



"Find your edge and put it to work..."
- Peter Lynch "Use Your Edge," *Worth Magazine*, 1997

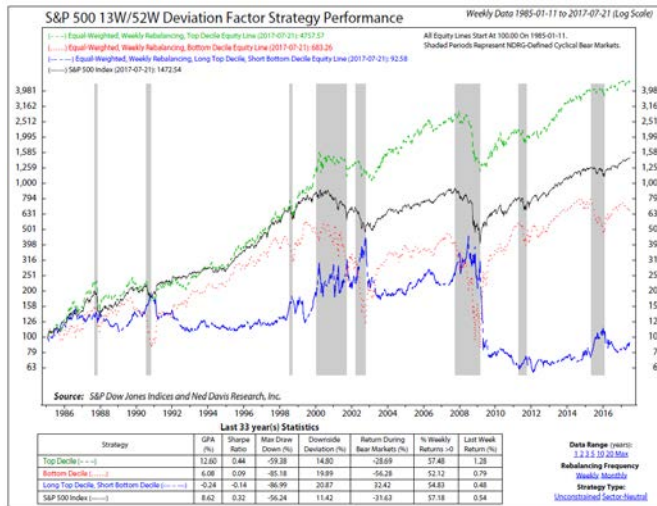


Source: Longboard Asset Management, S&P 500 Index

With an investment landscape populated by an array of asset classes and managers, how does one begin to make a selection that will be right? Across asset classes one question that investors can ask is "what is your edge?" or how does the investment professional seek to gain an advantage in what may be considered an efficient market? At an investment conference last week, one Chief Investment Officer from Seattle suggested that the question is not "what's your edge" but "what are your edges?" Moreover, his belief is that a manager's edge is something that exists beyond their process. As famed portfolio manager Peter Lynch stated above, managers are looking for an edge, but sometimes it is difficult to articulate that edge. Why does having an edge matter? As seen in the chart above, in the stock market, not all stocks are created equal. Having an edge should help a manager find those great "overachievers" while avoiding those stocks that can do damage to a portfolio. As active managers, we believe by researching stocks, we have the chance to shape portfolios that move the odds in our favor.

While we've stated before that our process of creating portfolios that have attractive traits of high returns on capital, strong balance sheets, above average growth with below average valuations place the odds in our favor; we'd also note a few potential "edges" beyond our process that can help the investment process.

- *Low personnel turnover.* Consistency of investment professionals is a good first step in setting the foundation for additional edges as the team builds institutional knowledge from successes and failures and is not constantly having to start from ground zero.
- *Dare to be different.* A premise from the founding of the Equity Opportunities group is that it is difficult to beat the benchmark when you look like the benchmark. Building unique portfolios give clients the chance to outperform.
- *Industry expertise.* Members of the investment team have worked for retailers, software companies, and commercial banks. Working for an operating company can help frame whether there is a disconnect between a stock price and the performance of the underlying company.
- *Know what you don't know.* The team operates under the belief that the stock market operates in an efficient manner most of the time. Research on new ideas is therefore done well ahead of time on a number of companies to create an attractive list of potential buy candidates should there be a new event that results in a dislocation of the stock price. When emotions outweigh underlying fundamentals, it can provide the team with a unique valuation opportunity (provided that one is prepared and can pull the trigger quickly).



Source: Ned Davis Research

The chart above shows the difference in performance (green line top versus the S&P 500 in the black line) in stocks that rebound from oversold positions.

- *Time arbitrage.* A study by Eagle Capital Management noted that 87% of questions on quarterly conference calls in 2012 were related to the next 12 months with only 13% beyond one year. By managing lower turnover portfolios, clients can benefit from longer term advantages while most investors are focused on near term concerns.
- *Always in search of another edge.* Whether it is using insider buying, owning faster growing smaller and mid-sized stocks, companies with established dividend growth track records, and/or companies with global revenue profiles, the team is always looking for ways to place the odds in the client's favor.

- *Being a client.* Since our portfolio managers own the portfolios they run, it is safe to say our interests are aligned with clients and focused on the mission of generating “above average returns with below average risk.”

The effort to generate different edges is based on a humble and hopefully realistic assessment of the challenge of investing in public equities. We believe a team approach that puts multiple disciplines to bear can augment our investment process for the benefit of clients.

As always thank you for your interest and trust managing your investments.

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