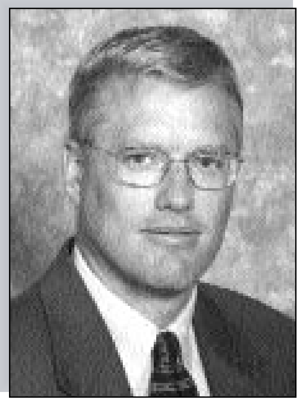
ASSET MANAGEMENT

Has the World Really Changed?



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An investment management consultant has a responsibility to assist clients with setting realistic expectations. Much has been written about the historical valuations of the markets and the soaring NASDAQ and technology stocks, but related investment trends should be worrisome to both clients and their advisors.

Growth Is King

There is no question that growth stocks have dominated. The adjacent Periodic Table of Investment Returns, developed by Callan Associates, reflects the outright whipping that the S&P/BARRA 500 Growth Index has put to other indexes since 1994. Technology stocks have driven the index to 20+% returns for five consecutive years, unprecedented by a long shot. It is quite clear that at least over the last 20 years as depicted by the Callan table, returns of various indices have been fairly random. The closest you get to the sort of domination that growth investing has experienced was the MSCI EAFE domination from 1985 to 1988. This was followed by four consecutive years of being the worst index for investment.

Think Concentration, Not Diversification

Today's trend is owning a half dozen growth stocks, and if diversification makes sense, maybe a few growth funds, and for a real conservative investor, maybe a "safe" investment in an S&P 500 index fund.

Again, if you examine Callan's periodic table, this approach hasn't historically worked either. Part of the problem is that the S&P 500 has become the investor's benchmark, regardless of the investment. Many investors and advisors compare their small stocks, foreign stocks, bonds, hedge funds, whatever the investment, against the S&P 500; and if it doesn't compare favorably, it's a failure. Hence, growth stocks are favorites, S&P 500 is adequate, and about everything else is lousy. A well-diversified portfolio, many investors would say, hasn't worked because it "underperformed the S&P." A diversified portfolio will always underperform the best performing index, and unfortunately the best performer has become the standard for all investments. This approach will come back to haunt them. Furthermore, regarding concentration, the S&P 500 is capitalization weighted, which makes it fairly concentrated itself.

Bonds Are For Losers

How many investors are questioning their commitment to bonds and making shifts from fixed income to equities? It seems that many are shocked by the dramatic underperformance of bonds in a roaring stock market. Surprise! The key for investors to understand is the very different characteristics of bonds from stocks and the rationale as a component in a portfolio – downside protection. 1994 was one of the worst years in bond market history, and the Lehman Aggregate was down only 3%. Investing in the stock market has much greater downside risk in a short timeframe. Moreover, fixed income's relative low correlation to equities further reinforces its rationale in a diversified portfolio. Portfolio downside risk can be controlled reasonably well through the stock/bond mixture.

Don't Bother With International Investments

International investing has performed quite well the last couple of years and was the dominant asset class in the middle 1980s. The strong dollar environment in the mid-1990s made the currency translation negative, but international equities do very well with a weaker dollar – like the 1980s. Domestic managers like to argue that in today's global economy, you get international diversification through owning multinational companies. Sure you do, but that argument does not explain why the correlation of international equities is particularly favorable to that of domestic stocks. But a conflict of interest certainly does.

Make High Return Through Trading

In the 50 NASDAQ stocks with the heaviest trading in 1999, investors held their shares on

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Periodic Table of Investment Returns

Annual Return For Key Indices (1980-1990)

Ranked in Order of Performance (Best to Worst)

1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Russell 2000 Growth 52.26%	Russell 2000 Value 14.85%	LB Agg 32.65%	Russell 2000 Value 38.63%	LB Agg 15.15%	MSCI EAFE 56.14%	MSCI EAFE 69.46%	MSCI EAFE 24.64%	Russell 2000 Value 29.47%	S&P/ BARRA 500 Growth 36.40%	LB Agg 8.96%	Russell 2000 Growth 51.18%	Russell 2000 Value 29.15%	MSCI EAFE 32.57%	MSCI EAFE 7.78%	S&P/ BARRA 500 Growth 38.13%	S&P/ BARRA 500 Growth 23.97%	S&P/ BARRA 500 Growth 36.52%	S&P/ BARRA 500 Growth 42.16%	Russell 2000 Growth 43.09%
S&P/ BARRA 500 Growth 39.40%	LB Agg 6.26%	Russell 2000 Value 28.52%	Russell 2000 29.13%	S&P/ BARRA 500 Value 10.52%	S&P/ BARRA 500 Growth 33.31%	S&P/ BARRA 500 Value 21.67%	S&P/ BARRA 500 Growth 6.50%	MSCI EAFE 28.26%	S&P 500 Index 31.69%	S&P/ BARRA 500 Growth 0.20%	Russell 2000 46.05%	Russell 2000 18.42%	Russell 2000 Value 23.86%	S&P/ BARRA 500 Growth 3.14%	S&P 500 Index 37.58%	S&P 500 Index 22.96%	S&P 500 Index 33.36%	S&P 500 Index 28.58%	S&P/ BARRA 500 Growth 28.25%
Russell 2000 38.58%	Russell 2000 2.03%	Russell 2000 24.95%	S&P/ BARRA 500 Value 28.89%	MSCI EAFE 7.41%	S&P 500 Index 31.73%	S&P 500 Index 18.67%	S&P 500 Index 5.25%	Russell 2000 24.89%	S&P/ BARRA 500 Value 26.13%	S&P 500 Index -3.11%	Russell 2000 Value 41.70%	S&P/ BARRA 500 Value 10.52%	Russell 2000 18.89%	S&P 500 Index 1.32%	S&P/ BARRA 500 Value 36.99%	S&P/ BARRA 500 Value 22.00%	Russell 2000 Value 31.78%	MSCI EAFE 20.00%	MSCI EAFE 26.96%
S&P 500 Index 32.50%	S&P/ BARRA 500 Value 0.02%	S&P/ BARRA 500 Growth 22.03%	MSCI EAFE 23.69%	S&P 500 Index 6.27%	Russell 2000 31.04%	LB Agg 15.30%	S&P/ BARRA 500 Value 3.68%	S&P/ BARRA 500 Value 21.67%	Russell 2000 Growth 20.16%	S&P/ BARRA 500 Value -6.85%	S&P/ BARRA 500 Growth 38.37%	Russell 2000 Growth 7.77%	S&P/ BARRA 500 Value 18.61%	S&P/ BARRA 500 Value -0.64%	Russell 2000 Growth 31.04%	Russell 2000 Value 21.37%	S&P/ BARRA 500 Value 29.98%	S&P/ BARRA 500 Value 14.69%	Russell 2000 21.26%
Russell 2000 Value 25.39%	MSCI EAFE -2.27%	S&P 500 Index 21.55%	S&P 500 Index 22.56%	S&P/ BARRA 500 Growth 2.33%	Russell 2000 Value 31.01%	S&P/ BARRA 500 Growth 14.50%	LB Agg 2.75%	Russell 2000 Growth 20.38%	Russell 2000 16.25%	Russell 2000 Growth -17.42%	S&P 500 Index 30.47%	S&P 500 Index 7.62%	Russell 2000 Growth 13.37%	Russell 2000 Value -1.55%	Russell 2000 28.44%	Russell 2000 16.53%	Russell 2000 22.36%	LB Agg 8.70%	S&P 500 Index 21.04%
S&P/ BARRA 500 Value 23.59%	S&P 500 Index -4.92%	S&P/ BARRA 500 Value 21.04%	Russell 2000 Growth 20.14%	Russell 2000 Value 2.27%	Russell 2000 Growth 30.97%	Russell 2000 Value 7.41%	Russell 2000 Value -7.12%	S&P 500 Index 16.61%	LB Agg 14.53%	Russell 2000 -19.50%	S&P/ BARRA 500 Value 22.56%	LB Agg 7.40%	S&P 500 Index 10.08%	Russell 2000 -1.81%	Russell 2000 Value 25.75%	Russell 2000 Growth 11.32%	Russell 2000 Growth 12.93%	Russell 2000 Growth 1.23%	S&P/ BARRA 500 Value 12.72%
MSCI EAFE 22.60%	Russell 2000 Growth -9.23%	Russell 2000 Growth 20.99%	S&P/ BARRA 500 Growth 16.24%	Russell 2000 -7.13%	S&P/ BARRA 500 Value 29.68%	Russell 2000 5.69%	Russell 2000 -8.76%	S&P/ BARRA 500 Growth 11.95%	Russell 2000 Value 12.43%	Russell 2000 Value -21.77%	LB Agg 16.00%	S&P/ BARRA 500 Growth 5.06%	LB Agg 9.75%	Russell 2000 Growth -2.44%	LB Agg 18.46%	MSCI EAFE 6.05%	LB Agg 9.64%	Russell 2000 -2.55%	LB Agg -0.82%
LB Agg 2.71%	S&P/ BARRA 500 Growth -9.81%	MSCI EAFE -1.86%	LB Agg 8.19%	Russell 2000 Growth -15.84%	LB Agg 22.13%	Russell 2000 Growth 3.59%	Russell 2000 Growth -10.48%	LB Agg 7.89%	MSCI EAFE 10.53%	MSCI EAFE -23.45%	MSCI EAFE 12.14%	MSCI EAFE -12.18%	S&P/ BARRA 500 Growth 1.68%	LB Agg -2.92%	MSCI EAFE 11.21%	LB Agg 3.64%	MSCI EAFE 1.78%	Russell 2000 Value -6.46%	Russell 2000 Value -1.48%

S&P 500 Index measures the performance of large capitalization U.S. stocks. The S&P 500 is a market-value-weighted index of 500 stocks that are traded on the NYSE, AMEX and NASDAQ. The weightings make each company's influence on the Index performance directly proportional to that company's market value.

S&P/BARRA 500 Growth and **S&P/BARRA 500 Value** indices measure the performance of the growth and value styles of investing in large cap U.S. stocks. The indices are constructed by dividing the stocks in the S&P 500 Index according to price-to-book ratios. The Growth index contains stocks with higher price-to-book ratios. The Value Index contains stocks with lower price-to-book ratios. The indices are market-capitalization-weighted, and their constituents are mutually exclusive.

Russell 2000 Index measures the performance of small capitalization U.S. stocks. The Russell 2000 is a market-value-weighted index of the 2,000 smallest stocks in the broad-market Russell 3000 Index. These securities are traded on the NYSE, AMEX and NASDAQ.

Russell 2000 Value and **Russell 2000 Growth** indices measure the performance of growth and value styles of investing in small cap U.S. stocks. The Value index contains those Russell 2000 securities with a less-than-average growth orientation, while the Growth index contains those securities with a greater-than-average growth orientation. Securities in the Value index generally have lower price-to-book and price-earnings ratios than those in the Growth index. The constituent securities are NOT mutually exclusive.

MSCI EAFE is a Morgan Stanley Capital International Index that is designed to measure the performance of the developed stock markets of Europe, Australia and the Far East.

LB Agg is the Lehman Brothers Aggregate Bond Index. This Index includes U.S. government, corporate and mortgage-backed securities, and includes maturities up to 30 years.

Source: Callan Associates

average just three weeks. According to Steve Galbrath of Sanford Bernstein, "It does look suspiciously like a game of musical chairs, and you do wonder when the music is going to stop, because three-week holding periods is not investing in my view, it is speculating." In addition, New York Stock Exchange statistics reflect shareholder trading has increased by nearly two-thirds in the 1990s.

On-line and nickel-a-share commissions have encouraged more active trading, and television commercials about "taking control of your own investments" has contributed. But in reality, compared to the size of investment, a nickel, dime or quarter is negligible in the whole scheme of things. Sure, you should get the best rate you can, but the commission isn't going to kill you. The "trade" will either make or break you.

Value Investing Is Dead

Looking at the Callan table, which index has had the least amount of representation in the bottom four slots over the last 20 years? Large Cap Value. While seldom the top performing sub-asset class, value stocks have been successful through more consistent performance. But as mentioned earlier, the S&P 500 is the benchmark of choice, and with growth stocks dominating value, it's taking a verbal beating. As for Small Cap Value – the heartbeat stopped long ago. Never have we seen the huge disparity between Small Cap Value and Growth. In 1999, the Russell 2000 Growth beat the Russell 2000 Value by almost 45%! Who needs value!

I've seen more articles critical of Warren Buffett than ever. No surprise though. The cheaper a stock in terms of valuation, the worse the performance. Since when are earnings a negative? Whether a company is delivering sales via the internet or stores, companies growing real earnings will be more reliable than those growing revenues at any cost.

Conclusion

I've only been in this business for 14 years, but when a very dear client of mine, a family friend who knows very, very little about investments, asked me about Qualcomm, I knew that investor expectations were ridiculous. Is it that common for investors to pay absurd prices for stocks that they can't explain? What they know is that it's tripled, quadrupled or more.

I don't think this way of thinking is only with the inexperienced. Most of my clients are institutions – fiduciaries and trustees. Believe me, it runs rampant with them, too. Maybe the world has changed. ■

SEI To Assume Responsibility For Account Performance In New MF/MA Platform

Continued from page 2

services firms to move from a product management to a process management organizational structure which is geared to adding value rather than distributing a wrap fee program product. The difference in the results actually achieved in the client's account is most significant. This makes SEI's new consulting platform a major innovation in how financial products and services are delivered.

The implications of SEI's new consulting platform are also most significant for financial consultants. It frees the independent financial advisor from the burden of portfolio construction, hiring extensive staff and buying and developing the technology necessary for high level advice. The independent advisor, in essence, uses SEI as a proxy for high level, comprehensive, expert advice, which allows the consultant to redeploy a large block of their time and resources (normally expended on portfolio construction, monitoring and management) to winning new client relationships.

Carmen Romeo, president of SEI's Investment Advisor Group which supports SEI's 5,000 independent advisor distribution channel said, "We are positioning ourselves differently from wrap fee program sponsors. Wrap fee programs are built around single investment vehicles, like mutual funds or managed accounts which limit the degree our independent advisors can be of assistance to their clients. We also found our independent advisors didn't just want access to investment vehicles where they had to pick the managers, but they wanted us to do it. So we are assuming the accountability for portfolio construction and account performance." The resulting new SEI platform (1) substantially elevates the competitive bar in the sophistication of portfolio construction brought to bear by the financial consultant, (2) fully integrates the firm as a collaborative partner in the consultant's practice by virtue of SEI assuming accountability for performance in each client account, (3) reconfigures and reprices the support services that firms provide, and (4) shows the financial services mainstream the efficiencies of a process management organization structure and how process management can enhance the earning margins and multiple of the traditional brokerage business.

SEI's much storied evolution from the largest institutional consulting firm in the U.S. to one of the fastest growing mutual fund asset management companies in the U.S. has been baffling the mutual fund industry. In little over eight years, SEI has gone from having virtually nothing under management to $70 billion today. By 2002, they plan to break $100 billion which would take them in the upper echelon of asset management. (SEI also has an additional $180 billion of bank assets under administration, where it acts as back office and distributor of bank mutual funds.)

SEI's extraordinary growth into the upper echelons of asset management over such a short period of time has been baffling to the mutual fund mainstream because the mutual fund industry has a significant blind spot. By definition, mutual funds cannot be investor-specific in managing investment portfolios. SEI has developed an investment process through which it can be investor-specific in constructing client portfolios using 38 very sophisticated, low cost, proprietary mutual fund portfolios which were created primarily for portfolio construction. By offering portfolio management and a process (investment policy, investment strategy and performance monitor) at a cost of 85-90 basis points that results in client-specific advice, SEI has created an investment methodology that allows independent advisors to manage

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