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BEACON POINTE RESEARCH

THE RIGHT PAGE OF THE RIGHT BOOK

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CONFIDENTIAL – PROPRIETARY

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The Right Page of the Right Book

Master Oogway, one of the animated stars of "Kung Fu Panda", cleverly remarked: "Yesterday is history, tomorrow is a mystery, and today is a gift – that's why it is called the present". While a 5-year old would watch the movie time after time for its fight sequences, we appreciate it for its subtle wisdom, which applies to real life just as well as it works in the fictional world of martial art heroes. Inspired by this gem of Eastern philosophy, in this letter we will reflect on the "yesterday", briefly ponder "tomorrow", and focus on "the present" with an overview of Beacon Pointe's manager research philosophy and due diligence process. That is what keeps us busy in up-days and down-days, during both bull and bear markets, regardless of the trend-du-jour and prevailing investor psychology. Since we cannot change the past or predict the future, we direct our energy and intellectual capital to the present in search of that select group of proven and trust-worthy asset management firms that would offer our clients the best opportunity to achieve their investment goals.

But first, let's look back at the past few months. The beginning of 2010 saw a continuation of the 2009 rally. Most bourses around the world, with the notable exception of China, posted positive returns for the quarter and added to their gains off the March 9, 2009 trough. The major indices, however, remain well below their previous highs, as shown in the table below. For instance, the S&P 500 Index closed the first quarter at 1,169, a 73% rebound off the bottom, but still 25% below the closing high on October 9, 2007. As Beacon Pointe observed in its last client letter, the post-bear rally has been fast and furious and at this time, a pause seems justified. However, the exact timing and nature of this pause, whenever it may occur, are highly uncertain.

GLOBAL STOCK MARKETS: INDEX MOVEMENTS (IN LOCAL CURRENCY TERMS)

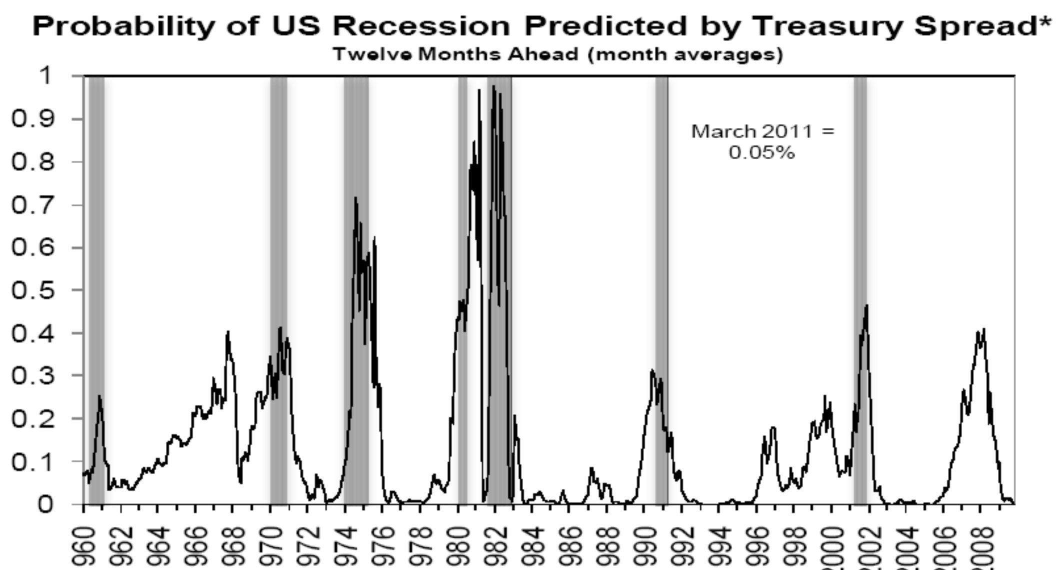
Index	3/31/2010 Index Value	Since High	Date of High	Performance Since 3/9/09 Low	2010 YTD Return	2009 Return
MSCI World Index	1,201	-28.6%	10/31/2007	74.3%	2.7%	27.0%
MSCI Emerging Markets Index	1,010	-24.5%	10/29/2007	108.2%	2.1%	74.5%
DJ Industrial Index	10,857	-23.4%	10/9/2007	65.8%	4.1%	18.8%
S&P 500 Composite Index	1,169	-25.3%	10/9/2007	72.9%	4.9%	23.5%
Nasdaq Composite Index	2,398	-16.1%	10/31/2007	89.0%	5.7%	43.9%
Russell 2000 Index	679	-20.7%	7/13/2007	97.7%	8.5%	25.2%
German DAX Index	6,154	-24.1%	7/16/2007	66.7%	3.3%	23.8%
Paris CAC 40 Index	3,974	-35.6%	6/1/2007	57.7%	1.0%	25.2%
UK FTSE 100 Index	5,680	-15.6%	6/15/2007	60.3%	4.9%	22.1%
Dublin ISEQ Index	3,178	-68.2%	2/20/2007	65.8%	6.8%	27.0%
Swiss SPI General Index	6,008	-22.4%	6/1/2007	65.9%	6.8%	23.2%
Nikkei 225 Index	11,090	-39.3%	7/9/2007	56.5%	5.2%	19.0%
Hang Seng Index	21,239	-32.9%	10/30/2007	87.2%	-3.0%	52.1%
Shanghai Composite Index	3,057	-49.8%	10/16/2007	44.3%	-6.7%	80.0%
Bombay Sensex Index	17,528	-16.0%	1/8/2008	114.8%	0.4%	80.9%
Brazilian Bovespa Index	70,372	-4.3%	5/20/2008	91.5%	2.6%	82.7%
Russian Trading System Index	1,571	-21.3%	5/19/2008	125.1%	6.7%	134.8%

Source: Plexus Asset Management (based on data from I-Net Bridge)

The advance in global asset prices kept pace despite mounting concerns over Greek sovereign debt, the onset of monetary tightening policies in a handful of emerging markets, and news of an SEC fraud charge against Wall Street behemoth Goldman Sachs. Because of Greece's membership in the European Union, what started as a small country's internal fiscal crisis has had repercussions well beyond its borders. It has put pressure on the Union's common currency and stirred up the global bond markets after a period of relative calm. Furthermore, while the Fed and its counterparts in most developed markets maintain an accommodative stance and historically low rates, China and India have started to raise interest rates in an effort to protect their economies from overheating. The question is when the rest of the world will follow and what the impact of monetary tightening would be on GDP growth and financial markets around the world. And finally, on April 16th, newswires announced that Goldman Sachs has been charged with fraud by the SEC in relation to the creation and sale of a mortgage security that was intended to fail. The firm's stock price has lost 15% since then, even though specifics about the charges and Goldman's defense are yet to emerge.

Meanwhile, the latest readings of various economic indicators validate a strengthening global economy, driven primarily by a rebound in manufacturing and corporate profit growth. The U.S. housing and employment markets are still giving mixed signals, but it seems that they have both established a trough. The resumption of global growth has worked its way through corporate income statements in the form of strong earnings. According to Bespoke Research, "so far this earnings season, 324 companies have released their quarterly numbers. Of those 324 companies, 234 beat earnings per share estimates, putting the current EPS beat rate for the quarter at 72.2%". The improvement in corporate profits, however, is still primarily driven by cost-cutting, rather than top-line growth, implying that caution is warranted going forward.

Looking ahead, some still worry about a double-dip, others expect a solid and sustainable recovery, while a third (and large) group calls for a "muddle-through economy. Each scenario is possible. One way to handicap these possibilities is by evaluating the shape of the yield curve. The so-called Fed model uses the difference between 10-year and 3-month Treasury rates to calculate the probability of a recession in the United States twelve months ahead. Data from the New York Fed, shown below, suggests that the probability of a recession in the coming year is close to 0%. As always, though, we caution against relying blindly on models and believe investors should avoid the temptation to predict the future. Remember that "tomorrow is a mystery".

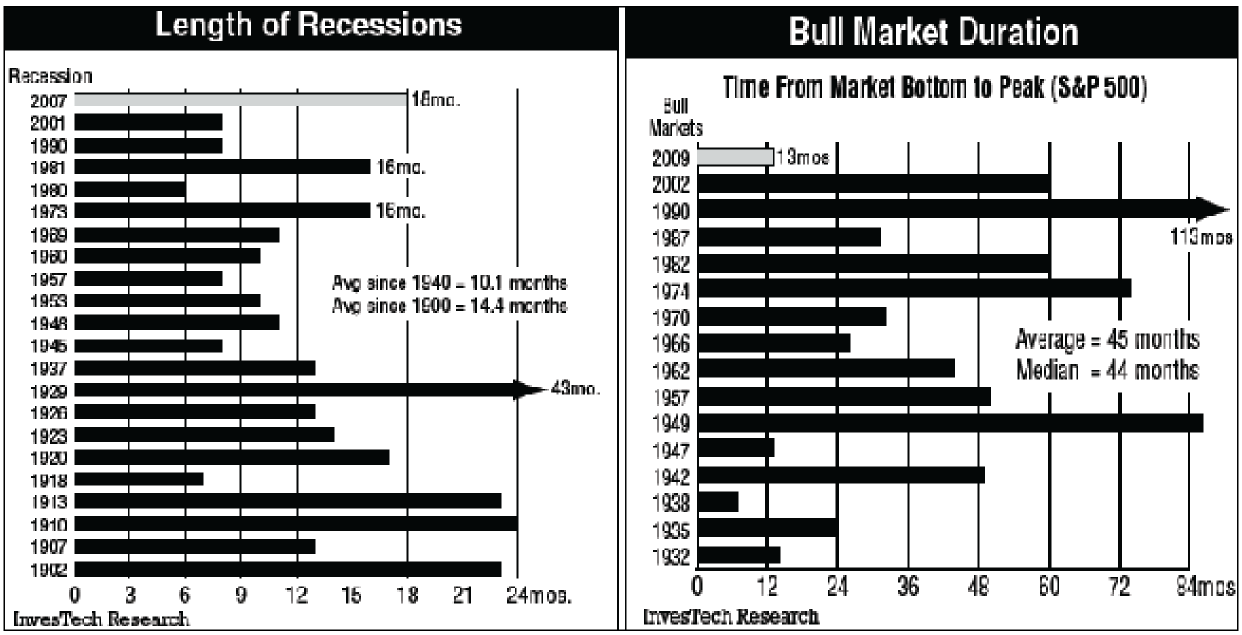


* Parameters estimated using data from January 1959 to December 2007, recession probabilities predicted using data through March 2010.

Note: The shading on these charts does not reflect the 12/1/2008 announcement by the NBER that the last period of expanison ended in December 2007.

Source: The Federal Reserve Bank of New York

The next two charts from InvesTech Research help place the Great Recession and the subsequent rally in historical context. As shown below, the length of the last recession (assuming it lasted from December 2007 to mid-2009 for a total of 18 months) makes it the worst in U.S. history since the Great Depression. On the flip side, the market recovery – which commenced in March 2009 and is now 13 months old – remains relatively young by historical standards. However, no two business or market cycles are identical and, therefore, historical precedent is never a precise blueprint for the future.

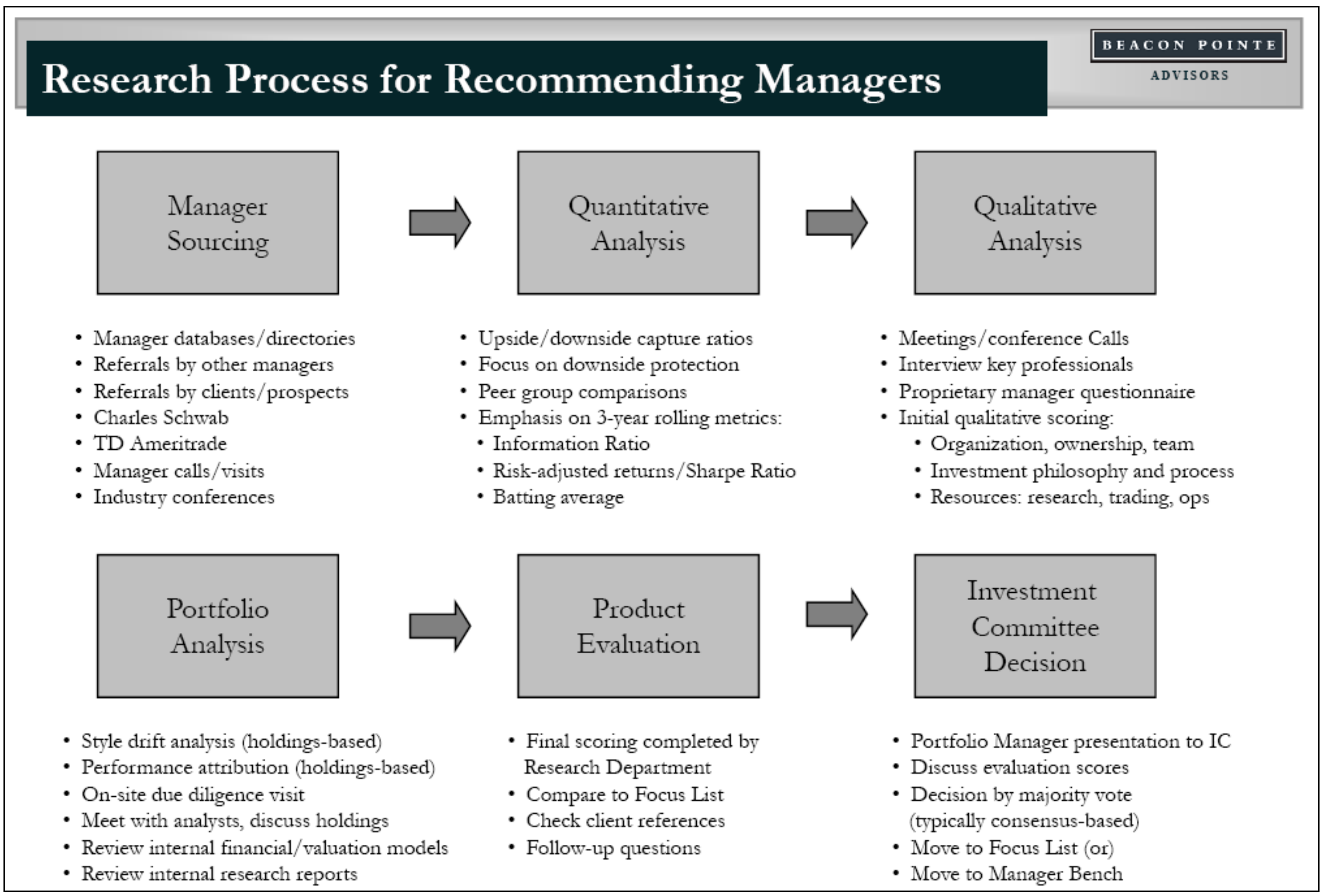


Source: InvesTech Research

Having a crystal ball would no doubt make our jobs considerably easier. But in reality, perfect insight into any situation is only available in hindsight. While economic forecasters and investment analysts make predictions for a living, it is a well-known fact that, in aggregate, their record is less than stellar. Chinese philosopher Lau-Tzu, who became prominent many centuries before Master Oogway premiered on the big screen, said that "Those who have knowledge don't predict. Those who predict don't have knowledge." We, at Beacon Pointe, certainly value knowledge and experience and we use both to formulate our views. We are happy to share these views in meetings, during calls, or on the pages of these letters. What we do not offer is predictions. Our role, as we see it, is to understand our clients' goals and priorities, to formulate an investment strategy and determine a strategic asset allocation, to recognize risk in all its forms and make sure it does not exceed the target parameters, and to implement each client's investment plan by constructing a diversified portfolio and recommending investment managers in the selected asset classes. A prudent investment plan, combined with a long-term investment horizon and strict discipline, should withstand the vagaries of economic and market weather over time and deliver results.

An essential component of that investment plan – and a key to its ultimate success – is manager selection. For that reason, manager research is central to what we do. Every investment professional at Beacon Pointe is involved in that process. Decisions are made by our Investment Committee as a group, but not before we have spent countless hours getting to know a firm and debating the merits and possible drawbacks of partnering with the asset management firm under consideration. Our clients see the end result of the process – the final recommendation. The remainder of this letter provides some background on Beacon Pointe's approach to manager search and due diligence – work that consumes our "present".

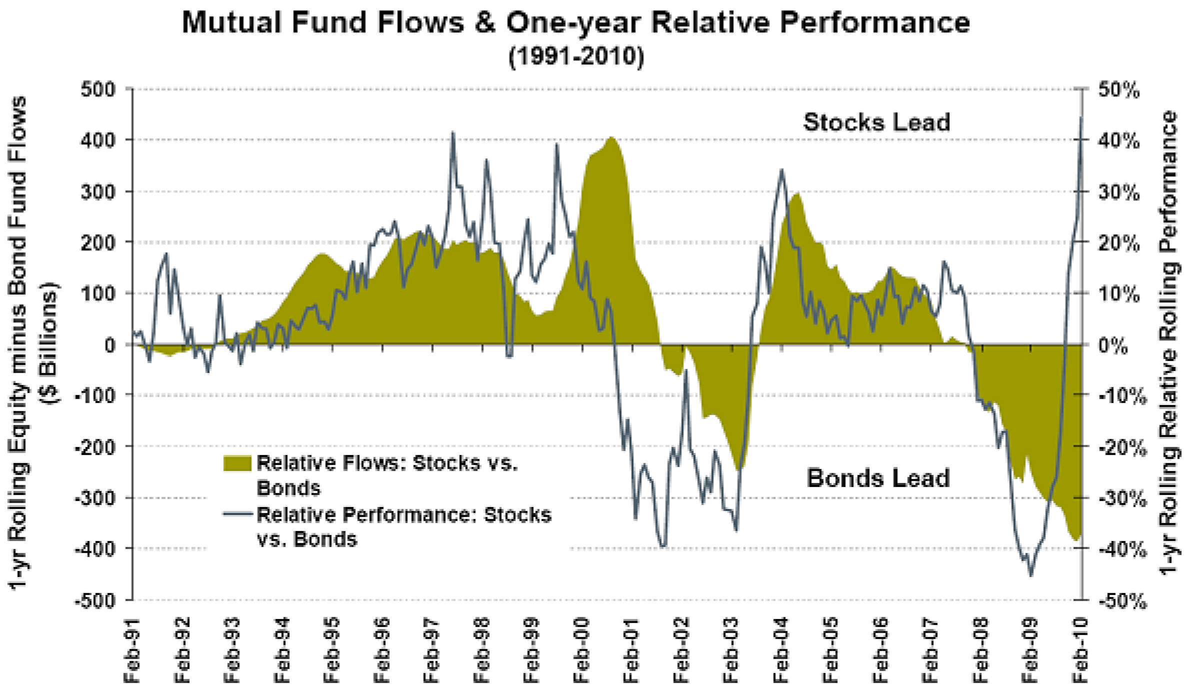
As the flowchart below illustrates, idea generation ("manager sourcing") and performance evaluation ("quantitative analysis") are the first steps in our research process. Our initial pool of candidates encompasses not only the standard sources – such as manager databases and directories – but referrals, industry contacts, and one-on-one meetings or calls. Some of our best ideas have been generated outside of database screening. While some of the firms we work with are among the largest and most well-known in the industry, often, the candidates we consider are "proven but unknown" firms – they are not found on manager databases and have little or no marketing effort, but at the same time they have solid performance track records. Beacon Pointe believes this is an important aspect of our value proposition to clients – looking where others may not and relying on our thorough due diligence efforts to independently verify a candidate's investment skill and resources.



We utilize a proprietary performance evaluation model, which allows us to filter the vast universe of investment managers and narrow it down to a focused group of strong candidates for further due diligence. Our performance scoring methodology emphasizes:

- Consistency of results (absolute returns and risk-adjusted returns) and ranks relative to peers; and
- An attractive ratio of upside to downside capture over the long term (10 years or since inception).

We measure consistency by focusing on rolling three-year periods rather than simply looking at a snapshot of annualized returns over the one-, three-, five-, seven-, and ten-year periods. The latter methodology, which is very much the industry standard, introduces a significant – though unintended – short-term performance bias. In other words, a very good or very poor last year skews the longer-term numbers and may be misleading. Investors' preoccupation with the short-term, we believe, is one of the main behavioral hurdles to good long-term results. It would explain why, as a group, investors' timing is irrational – moving into securities, segments, or assets classes at the top and exiting them at the bottom. According to a study by DALBAR Inc., over the 20-year period ended 12/31/2008, the average equity investor's return trailed the S&P 500 Index by almost 650 basis points per year (1.87% vs. 8.35%). This is further illustrated in the chart below, which shows mutual fund flows chasing the recent leaders – equities in the late 1990s and bonds in 2008-2009.



Source: Fidelity Research

Such sub-optimal decisions result from investors' tendencies to weigh the most recent past much more heavily than would be prudent. We equate this to reading the wrong page of the wrong book. It offers an interesting data point, but provides insufficient (and even sometimes misleading) information on which to base your investment decisions. The following song lyrics (from Depeche Mode's "Wrong") come to mind:

On the wrong day of the wrong week
I used the wrong method with the wrong technique
***
The wrong eyes on the wrong prize
The wrong questions with the wrong replies
***
I was ***on the wrong page of the wrong book***
With the wrong rendition of the wrong look

Beacon Pointe's process is geared toward asking the right questions, even when the temptation is to do otherwise. We maintain an unwavering focus on the right page of the right book. That is why our performance analysis centers on a long-term horizon, downside protection, and consistency of results. In addition, while we gain valuable insight from our quantitative analysis, we place much more importance on the qualitative steps in our research process. Ultimately, only 30% of Beacon Pointe's decision is based on performance; the remaining 70% of the decision is driven by qualitative factors around the organization, ownership, team, philosophy, process, and resources of each candidate under consideration.

While most consulting firms rely solely on quantitative analysis for their manager recommendations, Beacon Pointe recognizes the limitations of a "backward-looking" performance assessment. The ever-present disclosure "Past performance is not indicative of future results" is required by the SEC for a reason. That is where our qualitative research comes in – the preceding flowchart provides an overview of the different aspects of our due diligence process beyond the performance analysis step. Through multiple meetings and discussions, both at Beacon Pointe's offices and during on-site visits with managers, as well as through a detailed manager questionnaire and various reference checks, we gather and analyze information pertaining to the:

- History and ownership structure of the firm;
- Compensation policies and motivation programs;
- Qualifications of key investment professionals;
- Integrity of the team – can we trust the people who run the business and make the investment decisions;
- Team dynamics – who drives idea generation, who performs the research, and who makes the ultimate buy and sale decisions;
- Turnover among portfolio managers or analysts;
- Core investment philosophy – what is unique about the team's approach;
- Buy and sell disciplines, risk monitoring, and portfolio construction process;
- Depth of the team's research process and knowledge of each portfolio investment;
- Composition of the portfolio over time, holdings-based attribution and style analysis;
- Firm resources devoted to the research, client servicing, trading, operations, and IT functions; and
- Fees (which affect the actual or net results for clients).

As a firm, we have identified certain investment manager traits that we believe lead to long-term outperformance and alpha generation for our clients. Among these preferred characteristics are: boutique, independent organizational structure; client-centric firms as opposed to "asset gatherers"; significant and broad employee ownership; stable and high-tenured team with minimal turnover; key decision makers' assets invested alongside their clients'; highly-engaged, passionate investment professionals; truly active, benchmark-agnostic, and often concentrated portfolio construction; focus on capital preservation in difficult markets (the "make more by losing less" philosophy) with adequate upside participation; strong valuation discipline with a "margin of safety" requirement; and a willingness to be contrarian and move against consensus. Many of these characteristics cannot be measured or quantified. Albert Einstein once said: "Not everything that can be counted counts and not everything that counts can be counted." We agree!

Beacon Pointe's research team summarizes all findings into a detailed report which is debated meticulously by the Investment Committee before making a decision. The Committee meets with the Portfolio Managers for each strategy under consideration. Among the eight members of our Investment Committee, we assign a "devil's advocate" and often compile a list of follow-up question to be addressed before the final vote. Ultimately, the candidate is either added to Beacon Pointe's Focus List of approved managers, rejected, or added to the manager bench. We do not rush into decisions; the due diligence process takes at a minimum several quarters from start to finish (from idea generation to final recommendation) and sometimes we may be in talks with a firm for years before we start working with it.

This patience, we believe, pays off in the end. When we recommend a specific manager to our clients, we do so with very high conviction and with a long-term commitment. Our due diligence work is never complete, however. We monitor all Focus List managers on an on-going basis through quarterly communications (meetings or conference calls), organizational/team/asset updates, performance commentaries and attribution reports, portfolio and outlook discussions, periodic on-site visits, etc. Although our Focus List turnover is low, occasionally we are compelled to terminate a firm due to a) a material change in the organizational structure, ownership, or investment team, b) a deviation from the stated investment style, portfolio construction process, or target risk parameters; or c) a significant performance deviation from the benchmark or peer group that is not attributable to the manager's style being temporarily out-of-favor. At other times, we may identify a better alternative and the new candidate displaces the existing Focus List manager. None of these decisions are made lightly – we are very deliberate in the research we do, honest in the debates we have internally, and mindful of the impact our recommendations have on client portfolios. And at every step of the way, we remind ourselves to focus on the right page of the right book and keep our clients' objectives at the epicenter of everything we do.

Please feel free to call Beacon Pointe at 949-718-1600 should you need additional information or have any questions.