BEACON POINTE ADVISORS

BEACON POINTE RESEARCH

THE JOURNEY TO LONG-TERM OUTPERFORMANCE MAY BE BUMPY

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CONFIDENTIAL – PROPRIETARY

500 Newport Center Drive, Suite 125 Newport Beach, CA 92660
TEL 949.718.1600 FAX 949.718.0601 www.bpadvisors.com

Introduction - Manager Performance Study

Beacon Pointe studied its focus list of managers to analyze how they perform relative to the Index. The intent of the study was to determine if underperforming relative to the Index was normal for outperforming the Index over the long-term.

Beacon Pointe studied the various managers in the focus list in large cap growth, large cap value, international, and small cap value styles. Conclusions from our study did not surprise us. Without a doubt, the money managers' journey to long-term outperformance relative to their benchmark is quite bumpy.

Manager Performance Study

Beacon Pointe's investment philosophy is predicated on finding managers in the various asset classes after careful asset allocation modeling to determine successful candidates for the focus list.

Beacon Pointe believes that in order to outperform the Index over the long-term, it is imperative to have portfolio characteristics that are different from that of the benchmark. However, looking different from the benchmark might result in the product's performance that is out of sync with the corresponding indices. Extending this argument, it would also mean that the product could be underperforming the indices for a protracted period of time. Conversely, the money manager could also outperform the Indices for an extended period of time.

To gage the extent of the underperformance (or outperformance) of the focus list of managers, Beacon Pointe analyzed the historical calendar year performance (for simplicity and consistency) for the various products and evaluated the degree of outperformance and the underperformance of the various products. In the next session, we will present the findings of the various asset classes.

It must be pointed out at this time that some of the managers listed in the study have been closed to new investors and/or are no longer recommended due to their asset growth. However, they have been chosen for their long-term history as well as our familiarity with those firms.

The Study in Detail

Large Cap Growth

On the following page are the results of managers in the Large Cap Growth category. Even though Manager A had outperformed both the S&P 500 Index and the Russell 1000 Growth Index over the last 27 years (on a calendar year basis), the firm had underperform the indices 55.6% of the time. That is, of the 27 years of historical returns, Manager A had underperformed the S&P 500 Index in 15 of those years. Yet, over the long haul, the firm has handily beaten the S&P 500 Index.

When using the Russell 1000 Growth Index as a benchmark, it can be observed that the firm has underperformed the Index about 40% of the time.

Astoundingly, Manager C has underperformed both the S&P 500 and the Russell 1000 Growth Index about 77% and 62% of the time, respectively. Yet over the 13 years of historical returns, Manager C has outperformed both the indices.

Table 1

Large Cap Growth Managers Performance Study

Managers	Annualized Returns 1980-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager A	14.89%				
S&P 500	13.42%	12	15	44.44%	55.56%
Russell 1000 Growth	11.68%	16	11	59.26%	40.74%

Managers	Annualized Returns 1980-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager B	14.44%				
S&P 500	13.42%	14	13	51.85%	48.15%
Russell 1000 Growth	11.68%	18	9	66.67%	33.33%

Managers	Annualized Returns 1994-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager C	13.75%				
S&P 500	12.91%	3	10	23.08%	76.92%
Russell 1000 Growth	11.14%	5	8	38.46%	61.54%

Managers	Annualized Returns 1993-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager D	14.74%				
S&P 500	12.55%	9	5	64.29%	35.71%
Russell 1000 Growth	11.14%	11	3	78.57%	21.43%

Sometimes, the extent of underperformance can stretch for many years, testing investors' patience. The number of years of underperformance varies from one to six years as shown in Table 2 on the following page. Admittedly, six years of underperformance can cast doubts on the effectiveness of the investment philosophy & process.

Beacon Pointe Research performs extensive qualitative and quantitative analysis of the managers before putting them on the focus list. As long as there is demonstrated evidence of long-term effectiveness of the investment philosophy & process, Beacon Pointe would normally advise its clients to stay invested in the manager.

Table 2

Large Cap Growth - Consecutive Years of Underperformance

Managers	S& P 500	Russell 1000 Growth
Manager A	4	5
Manager B	3	3
Manager C	6	6
Manager D	1	1

The largest magnitude of underperformance was over 19% (relative to the Index) for the above managers while the maximum outperformance was over 43% (relative to the Index).

Large Cap Value

Analysis of Large Cap Value managers results in similar conclusions. The table below shows the results of historical performance relative to the S&P 500 and Russell 1000 Value Indices.

Table 3

Managers	Annualized Returns 1980-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager A	15.94%				
S&P 500	13.28%	18	9	66.67%	33.33%
Russell 1000 Value	14.38%	14	13	51.85%	48.15%

Managers	Annualized Returns 1991-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager B	16.83%				
S&P 500	11.79%	11	5	68.75%	31.25%
Russell 1000 Value	13.74%	11	5	68.75%	31.25%

Managers	Annualized Returns 1981-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager C	15.98%				
S&P 500	12.60%	16	10	61.54%	38.46%
Russell 1000 Value	14.01%	17	9	65.38%	34.62%

Managers	Annualized Returns 2001-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager D	11.94%				
S&P 500	1.49%	4	2	66.67%	33.33%
Russell 1000 Value	8.21%	4	2	66.67%	33.33%

The degree of underperformance relative to the Index varies from approximately 31% of the time to approximately 48% of the time. In terms of consecutive years of underperformance, one can see that the stretch can last as long as five years (versus Russell 1000 Value Index) as shown in Table 4. Once again, as shown in Table 3, patience pays as these managers have a compelling investment philosophy & process that is likely to outperform the indices over the long-term. By now, one can deduce that long-term implies in excess of five years.

Table 4

Large Cap Value - Consecutive Years of Underperformance

Managers	S& P 500	Russell 1000 Value
Manager A	3	3
Manager B	3	2
Manager C	6	5
Manager D	0	1

On a year-over-year basis, the magnitude of the outperformance and underperformance (relative to the Indices) was in excess of over 20%.

International

As seen in Table 5, in the international space, due to higher informational inefficiency, managers tend to outperform the Index more often than not. This makes intuitive sense as inefficiency (due to lack of or limited analysts' coverage of companies), would result in managers employing fundamental research to outperform on a more consistent basis. The maximum stretch of consecutive years of underperformance was three as shown on the following page in Table 6. We believe the stretch of underperformance is likely to lengthen going forward as these markets become more efficient over the next 10 years or longer.

Table 5

Managers	Annualized Returns 1996-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager A	16.06%				
MSCI EAFE	7.91%	7	4	63.64%	36.36%

Managers	Annualized Returns 1991-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager B	16.95%				
MSCI EAFE	9.80%	11	3	78.57%	21.43%

Managers	Annualized Returns 1988-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager C	13.14%				
MSCI EAFE	7.59%	15	4	78.95%	21.05%

Managers	Annualized Returns 1995-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager D	16.39%				
MSCI EAFE	8.21%	7	5	58.33%	41.67%

Table 6

International - Consecutive Years of Underperformance

Managers	MSCI EAFE
Manager A	3
Manager B	1
Manager C	2
Manager D	2

In international, the magnitude of underperformance (relative to the Index) was as high as 11% while outperformance (relative to the Index) was as high as 55%.

Small Value

Analysis of small cap value managers presents a similar outcome compared to international investments. This is because the lower informational efficiency in this space lends itself to value-add opportunities compared to domestic large cap stocks that are covered by many analysts. Table 7 illustrates how small cap managers on the focus list have fared over the long-run.

Table 7

Managers	Annualized Returns 1987-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager A	18.88%				
Russell 2000 Value	13.47%	16	4	80.00%	20.00%

Managers	Annualized Returns 2000-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager B	19.38%				
Russell 2000 Value	16.2`%	6	1	85.71%	14.29%

Managers	Annualized Returns 1988-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager C	17.93%				
Russell 2000 Value	13.56%	9	4	69.23%	30.77%

Managers	Annualized Returns 1995-2006	No. of Calendar Yrs of Outperformance	No. of Calendar Yrs of Underperformance	Percent Yrly Outperformance	Percent Yrly Outperformance
Manager D	16.87%				
Russell 2000 Value	11.38%	6	3	66.67%	33.33%

Table 8

Small Cap Value - Consecutive Years of Underperformance

Managers	Russell 2000 Value
Manager A	1
Manager B	1
Manager C	1
Manager D	1

Conclusions

- Beacon Pointe believes that 30%-60% (on a calendar year basis) underperformance relative to the indices is normal for managers. This is because the discipline enforced by their confidence in their compelling investment philosophy & process can result in performance that is not in sync with the benchmarks. However, these managers have the ability to outperform their respective benchmarks over the long run. As such, we advocate that patience is critical for our clients to stay invested in underperforming managers in order to outperform the respective benchmarks.

- Beacon Pointe continues to monitor underperforming managers to evaluate any change in philosophy & process and personnel. We believe that the qualitative factors are critical to determine long-term success. Thus, we would make a recommendation to terminate the underperforming managers only in the event we believe these factors have been compromised.

- Please contact your Beacon Pointe consultant at 1-866-272-1272 should you have any questions.