

INVESTMENT CONSULTING IN 2002

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BACKGROUND: STRATFORD ADVISORY GROUP, INC.

- **Founded in 1982 to primarily consult to high-net worth individuals and endowment/foundation clients**
- **A privately-held firm currently owned by 4 senior consultants**
- **Independent, full-service investment consulting firm**
- **Our only business is investment consulting – the only money we take in is from clients**

BACKGROUND: STRATFORD ADVISORY GROUP, INC.

- **Consult to 50 clients, over \$11 billion in assets**
- **Representative clients:**
 - **The Tribune Company**
 - **Knight-Ridder, Inc.**
 - **IIT**
 - **Marquette University**
 - **Jewish Federation of Metropolitan Chicago**
 - **Museum of Science and Industry**
 - **The Goodman Theater**

WHO ARE STRATFORD'S COMPETITORS?

Other consultants in the Chicagoland area include:

- **Becker, Burke**
- **DeMeo Schneider**
- **Disabato**
- **EnnisKnupp**
- **J.H. Elwood**
- **Hewitt Associates**
- **Mercer**
- **Marco**
- **Marquette**

WHAT SETS STRATFORD APART?

- **All of our research professionals conduct research and provide consulting services**
- **A partner of the firm heads every client account**
- **We are completely independent – cash only comes in the door when a client writes us a check**

ISSUES FACED IN 2002

- **Underfunded pension plans**
- **Rising interest rates and the effect on your fixed income portfolio**
- **Manager turmoil**
- **Consultant independence**

UNDERFUNDED PENSION PLANS

- **The majority of pension plans are underfunded primarily due to the worst bear market since 1929.**
- **Wilshire Associates predicts that 75% of all public plans will be underfunded, a high that was last reached during the recession of 1993.**
- **Recent CSFB study noted that 90% of the S&P 500 companies that offer a DB plan are underfunded (325 major US corporations).**

Investors Guide 2003. Fortune, December 3, 2002.

UNDERFUNDED PENSION PLANS

What does this mean specifically for corporations?

- **They will likely reduce their return assumptions, which will, in turn, lower their earnings significantly**
- **Companies must make cash contributions to reduce the level of underfunding**

Shareholders need to understand the status of a company's pension fund and its effect on earnings.

2003: RISING INTEREST RATES

- **As rates are now at a 40-year low, the consensus expectation is that we will see rates rise in 2003**
- **Bill Gross recently noted that “short rates are going no lower.”**

Investment Outlook, Bill Gross. PIMCO.com, December 2002.

2003: RISING INTEREST RATES

- **An increasing rate environment spells trouble for intermediate- and long-term bonds**
- **Should investors reduce the maturity of their fixed income portfolio given the likely increases?**
- **We are conducting research on the issue but our preliminary work indicates that we will not change our long-term fixed income recommendations.**

MANAGER ISSUES

- Alliance Capital Management manages a large-cap growth strategy headed by Alfred Harrison out of Minneapolis.
- Harrison held a large position in Enron and continued to add to the position even as the company's share price fell and CEO Skilling resigned.
- The strategy lost the Florida State Board of Administration nearly \$300 million alone (total plan size was \$100 billion).

MANAGER ISSUES

- **Florida has filed a lawsuit against Alliance charging negligence and asking for \$313 million in damages.**
- **An Alliance director sat on the board at Enron as well, adding a potential conflict of interest to the situation.**
- **Alliance maintains that they were deceived by Enron and were not negligent in their management of the strategy.**

MANAGER ISSUES

- **Advanced Investment Management was a Pittsburgh-based firm that ran approximately \$5.3 billion in an synthetic enhanced index equity product for a number of large institutions.**
- **In the second quarter of 2002, the product experienced significant underperformance relative to the S&P 500 Index.**
- **In some cases, the strategy underperformed by more than 30 percentage points – 3000 basis points.**

MANAGER ISSUES

AIM wrote uncovered out-of-the-money puts on the S&P 500 and then rolled the position into a long S&P 500 futures position when the options expired. The price of the puts had ballooned out due to extreme volatility. AIM was betting that volatility would collapse and the price of the put would decrease. Contrary to AIM's expectation, volatility continued to increase.

MANAGER ISSUES

- **AIM has been sued by 9 institutions thus far for violating investment guidelines, most notably SBCERA for \$55 million, Dow Chemical, and Minnesota Teachers. The amount of capital lost to clients is over \$400 million.**
- **The firm closed its doors in August after it was no longer viable to continue due to client departures and lawsuits.**
- **AIM's counsel is meeting with former clients to discuss settlement possibilities.**

CONSULTANT INDEPENDENCE

- **An increasing number of institutions are placing emphasis on reducing the potential for unbiased advice.**
- **Many RFPs now directly ask consultants to detail sources of revenue.**
- **A trustee for the \$10 billion Chicago Public School Teachers' Retirement Fund has asked its consultant to disclose revenues generated from money managers.**

Are your savings safe? The seamy side of pension funds. Fortune, August 12, 2002.

CONSULTANT INDEPENDENCE

- **Cooper Consultants, a Berkeley-based firm, rates consultants on issues such as independence and sources of revenue.**
- **A number of clients have engaged Cooper to assist with consultant searches.**
- **In a challenging market such as we have just experienced, independence becomes an increasingly important factor in selecting a service provider.**

OUTLOOK

- **We continue to maintain our long-term investment perspective and have not made any major shifts in our return assumptions or asset allocation recommendations.**
- **Managers have undergone tremendous stress during the bear market and we have increased our due diligence and communication.**
- **Our clients have been concerned but not reactive during the down market and have exercised sound judgment despite the incredible pressure to “duck and cover.”**
- **We continue to maintain our independent status and will focus our efforts on full-service investment consulting.**