

EXTERNAL MANAGER SELECTION & MONITORING

RESEARCH, DISCIPLINE AND EXPERIENCED JUDGMENT

Northern Trust's professionals look beyond the numbers to identify superior investment managers

Northern Trust has been researching and monitoring investment managers for client programs for more than 25 years. Northern Trust Global Advisors is a leader in researching external investment managers. Our expertise in manager selection and monitoring provides you with a single, convenient means to access global investment talent.

Our staff's decades of combined experience as fund managers, consultants and corporate pension directors give us a rich perspective on investing, spanning numerous global markets and asset classes. We use a rigorous, uniform process that employs qualitative and quantitative tools to understand each manager's investment process and discipline.

MANAGER SELECTION

We combine managers with complementary styles and philosophies, closely monitor results and make changes as appropriate. The total investment strategy is a synergistic combination of investment managers, carefully structured to optimize return and diversify risk.

Qualitative Investigation

The qualitative investigation focuses on the portfolio management team. We search out managers who have the attributes to make success repeatable.

Research is compiled by drawing on a broad array of resources. Among the most illuminating are in-depth face-to-face management interviews, of which we conduct more than 700 per year. We evaluate the role, training, personality and decision-making habits of key professionals within the context of the firm's organizational and incentive structure.

This research helps us avoid surprises by anticipating how the portfolio might react in a variety of market circumstances. It also enables us to fully appreciate the dynamics of a manager's approach. In designing a multiple manager program, we develop a qualitative sense of how different managers' styles might fit together before we test the combinations statistically.

Traits of Successful Managers

Several characteristics – unrelated to investment philosophy, asset class or assets under management – are helpful in identifying managers who may tend to achieve superior, long-term results. Successful managers often exhibit the following traits:

- Independent thinking,
- Strong personal discipline,
- Intellectual flexibility,
- Exceptional histories and
- A deep understanding of and commitment to their business.

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Successful managers encourage creativity and prudent risk-taking through:

- Strong leadership,
- A crisp, non-bureaucratic decision-making process,
- Appropriate incentive structures,
- A dynamic, high-energy environment and
- A robust array of resources dedicated to the investment effort.

Quantitative Performance Review

We generally conduct a quantitative review after a manager has undergone a thorough qualitative review. Unlike consultants who screen managers based on performance data, we believe that historical performance is a poor predictor of future success and can be grossly misleading.

The role of past performance is to help better understand the historical circumstances and the decision processes that led to the investment choices. A judgment as to whether expected performance can be sustained can only be made after a qualitative assessment of the people, investment approaches and decision-making processes.

Our quantitative review aims to augment the conclusions of our qualitative due diligence, using both performance and portfolio data. We ask:

- Is the manager's portfolio and performance consistent over time with their stated style and strategy?
- Is the level and composition of risk consistent across time?
- Which types of decisions contributed positively or negatively to results?
- Does the manager's performance indicate skill or a favorable environment?

- Is performance commensurate with the risks taken?
- Does the process result in hidden or unintended risks?
- Is the process responsive to changing markets?
- Are there any inconsistent results that warrant further investigation before rendering a final decision?

We compare the manager's results to the appropriate benchmark and look at returns within different phases of the market cycle. In combining managers, we evaluate whether the portfolio will overlap with or complement those of our other managers and use correlation data to project the potential for superior combined performance, controlling for risk.

MANAGER MONITORING

We continuously evaluate all external managers after selection for our programs, reviewing our actual experience with them against all factors that were part of our decision to retain them.

Ongoing Manager Review

The investment manager review team maintains regular communications with managers. The team reviews portfolios at least quarterly, but more frequent conversations are common and can even occur daily during fast-moving markets. In many cases, we can provide valuable feedback to our managers based on our market intelligence and experience.

Reviews typically include discussions of market views, strategy and likely future trades. Formal on-site reviews are held at least annually to focus on the organization, people, business plan, investment process and results.

Senior investment professionals review investment strategy from a longer-term perspective for each investment program and external manager. Our investment committee reviews performance, risk analysis, investment policy, strategy and client activity. Committee approval is required for any fundamental product or process change.

TERMINATION

Termination of managers is a difficult and necessary responsibility. We closely monitor early warning signs and have developed a process for prompt analysis that has been tested through experience.

Discussions with the manager and in-depth analysis of the portfolio will help determine whether immediate action is necessary or whether the manager should be placed on an active watch list. Poor performance is seldom an instigator of change. Causes for termination include:

- Major staff defections,
- Changes in firm structure,
- Changes in investment style and
- Unexpected performance results and/or unexpected risk profile of the portfolio.

ACCESS TO GLOBAL TALENT

Northern's expertise in manager selection and monitoring gives you a single, convenient vehicle to access global investment talent. To learn more, please contact your Northern Trust Relationship Manager or visit northerntrust.com.

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