

**BEACON POINTE**

**ADVISORS**

**BEACON POINTE RESEARCH  
WHITE PAPER**

**PAST PERFORMANCE IS NOT A GUARANTEE OF FUTURE RESULTS**

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610 Newport Center Drive, Suite 750 Newport Beach, CA 92660  
TEL 949.718.1600 FAX 949.718.0601 [www.bpadvisor.com](http://www.bpadvisor.com)

### HIGHLIGHTS

- *Background:* “Past performance is not a guarantee of future results.” Not only have individual and institutional clients heard this time and time again, but they have seen the sentence written on investment management firm and mutual fund advertisements and marketing material. Even though this statement has been printed on millions of prospectuses and supported by the Association of Investment Management and Research (AIMR), institutional and individual clients continue to focus solely on past performance.

Beacon Pointe understands the limitations of focusing only on past performance and has implemented a stringent process that will enhance its investment manager research and evaluation process. The goal of our process is to cover the large universe of investment managers, but *more importantly, to have a thorough and in-depth analysis of each firm’s investment capabilities*. In this process, past performance is not the only factor analyzed when evaluating an investment manager, but *one of a number of different factors*.

Although most consulting firms rely exclusively on quantitative analysis to recommend or monitor investment managers, quantitative analysis is “backward-looking” and shows how the investment managers have performed in the past. Studies show that past performance is not a good indicator for future performance, and yet many consulting firms continue to rely solely on, or heavily on quantitative analysis. *It is great to see that a manager has performed well in the past, but what Beacon Pointe research professionals are interested in is how well the investment managers will do for our clients in the future.*

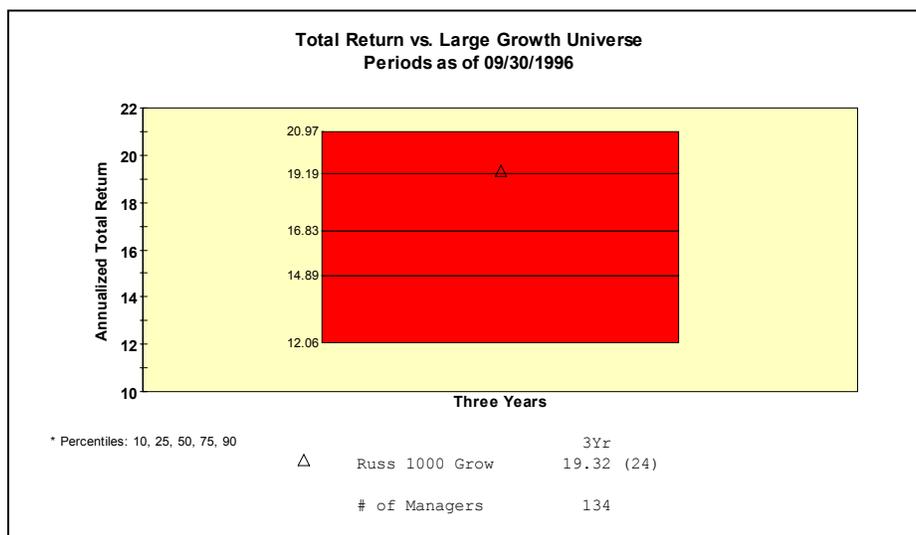
Factors that Beacon Pointe’s research team have incorporated into the manager research process fall within the categories of People/Organization, Investment Philosophy/Process, and Firm Resources. Beacon Pointe is interested in whether the firm has a strong culture, whether the employees all have the same conviction, if the employees are motivated and have ownership in the company, what is unique to the manager’s philosophy and process, how a manager will add value in the future, whether a manager knows what types of risks he is taking and if those risks are being managed, and what types of research and resources are available to the manager. *Beacon Pointe, will discuss these factors with each investment manager and subsequently rank these factors, assigning a value to each factor.* Answers to these questions will give Beacon Pointe consultants the ability to select managers with the highest probability of meeting future objectives and of adding future value or “alpha”. These factors are evaluated in conjunction with a product’s historical performance and fees to give clients a deeper insight into how well a firm will do *going forward*. Beacon Pointe strongly believes that a combination of quantitative and qualitative analyses will maximize value to our clients.

The following pages are presented to give our clients a better understanding of the statement “past performance is not a guarantee of future results”. The following analysis shows that most managers who had ranked in the top quartile over a period of time, oftentimes do not rank in the top quartile for subsequent time periods. Beacon Pointe believes that a strong and successful manager research process will focus not only on qualitative and quantitative factors, but also understand the limitations of historical performance.

## Where Have They Gone? – Large Growth

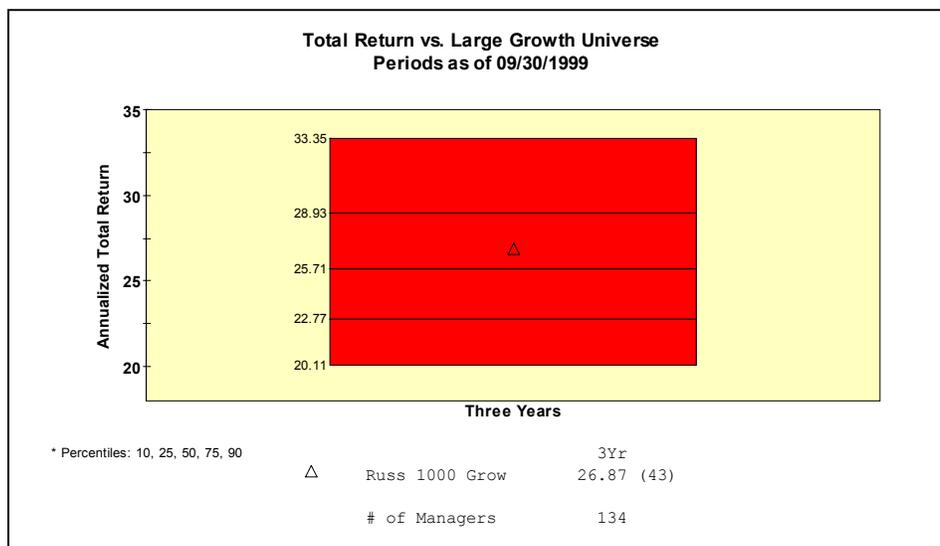
- To begin our analysis, Beacon Pointe screened large cap growth managers with 9 years of historical performance (as of 9/30/2002). Exhibit 1 shows how these investment managers performed over a three-year period as of 9/30/1996.

### Exhibit 1



- The universe comparison shows the median 3-year large cap growth return as of 9/30/1996 was 16.83%. Large growth managers that ranked in the top quartile (25<sup>th</sup> percentile) had a 3-year return of 19.19% and greater. Those in the top decile (10<sup>th</sup> percentile) had a 3-year return of 20.97% and greater. The Russell 1000 Growth index outperformed the median manager and ranked in the top 24<sup>th</sup> percentile.
- Exhibit 2 below shows how large cap growth managers performed over a 3-year period as of 9/30/1999.

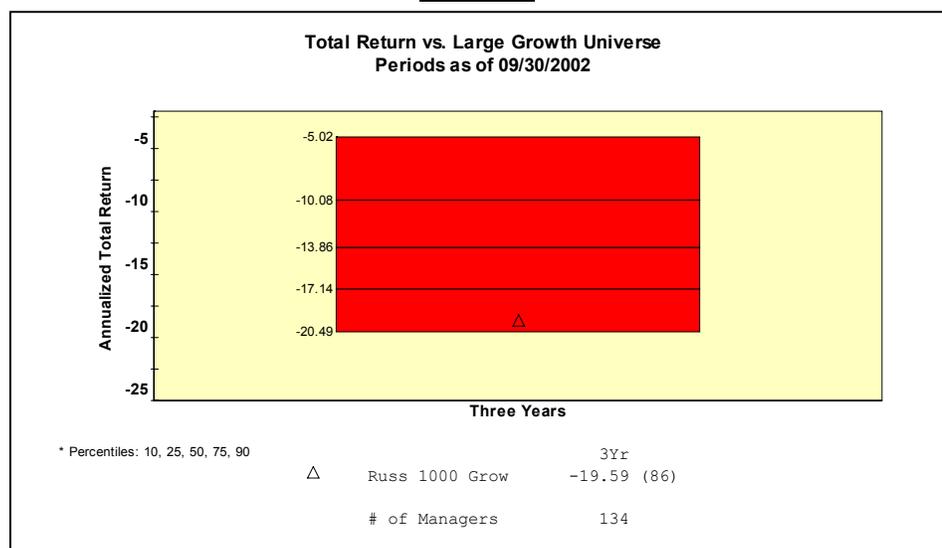
### Exhibit 2



## Where Have They Gone? – Large Growth

- The median large cap growth manager had a 3-year return (as of 9/30/1999) of 25.71%. The top quartile manager had a 3-year return of 28.93%. The Russell 1000 Growth index outperformed the median large cap growth manager and ranked in the top 43<sup>rd</sup> percentile.
- Exhibit 3 below shows how large cap growth managers performed over a 3-year period as of 9/30/2002.

**Exhibit 3**



- The median large cap growth manager had a 3-year return (as of 9/30/2002) of -13.86%. The top quartile manager had a 3-year return of -10.08%. The Russell 1000 Growth index underperformed the median large growth manager and ranked in the 86<sup>th</sup> percentile for the 3-year period.
- Oftentimes in an investment manager search, plan sponsors and consultants simply screen and consider investment managers in the top quartile for a 3- or a 5-year period. This process is often used due to its simplicity and quick results.
- The analysis on the following pages will show, however, that investment managers do not consistently rank within a universe over a number of periods. Investment managers that rank in the top quartile oftentimes do not rank in the top quartile in subsequent periods. Simply screening a database for the top performers, therefore, does not guarantee future results.

**Where Have They Gone?**

- 34 large cap growth managers ranked in the top quartile in a universe of 3-year returns (as of 9/30/1996). Exhibit 4 shows how these 34 large cap growth investment managers performed in subsequent 3-year periods.

**Exhibit 4**

<u>Universe Rank</u>	9/30/1996	9/30/1999	9/30/2002
0% - 25%	34	11	4
26% - 50%	-	9	8
51% - 75%	-	10	11
76% - 100%	-	4	11

- Exhibit 4 demonstrates that investment managers do not consistently rank in different periods. Of the 34 top quartile large growth managers in 1996, only 11 ranked in the top quartile in 1999 and only 4 in 2002. 4 of the 1996 top quartile managers fell into the bottom quartile in 1999. 11 of the 1996 top quartile managers fell into the bottom quartile in 2002.
- This phenomenon does not only hold true for large cap growth managers. Exhibit 5 and Exhibit 6 identify the same conclusion with large cap value and international equity managers, respectively.

**Exhibit 5**

<u>Universe Rank</u>	9/30/1996	9/30/1999	9/30/2002
0% - 25%	39	10	11
26% - 50%	-	11	13
51% - 75%	-	11	5
76% - 100%	-	7	10

**Exhibit 6**

<u>Universe Rank</u>	9/30/1996	9/30/1999	9/30/2002
0% - 25%	27	9	9
26% - 50%	-	7	8
51% - 75%	-	6	4
76% - 100%	-	5	6

### Where Have They Gone?

- Exhibit 5 (Large Growth), Exhibit 6 (Large Value), and Exhibit 7 (International Equity-EAFE) show that investment managers do not consistently rank in their respective universes over different time periods.
- Investment managers do not consistently rank in their respective universes over different time periods due to the following factors: poor sector selection, poor stock selection, overall poor/good performance, and specific investment style out of favor.
- It is critical to understand that a style within an investment style may be out of favor for a period of time. Core-to-Growth investment managers, for example, did not rank well within the large growth universe during the late 1990s. Those who ranked well during this period were the aggressive growth managers and those who had a large allocation to technology and dotcom stocks. In recent periods, however, Core-to-Growth investment managers now rank in the top quartile of the large growth universe and aggressive growth managers now rank in the bottom quartile.
- The same is true for the large cap value universe. In the late 1990s, relative value managers performed well in comparison to deep value managers. In recent periods, however, deep value managers have ranked in the top quartile while relative value managers have fallen in the ranks within the universe. In a recovering economy, however, we would expect relative value managers to outperform the deep value managers.

### Summary

- The analyses shows that managers have not consistently ranked in their respective universes over different time periods. Investment managers who have ranked in the top quartile have not consistently ranked in the top quartile in subsequent time periods.
- Screening a database for the top performing managers is not sufficient in evaluating and searching for an investment manager.
- Beacon Pointe understands that a number of factors may influence the relative performance of a manager within a universe, including the “style within a style” factor. For example, deep and relative value managers will cycle differently within a time period. The same holds true for aggressive and core-to-growth or conservative growth managers. It is imperative that clients understand that good managers will underperform in certain periods due to out of favor styles and this could lead to inopportune manager terminating.
- Beacon Pointe places heavy emphasis on rolling period performance analysis. The rolling periods analysis allows the client to understand an investment manager’s performance consistency. As the analysis shows, however, it is often difficult to find managers who consistently rank well over a number of time periods.
- Beacon Pointe’s investment manager research does not simply focus nor depend upon historical performance. Our detailed process evaluates an investment manager on a number of qualitative and quantitative factors, including the firm’s People/Organization, Investment Philosophy/Process, Firm/Product Resources, Performance, and Fees. We believe that an analysis of qualitative and quantitative factors will give Beacon Pointe consultants the ability to select managers with the highest probability of meeting future objectives and of adding future value or “alpha”.
- Please feel free to call your Beacon Pointe consultant if you have any questions.

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