

BEACON'S POINT:  
A RARE AND DYING BREED

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## A Rare and Dying Breed

One of Beacon Pointe’s core tenets is our belief in active, fundamentally-driven investment management. Despite the rapid ascent of index funds and ETF investing during the past decade, we contend that carefully researched and selected active strategies offer the best opportunities for our clients to achieve their investment objectives while taking the least amount of risk possible. Our conviction is based on past experience, the depth and discipline of Beacon Pointe’s manager research and selection process, and our analysis of manager performance in the context of “active share,” first introduced by Yale School of Management’s Cremers and Petajisto in a 2006 academic paper discussed below (“How Active Is Your Fund Manager? A New Measure That Predicts Performance”, Antti Petajisto and Martijn Cremers, International Center for Finance, Yale School of Management, August 2006).

The researchers define active share as the percentage of holdings in a manager’s portfolio that differ from the benchmark index. It is calculated by finding the sum of the absolute values of the differences in weight for each holding in the manager’s and the index’ portfolios and dividing the sum by two. A simplified example below helps illustrate the mathematics behind active share. This hypothetical portfolio has a 55% active share relative to its benchmark, which is equivalent to a 45% commonality between the two.

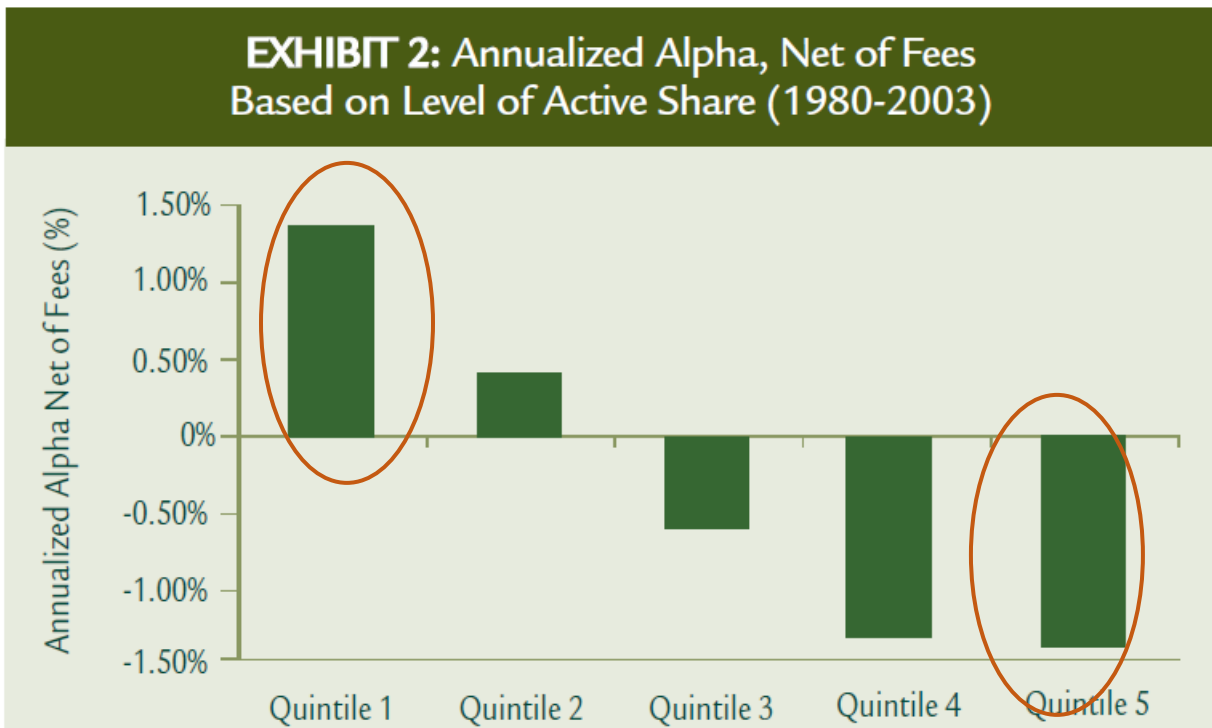
### Calculation of Active Share

Stock	Portfolio Weight (%)	Benchmark Weight (%)	Difference	Absolute Value
A	25	35	-10	10
B	10	25	-15	15
C	30	10	20	20
D	0	30	-30	30
E	35	0	35	35
Total	100	100		110
<b>Active Share</b>				<b>110/2=55%</b>

Unlike tracking error, which is based on past returns, active share is holdings-based and forward looking. It is found by analyzing the manager’s actual portfolio and comparing its holdings to the benchmark index. By using this method to measure active management, investors can get a better understanding of what exactly a manager is doing to drive performance, rather than drawing conclusions from past performance. In essence, active share takes into account all “active” decisions by Portfolio Managers in constructing their portfolios. The stock selection and portfolio weighting decision reflect the entirety of research views formulated by the investment team regarding valuation opportunities, future company prospects, and securities’ risk/reward profiles. Naturally, if a manager’s views differ from consensus expectations, the fundamentals-driven, actively-managed portfolio would look quite different from the broad market, the relevant benchmark, and the majority of its peers.

Generally, strategies with active share of 60% or higher are considered truly active. Passive strategies typically have an active share of 0%-20%. Products with active share between 20% and 60% fall into the “closet indexer” category -- these are managers who claim to be active, but whose portfolios are very similar in composition to the benchmark portfolio. This is an important distinction, because “closet indexers” charge active fees, yet produce results that are similar to -- and often below -- those of the benchmarks.

The first important finding of the seminal Yale study is that active share is a powerful tool for identifying potential future outperformers. Examining the returns of 2,650 mutual funds from 1980 to 2003, Cremers and Petajisto found that **the highest ranking active funds (those with an active share of 80% or higher) beat their benchmark indices both before and after fees.** In contrast, low active share managers generated negative alpha. The following chart compares the annualized excess returns of U.S. equity mutual funds, broken into five active share quintiles. The alpha differential between the two groups is evident and significant.



Source: Cremers, Martijn and Antii Petajisto. “How Active is Your Fund Manager? A New Measure That Predicts Performance.” October 3, 2006.

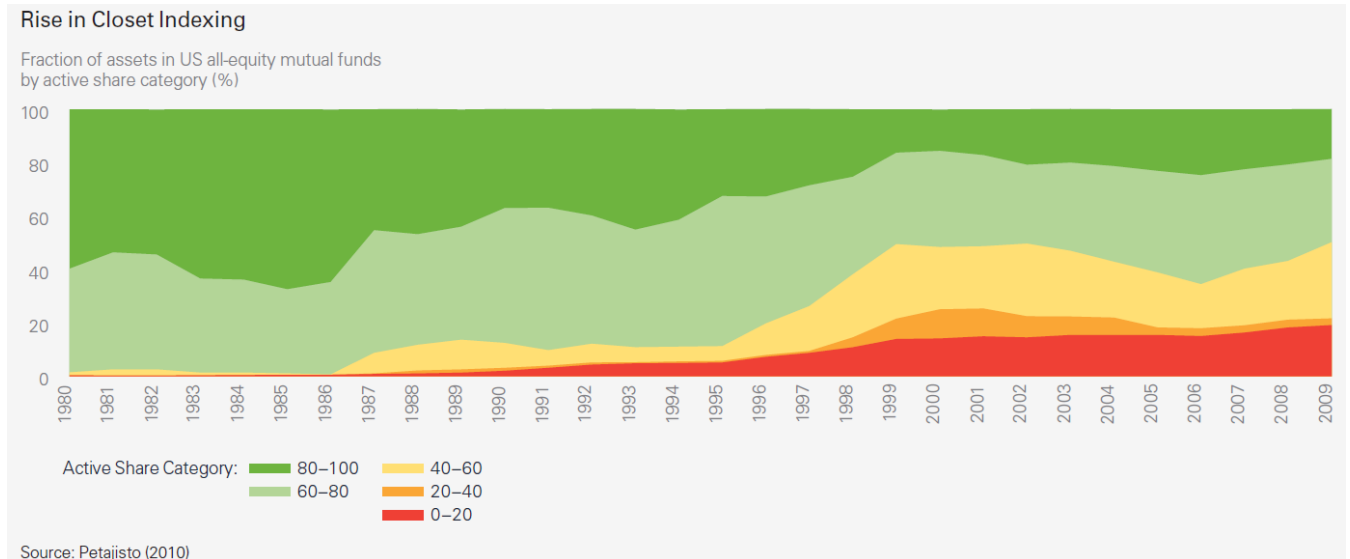
Past performance is not a guarantee of future results.

*Source: Brandes Investment Partners*

The researchers concluded that “active share significantly helps predict fund performance.” Importantly, the authors also found that active share and excess returns are higher among funds with lower levels of assets under management.

The second important finding of the Yale study, corroborated by subsequent research by Petajisto, is that **over time the investment management industry has reduced its active share and become more index-like.** Specifically, the percentage of assets under management with active share of less than 60% increased from 2% in 1980 to almost 50% in 2009. Correspondingly, the percentage of assets under management with active share greater than 80% declined from 58% in 1980 to approximately 20% in 2009. Are active managers “a rare and dying breed”? These data points certainly seem to indicate a shift in the money management world towards passive and quasi-passive strategies. Since the growing number of “closet indexers” are included in most performance studies of the broad active management universe (which do not take active share into account), their sub-par performance materially skews the overall results. It is not

surprising, therefore, that many draw the conclusion that the average active manager underperforms after fees. In contrast, the incorporation of active share in the research of Cremers and Petajisto shows that truly active managers are able to generate benchmark-beating returns consistently over the long term.



Source: Lazard Asset Management

As with any other statistical study, a cautious interpretation of the results is warranted. While the average return of the group of managers with high active share indicates outperformance, not every manager with high active share outperformed its respective index. Furthermore, the incorporation of active share in the manager search and selection process requires a patient and long-term oriented approach. It is well known that even top-performing managers occasionally experience periods of short-term underperformance.

Beacon Pointe’s research efforts emphasize investment managers that are truly active -- those that are benchmark-agnostic and rely on bottom-up stock picking; focus on capital preservation in difficult markets (the “make more by losing less” philosophy) with adequate upside participation; are committed to a strong valuation discipline with a “margin of safety” requirement; and exhibit a willingness to be contrarian and move against consensus. The Yale study on active managers and their historical results validates our research work and conviction in the managers we recommend to clients. Active share, which we calculate through our analytical software program Morningstar Direct, gives us a valuable tool for identifying and evaluating potential candidates that fit Beacon Pointe's requirements. In addition, active share confirms that the managers we already recommend in client portfolios are “truly active” as shown on the following page.

Please feel free to call Beacon Pointe should you need additional information or have any questions.

## Beacon Pointe: Focus List Managers' Active Share

*Data as of 6/30/2010 (Source: Morningstar Direct)*

BPA Large Cap Value/All Cap Value Managers*		
All Cap Value Manager A	Russell 3000 Value TR USD	97.77
Large Cap Value Manager A	Russell 1000 Value TR USD	94.38
All Cap Value Manager B	Russell 3000 Value TR USD	92.94
All Cap Value Manager C	Russell 3000 Value TR USD	91.12
Large Cap Value Manager B	Russell 1000 Value TR USD	90.56
All Cap Value Manager D	Russell 3000 Value TR USD	89.00
BPA Large Cap Growth Growth Managers*		
Large Cap Growth Manager A	Russell 1000 Growth TR USD	95.63
Large Cap Growth Manager B	Russell 1000 Growth TR USD	87.29
Large Cap Growth Manager C	Russell 1000 Growth TR USD	86.47
Large Cap Growth Manager D	Russell 1000 Growth TR USD	83.10
Large Cap Growth Manager E	Russell 1000 Growth TR USD	82.40
Large Cap Growth Manager F	Russell 1000 Growth TR USD	81.95
BPA Small Cap/SMID Cap Managers*		
Small Cap Value Manager A	Russell 2000 Value TR USD	98.91
Small Cap Value Manager B	Russell 2000 Value TR USD	97.41
Small Cap Value Manager C	Russell 2000 Value TR USD	97.35
SMID Cap Value Manager A	Russell 2500 Value TR USD	96.54
Small Cap Value Manager D	Russell 2000 Value TR USD	95.60
SMID Cap Value Manager B	Russell 2500 Value TR USD	95.06

*\* Beacon Pointe's approved manager list is confidential information. However, we would be happy to discuss any particular manager or recommendation upon request.*