

STEWARD

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Investors ought to be focused on creating a reproducible methodology, regardless of luck or misfortune in any given quarter.

Barry Ritholtz, CEO of FusionIQ

Investors spend a lot of time searching for investment managers (i.e., mutual fund, exchange-traded funds (ETFs), etc.) that will provide satisfactory investment performance — often focusing most of their attention on which investment managers to use. Investors tend to spend much less time thinking about when to terminate an investment manager that they're already using in their portfolios. Since the selection, monitoring and termination of investment managers are all important aspects of successful investing, I'd like to share our approach for this at Allodium.

Selecting Investment Managers

Many methods are used by investors and investment advisory firms to sort through the more than 40,000 mutual funds and ETFs available and select investment managers. In an attempt to align with fiduciary best practices, Allodium uses a disciplined investment screening process that is based on a rigorous methodology created by fi360 (www.fi360.com), an independent organization that exists to define and promote fiduciary best practices. Fi360's screening methodology — called their Fiduciary Score Average — is calculated quarterly and evaluates investment managers on nine key criteria, including 1) regulatory oversight, 2) performance track record, 3) assets under management, 4) stability of the organization,

5) consistency of investment composition with asset class, 6) investment style consistency, 7) expense ratio relative to peers, 8) risk-adjusted performance relative to peers and 9) performance relative to peers. These criteria are supported by the Global Fiduciary Standards of Excellence which were also published by fi360.

Generally we search for investment managers that score in the top quartile of the Fiduciary Score Average which evaluates the above nine criteria over a rolling 12-quarter or three-year period. In addition to selecting top-quartile index funds, we look for active managers with performance that has been on par with appropriate comparative passive indices but have also shown a history of outperforming these benchmarks over longer time periods. All investment managers that we select are then added to our "recommended list".

Monitoring Investment Managers

Once investment managers are selected, it is important to closely monitor their performance over time to ensure they are delivering expected results. Ideally this monitoring process should employ the same criteria used to select the investment managers in the first place. Therefore Allodium uses the fi360 Fiduciary Score Average for both selecting and monitoring investment managers.

We use the Fiduciary Score Average to monitor results for each investment manager on our recommended list every quarter. If an investment manager drops out of the top quartile, we will place them on our "watch list" and invest extra time researching why their score fell and whether we should remove them from our recommended list.

Terminating Investment Managers

In our view, a decision to terminate an investment manager should also be based on the same criteria that are used to select them, and an investment manager should be terminated when one or more of the following occur:

- They no longer consistently deliver the specific results they were selected to provide.
- We lose confidence in their ability to deliver expected results consistently going forward.
- We find an investment manager with far superior results to replace them.

If the results of an investment manager on our recommended list begins to falter and/or we begin to lose confidence in their ability to deliver expected results in the future, we return to the investment screening and selection process outlined above to find a suitable replacement. Using this disciplined selection, monitoring and termination process helps remove emotion and "hot" investment tips from influencing our investment choices and keeps us focused on skilled and reputable investment managers with proven investment results over time.

If you'd like to learn more about our investment selection, monitoring and termination process, please call me. I'd enjoy the opportunity to talk with you.

David Bromelkamp

President and CEO

Headlines

- We were pleased to welcome three new clients to Allodium in the third quarter and appreciate their trust and business.
- Recently Allodium was ranked among the top independent Registered Investment Advisors in the nation in terms of total assets under management. Allodium was ranked 281st by *AdvisorOne* and 312th by *Financial Advisor* magazine.
- We're pleased to introduce the newest member of Allodium, Rachel Halverson, who will assist with client service, marketing and operations. Rachel joined us in September from Wells Fargo where she worked in a variety of roles since 2006.
- Our office will be closed to celebrate these upcoming holidays:
 - Thursday, November 24 & Friday, November 25 - Thanksgiving Holiday
 - Monday, December 26 - Christmas Holiday

We Appreciate Your Introductions

We launched Allodium to provide objective investment advice and personal service to a limited number of individuals, families and organizations. We embrace our responsibility to always act in our clients' best interests. To maximize our objectivity and avoid conflicts of interest, we are a fee-only registered investment advisor that is completely independent from banks, brokerage firms and other financial product providers, and we do not receive commissions for the investment options that we recommend. If you know someone who may be looking this type of objective investment advice, please contact Dave Bromelkamp at 612-230-3702 or dbromelkamp@aicria.com to arrange a friendly, no-obligation introduction.

FINANCIAL PLANNING TIP:

Roth Conversions

2010 was the "year of the Roth conversion" as many high-income individuals became eligible to participate in Roth conversions when the federal income limitation was repealed. It also was a unique year due to the ability to spread the income from a Roth conversion over two tax-years rather than one. By October 17th of this year, investors can reverse part or all of a Roth conversion — which is called a recharacterization. Common reasons for considering a recharacterization follow:

- 1) If the investments within the Roth conversion account have declined significantly in value, it may make sense to recharacterize and wait the required amount of time to re-convert back to a Roth IRA in order to pay tax on the lower conversion value.
- 2) If overall income came in higher than expected, resulting in a higher tax bracket than anticipated, it may make sense to recharacterize part or all.

Here are some cautions to be aware of when considering a recharacterization:

- 1) Be sure to recharacterize the correct value adjusted for gains/losses.
 - 2) Be aware of the October 17th deadline for completing both the recharacterization and amended tax return.
 - 3) Funds pulled from an IRA to pay the expected taxes related to a Roth conversion cannot be put back.
 - 4) Recharacterizing could affect 2011 Required Minimum Distributions for those older than 70 ½.
- Therefore, before recharacterizing, it's wise to consult with a qualified tax expert and financial advisor.

Upcoming Events

As a client and community service, we welcome opportunities to share investment and fiduciary best practices with individuals, families and organizations. To this end, Allodium will speak at or host these upcoming events:

- **Tuesday, September 20:** Anne Ward will speak at the Alternatives Forum on the topic of alternative investments.
- **Tuesday, October 25:** Dave Bromelkamp will speak at the Minnesota Society of CPAs 31st Annual Not For Profit Conference on the topic of Investment Policies for Nonprofits.
- **Thursday, November 3:** Dave Bromelkamp will speak to the Minnesota Association for Financial Professionals on the topic of Responsible Investing and the Fiduciary Role of Institutional Investors.
- **Wednesday, December 7:** Allodium will sponsor a free educational lunch workshop for non-profit leaders on the topic of Socially Responsible Investing.

Please contact Rachel Halverson at 612-230-3706 or rhalverson@aicria.com to RSVP or to be added to our invitation list for future workshops.

Steward is published quarterly by Allodium Investment Consultants. Please contact Rachel Halverson at 612-230-3706 or rhalverson@aicria.com if you have any comments about this publication or would like to be added to or removed from our mailing list.



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