GenSpring
FAMILY OFFICES

Manager Selection – More than just performance numbers

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GenSpring has been outsourcing the management of specifically defined investment strategies since day one. Our process is a function of how we believe investments should be managed and not a choice based on marketing trends; something we have witnessed with large Wall Street firms that aim to create open architecture platforms. We thought it would be interesting to describe the differences in GenSpring's manager selection process relative to our major competitors, and how emphasis on gaining market share by larger institutions in the family office segment has only enhanced our ability to differentiate and establish our value.

Using three actual scenarios, we can illustrate how GenSpring's process does not rely solely on the numbers and how it instead focuses on determining the future expected performance of the managers relative to their peers. It is this methodology that has helped us continue to add value over and above what a more typical consultant selection process might generate. Before going through the examples, we want to make a couple of points to provide a reference point that will help clarify our position.

First, GenSpring manages money on a discretionary basis. We build portfolios; we do not sell managers. Our focus is on strategy allocation and hiring the best managers available to execute on our behalf. It is our belief and has been our experience that outsourcing specific investment management activities adds significantly more value than attempting to retain the best talent on a proprietary basis across our broad spectrum of investment strategies. Although our process includes a number of quantitative screens to identify strong performing managers, we understand that circumstances can hide the real value that a manager brings to the table. We believe that it is not to our advantage to rely solely on past performance and statistics (Sharpe, Alpha, Sortino, etc.). Therefore, it is GenSpring's position that the difficult task of determining a manager's true level of skill can be best accomplished with a thorough review of the strategy and the manager, as well as the past performance attribution.

GenSpring's belief is that manager selection is impacted by three broad categories: 1) the attractiveness of the underlying strategy going forward; 2) the edge brought to bear on the strategy implemented through the manager's philosophy and process; and 3) the sustainability of that edge going forward.

With regard to the attractiveness of the underlying strategy we would highlight the opportunity in distressed debt in 2002 after credit spreads widened materially. This was a perfect time to allocate new assets into this strategy but many were hesitant to do so as the industry tends to focus too much on recent history.

Identifying an edge may be difficult at times, but is an important ingredient in manager selection if one expects to add value at the manager level. GenSpring tends to focus on taking advantage of widely held assumptions regarding strategies that are flawed in reality, and whether or not a manager's philosophy and process actively seeks to exploit these flawed assumptions. Some managers have developed cost advantages, computing power advantages, or simply taking advantage of the temporary irrationality of market participants.

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Finally, GenSpring focuses on the sustainability of that edge into the future. In many strategies, asset size can impact the viability of sustaining an edge. Some strategies rely on larger asset bases to sustain an edge while others lose their competitive advantage as assets increase. Furthermore, a firm's culture can be either a benefit or hindrance to future success. GenSpring focuses on firms filled with individuals that are driven and incented to perform, have passion for what they do, and an ownership structure to reward them for their continued success.

Our first example highlights the importance of not relying solely on great performance numbers and statistics. Having a deeper level of analysis enables us to identify the environment and mandate that will best utilize and leverage the manager's process and skill. We attribute the success of our largest equity manager, in terms of GenSpring assets, to his process and the manager's ability to identify great companies trading at prices below intrinsic value. While GenSpring was happy to invest with the manager based on his core strategy results, we determined that we were sacrificing opportunities for better returns due to the manager's desire to mitigate his business risk by holding 40 stocks. While most firms invest with the manager based on this experience, GenSpring asked him to only hold 10 to 12 stocks, thus giving us the ability to leverage the manager's skill, which was finding and investing in great companies at low prices.

As illustrated below, GenSpring's performance with the manager has been much stronger compared to his firm's own client composite, which adheres to the standard portfolio.

Return Since Inception (1/31/96)		
	Annualized	**Cumulative**
GenSpring Mandate	15.8%	360%
Manager Composite	14.0%	292%

Performance as of May 31, 2006

Our second example attests to GenSpring's ability to find unique ways to invest capital in attractive strategies and niche markets. The analysis is similar in terms of identifying an edge, but is more focused on the specifics of the underlying strategy. GenSpring is constantly looking for ways to invest capital in various strategies as well as ways to take on specific market or manager risk depending on the market environment or the nature of the underlying strategy. For example, based upon our view that certain Asian markets were attractive, particularly small cap Japanese equities, we became very interested in using an active manager, either long only or long/short in order to take advantage of the inefficiencies within the local Japanese market.

Return Since Inception (4/30/02)			
	Cumulative	**Annualized**	**Worst Drawdown**
GenSpring Manager	105.8%	19.9%	5.2%
Nikkei Index	71.9%	5.4%	29.9%

Performance as of May 31, 2006. * Worst Drawdown is defined as the percent retrenchment from a market peak to a market valley. A drawdown is in effect from the time a retrenchment begins until a new high is reached.

As our research and due diligence progressed, we identified a few strong Japanese hedge funds with excellent records. However, after applying our performance attribution and identification process to assess the extent of the edge offered by the strategy, we found that having a hedge fund in this particular area could potentially add additional permanent risk to the overall strategy that would not add an incremental increase in expected return. What we learned here is that many consultants would have stopped at the performance review and accepted the hedge fund methodology. They would not have evaluated the data deeper to determine if the hedging was contributing to returns (which it wasn't), lowering temporary risk (which it does when you look at the statistics), increasing permanent risk as a result of the hedging (which it does), or whether there was a real opportunity to have a clean hedge in this strategy. GenSpring's solution was to hire the manager with a long only mandate and to utilize other exposures in the balance of the portfolio to provide an indirect hedge for the equity exposure that was present in the Japanese small cap strategy.

The last example involves a case of looking past a recent mediocre track record to the inherent talent of the team behind it. This decision was made based on qualitative factors, ones which a typical open architecture firm would have ignored, given the unattractiveness of the historical track record. At GenSpring we believe managers must have a passion for what they do and a level of hunger to strive to get better and as a result deliver superior performance to their investors. This philosophy was visible in our dealings with one of our international managers, with whom we had been familiar for over ten years. However, we became less interested with them following the acquisition of their firm by a major Wall Street firm in 1996 because while the team remained the same, their loss of independence altered their incentives. We believed that this change, combined with the parent company's objective of gathering new assets, created a prescription for mediocre performance. Early in 2001, the team was in a position to leave the Wall Street firm and recreate the incentives for the team as owners and return to doing what they did best – manage international equities. From our perspective, this new dynamic would likely move them back to excellence when the ownership incentive was combined with the fact they were hungry and had a low asset base. We have been invested with them since day one and over the last 4 1/2 years they have delivered excellent results.

Return Since Inception (11/30/01)		
	Annualized	**Cumulative**
International Manager	17.6%	113.4%
MSCI EAFE	13.8%	82.8%

Performance as of May 31, 2006

GenSpring's manager selection process is much more than finding great performance numbers. Although it would be easy to only sell manager performance numbers, in the end that isn't where our value resides. The value from our approach is centered around a thoughtful and thorough understanding of the investment strategies, the manager's edge, and how a given combination of managers will act in concert to improve the overall investment portfolio for our families.

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