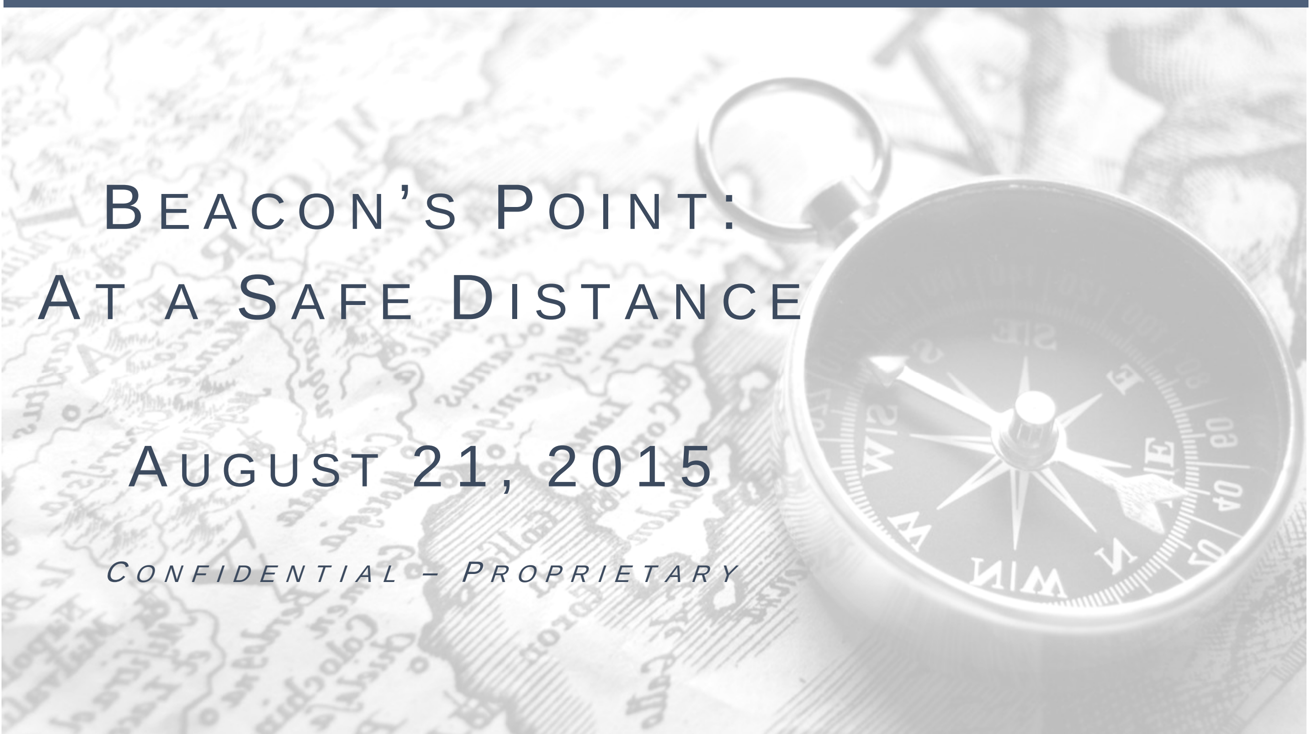

BEACON'S POINT:
AT A SAFE DISTANCE

AUGUST 21, 2015

CONFIDENTIAL – PROPRIETARY

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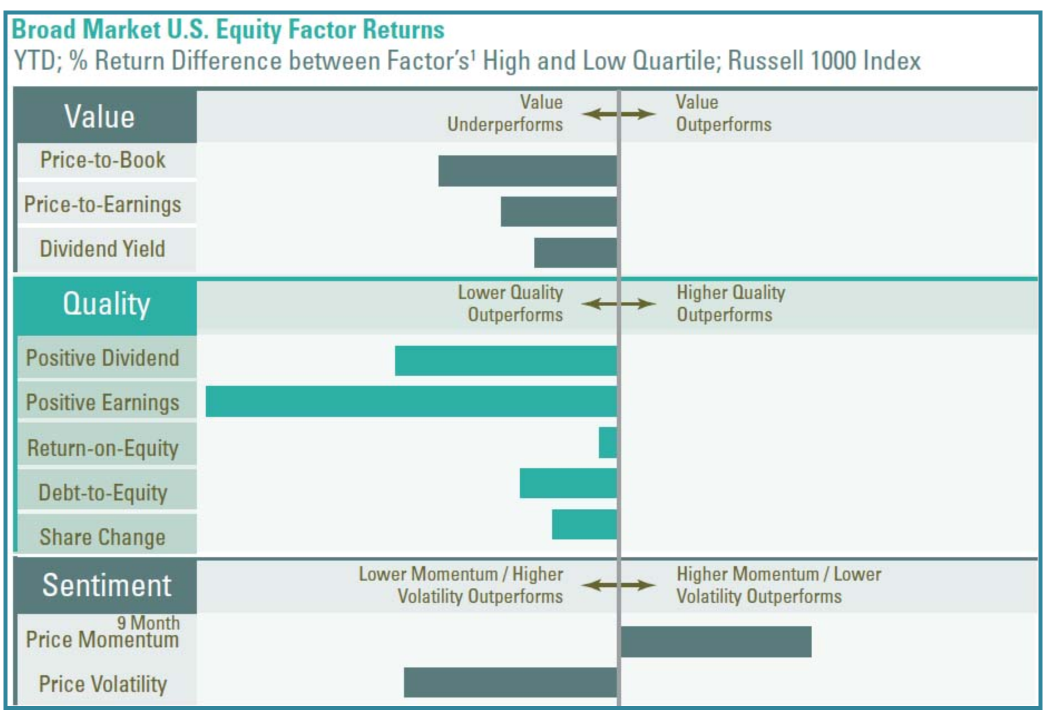
At a Safe Distance

"The less prudence with which others conduct their affairs, the greater the prudence with which we should conduct ours."
Warren Buffett

The most important lesson for aspiring drivers is to keep a safe distance, look over their shoulders before a lane change, scan the environment for potential dangers and stay focused on their ultimate destination. Driving with a margin of safety may not lead to any speed records, but significantly improves the odds of reaching one's target without an accident or a ticket. Similarly, investing with a margin of safety and an unwavering focus on one's return objectives and risk tolerance may lack the excitement of other approaches (such as high-frequency trading, trend following, or chasing market momentum) but allows investors to achieve their long-term goals in a prudent and consistent manner. At times, this strategy may appear too cautious, especially when other market participants conduct their affairs without much prudence, to paraphrase Warren Buffett's words. We believe this had been the case for several years. However, market corrections, such as the current episode, are a natural and necessary part of the cycle and remind us why it is important to keep a safe distance.

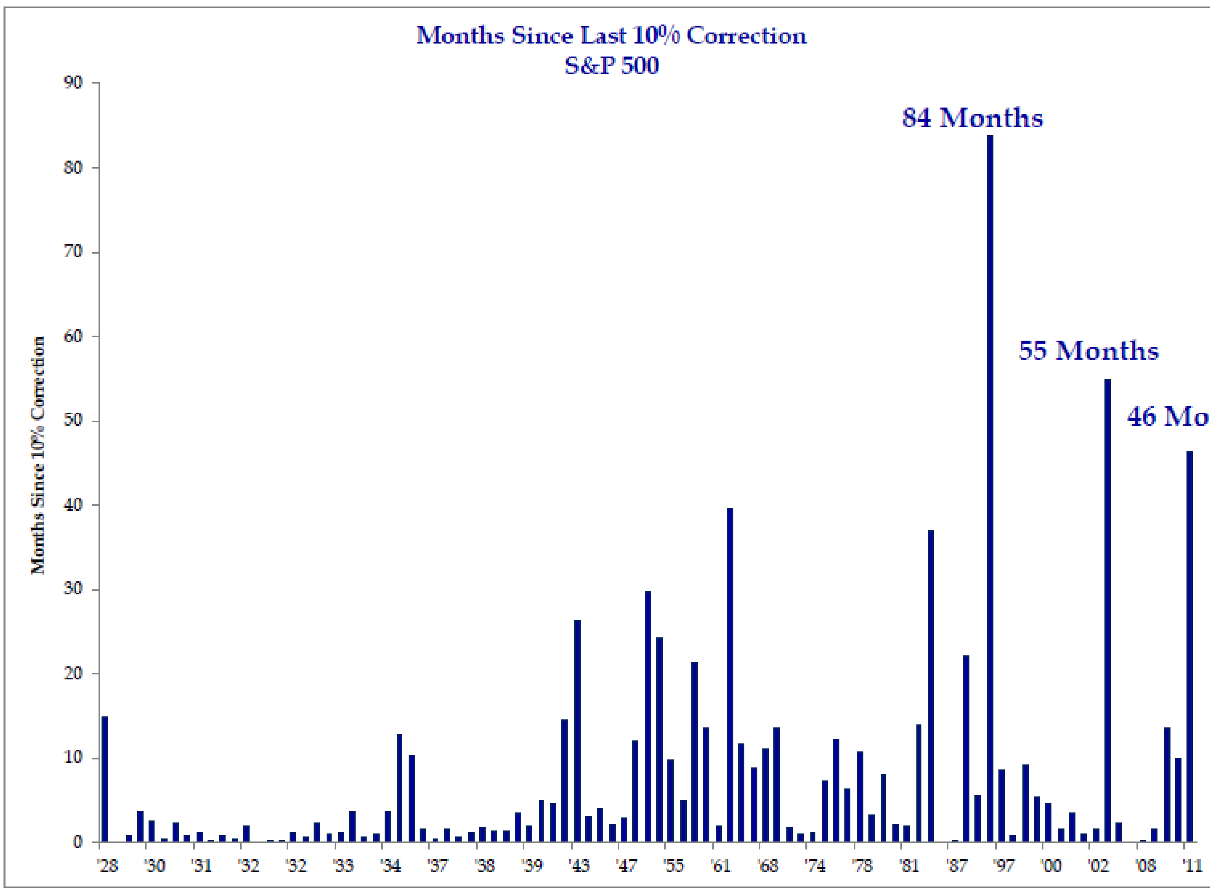
During the past week, global stocks plunged on fears about China's growth slowdown, the impact of the Yuan devaluation on other emerging currencies, the consequences of commodity price weakness, new elections in Greece, strained liquidity in global credit markets, and persistent uncertainty around the start date and pace of Fed tightening. VIX, a common volatility gauge, started the week at 13 and closed it at 27. The S&P 500 Index lost almost 6% over the five trading days. This may prove to be the long-awaited signal of a transition to a "risk-off" market. If so, we would expect performance drivers to reverse course and market leadership to change hands. As shown below, through the mid-point of 2015, value and quality factors underperformed, while high momentum and high risk factors outperformed.



Source: Brandywine Global Investment Management, LLC

In contrast, a risk-off environment typically rewards investments seen as “safe havens”. Consistent with that, cyclical stocks significantly underperformed defensive names during the big down days (Thursday and Friday), while Treasury prices and gold advanced.

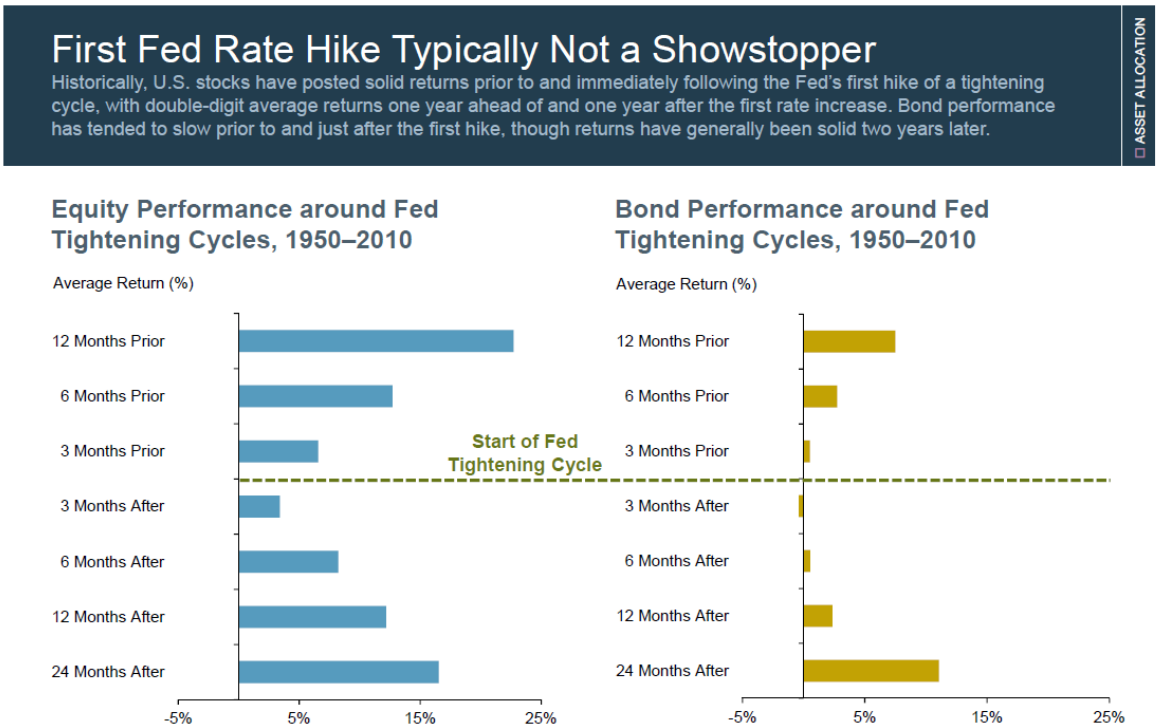
None of today’s headlines are breaking news as many of the macro-economic and geo-political issues have been known for a while. However, in aggregate, they became the catalyst for a change in sentiment. Increased volatility should not come as a huge surprise after several years of almost unnatural calm. Until recently, the S&P 500 Index was recording new highs at an unprecedented rate. Valuations were expanding from already elevated levels. Diversification, which is typically a valuable risk control tool, was hurting portfolio performance. According to data from Strategas Research, it has been 46 months since the last 10% correction in the U.S. stock market. This is the third longest stretch in S&P 500 history, as shown in the chart below.



Source: Strategas Research

What are investors to do if, indeed, sustained higher volatility brings on a risk-off regime? We agree with J.P. Morgan’s commentary that highlights “*three simple principles that can help investors maintain this balance: keeping market volatility in perspective, focusing on longer investment time horizons and maintaining portfolio discipline. While the past is clearly no guarantee of the future, we believe that investors who can see beyond short-term volatility will make better investment decisions*.”

Although we have no crystal ball to tell us how China, Greece, currencies, commodity prices, etc. will play out, we believe we have helped Beacon Pointe’s clients build resilient portfolios that can weather a rough patch. The typical investment manager we recommend is very cognizant of market risks, invests with a margin of safety, performs deep fundamental research, and builds high-conviction portfolios with attractive quality and valuation characteristics. A more challenging market may generate anxiety among clients, but presents active managers with an opportunity to add value by investing in securities with increasingly favorable return-to-risk profiles. A normalization of the interest rate environment, despite all the accompanying uncertainty, is likewise a positive for both equity and (with a lag) bond portfolios. The following chart by Fidelity Research provides some historical context from prior Fed rate hikes.



Source: Fidelity Research

Beacon Pointe emphasizes the principles of prudent investing even when volatility is low and more aggressive investor behavior could potentially generate stronger results. This is because we believe that investors should always focus on their personal investment goals or the goals of the institution which they serve, rather than worrying about keeping up with a particular market index or a fellow market participant. One shoe does not fit all when it comes to investing. A deliberately designed investment strategy and financial plan that takes into account your unique needs, risk tolerance, and time horizon should give you the confidence to stay disciplined in times of trouble for the broad markets.

Jittery markets are often likened to choppy seas. Experienced sailors know not to over-steer a boat in choppy seas. Rather than trying to compensate for every wave or bump in the ocean, they keep an eye on the horizon and hold a steady course. Overreacting is unproductive, even if it gives the illusion of efficiency. Attempting to achieve better short term results may create longer-term issues; going at a high speed is often dangerous; and taking risky shortcuts may lead to catastrophic loss. Whether you are driving or sailing towards your financial destination, remember to maintain a safe distance, keep an eye on the horizon, conduct your affairs with prudence, and patiently stay the course.

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