Investment Management: Philosophy & Process

"In all endeavors, generating true value requires time, a philosophy and a process."

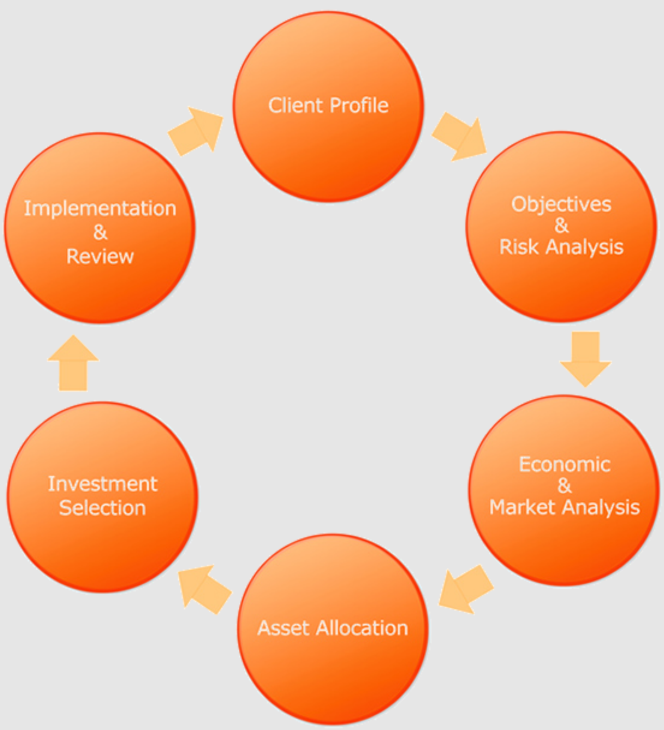
The Loser's Game

Roughly two-thirds of money managers fail to beat their benchmarks over the long run. In an industry filled with bright, capable people, armed with the best information, more fail than succeed. Win or lose, however, their fees rarely decline.

Money managers make one of two mistakes. They buy and hold investments that fall with every precipitous decline, and fail to outperform indexes over most time frames. Or, they overtrade the portfolio. Responding to every piece of news. Failing to let winners run. Cutting their losses and holding cash, even as the sold position rise back above their sale price.

To outperform, one needs better information, or a better means of processing that information. Unfortunately, neither is generally available. The key to winning? A more effective process.

Process & Philosophy



An effective investment process is derived from a thoughtful investment philosophy. Process without belief is a book without text. Empty. Only from a well-conceived philosophy can effective methodology spring.

An investor's philosophy illuminates a market anomaly and re-occurring pattern that the investor hopes to exploit. The process provides the plan of attack. So, the philosophy is the cornerstone of any investment firm. The ability to provide clients with value through one's portfolio management efforts is born of philosophy. The process puts the philosophy to work. Leverages a firm's beliefs, over time. If the philosophy is correct, then clients consistently outperform risk-adjusted, blended benchmarks, over time.

So, philosophy represents the recipe used by the investment management firm. The process by which that philosophy is utilized? No different than getting up and making the donuts.

For a philosophy to be effective, it must be utilized consistently over the long run. In good markets, and in bad. It must be counted on to find opportunity in good times, and to provide safe harbor by preserving capital in bad times. While there will be periods during which the philosophy, and so its process, are less effective, it must be adhered to unwaveringly. For an investment firm without a set philosophy is a ship without sails. Meandering and wayward in neutral seas. Likely to capsize when the environment becomes turbulent.

Our Philosophy

Our investment philosophy is predicated on five ideas:

1. **Market Mispricing**… While the market is an efficient pricing mechanism, incorporating new information instantaneously, there exist situations where investor's fear and greed will cause temporary price dislocations. We endeavor to buy capital efficient companies that are temporarily undervalued and sell them as prices become fairly valued. Or, hold them so long as they remain capital efficient. These can be identified by locating companies that are fairly or undervalued within their peer class, offer a price/earnings-to-growth ratio (PEG) of roughly 1.0, signifying strong forward-looking earnings per share potential married to a low current valuation. And have a return on equity above 15%.

2. **Underappreciated Asset Classes**… Wall Street's sell-side analysts find it much easier to glean information on and create metrics for large-cap, blue chip companies. Accordingly, most of the time and attention is spent on these well-known corporations. This leaves savvy investors with an opportunity to seek out promising, underappreciated stocks in the small– and mid-cap equity arenas. Thousands of companies representing tomorrow's Amgen, Intel and Hershey. Possessing real earnings growth, solid business models and dynamic growth opportunities. While still flying beneath Wall Street's radar.

> "The basic drive behind real philosophy is curiosity about the world, not interest in the writings of philosophers." —Bryan Magee

3. **Lower Costs Provide Higher Returns**… HPWM's investment team understands that, over time, every basis point returned counts. Time value of money, and the power of compounding returns, can turn meager gains into large profits in the long run. So, we endeavor to keep portfolio management costs low. This entails the utilization of indexes like exchange-traded funds (ETFs) and individual equity positions. Why shun mutual funds, for the most part? Because these overly expensive investment vehicles are usually run as closet indexes and very rarely even keep pace with their benchmark indexes. Let alone outperform them.

4. **Tactical Approach to Asset Allocation**… HPWM's investment managers establish strategic asset allocation models based upon client risk tolerance. Knowing, however, that different market environments favor specific asset classes, we will actively manage portfolios in order to overweight promising market areas, or underweight asset classes set to underperform. Experiences like 2002 and 2008 have revealed that a tactical approach to asset allocation and portfolio management is more client-centric than a buy-and-hold approach

5. **Cut Portfolio Losses Quickly**… Good investment managers let winners run, and losers die. While market corrections of 10% are common place, losses beyond that are the market's means of telling investors to "look out below." Accordingly, we set trailing sell stops beneath most of our risk-oriented positions, including most equities. Stops are often tied to predetermined percentages or moving averages. These enable our portfolio positions to run up as much as possible, or even trade sideways and provide dividends. They prevent positions from falling precipitously, dollar for dollar, when markets go through those occasional bouts of hyper-volatility.

   Our investment team prefers to hold cash and watch the carnage, than hold massive losses and be a part of it. This underscores our preference for indexes and equity positions, as opposed to mutual funds or money managers (separately managed accounts). Funds and managers do not enable an investor to set stops. So exposing portfolios to precipitous declines during periods like 2002 and 2008.

Hyde Park
Wealth Management

Measuring Success

The firm's investment management team seeks to achieve the most effective risk-adjusted return per client. Thus, it is critical that we utilize a consistent means of measuring the success in achieving that return.

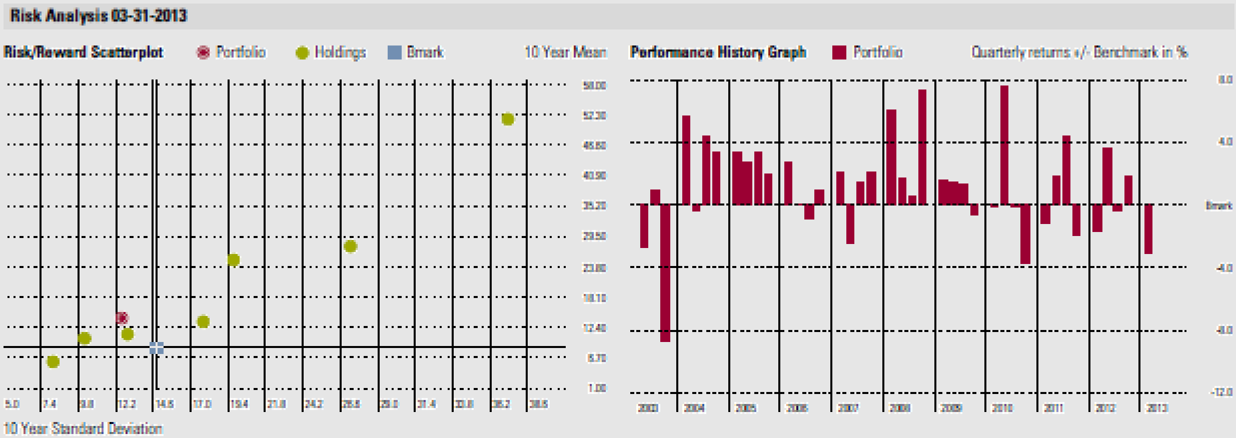
The most effective means of measuring success? The consistent comparison of our portfolio returns to that of a blended, like-to like benchmark. So, a client with a moderate tolerance for risk, and a preference for growth and income might utilize a benchmark like the following:

35% S&P 500 / 35% MSCI EAFE / 20% DJ AGG Bond Index / 5% Treasury Inflation Protection / 5% Cash

Overtime, through most — though not all — time periods, HPWM's investment team seeks to outperform the blended benchmark indexes, after fees.

Most importantly, however, HPWM investment team seeks to annually assess that a client continues to make consistent progress towards long term goals. Specifically, as determined by the figure we have deemed necessary to achieve a desired level of financial independence. This realization enables clients to engender the peace of mind that comes from knowing they are effectively working towards their personal financial objectives.

Risk versus Reward



Seeking Long-Term Outperformance

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