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STEWARD

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"Index funds eliminate the risks of individual stocks, market sectors and manager selection. Only stock market risk remains." ~ John C. Bogel - founder of the Vanguard Group mutual fund company and creator of the first index fund

For investors who may not have the time, interest or training to properly research and monitor companies, there are significant risks inherent in selecting and holding a portfolio of individual stocks. To reduce such risks and simplify their investing, a growing number of investors have turned to mutual funds over the past 25 years for professional investment management and diversification. However, a debate has emerged among investors about whether actively-managed or passively-managed (i.e., index) funds are better. I'd like to share our view on this debate after briefly describing key differences between these two options.

Passive investment management (i.e., index funds):

Passive investment strategies typically do not attempt to out-perform market indexes by profiting from stock market inefficiencies and related short-term price fluctuations. Instead passive or index funds typically buy and hold a well-diversified portfolio of securities that remain relatively constant without the need for large daily changes in securities held in the portfolio. For example, an S&P 500 index fund may buy and hold most of the securities in the S&P 500 index to mirror performance of this index over time. Therefore, index funds are typically less costly to manage and generally pass on this savings to investors in the form of lower management fees, providing a low-cost and low-turnover way to invest in the stock market.

Active investment management:

Alternatively, active investment managers typically attempt to outperform market indexes like the S&P 500 by employing various strategies to capitalize on stock market inefficiencies and related short-term price fluctuations. They seek to achieve this out-performance either via superior security selection or by over-weighting or under-weighting certain market sectors in their portfolios. Typically these strategies require more active security monitoring and trading, resulting in higher management costs and fees to investors compared to index funds. Unfortunately, the vast majority of active investment managers have been unable to consistently out-perform their target benchmarks or comparable index funds over time. They typically under-perform in some years and out-perform in others. However, on occasion there have been some exceptional investment managers who have been able to consistently outperform their target index over long time periods, contributing to the active versus passive debate.

Core - satellite approach:

We believe that there is a place for both passively and actively-managed funds in long-term investment portfolios via a "core-satellite" investment approach. This approach seeks an optimal mix of passively and actively-managed funds by indexing the "core" asset classes that are highly efficient and employing active managers in less efficient "satellite" asset classes.

"Core" asset classes - like large capitalization domestic equities (i.e., S&P 500) - are widely followed by many investment research analysts and highly efficient. New information about these companies is generally widely known by professional investors and quickly priced into the market, making it very difficult to outperform market benchmarks like the S&P 500 over time. For this reason, we believe low-cost index funds make sense for investment allocations to "core" asset classes.

"Satellite" asset classes - like small-capitalization and international equities - include securities with less information available about them and/or fewer research analysts following the companies. This can result in greater market inefficiency, meaning that new information about these companies may not be as widely known or as quickly priced into the market. Less efficient asset classes tend to give uniquely-skilled active investment managers greater opportunity to outperform relevant market indexes over time. So we believe actively-managed funds can make sense for investment allocations to "satellite" asset classes when uniquely-skilled asset managers can be identified.

Ultimately, we recommend that all investors adopt a long-term perspective and maintain a well-diversified portfolio employing appropriate asset allocation to minimize investment risks. We're happy to help investors weigh the pros and cons of both passive and active strategies to arrive at an investment portfolio that they are most comfortable with.

David Bromelkamp

President and CEO

ALLODIUM INVESTMENT CONSULTANTS | 500 WASHINGTON AVENUE SOUTH | SUITE 2015 | MINNEAPOLIS, MN 55415 | 612-230-3700

HEADLINES

- We're pleased to announce that The Minnesota Institute of Public Health (MIPH) recently selected Allodium as their investment advisor. We are honored to serve MIPH and help them fulfill their mission.

- On Thursday, January 29 Dave Bromelkamp was the featured speaker at the Minnesota Council on Foundations 2009 Grant Making Program Series. Dave spoke about foundation investment management best practices. As a community service, Dave enjoys and welcomes all opportunities to help educate foundation and endowment leaders about fiduciary and investment management best practices.

- FYI - during the second quarter of 2009, our office will be closed to observe the following New York Stock Exchange holidays:
  - Friday, April 10 - Good Friday
  - Monday, May 25 - Memorial Day

UPCOMING EVENTS:

- Allodium is sponsoring the following free educational lunch workshops for foundation & endowment leaders:

  ◊ Wednesday, March 11, 2009 - How to Manage Risk with Alternative Investment Strategies
  ◊ Wednesday, June 10, 2009 - How to Adopt Socially Responsible Investment Policies

  Please contact Cristy Leaf at 612-230-3706 or cleaf@aicria.com to RSVP or to be added to our invitation list for future workshops.

- Allodium & AIP Mutual Funds are co-sponsoring a free educational event for Allodium clients on Thursday, March 19 . The event will feature Lee Schultheis - CEO, Chief Investment Strategist and Founder of the AIP Mutual Funds. Clients who would like to attend should contact Cristy Leaf at 612-230-3706 or cleaf@aicria.com to RSVP.

- Dave Bromelkamp will speak at the following event:

  MN Society of CPAs Caffeinated Conversations—Tuesday, March 24, 2009. Topic: Fiduciary Investment Management Best Practices for Corporate CPAs

ALLODIUM TEAM PROFILE: DAWN COUGHLIN

Role At Allodium: Operations Associate
Joined Firm In: 2005

Hometown:
Brooklyn Park, MN

Favorite TV Show:
Brothers & Sisters

Favorite Movie:
The Wizard of Oz

Favorite Vacation Spot:
Driving along the California Coastline

Favorite Hobby:
Reading

If I won the lottery I'd… Setup several foundations and hire Allodium to mange the funds.

Click here to see more about Dawn on our website.

We Appreciate Your Introductions:
We launched Allodium to provide unbiased, objective investment advice and personal service to a limited number of individual and institutional investors. We embrace our responsibility to always act in our clients' best interests. To avoid any hint of real or perceived conflicts of interest, we are a fee-only registered investment advisor that is completely independent from banks and brokerage firms. If you know of a friend or associate who may be looking for this type of objective investment advice, please contact David Bromelkamp at 612-230-3702 or dbromelkamp@aicria.com to arrange a no-obligation introduction.

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Published quarterly by Allodium Investment Consultants.

Please contact Cristy Leaf at 612-230-3706 or cleaf@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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