RAYMOND JAMES

Cultivating relationships with skilled money managers

The Manager Research & Due Diligence team evaluates managers on 10 key traits.

Dedicated to the research and evaluation of professional portfolio managers, the Manager Research & Due Diligence department plays a vital role in identifying the investments available to clients through Raymond James Asset Management Services' Freedom fund portfolios, Freedom UMAs, and RJCS SMAs. This team uses an established, proactive due diligence process to help ensure the funds and managers invited onto the platform have maintained their standards of excellence over time.

At any given time, there are roughly 200 portfolio managers on the AMS platform. If that sounds like a lot, consider there are more than 10,000 investment disciplines in the databases, consultant publications, financial industry websites and other sources where the team begins its search. From the outset, the Due Diligence team looks for managers with excellent reputations who are committed to helping clients reach their investment goals.

Once a manager passes through a rigorous screening process and enters the program – final decisions are made with input from the AMS Investment Committee – the Manager Research & Due Diligence team continues to analyze the manager's performance, portfolio characteristics and business infrastructures. The team is also responsible for providing ongoing resources to keep financial advisors and their clients informed of changes in an investment manager's product, process or status within the AMS program.

AMS MANAGER SELECTION

The manager evaluation process begins with a broad review of performance, investment strategy and regulatory record for indications of a fiduciary culture. If an investment manager passes these initial screens, the team then conducts investigative research and analysis, including an initial visit to the manager's offices, followed by regular calls and visits with the manager. Each manager is evaluated based on 10 key performance criteria, known as the 10 P's: philosophy, people, passion, process, portfolio, predictability, product proliferation, price, parent and progress. The 10 P's can be considered the qualitative ingredients that, when combined, create a complete manager evaluation process. To fully explore each aspect, we ask more than 250 questions about the 10 P's.

KEY TAKEAWAYS

- The Manager Research & Due Diligence team is responsible for ensuring the quality of the professional portfolio managers available on the Asset Management Services platform.
- The Due Diligence process evaluates managers on 10 key performance criteria, known as the 10 P's: philosophy, people, passion, process, portfolio, predictability, product proliferation, price, parent and progress.
- The team has several questions – a bank of more than 250 – it can ask to evaluate a manager on the 10 P's.

MANAGER RESEARCH & DUE DILIGENCE

- **31** professionals
- Over **400** combined years of industry experience
- **100+** on-site manager visits per year
- **250+** meetings in Raymond James offices in St. Petersburg and Memphis
- **150+** conference calls per year

The **10** P's of Performance

PHILOSOPHY

The Manager Research & Due Diligence team believes the most successful investment managers have well-defined, well-articulated investment philosophies that are independent of conventional wisdom. Without understanding the philosophy, the Due Diligence team cannot determine the reason for an investment manager's past successes, nor can it determine whether the investment manager may have the potential for future success.

PEOPLE

When assessing the people that make up a manager's investment team, the Manager Research & Due Diligence team must determine whether the existing investment team has the ability and experience to add value to the investment process, through good times and bad. Also, the people responsible for the past successes of the firm must be involved in the management process now and be expected to remain in place or train potential replacements for the foreseeable future. A further consideration is to determine whether there are adequate incentives to retain these people (e.g., deferred compensation, employment contracts, ownership, etc.). In the team's view, the most important aspect to consider is whether or not these people act as an efficient team. Manager Research & Due Diligence believes a diverse investment team with good chemistry is a key strength. Without a true team environment and a great flow of communication, an investment management firm may have difficulty achieving continued success.

PASSION

Asset management is a competitive and humbling field in which few stand out but many see short-term success for their businesses. Successful investment managers over the longer term appreciate the high probabilities for intermittent failure and learn from collective experiences. Common among the most highly regarded in the field is an altruistic admission of mistakes and the drive for improved decisions. In assessing manager skill, it is important to consider the sources of motivation in decision-makers and investment contributors. Once found, it is as important to assess regularly whether the motivating drivers have eroded or remain intact. Asset managers that have endured long periods of time with high levels of consistency understand how to structure an organization to optimally minimize complacency and support a chemistry that propels insights and outcomes.

PROCESS

The Manager Research & Due Diligence team believes that a successful investment manager has a well-defined investment process that is consistent with its investment philosophy; the investment process is the mechanism by which the firm's philosophy is transformed into a product. It is necessary to determine if the manager has been true to the process over time and if the "real process" differs from the "stated process." In addition, as an investment management firm grows, it may neglect to add sufficient operational and client service personnel to continue to serve its clients in an effective manner. As a result, it is important to assess whether the firm has the infrastructure to support its process and to evaluate the efficiency and effectiveness of the process overall. Finally, successful investment managers over time will continually make small enhancements to keep up with the changing marketplace and also to adapt to the makeup of their evolving investment staff.

(continued on next page)

PORTFOLIO

A firm's product should be consistent with its investment philosophy and its investment process. The product should be flexible enough to meet the needs of a variety of clients and able to adapt to the changing dynamics of the markets. Changes in the macroeconomic environment have different effects on different assets. For instance, prices of assets like stocks and bonds may move differently at times and knowing the investment characteristics of the securities held allows our team to properly position the discipline. The Due Diligence team sets expectations for each portfolio upfront and closely monitors the makeup and results over time.

PREDICTABILITY

While it is true that past performance is not indicative of future results, the same cannot be said necessarily about the types of risks a given asset manager takes. The Manager Research & Due Diligence team allocates considerable resources toward understanding process biases, investment predispositions and the continuity of implementation over long periods of time. Asset managers that possess a predictable risk footprint provide for more efficient exposure within the overall portfolio context, as attractive risk exposures can be accentuated while undesirable risk exposures can be diversified away through offsetting investment selections elsewhere in the overall portfolio.

PRODUCT PROLIFERATION

At the onset, it is important to determine how an investment manager plans to extract abnormal returns from the market. Early on in the due diligence process, it is also important to understand the culture of the organization and whether the operating environment is conducive to supporting such skills over long periods of time. Generally speaking, Manager Research & Due Diligence finds greater success with asset managers that maximize what they are good at while minimizing efforts where greater uncertainty of skill reside. Investment-driven cultures are more likely to appreciate the former proposition and often establish processes that are designed to protect such assets. Marketing-driven cultures, on the other hand, tend to be more solutions based, with less regard for the level of skill available to deliver on promised product outcomes.

PRICE

Popular academic studies highlight the importance that price plays in determining the attractiveness of plan implementation, especially through active management solutions. As low-cost exchange-traded options abound in virtually every asset class, it is paramount that the price paid be supported by outcomes that warrant the fees. A passive approach to achieving the overall stock or bond market returns can often be acquired quite cheaply, therefore the expense ratio, management fees and any "hidden" fees, must be included in decision-making.

(continued on next page)

PARENT

Investment managers come in all shapes and sizes. Many smaller firms are privately owned, often by the founder. Some larger companies are private, some are publicly traded and some are considered boutiques of a much larger parent firm. The culture of these investment firms often starts at the top, which is why the due diligence process includes speaking with many levels of management. Parent firms often offer distribution, compliance, trading and operations. Resources requested by the specific portfolio managers of the products our team is interested in must be gladly supported by the broader firm. Incentives to keep the key investment people are very important also; therefore compensation, revenue sharing and equity ownership plans are integral discussion topics during the ongoing due diligence process.

PROGRESS

The Manager Research & Due Diligence team believes that investment managers should continuously integrate innovative ideas into their investment philosophy and process. Once an idea has been proved, imitators will enter the market, diminishing the value of that idea. In order to sustain a record of success over time, an investment manager must be willing to foster innovation, to try to do things a little differently from the rest of the investing world. Up-to-date computer systems often enhance a firm's efficiency and capability; therefore it is important to stay ahead of the technology curve and use of risk systems involved with portfolio management. The team focuses carefully on the merit of innovations and growing numbers of key people. The culture of the firm and the strengths of the process must continue through the changes.

PUTTING IT TOGETHER

While other firms may have four or six P's, we have found 10 important ones that collectively contribute to the performance earned by these investment managers. The Manager Research & Due Diligence team scrutinizes historical performance patterns before adding a manager or fund to the platform. While numerous studies have demonstrated that historical performance has little or no relation to future performance, it is important to review this historical performance data and risk taken in seeking to identify managers whose process has been successful over time.

With current technology the team has the capability to monitor portfolios and performance regularly, analyzing numerous data points, including statistics that relate returns to risk taken and that measure consistency of a manager's success. Other items of scrutiny may include comparing performance patterns against expectations given a manager's philosophy and process; review of composites to establish a performance track record as comparable to the product currently offered; identifying the managers responsible for reported performance; and analysis of institutional composites and other pooled vehicles of a manager if applicable.

INTERNAL ANALYSIS OF ASSET MANAGEMENT SERVICES MANAGERS

Once an investment manager enters the AMS program, a continuous, detailed analysis is maintained on their products. This analysis includes performance calculations, peer comparisons and examination of portfolio characteristics. The Manager Research & Due Diligence team's goal is to ensure that the manager stays true to their discipline, while providing clients with quality investment decisions. Information flow and performance monitoring is daily, and each quarter the team requests of each investment manager an in-depth questionnaire that provides detailed information about the entire organization and the products they offer. In addition, an on-site visit, conference call, and/or home office visit with the investment manager is performed typically each year to interview the portfolio's stock selector(s) and analysts, as well as their operations and client services personnel. This provides considerable insight on the people, process and progress of the firm. It is important to note that one or two conference calls to the investment manager are scheduled between on-site visits if progress and performance are meeting expectations. If not, communication is as needed. These calls are held with the key investment professionals of the firm and emphasize the team's perspective on current events, issues and market conditions.

DIFFERENTIATION

In addition to providing information based purely on performance and index comparisons, the Manager Research & Due Diligence team has developed unique qualitative and subjective tools to examine AMS managers compared to their respective peer groups. Examples would be the Asset Class Reviews and the WatchList process. The Asset Class Reviews are a team effort discussing findings from travel, calls, data gathering and performance patterns. There are numerous factors and data points that are scored while comparing managers versus peer groups and benchmark indices in terms of all of the 10 P's. Products failing to meet AMS standards qualitatively, or when using quantitative measures such as alpha and information ratio, over the long term will be added to the WatchList. This can result in a hold being placed on the product for new accounts, a recommendation to move client assets to another product, or even termination of the product from AMS. Additionally, portfolio holdings are stored daily in a computer database to allow the department to review specific portfolio characteristics and perform attribution analysis on an ongoing basis.

PORTFOLIO STATISTICS

Using various holdings-based analysis systems, the Manager Research & Due Diligence team has the ability to keep track of equity managers' portfolio characteristics and has access to hundreds of statistics for more than 10,000 traded stocks. For example, the Manager Research & Due Diligence team keeps close track of managers' price-to-earnings, price-to-book value and price-to-cash flow ratios; median market capitalizations, sector weightings and stock allocations; and yield, return on equity and earnings-per-share ratios. Both correlation (R-squared) and product holdings allow Manager Research & Due Diligence to determine if a manager and/or fund is staying within its discipline and being compared versus the appropriate peer groups and index. Attribution analysis is used to separate a return figure into three components: the performance contribution/detraction of the market or index; the performance contribution/detraction of the manager's sector and industry selections (indicative of a top-down or thematic approach); and the performance contribution/detraction of the manager's specific security selection (indicative of a bottom-up or fundamental approach). The Manager Research & Due Diligence team also closely tracks the number of holdings, turnover and tax efficiency of each manager.

FINANCIAL ADVISORS AND THEIR CLIENTS

The Manager Research & Due Diligence team believes that communication is a key to success in the investment management business. The various reports we produce are designed to help financial advisors and their clients ascertain which AMS managers and Freedom products could help clients reach their investment goals. The due diligence process often results in hundreds of pages of information, and much of this is distilled into pieces helpful for advisors and clients. For example, "A Closer Look" booklet has been published every quarter since 1997. Material happenings and events affecting our investment opinion are communicated broadly and as soon as possible.

The Manager Research & Due Diligence effort, developed by AMS, is a detailed and ongoing service. By maintaining a proactive manager search, selection and monitoring program, AMS hopes to better serve clients by identifying and offering programs with the highest caliber of investment managers, analyzing and monitoring their portfolios, and effectively communicating relevant information.

Questions about the **10 P's**

To evaluate a professional portfolio manager, the Manager Research & Due Diligence team may ask the manager and other key members of the management team more than 250 questions about the 10 P's.

WHAT WE ASK ABOUT **PHILOSOPHY**

- How much of your philosophy is art vs. science?
- Can your philosophy be explained in a few simple sentences?
- What, if any, of your philosophy was learned at another firm?
- What differentiates you or gives you a competitive advantage?
- What are the most enduring elements of your philosophy and when were they last tested?
- Who on your team is learning the most from you and applying your philosophy?

WHAT WE ASK ABOUT **PEOPLE** AND **PASSION**

OWNERSHIP & ORGANIZATION

- How is ownership structured?
- Who owns the equity? When and how was it obtained?
- How is equity transferred? What happens when someone leaves?
- How will ownership structure evolve and what is the timing?
- If your biggest account left, would it change any business decisions or staffing?
- Do you want to sell your business someday? What are your specific plans?
- What is the reasoning behind the organizational structure?

RETENTION & COMPENSATION

- Tell us about your background and how you came to this firm?
- How do you keep good employees happy?
- What is the bonus structure?
- Why is this place a good fit for you?
- How much of your money is in your fund?

TEAM CULTURE

- Describe the team culture?
- How do you build a culture of excellence within your team?
- Who were your mentors?
- How are you teaching team members to think like you?
- What is your boss's management style?
- What motivates you to perform?
- What motivates your team members to do well for clients?
- Do team members spend time together outside of work?
- What are the portfolio manager's hot buttons? What do they like or dislike?

COMMUNICATIONS

- Who do you interact with most day to day?
- What are the team's daily interactions?
- How is information shared within the team? The firm?

PORTFOLIO MANAGERS & ANALYSTS

- How are you allocating your time to the many roles of a portfolio manager?
- How much time do you spend mentoring?
- How do you break down stock coverage among the team?
- Which areas do team members gravitate toward?
- What are each analyst's coverage names, countries or sectors?
- Team member strengths/weaknesses
- What nuances or tilts does the team have?
- How do team members complement each other?
- What do you admire about each of your team members?
- What did you learn for your most recent performance review?
- How are you seeking to improve?
- Do you admire any teams outside of the organization?
- How often do portfolio managers buy an analyst's idea?

RESPONSIBILITIES

- Do team members have areas of focus? Do they rotate?
- What does the director of research do here?
- Do you sit on any boards?
- What are the expectations for analysts regarding maintenance and new-idea generation?
- What is the expected workload per analyst?

SUCCESSION

- What is your succession plan?
- What is your expectation for people turnover per year?
- Why did the last person leave?
- What are the expectations for leadership in the next 5-10 years?
- Who do you think is next in line for Portfolio Manager?
- What is your hiring process and what do you look for in a new hire?
- What are the plans to make the business stronger in the next generation?

PERSONAL

- What are your hobbies?
- How do you invest your money? Your parents' money?
- Do you manage a hedge fund?
- How would you spend a perfect day – and who is handling the headaches?

CLIENT FIT

- Do you enjoy marketing and client service? Meeting the people who invest with you?
- Do you write monthly or quarterly portfolio commentaries?
- What is your best definition of client risk and how do you control it?

WHAT WE ASK ABOUT **PROCESS**

INVESTMENT PROCESS

- What is your investment process?
- What are its strengths?
- What are the more salient parts of the process?
- How do you get information on who else holds the stocks in your portfolio and whether they are selling or buying?
- What recent tweaks have you recommended to your team?
- How has the strategy evolved over the years?
- Is the tendency to trim on strength, let winners run, sell on weakness or buy more?
- Is there a common framework for evaluating securities?
- What parts of the market does the product tend to lean into or away from?
- How do you balance top down views with bottom up work?
- How important is price momentum or a recent earnings surprise?
- Do you visit competitors or suppliers/customers of companies you hold?

SCREENING

- How important are front-end screens or quant rankings?
- What is your buy universe and how quantitatively do you narrow it down?
- How are you dealing with the inflow or new data?
- What is your market cap range and how important and consistent is the concentration of certain sized holdings?
- How is artificial intelligence/machine learning used?

IDEA GENERATION

- How does an investment go from an idea into the portfolio?
- Where do you get most of your new stock/bond ideas?
- Do you maintain a list of vetted securities waiting for a catalyst?
- How many stocks are in your bullpen, and whose responsibility is it to keep it fresh?
- How do you source investment ideas?

DECISION-MAKING

- Do you like to go out on a limb by yourself?
- How has the decision-making group evolved, including a timeline for the people involved?
- Are analysts pushing ideas to portfolio managers, or are portfolio managers giving ideas to analysts?
- How involved are analysts in vetting ideas outside their spaces?
- How involved are analysts in position sizing?
- How do you avoid behavioral pitfalls?
- Provide an example of a disagreement on a specific name with details about who was on each side and what was decided.
- In a disagreement, who has the final say?
- How has your discretion over buys and sells evolved?
- Do a certain number of analysts have to agree on a name for it to be implemented?
- Walk us through a recent sale/purchase.

SYSTEMS AND DOCUMENTATION

- How is research documented?
- What systems have improved your process and how?
- Do you outsource anything or do you plan to – technology systems, public relations, compliance, data gathering?
- Do your analysts write down their theses or catalysts and then monitor?
- Do you keep a notes database?

WHAT WE ASK ABOUT **PORTFOLIO** AND **PREDICTABILITY**

SIZING

- How do you size your positions?
- How do you consider sizing at different conviction levels?
- How involved are analysts in position sizing?

SECTOR TILTS

- Are there any sector biases in this portfolio?
- What is the reasoning behind the current sector weightings?

MARKET CAP

- What is your market-cap range and how important/consistent is the concentration of certain sized holdings?

HOLDINGS

- Why do you think this number of holdings best represents this portfolio?
- Why own so many stocks rather than concentrate into your best ideas?
- Give examples for each type of bucket of stocks the portfolio is invested in?
- What is the tendency to hold positions not held elsewhere at the firm?
- How important is tax* efficiency for your fund and for all clients?

*Raymond James does not give tax or legal advice, please speak with your appropriate professional.

RISK MANAGEMENT

- How do you manage risk in the portfolio?
- What is your method for combining factor exposure?
- How do you set discount rates, assign valuation multiples?
- How important are risk management reports? Do you look at impact before making a trade?
- Do you tend to scale in and out of position, or buy and sell full positions?
- What is your process when you find out bad news?
- What is the process for mitigating risk on an ongoing basis?
- What are your risk-return goals?
- If you do not run an exact clone model for all clients, what are your dispersion goals?
- What beta should we expect?

CAPACITY

- How is capacity measured?
- Are there specific percentages of stock or bond issues that trigger capacity conversations?
- Where will the bottlenecks be as assets ramp closer to capacity?
- How, on the margin, will the product have to adapt to growth?

STYLE

- Do you agree with Morningstar's style box assessment of this portfolio?
- What is the reason for the style drift?
- How would you define your product from a style perspective?
- What times would you expect to underperform?

POSITIONING

- What are the non-consensus views in the portfolio?
- What is the market missing that you are seeing? What could go wrong?
- How do you hedge for the possibility your positioning is off the mark?
- Where are you finding value currently?

BENCHMARK

- How important to you is the benchmark? Any rules of thumb for tracking error, sector weights, etc.?
- Are you concerned with beta, tracking error or what industries are moving the markets?
- Are there nuances in the Russell or S&P indices you take issue with?
- What is your best benchmark?

WHAT WE ASK ABOUT **PRODUCT PROLIFERATION**

- What product ideas are being discussed and who is leading that project?
- What market trends are you interested in?
- How do you assure the business will be stronger under the next generation?
- What research initiatives are you considering?
- If you had a magic wand, what would you change?
- Do you have any active ETFs available?
- What happens when multiple products are interested in the same stock?
- What other products does the team contribute to?

WHAT WE ASK ABOUT **PRICE**

- What is the broker/dealer SMA pricing versus institutional pricing? How transparent is it? Who makes decisions?
- What is your strategy for mutual fund pricing/expense ratio?
- What are your trading costs?
- What are your actual vs. targeted costs for new product implementation?

WHAT WE ASK ABOUT **PARENT**

- How is the firm managed: committee, CEO, parent?
- How hands on is the parent company, especially when things aren't working?
- What issues could derail the relationship with the parent?
- What updates are taking place at the firm level and how are they affecting this strategy?
- Are there any contracts? Non-compete or non-solicit clauses?
- How are portfolio managers and analysts compensated?
- Who makes compensation decisions?

WHAT WE ASK ABOUT **PROGRESS**

INTROSPECTION

- What stocks that you bought early or late did you learn a lesson from?
- Where were results better or worse than expected – what are you proud of and where did you leave money on the table?
- What internal goals do you have for outperformance?
- How do you reconcile recent performance vs. your expectations?
- How much credit or blame belongs to the portfolio manager?
- Are postmortems conducted?
- What stock was not implemented in the portfolio that should have been?

- What do you still have to prove?
- What part of your skill set are you trying to improve?
- What steps are you taking to ensure your cyber security is best-in-class?
- What new research initiatives are you thinking of incorporating?

NAME CONVICTION

- What economic variables are most important to growing earnings?
- What do you look for in the CEO of a firm?
- Where do you get your best information on a company – what is your advantage?
- How do you adjust stock options and employee healthcare assumptions to forecast earnings?
- How do you compare and adjust for depreciation vs. maintenance capital expenditures?
- How patient are you regarding a negative earnings/cash flow surprise?
- What insight do you get from sell-side analysts?
- Do you find yourself selling or buying old favorites at opportune times?
- How important are management contract and/or travel to gaining insights?

BUY/SELL DISCIPLINE

- What is your sell discipline?
- Give examples of positions sold – one good, one bad.
- What is your typical planned holding period and goal for upside of a stock?

MARKET OUTLOOK

- In your opinion, where are we in the market cycle?
- What does today's market environment remind you of?

DEFINITIONS:

Price-to-earnings: The price-earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings. The price-earnings ratio is also sometimes known as the price multiple or the earnings multiple.

Return on equity: Return on equity (ROE) is the amount of net income returned as a percentage of shareholders equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Earnings-per-share: Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. Earnings per share serves as an indicator of a company's profitability.

R-squared: R-squared is a statistical measure that represents the percentage of a fund or security's movements that can be explained by movements in a benchmark index. For example, an R-squared for a fixed-income security versus the Barclays Aggregate Index identifies the security's proportion of variance that is predictable from the variance of the Barclays Aggregate Index. The same can be applied to an equity security versus the Standard and Poor's 500 or any other relevant index.

Top-down investing: Top-down investing is an investment approach that involves looking at the overall picture of the economy and then breaking down the various components into finer details. After looking at the big-picture conditions around the world, analysts examine different industrial sectors to select those that are forecast to outperform the market. From this point, they further analyze stocks of specific companies to choose potentially successful ones as investments.

Bottom-up investing: Bottom-up investing is an investment approach that focuses on the analysis of individual stocks and deemphasizes the significance of economic cycles and market cycles. In bottom-up investing, the investor focuses his attention on a specific company, rather than on the industry in which that company operates or on the economy as a whole. This approach assumes individual companies can do well even in an industry that is not performing.

RAYMOND JAMES®

INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER
880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 727.567.4569