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MONTHLY

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THE VALUE OF OBJECTIVE REPORTING

Introduction

2008 and 2009 were dramatic years for investors, as global equity and credit markets plunged in response to a deepening financial crisis and then rebounded as investors worst fears were not realized. Looking back through the extreme volatility, many investors find it difficult to judge how well their portfolios performed over the entire period. The task of evaluating performance for multi-asset portfolios requires transparent reporting and a working knowledge of some simple methods of comparison. Because a well informed investor has the best chance for success, we believe that it is important to have a rigorous process around the monitoring of portfolio performance.

In this *Monthly* we will review the benefits of objective performance reporting, and examine the best practices for evaluating total return, manager skill and results relative to available alternatives.

Background

For many individual investors, it is a difficult task to gather the performance data for their entire portfolio, and to determine how past performance stacks up against their long term objectives and available alternatives. Without the proper tools, investors must rely on their own recollection to gauge the performance of their investments. This may be problematic because investors are human and may have cognitive biases which can affect their ability to objectively look back at their investment results.

The most basic of these cognitive biases is overconfidence. When surveyed about their level of skill in various activities, an inordinate number of people categorize themselves as "above average". In an often quoted 1981 study, Ola Svenson

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CURRENT TOPIC

The Value of Objective Reporting

- *Introduction*
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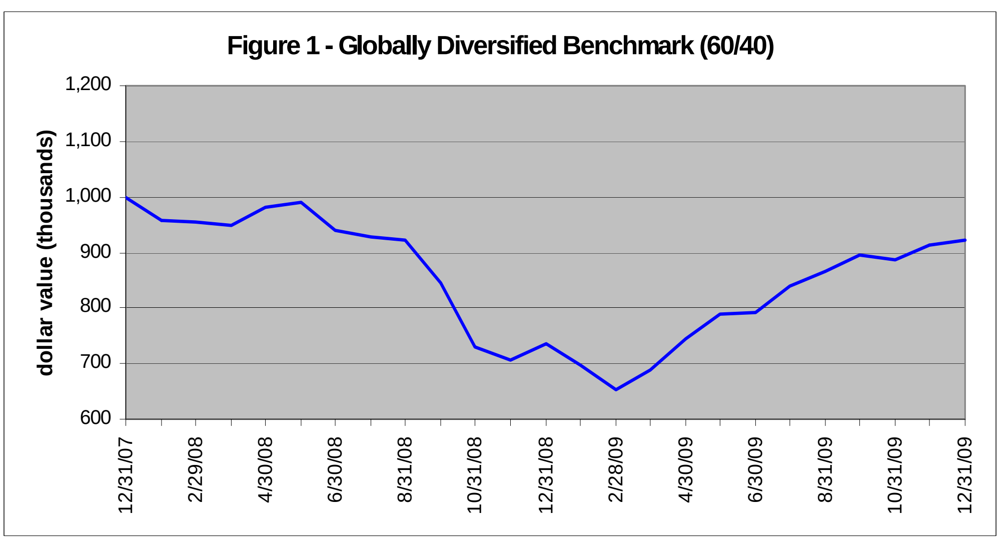
Strategy

- *There were no strategy changes during the month of January*
- *Portfolio strategies remain overweight developed equity markets*

"HAVING A BENCHMARK ALLOWS INVESTORS TO OBJECTIVELY LOOK BACK AT THE RETURNS OF THEIR PORTFOLIO"



Sources: Russell, MSCI, Barclays, Stairway Partners Note: assumes monthly rebalancing

The Value of Objective Reporting- Cont'd

from the University of Stockholm found that 93% of American automobile drivers viewed themselves as more skillful than the average driver. This type of bias explains that even though people believe the multitude of studies that show most investors underperform "the market", few see themselves in the underperforming group.

Overconfidence can impair an investor's ability to objectively look back at performance. The recollection of unsuccessful investment strategies conflicts with the self image of being above average. As a result, measured returns often fall short of subjective memory.

Measuring Returns

Transparent return data for multi-asset portfolios is not always easy to come by. Many investors receive only account balances and then have to translate changes in account value into a total rate of return for their portfolio. The translation is necessary because the total rate of return must be known to perform further analysis. Total return is the sum of the income and principal returns on all of the assets in the portfolio, adjusted for any money that is contributed to or withdrawn from the portfolio during the measurement period.

Putting the portfolio return into perspective requires having an objective measure of market performance. This measure usually takes the form of a policy benchmark comprised of independent index data. The benchmark should be constructed to reflect the investor's long-term return objectives and risk tolerance.

The market volatility of the recent past provides a good backdrop in which to view the performance of a common policy benchmark. Figure 1 shows how the market movements of 2008 and 2009 affected a globally diversified benchmark with 60% equities and 40% bonds. This benchmark, which started 2008 with $1 million, lost 35% of its value by February of 2009. As frightening as the results were, a disciplined investor who left the remaining $653,000 invested in the original strategy would have recovered the bulk of their losses and finished the two year period with $923,000.

Having a benchmark allows investors to objectively look back at the returns of their portfolio and determine what portion came from the overall market, and which portion came from factors unique to the portfolio. These factors may be related to asset allocation decisions, specific investment choices or transaction costs. Taken together, they represent the value added from the management of the portfolio, and can be calculated by subtracting the benchmark returns from the gross returns of the portfolio. (see Figure 2)

If an investor uses a professional to manage their portfolio, then it is also important to measure how management fees affect the net return. This simple calculation is shown in Figure 3. Over time, the fees paid to a manager should be justified by the value added from their services. It should be noted that a passive portfolio, one that tries to mirror the benchmark, will have difficulty keeping up with index returns since even the most efficient investments have some costs that detract from performance.

Figure 2 - Relative Portfolio Returns

	Portfolio Returns (Gross)
-	Benchmark Returns
	Value Added

Figure 3 - Absolute Portfolio Returns

	Portfolio Returns (Gross)
-	Management Fees
	Investor Returns (Net)

"OVER TIME, FEES PAID TO A MANAGER SHOULD BE JUSTIFIED BY THE VALUE ADDED FROM THEIR SERVICES"

Stairway Partners provides clients with online access to monthly detailed portfolio performance reporting. This includes net and gross portfolio returns, benchmark returns, and detailed attribution of the sources of added value. For a more detailed explanation please see our October 2005 *Monthly* titled "Performance Reporting".

Comparing Managers

The individualized nature of multi-asset or balanced portfolios makes it difficult to know how one's own portfolio compares to the available alternatives. Because individuals investors do not have access to the information that is needed, they often rely on anecdotal information about specific investments to judge their overall performance.

As a contrast, institutional investors require asset managers to calculate composite returns. These composite returns are the weighted-

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About Stairway Partners, LLC

Stairway Partners was formed to provide our clients (starting with ourselves) with an effective and comprehensive solution for managing their wealth. Our disciplined and rigorous approach comes from our collective knowledge in serving large institutional clients over many years.

Our core investment belief is that asset allocation is the single most important determinant of success in any investment plan. The dominant amount of risk and return comes not from your choice of individual investments but from your asset class mix. Stairway Partners focuses our resources on risk management and asset allocation. This includes building your custom blueprint (investment policy and benchmark) and aligning your portfolio with our investment strategy utilizing the global capital markets.

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average returns for all portfolios that are managed against similar benchmarks. With this information, investors can compare the actual performance of different asset managers with similar mandates.

To insure consistency in reporting, the CFA Institute has created guidelines for uniform reporting known as Global Investment Performance Standards (GIPS). Stairway Partners maintains GIPS compliant composites that include all of the portfolios that we manage. These composites, which now include up to five years of performance data, are available upon request.

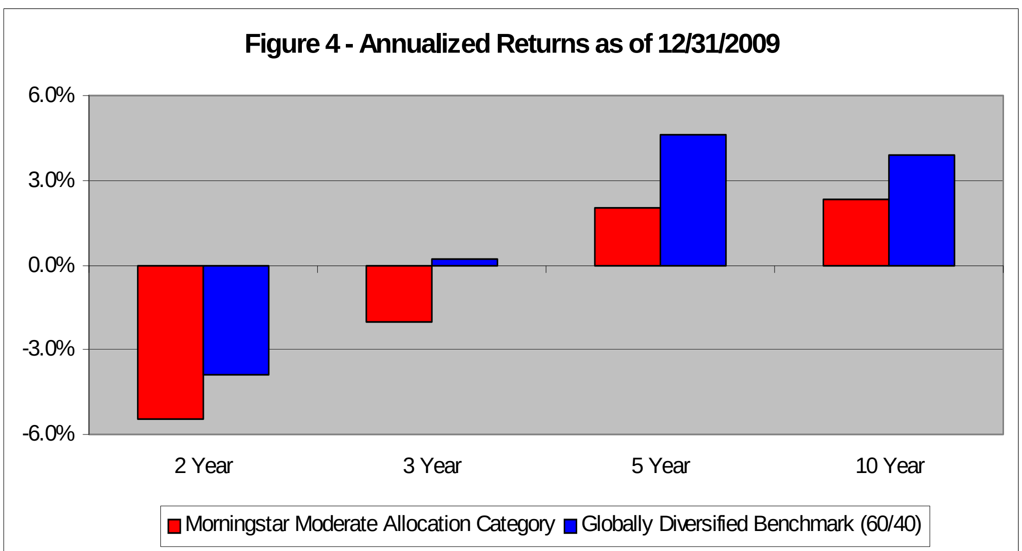
Although they do not offer the same benefits as a customized portfolio, balanced mutual funds are sometime used to gain access to a diversified portfolio. These mutual funds provide an additional point of reference for our globally diversified benchmark shown in Figure 1. Figure 4 shows the average performance of the Morningstar Moderate Asset Allocation Fund category, compared to our globally diversified benchmark, which has a similar risk profile.

As one might expect, the performance of the average mutual fund manager trailed the performance of the globally diversified benchmark in every period. This is most likely the result of management fees and the well documented lack of ability for the average manager to keep up with the broad market.

Conclusion

Many investors do not receive comprehensive performance data for their portfolios, and must evaluate past results based on changes in their account balances or anecdotal information on specific investments. Additionally, certain cognitive biases can interfere with an investor's ability to accurately judge past performance.

Fortunately, there are well defined industry practices that are utilized by institutions to objectively analyze the performance of their portfolios. Individuals should be able to benefit from the same practices. We believe that monitoring performance is an important part of the investment process, and that a well informed investor has the best chance of reaching their financial goals. Stairway Partners produces detailed monthly performance attribution for all client portfolios, and also publishes composite performance data.



Source: Morningstar, Russell, MSCI, Barclays, Stairway Partners

"The performance of the average mutual fund manager trailed the performance of the globally diversified benchmark"

Strategy

Asset Class	Expected Return	Hurdle Return	Strategy Exposure	Comment
Equities				
US	18.3%	5.8%	over	Exposure above benchmark weight due to attractive pricing
Non-US Developed			over	Asset class remains attractive
Eurozone	21.8%	5.8%		
Japan	15.2%	4.4%		
UK	16.7%	6.1%		
Emerging	4.6%	10.3%	neutral	Asset class is close to fair value
Fixed Income				
US Treasury Bonds			under	Treasuries expensive, but non-Treasury sectors are more attractive
2-Year	0.6%	2.8%		
5-Year	0.7%	3.6%		
10-Year	1.5%	4.4%		
30-Year	1.7%	4.9%		
US Municipal Bonds			under	In most maturities, municipal bonds are modestly overpriced
2-Year	0.5%	2.0%		
5-Year	0.7%	2.6%		
10-Year	1.8%	3.4%		
30-Year	6.1%	4.2%		
US High Yield	3.6%	4.3%	over	Sector is close to fair, but attractive relative to other fixed income
Non-US Government Bonds			under	Yields remain below fair levels
Euro 10-Year	1.0%	4.1%		
Japan 10-Year	-0.4%	1.9%		
UK 10-Year	1.7%	4.6%		
Emerging Markets Debt	2.7%	4.6%	under	Other asset classes offer better value
Cash	2.6%	---	minimal	

Currencies	Expected FX Change	Equity Return with Currency	10-Year Bond Return with Currency	
Euro	-5.9%	15.9%	-5.0%	Euro is overpriced
Japanese yen	-1.5%	13.7%	-1.9%	Yen is near fair value
UK pound	0.4%	17.2%	2.1%	Pound is near fair value

Notes: **As of: January 29, 2010**

The expected return is our estimate of the annualized return likely to be generated over a 3-year horizon.
The expected returns are expressed in local currencies (e.g., Japanese equity return is stated in yen terms).
The hurdle rate represents the annualized return that an asset needs to generate in order to cover its risk.
Equity Return with Currency (in Currencies section) is the annual return we would expect a US dollar investor to earn from holding foreign equity markets.