related factors. This mosaic identifies the relative attractiveness of the various asset classes and sub-asset classes.

With views on the major asset classes and sub-asset classes established, implementation continues with the selection of strategies that execute the asset classes and sub-asset classes. Passive strategies are selected when only pure asset class exposure is sought. Active management strategies are typically selected for asset classes and sub-asset classes that are inefficient and when it is clear that an active manager adds significant value.

In selecting active managers, Brinker Capital follows a rigorous initial and ongoing due diligence process. Initially, candidates are screened through a quantitative screening process with a working group of candidates identified. Due diligence continues with a scrub of individual manager data through the prism of a wide array of quantitative data. Next are phone interviews, after which the finalists are chosen. Finalists then complete a detailed questionnaire that after review is followed up with an onsite visit to the manager's offices. After completion of the onsite visit, a manager scorecard is filled out. Finally, Brinker Capital portfolio managers debate the manager merits and make a selection judgment. Once managers are selected, we make onsite visits annually. Manager terminations are approached carefully. Generally, managers are terminated when there is a fundamental change in the firm that is likely to negatively affect performance or when performance does not meet Brinker Capital's expectations.

There are two other important aspects to the implementation of Brinker Capital's investment philosophy: the establishment of themes and the establishment of risk controls. The work done in determining views on the appropriate weightings to asset classes and sub-asset classes and in choosing specific strategies leads Brinker Capital's staff to see or identify themes. These investment themes can be shorter term opportunities, but they are typically longer term, longer than 12 months in duration. These themes can lead to under- and over-weightings within and across asset classes and sub-asset classes.

Several risk controls guide the implementation of portfolios. First and most important is broad diversification across and within asset classes. Also important is the sizing of positions to mitigate specific manager and strategy risk. Finally, it is important not to lose sight of the forest for the trees. Accordingly, asset class exposure for each portfolio must remain within the stated ranges.

Charles Widger
Founder and Executive Chairman, Brinker Capital

Mr. Widger is the founder of Brinker Capital and has over 30 years of experience working with investors in strategic investment planning and manager search and monitoring. He is a past chairman of the board of trustees for Gettysburg College and is chair-emeritus of the Money Management Institute, the $3.2 trillion dollar managed account industry's association. He is also the chairman of the Villanova University School of Law Board of Consultors. He was previously chief executive officer of the Mutual Benefit Capital Companies, first vice president with Van Kampen, Morris Stone and a vice president at CIGNA. Earlier in his career, he practiced law in Pennsylvania in private practice and as an assistant attorney general for the Pennsylvania Department of Justice. Mr. Widger is a frequent market and industry commentator, with his thoughts having appeared in top outlets such as *The Wall Street Journal*, *Barron's*, *the Associated Press*, *Dow Jones*, *Investment Advisor*, *Fund Action* and many others. Mr. Widger is a graduate of Gettysburg College and Villanova University School of Law, and holds an L.L.M. in Taxation from Boston University's School of Law. He also served as a Lieutenant in the U.S. Navy.

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