
Letter From The Portfolio Manager

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Some Good Questions



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Key Points

- *We receive questions each month from clients about how KIM manages portfolios and our outlook on the markets.*
- *One recent example is: “Do you own the same funds that I do?”*
- *Another is “What is your corporate culture like?”*
- *Given that we’ve been bullish for some time now, some have asked: “What would make you bearish?”*
- *Lastly, “How do you factor politics into your stock market outlook?”*

The questions we get from clients each month are the materials that typically build the framework for this monthly commentary. If we get the same question from at least a couple of clients, or if we recognize a clear theme or concern from clients, it will be addressed.

In recent weeks, we have received a few interesting questions, not necessarily market outlook related, that I think are important to touch upon this month.

“Do You Own The Same Funds That I Do?”

A common question – and an excellent one – is “do you own the same funds that I do?” It’s a great question and one we ask of the portfolio managers of the funds that we interview and analyze before we put them in your portfolios.

The answer is both “yes” and “maybe.” Every investor has a different investment situation and each of us at KIM is no different. As for myself, I love analyzing and investing in mutual funds and I own a lot of them. In fact, I personally own at least one fund from each major target portfolio built for clients. My holdings clearly overlap with what you own in your KIM portfolio.

The key point to make here though is that what we’re “selling” at KIM isn’t a specific portfolio, but a philosophy. And, it’s one I wholeheartedly believe in. *We build balanced, diversified portfolios for long-term investors¹.*

Understanding what a portfolio manager owns is critical to knowing if they believe in what they do. We eat our own cooking. Clients should expect nothing less from their portfolio manager.

While knowing what an investment manager owns is important, it’s not a complete picture when it comes to understanding financial incentives. While some fund analysts tout fund ownership as the primary statistic to understanding financial motivations, I somewhat disagree for two reasons.

First, mutual funds that have the highest portfolio manager investments tend to be the funds that have the most experienced portfolio managers. They have more in absolute dollars in their funds because they have had more time to build their assets. We also don’t necessarily know how much of their over-all personal portfolio is allocated to their professional fund. In addition, these

managers are often at the stage in their career where they are handing the ball off to a younger associate to run their investment portfolios.

Second, in most situations, an equally – if not more important - item to know is how the investment manager is paid. What are their incentives? How do they get rewarded if they do well? How do they get punished if they do not do well?

At KIM, we do better if our clients do better. If your assets grow, we'll do better. If your assets don't grow, we are paid less. And if we're doing our job well, we attract more clients as a result, and that symbiotic relationship benefits all of us.

Making sure an investment manager's interests are aligned with investors is important to us – and should be to you as well.

“What is Your Corporate Culture Like?”

This is another great question – and again this is something we try to discern in the money management firms we analyze. In short, when we speak of culture, we are referring to the attitudes and values of the organization. It's not an easy question to answer. If we get a good sense of a firm's culture though, and assuming it's positive, then we typically have a higher level of confidence in working with that firm.

When we go to an investment firm, we try to get a sense of the working atmosphere. Is it creative? Competitive? Collaborative? Ego-centric or service-centric? Are managers providing the necessary support for investment professionals to excel? Are people within the firm on the same page when it comes to their corporate mission?

Formal interviews with firms rarely provide enough information to answer this question. This is where the scuttlebutt of meeting with various people within a firm, usually in a more informal setting, often gets to this answer. And this is why we eagerly meet and try to build relationships with various people within an investment firm.

To generalize, it's often easier to get a comfort level with another firm's culture if the firm is smaller in size. Investment boutiques are typically populated by professionals who all buy into what the firm is doing. Larger firms, while obviously still able to provide quality products, often have corporate cultures that are much more difficult to pin down.

At KIM, even though we are part of a much larger financial services firm, we have been able to retain the boutique approach that we've had since the firm's founding. We still do what we've always done.

As for the atmosphere within our office, I like to think we have a great group of people who believe in putting clients first and maintaining a strong business as a result. We believe in continuous professional growth and fostering a supportive and collaborative environment.

And, we like to challenge each other – inside the office and out. One fun example is our regular “Kobren Cup” challenge between the Research Team and the Account Management Team. These are sporting events during a weeknight evening, where we pit the athletic prowess of the

two groups against each other. You may have heard of this before from your Account Manager, but if you haven't, you can make an educated guess which team has won more!

“What Would Make You Bearish?”

Given that we've maintained an over-all bullish bias on the stock market for some time now, in the face of persistent bearish sentiment from investors, this question has come a few times of late.

For our regular readers, this should be a surprising question though, since we compile and publish on our website (www.kobreninsightmanagement.com) each month our Equity Five-Factor Model, which drives our perspective. In short, when these factors falter, then our market bias will falter as well.

At present, the outlook remains positive. Earnings are still accelerating and surprising to the upside, valuations suggest the market is moderately cheap, and the interest rate backdrop is very supportive of the stock market. In tandem, these three factors alone drive our Capital Market Assumptions (CMAs), which are the building blocks for deriving our longer-term expected returns for each asset class. In addition, the remaining factors for our five factor model – sentiment and liquidity – also currently suggest that the market should do better moving forward.

“How Do You Factor In Politics?”

Some have suggested that we make a sixth factor in our model for “Politics”. It's a fair question given how much politics have impacted investor mood of late, but our answer is that we won't. Most of the political news that is created each day is noise. The constant conjecture about what may or may not happen may appear actionable, but it's often just a distraction, and a costly one at that for many investors.

That is not to say that government policy – even when it is mostly symbolic - is not important. It often is. But, in our assessment, it will get picked up in the aforementioned five factors. Higher taxes and more regulation, for instance, often translate into lower economic growth and lower valuations. Increased government debt, all else being equal, usually means higher interest rates over time. Politics impact consumer and investor sentiment. This is apparent these days as political partisans seem even more eager than usual to use fear to push their respective agendas. Lastly, and perhaps most importantly, is that government policy often drives liquidity. One example is that government can exert considerable influence over money supply growth, which is often a leading indicator of what the economy and markets will do.

So, politics do matter, and will impact each of the five factors over time.

Summary

The questions above were just some of the many questions we received last month. If we haven't answered a question that you have – either about KIM or the markets – please let us know. Answering your questions is the best way for you to understand what we do and for us to understand what you need.

Enjoy the remaining weeks of summer. Thank you for reading.

Sincerely,



Rusty Vanneman, CFA, CMT
Chief Investment Officer
Portfolio Manager

¹A “balanced” portfolio is one that balances a mix of asset classes, such as stocks and bonds, to attain an appropriate risk level given an investor’s unique situation. A “diversified” portfolio is one that spreads its investments among a variety of securities within an asset class to reduce additional risks. A “long-term” portfolio is one that is designed to produce results over a period of years (often ten years or more), instead over a shorter time period such as months or weeks.

We also believe that long-term growth portfolios should have a consistent equity orientation. We also believe in being sensitive to the price paid for an asset and the costs associated with transactions.

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