

# INVESTMENT MANAGER SELECTION AND MONITORING



LAIRD NORTON WEALTH MANAGEMENT  
INVESTMENT PROCESS



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## LAIRD NORTON WEALTH MANAGEMENT INVESTMENT PROCESS

### INTRODUCTION

In developing an investment plan we begin with the decisions that will have the greatest impact on a client's portfolio, and then continue to add accretive elements. We start with asset allocation, as empirical studies<sup>1</sup> demonstrate that it is the most important factor impacting a portfolio over a long-term horizon.<sup>2</sup> The second-most important decision relates to manager selection.

For each asset allocation strategy, Laird Norton Wealth Management (LNWM) searches for the managers that are able to assist our clients in reaching their investment goals. We have developed a systematic, rigorous approach to manager selection that focuses not just on historical performance, but also on a manager's ability to execute a proven strategy going forward. We also emphasize strong corporate governance and investment stewardship in the managers we include in client portfolios. LNWM views our selected investment managers as partners in helping to achieve our clients' goals, which is why we conduct our due diligence process with that long-term partnership in mind.

### MANAGER SEARCH PROCESS

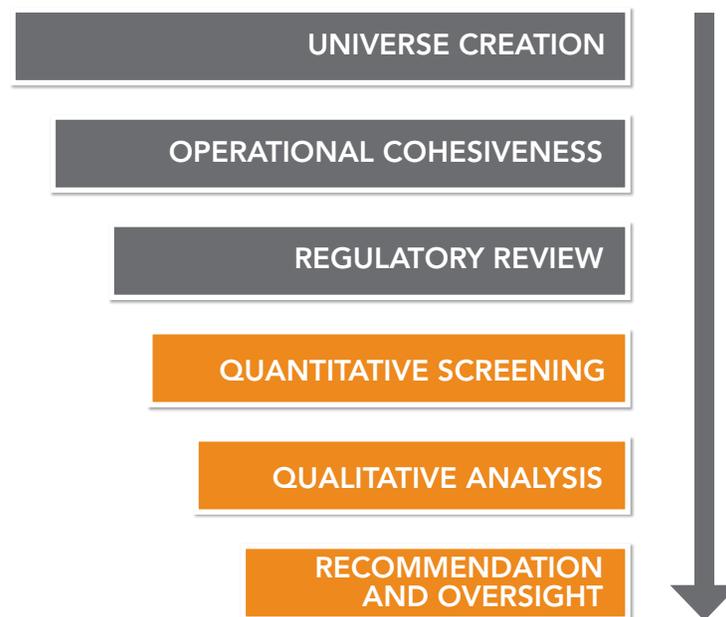
The process begins when either our Chief Investment Officer or the firm's Investment Committee determines a need for a new manager. This need may arise either through the termination of an existing manager or to execute on a new allocation. Once the need has been determined, the Investment Strategy and Research team identifies the search's purpose and scope. The search purpose, for example, could be the need for a long-term investment solution or one to capitalize on a current opportunity (strategic vs. tactical). The scope of the search relates to its optimal structure (mutual funds, exchange-traded funds (ETFs), separate accounts, or limited partnerships) and strategy (active or passive). This information frames the upcoming search.

We employ a team-based approach to our due diligence and monitoring of managers, but segregate primary responsibilities by asset classes. Each analyst is assigned to a particular asset class based on their unique experience and knowledge, and are considered the subject expert on that segment of the market. They are continuously evaluating the universe of managers within that asset class and will take the lead on searches within the segment.



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Manager searches gain complexity in line with the complexity of the strategy or vehicle, but all employ the same five steps throughout: Universe Creation, Operational Cohesiveness, Regulatory Review, Quantitative Screening and Qualitative Analysis.



We value the importance of this process in helping our clients realize their investment goals. Thus we apply strict attention to detail at each of the following steps:

## UNIVERSE CREATION

We believe that the Universe Creation step, in which we develop a broad list of candidates, is integral to the success of each search. If the universe is incomplete or lacking in qualified candidates, it can lead an analyst to a suboptimal manager selection. Therefore we employ a number of databases, as well as our professional network, to generate a comprehensive list of managers. Applying screens for style (i.e. value or growth bias) and market capitalization is an important part of this step.

## OPERATIONAL COHESIVENESS

In this step we verify certain things like whether the fund is open to new investment; that it is the appropriate fund structure (mutual funds, ETFs, or separate accounts); and that it is investable



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through our two operational platforms. We also evaluate each fund's size to ensure that it is sufficient to withstand an allocation from LNWM clients without compromising liquidity or trading efficiency within the portfolio. Investment Strategy and Research will often leverage the expertise of LNWM's Operations team to confirm the usability of a prospective investment manager.

## REGULATORY REVIEW

This phase involves reviewing remaining candidates for any regulatory infractions, conflicts of interests, or other corporate governance concerns. We research any legal settlements, SEC fines or sanctions, or other issues incurred by the fund or the firm's personnel. If a firm has conflicts of interest inherent in its business model, such as a mutual fund operated by a large broker dealer, it would likely be eliminated at this stage. In this step, Investment Strategy and Research often recruits LNWM's Legal team to evaluate legal documentation and compliance procedures of prospective managers.

We generally screen out managers that cannot offer a sufficient track record (typically three years) in our desired strategy. We also analyze characteristics like asset size of the fund to determine whether management is employing the greatest degree of stewardship over client assets. As an example, consider a manager who typically holds 40 to 50 stocks in a portfolio, representing their best ideas. If the fund receives too many assets, the manager must either continue to purchase shares of those 40 or 50 stocks, which could manipulate prices upward, or purchase additional new stocks (outside of their best ideas). Because of this potential dynamic, we prefer to see management thoughtfully plan on closing a fund after it reaches a certain level of assets rather than allowing growing assets to put pressure on stock prices or force additional trades. We want the fund to maintain a size that allows managers to employ only their best ideas.

## QUANTITATIVE REVIEW

At this juncture, we begin reviewing the performance and risk metrics of the remaining candidates. LNWM licenses data from a number of highly reputable vendors, which we analyze using our proprietary model for ranking and scoring managers on a myriad of statistics. We evaluate manager performance against various benchmarks and against their peer group over numerous time periods. We then try to identify on a quantitative basis a manager's skill, consistency and, most importantly, ability to replicate their strong historical performance in the future. At the conclusion of this step, we strive to pare the remaining list of candidates down to a select few, as the next phase is by far the most complex and time consuming.



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## QUALITATIVE REVIEW

At this stage, we conduct a very thorough review of the firm and its people. We analyze all related documents including Requests for Information (RFIs) or Due Diligence Questionnaires, the fund's Prospectus or Offering Memorandum, annual reports, quarterly reports, regulatory filings (like Forms ADV), along with other filings and reports on each manager. We also conduct multiple interviews of the firm's investment staff and thoroughly interview the firm's clients as well. A member of the Investment Strategy and Research team typically visits the manager's headquarters during this stage of the analysis to view firsthand their various resources and tools. The site visit is a great opportunity to meet face-to-face with a number of key personnel and to fully understand the manager and their strategy. Before a manager is added to our clients' portfolios, we must fully appreciate when a strategy will excel and when it will falter. This information aids us in deciding how and when to allocate to the managers. It also helps establish realistic expectations for their performance. We ultimately strive to establish confidence in the manager's ability to consistently apply their strategy going forward.

The Investment Strategy and Research team has at their disposal an additional resource that can be leveraged in any or all the five steps outlined above. The firm has contracted the services of a third-party research provider who specializes in analyzing asset managers across a wide range of strategies. We have the option of requesting their analysis early in the search, while constructing an adequate universe of managers; late in the review, when evaluating the manager's qualitative aspects; or any time in between. They are a great sounding board for ideas, as well as an additional resource for questions and due diligence checks. While they can be a very useful resource throughout our search process, it is important to distinguish that it is only one small element of our process. LNWM takes the stewardship of our clients' assets very seriously, and thus require that the basis for each manager decision, and the decision itself, remains solely the responsibility of our firm.

At the completion of these steps, the primary analyst assigned to the search details his or her thesis about the manager and strategy in a comprehensive document. The analyst also completes a profile sheet on the manager. Profile sheets are multi-page, proprietary reports offering analyst commentary on performance drivers, manager ranking (outlined below in the manager watch-list discussion) and relevant risk and return metrics. All information gathered since the initiation of the search process is documented in an electronic search binder and cataloged for future research.



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## PEER REVIEW

Before the analysis moves outside of the Investment Strategy and Research group, the analyst must undergo one of the most important, and most difficult, steps in the process: the peer review. When the analyst feels conviction in his or her analysis and believes it to be complete, he or she will formally present the analysis to the rest of the Investment Strategy and Research team. Each team member thoroughly reviews all search materials along with the analyst's conclusions to evaluate both accuracy and completeness. Team members bring their unique knowledge of other asset classes and managers to the analysis and question any assumptions or details of the analysis to confirm the analyst's understanding. This review is performed with the utmost respect and professionalism, but is intended to challenge the analyst's thesis regarding the manager and to make sure that any questions regarding the manager can be confidently answered. In the event a peer review uncovers new ideas or requires further analysis, another peer review might be scheduled. Only upon full consensus from the members of Investment Strategy and Research can a manager be considered for presentation to the Investment Committee.

## INVESTMENT COMMITTEE RECOMMENDATION

The final stage in the manager selection process involves presenting the analysis to the Investment Committee. Although the analysis has already undergone a rigorous peer review, this committee meeting is not a rubber-stamp process. Members of the Investment Committee comprise senior management and decision makers from across the firm including Client Services, Operations, Legal, Trust and Compliance groups. This level of inclusion demonstrates the importance we place on each decision about investment managers. Voting members of the Investment Committee are the firm's Chief Executive Officer and President, Chief Investment Officer, General Counsel, Chief Compliance Officer, Managing Director of Fiduciary Services, Investment Strategist, Director of Operations and Client Service Team Leaders. Investment Analysts and Client Service Analysts are typically also in attendance.

In these meetings, the analyst presents his or her thesis regarding the manager. Interested parties from across the firm discuss the analysis and address any issues or questions that arise. With a majority vote of the Investment Committee the manager is added to LNWM's list of approved managers.



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## ONGOING MONITORING

LNWM views our third-party managers as partners in helping us achieve our clients' investment goals. Regardless of the length of time LNWM invests with them, we look at each manager engagement as a long-term relationship. We believe every good relationship centers on great communication. We connect with our managers at least quarterly, but in many cases much more frequently to maintain an open dialogue and to better understand any implementation challenges. We focus our attention on those individuals who directly manage the portfolio. These conversations include a discussion of any transactions that have taken place, as well as their outlook on future changes. This consistent level of communication facilitates LNWM's efforts in really understanding managers on our approved list, and verifies that they are managing our clients' assets in line with our expectations.

The Investment Strategy and Research team's communication extends to our clients as well. On a quarterly basis, members of the Investment Strategy and Research team compile timely analysis of each manager into a manager profile sheet. These reports provide LNWM clients with a concise resource for keeping abreast of the managers with whom they invest. Members of the Investment Strategy and Research team are also readily available to clients, through their Client Service teams, to discuss approved managers. All documentation gathered over the course of our continuous monitoring is cataloged in our electronic filing system and maintained for a minimum of seven years.

LNWM ranks managers on a quarterly basis through our watch-list process. We have developed a system by which we evaluate both quantitative and qualitative characteristics of each manager. Each quarter, through a peer review process, the team will rate each manager on the approved list. The rating levels are: Above Expectations, Meets Expectations, Below Expectations and Under Review.

The Under Review ranking could signal one of two things. The first indicates that the fund has reached its mandatory review cycle and the asset class is now under review. The second signifies that there has been a material change with the manager that we believe could have an impact on our clients' investment. When a manager is Under Review, LNWM does not permit additional purchases of the manager's product until a review period has been concluded.

Along with quarterly evaluations of our managers' performance, we also conduct a comprehensive review of managers against their peer groups periodically. The frequency of this process depends on the nature of the investment. The asset classes reviewed more frequently tend to exhibit higher



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volatility or are relatively new and thus have a higher degree of new entrants to the market. In addition, those managers who have a higher concentration of LNWM assets will be reviewed more frequently. This review process is designed to reestablish the original investment thesis on an approved manager, and to confirm that it is still the best manager for the allocation. To make that determination, we use a slightly modified version of the manager search and selection process including the peer review.

Each step in this process is designed to give us a greater understanding of the available managers in each asset class and the individual strengths and weaknesses of each. It is diligently followed to ensure a consistent and repeatable process offering superior manager selection for our clients.

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1. Gary P. Brinson, L. Randolph Hood, and Gilbert L. Beebower, "Determinants of Portfolio Performance", *The Financial Analysts Journal*, (July/August 1986) p. 39-44. This is a study which found that asset allocation explains more than 90% of the volatility of returns of an overall portfolio.

2. For more information on LNWM's asset allocation framework, please see our white paper on the subject.



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## ABOUT LAIRD NORTON WEALTH MANAGEMENT

With nearly \$4 billion in assets under advisement, Laird Norton Wealth Management is the Northwest's premier wealth management company. Originally founded to serve the financial management needs of the Laird and Norton families in 1967, the firm now provides personalized wealth management solutions for more than 425 individuals, families, business leaders, private foundations and nonprofit organizations. For nearly half a century, Laird Norton Wealth Management has been driven by a passionate commitment to help its clients and their families achieve security, find happiness and thrive in every aspect of their lives. The company is relentless in the pursuit of client satisfaction and is committed to never fail at putting a client's best interest as the number one priority.

## DISCLOSURE

The information presented herein does not constitute and should not be construed as legal advice, as an endorsement of any party or any investment party or any investment product or service, or as an offer to buy or sell any investment product or service. The views and solutions described may not be suitable for all investors. All opinions expressed are those of Laird Norton Wealth Management and are current only as of the date appearing on this material.

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