Commentary: November 2016

A SIGNATURE DISCIPLINE

Our approach to investment management seeks pragmatism in concept and efficiency in practice. It is grounded upon more than a century of market history and informed by our collective decades of investment and advisory experience. Executed with cost effectiveness and practicality in mind, our methodology acknowledges the give and take of return and risk inherent to all investments and is designed to be applicable to a very wide range of individual investment scenarios.

Many-Legged Stool

A series of fundamental tenets comprise a discipline that defines our investment methodology. Those tenets formulate our core value proposition. Foremost in our work, we look at market history to inform our investment strategies, using the breadth of knowledge gained over the past century of research and practical implementation to guide our decisions. In turn, we diversify our portfolios with a purpose, with investment conclusions informed principally through empirical evidence and the quantitative evaluation of investment opportunities. Even so, we allow our methodology to evolve and improve over time through an environment that fosters continual learning. Meantime, we present our methods with transparency and we review our results with candor, remaining as accessible as possible to our clients and partners for clarity and collaboration.

Lean on Market History

We understand the first trading in individual stocks occurred in Amsterdam in 1602 with speculation in the shares of the Dutch East India Company. According to The Library of Congress, the first stock traded on an exchange in the United States in 1792. The investment community has learned much since then in regard to the manners in which markets function. Our work focuses primarily on fixed income and equity asset classes, where collective knowledge is particularly rich. What we principally have learned is that various characteristics, to which we commonly refer as *factors*, of stocks and bonds can be seen to have proved indicative of relative performance within both of those broad asset classes. For example, we can see that smaller stock historically have performed better than larger stocks, giving rise to a *size* factor. And less expensive stocks have performed better than more expensive stocks over longer periods of time, pointing to a *value* factor. Given the depth of that empirical support, we modestly "tilt" our portfolios in favor of those factors with the intention of benefitting from similar relative performance over time.

We must note that the past is only a guide and is not strictly indicative of future performance. And in that sense our work demands not only science, but a mix of art as well. Nonetheless, we believe that leaning much more heavily on evidence is far more defensible and in our own experience has proved far more successful than relying on methods artier in their nature.

Diversify with Purpose

At its core, our investment approach proposes a rather simple solution to the complex world of investing. Diversification is our strongest ally. From it we can receive much, with little demanded of us in return. Nonetheless, diversification should be sought with a purpose, in our view. First, the approach should seek to enhance representation of global markets. That means including, in effect, each and every one that is accessible via our investment opportunity set[1]. Furthermore, we should seek also to bolster portfolio diversification through our tilts to those factors the investment world has shown to potentially improve long-term risk-relative performance.

In accordance with our emphasis on diversification, we believe clients are best served with portfolios that remain fully invested through market cycles at target allocations appropriate for their ability to tolerate risk. We have found that little can be gained by attempting to time the market, either as a short- or medium-term tactic. Rather, we believe that the drivers of long-term portfolio total return should prove our approach to diversification and our emphasis of those characteristics, such as size and value, that have demonstrated potential to enhance relative return.

Quantify Each Decision

The investment world is chock full of numbers. These data describe the aggregate decisions made by all investors. This information–the collective wisdom of the investment masses–serves as the foundation for the determination of investment factors. In turn, we incorporate a range of such data into a model that guides our investment decisions. “Guide” is a key word here. We find it critical to understand that no black box can ever truly describe the always evolving capital market landscape. Still, as with any proper guide, our framework provides the direction we choose to navigate the investible universe.

Our focus on data also helps us, and in turn our clients, to weather market tumult. Short-term market shifts can be unnerving if we let them. Though not always easy to practice, we should try to avoid letting near-term market movement–up or down–drive our emotions. Instead, we can gain comfort by basically ignoring day-to-day and even week-to-week market fluctuations, confident that most “breaking news” is lost to history.

Foster Continued Scholarship

After decades of research and reporting on capital market activity, much can be considered “settled” in terms of collective knowledge and appropriate practice in investment management. Still, the industry continues to learn as the broader macroeconomic environment and investable markets evolve. Our Investment Team thus seeks to continually improve upon its shared competence and understanding of the financial world. That focus includes ongoing attention to how investors collectively understand and interact

[1] The mutual funds and exchange-traded funds available to us and relevant to our work comprise the investment opportunity set.

with investments so that we can feel confident on our abilities to provide support for the long-term goals of our clients and partners.

Evaluate with Candor

In our approaches to financial planning, investing assets, structuring fees and reflecting on performance, we engage clients and partners with candor and honesty. The goal is to earn trust every day in all that we do. With regard to individual clients, trust can be fostered through clear and candid review of their changing financial circumstances relative to their long-term financial goals. To that end, our Advisors reach out regularly to candidly assess the performance of client financial plans relative to their goals.

Likewise, our Investment Team offers relevant investment commentary to ensure our clients and partners are well informed regarding factors influencing investment positioning and performance. The Team further utilizes commentaries such as this one to reflect upon the features of the investment landscape that guide the work of the firm.

Discipline for the Portfolio Core

Our investment objectives are bound by a discipline we believe most effectively targets client aspirations. As importantly, we view this discipline as a foundation that nurtures the trust that is required for clients and colleagues to share in the team's confidence in its work. At SRCM, we believe that a methodical approach, respecting more than a century's worth of collective industry knowledge and evolved to be relevant to the investment challenges and opportunities of today, ultimately will enable the firm to achieve client investment goals.

Important Information

Investing involves risks. Past performance is not indicative of future results.

One cannot invest directly in an index. Index performance does not reflect the expenses associated with the management of an actual portfolio.

Asset classes and their respective indexes mentioned in this report include the following:

International (global non-U.S. dollar-denominated) fixed income: The Bloomberg Barclays Global Aggregate Index is a multi-currency benchmark that measures global investment grade debt and includes fixed-rate treasury, government-related, corporate and securitized bonds from developed and emerging markets issuers while excluding U.S. dollar-denominated debt.

Domestic (U.S.) fixed income: The Bloomberg Barclays U.S Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market.

Global equity: The MSCI ACWI Index captures large- and mid-cap representation across 23 Developed Markets and 23 Emerging Markets countries. The index covers approximately 85% of the global investable equity opportunity set.

International equity: The MSCI ACWI ex. USA Index captures large- and mid-cap representation across 22 Developed Markets countries and 23 Emerging Markets countries. The index covers approximately 85% of the global equity opportunity set outside the U.S.

International small-cap equity: The MSCI ACWI ex. USA Small Cap Index captures small cap representation across 22 Developed Markets countries (excluding the U.S.) and 23 Emerging Markets countries. The index covers approximately 14% of the global equity opportunity set outside the U.S.

International value equity: The MSCI ACWI ex. USA Value Index captures large- and mid-cap securities exhibiting overall value style characteristics across 22 Developed and 23 Emerging Markets countries. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield. The index targets 50% coverage of the free float-adjusted market capitalization of the MSCI ACWI ex. USA Index.

International small-cap value equity: The MSCI ACWI ex. USA Small Cap Value Index captures small-cap securities exhibiting overall value style characteristics across 23 Developed Markets countries and 23 Emerging Markets countries. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield. The index targets 14% coverage of the free float-adjusted market capitalization in each country.

Emerging markets (EM) equity: The MSCI Emerging Markets Index captures large- and mid-cap representation across 23 Emerging Markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

Domestic (U.S.) large-cap equity: The S&P 500 Index represents 500 U.S. companies and captures approximately 80% coverage of available market capitalization.

Domestic (U.S.) small-cap equity: The S&P SmallCap 600 Index represents 600 U.S. small-cap companies that meet investability and financial viability criteria.

Opinions expressed herein are subject to change without notice. SRCM has exercised reasonable professional care in preparing this information. The information has been obtained from sources we believe to be reliable. However, SRCM has not independently verified or attested to the accuracy or authenticity of the information.