



Monthly Update

May 2015



The Active vs. Passive Battle

Carl W. Hafele, CFA, CPA
Managing Director & Principal

Virtually every semester over the last ten years, I find one or two truly superb financial brains in my investment and MBA classes. Each of these students typically ask for items to read to satiate their blossoming financial appetite and their 'love of the game.'

Over the last several years, I have recommended (among a host of books and articles) the 2013 article "The Bumpy Road to Outperformance" from the Vanguard Research Team. "The Case for Index-Fund Investing" is a recent updated version available on the Vanguard website (<https://pressroom.vanguard.com>). I highly recommend it for all investors. It addresses the active versus passive great fight!

In summary, passive investing using low cost index funds gives the investor a much higher probability of outperforming active management. The study covers the traditional asset classes including domestic stocks and bonds, as well as international equities. It quantifies the probability of managers outperforming in subsequent periods after getting the proverbial 'hot hand' for five years – and it's very low. Add the important 'Survivorship Syndrome' (bad funds are closed or go out of business), the probability goes even lower. If you are in the top 20% for five years, the probability of being there in the next five? A minuscule 2%.

The article convincingly details that past performance is not a predictor of future performance. There is considerable evidence that the odds of achieving a return that outperforms a majority of similar investors are increased if one simply aims to seek the lowest cost for a given strategy.

At Lanier, we subscribe to the passive/low cost investment philosophy for most of the traditional stock and bond categories, and refer to them as "efficient asset classes." So Mr. Passive throws a solid right hook in the active/passive battle.

But active management indeed has its place! We also subscribe to this approach in the "inefficient asset classes" – namely in real assets and hedge funds. There is evidence that suggests that past performance can be a predictor of future performance in these asset classes. In other words, the "best of the best" in the hedge fund world are truly superior,



delivering a large and consistent level of outperformance versus the indices and median managers. Lipper studies also show that the better hedge fund managers significantly outperform the typically smaller one.

We have said for years that the average hedge fund manager delivers 4-5% a year over a multi-year period (truly unexciting), while the best of the best deliver an additional 4-5% (quite exciting!). Having access to the best and brightest is the key! Most importantly, the correlation of Hedge Funds to the S&P 500 is very low or even negative, and the standard deviation of returns are less than 50% of the stock market. Sign me up! Mr. Active landed an incredible left hook in the active/passive battle.

Our investment approach at Lanier 1) starts with understanding an individual client's risk/return profile, 2) builds an appropriate asset mix to fit that profile, 3) combines passive investing in the efficient classes and active management in the inefficient classes, and 4) selects and provides access to the best of the best active managers in those inefficient asset classes. Our approach focuses on delivering 2-3% more per year than a typical 60/40 blend over the next market cycles.

Key Points From Our Investment Meeting – 5/8/15

Macro Viewpoint

- Volatility quite pronounced primary based on timing of any Fed rate hikes.
- European quantitative easing still in the first inning...
- Strength and volatility of the US dollar is beginning to show signs of stress for the multinationals.
- Consumers continue to save at higher than expected levels even after a significant drop in energy cost.

Asset Class Comments

- Short Duration High Yield is at an attractive buy point.
- Mid and Small Cap are again extended.
- International Developed and Emerging Markets swiftly advancing.
- Real Estate – Attractive buy point.
- Expecting Hedge Fund indices to continue multiyear 4-5% annually. Access to superior managers adds 4-5% more.
- Futures market one year plus strong performance continuing.



Building **Confidence** and **Security** in Your **Financial Future**



Performance Update

TRADITIONAL ASSETS

Investment Vehicle	Total Return (%)							
	APR	QTD	YTD	1-Year	Annualized			
					3-Year	5-Year	7-Year	10-Year
Cash								
Vanguard Reserve Prime Money Market	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	0.4%	1.6%
Fixed Income								
Domestic (Barclays US Agg)	-0.4%	-0.4%	1.2%	4.4%	2.6%	4.1%	4.7%	4.8%
Eaton Vance Floating Rate	0.8%	0.8%	2.7%	2.8%	4.1%	4.5%	4.8%	4.2%
High Yield (Barclays US Corp HY)	1.1%	1.1%	3.7%	2.2%	7.2%	8.2%	9.0%	8.3%
Short Term High Yield	0.9%	0.9%	2.7%	-0.3%	-	-	-	-
Equities								
Domestic Large Cap (S&P 500 TR)	1.0%	1.0%	1.9%	13.0%	16.7%	14.3%	8.4%	8.3%
S&P Equal Weight	0.4%	0.4%	2.1%	12.8%	18.3%	15.0%	10.5%	9.8%
Domestic Mid Cap (S&P 400 TR)	-1.5%	-1.5%	3.7%	12.3%	16.5%	14.4%	10.3%	10.6%
Vanguard Mid-Cap ETF	-3.4%	-3.4%	3.8%	15.3%	18.0%	15.2%	10.0%	10.3%
Domestic Small Cap (S&P 600 TR)	-2.3%	-2.3%	1.5%	9.2%	16.9%	14.4%	10.6%	10.1%
Vanguard Small-Cap ETF	-2.0%	-2.0%	3.0%	10.6%	17.3%	14.2%	10.8%	10.4%
Developed Intl. (MSCI EAFE)	4.1%	4.1%	9.2%	1.7%	11.2%	7.4%	1.4%	5.6%
MSCI EAFE	3.7%	3.7%	9.3%	9.3%	10.9%	7.4%	1.2%	5.4%
Emerging Intl. (MSCI EM)	7.7%	7.7%	10.1%	7.8%	3.2%	3.0%	0.6%	9.6%
Vanguard FTSE Emerging Markets ETF	7.4%	7.4%	9.9%	10.1%	3.8%	3.3%	0.5%	9.2%
Real Assets								
Real Estate (FTSE NAREIT US REIT)	-4.7%	-4.7%	-0.9%	12.9%	11.3%	12.9%	7.1%	7.8%
Mortgage Real Estate	-0.6%	-0.6%	1.8%	5.4%	7.4%	7.0%	1.4%	-
REIT ETF	-5.9%	-5.9%	-1.4%	13.0%	10.8%	12.9%	7.2%	8.6%
Commodities (Thomson Reuters/Jefferies CRB Index)	8.3%	8.3%	-0.2%	-25.9%	-9.1%	-3.7%	-7.9%	-2.8%
AVENTIS*	0.9%	0.9%	2.1%	1.7%	-4.1%	4.0%	-2.0%	-
DIVERSIFYING STRATEGIES								
Hedge Funds								
HFRI WCI	0.8%	0.8%	3.3%	5.4%	5.8%	4.5%	3.6%	5.5%
INFINITY*	0.2%	0.2%	3.3%	9.6%	10.0%	8.2%	7.5%	9.2%
Robeco Long/Short Equity	3.7%	3.7%	-0.6%	-4.4%	5.8%	8.1%	13.4%	11.1%
Lanier All Asset Strategy**	-0.3%	-0.3%	0.3%	5.9%	10.2%	6.6%	12.8%	14.0%
Managed Futures								
Barclays CTA Index	-1.1%	-1.1%	2.9%	11.4%	2.6%	2.2%	2.5%	4.2%
WINTON*	-3.7%	-3.7%	-0.3%	8.2%	1.2%	1.3%	1.3%	4.9%
AQR Managed Futures Strategy	-3.2%	-3.2%	5.0%	22.8%	9.3%	-	-	-
WisdomTree Managed Futures Strategy	-1.5%	-1.5%	0.1%	5.2%	0.7%	-	-	-

 = Benchmarks
 = Lanier Selections

* For Accredited Investors Only

** Based upon since inception (Jan 2006). Prior data uses 60/40 Blend

Our Firm

Lanier Asset Management is an independent Registered Investment Advisory firm with a mission to build confidence and security in our clients' financial future. The firm uses an open architecture investment structure to combine the best of proprietary and independent investment strategies. At Lanier, we deliver superior service and performance to our clients as a result of four key elements:

- Our People:** we are an independent firm, providing objective advice from experienced investment professionals working in your best interests
- Our Investment Philosophy:** we seek to smooth investment returns, providing superior performance and lower correlation
 - Focus on projected returns rather than historic
 - "A Better Mouse Trap" – similar to the largest U.S. endowments
- Our Investment Process:** we combine active and passive management in traditional asset classes, and complement them with diversifying strategies/alternatives
- Our Conviction:** we believe in our approach – this is how we invest our own money



Mark R. Hoffman
*Managing Director, CEO,
 Principal*



Junius V. (Trip) Beaver, III
*Managing Director, CIO,
 Principal*



Carl W. Hafele, CFA, CPA
*Managing Director,
 Principal*



Deidre M. Durbin
Chief Compliance Officer



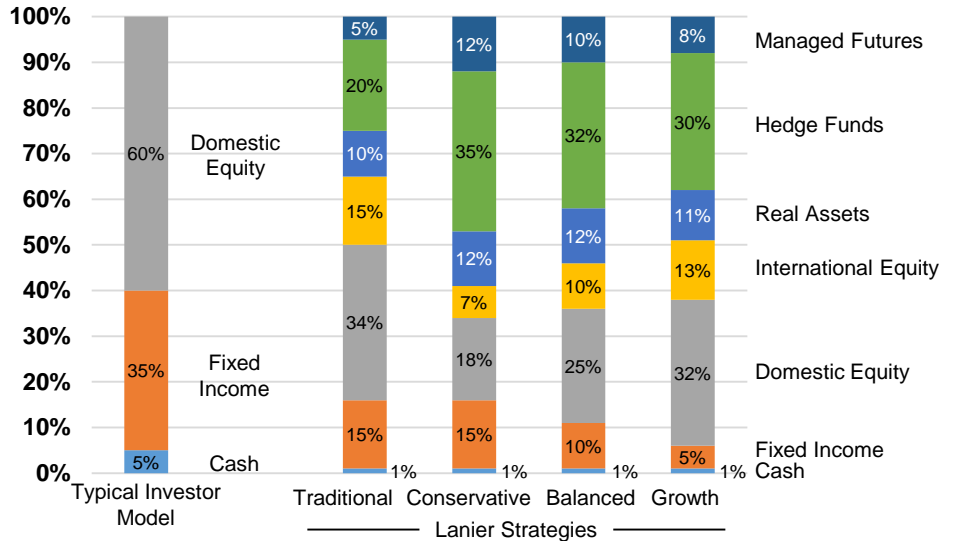
Emily A. Spendlove
Investment Associate

Building Confidence and Security in Your Financial Future



Our Approach

The Lanier Approach complements typical equity and fixed income investments with non-correlated assets including hedge funds, real assets and managed futures. This investment process improves long-term performance while simultaneously reducing risk.



Our approach seeks to both A) limit losses in periods of market correction and B) participate in gains during periods of market appreciation. Across the last two economic cycles, our strategies have outperformed the typical investor model by 3%/year with 10-15% lower correlation to the overall market. The long-term result has been significant value creation versus the stock/bond/cash model.

Historic Performance: Economic Cycles

Cycle 1:
April 2000 –
September 2007

	Annualized Period Return			Correlation To S&P 500
	Down Market 4/00-9/02	Up Market 10/02-9/07	Full Cycle 4/00-9/07	
Lanier Balanced	-4.9%	+16.3%	+8.8%	.62
60/35/5	-9.1%	+10.9%	+3.8%	.74
Difference	+4.2%	+5.4%	+5.0%	

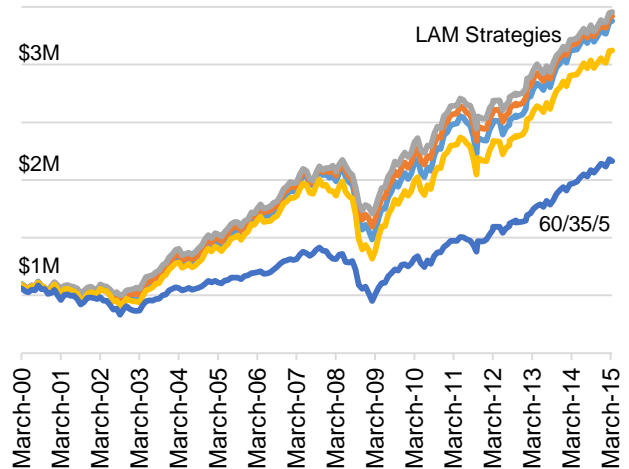
Cycle 2:
October 2007 –
March 2015

	Annualized Period Return			Correlation To S&P 500
	Down Market 10/07-2/09	Up Market 3/09-12/14	Full Cycle 10/07-12/14	
Lanier Balanced	-16.1%	+13.4%	+6.9%	.66
60/35/5	-23.6%	+14.9%	+6.1%	.71
Difference	+7.5%	-1.4%	+0.8%	

Two full cycles:
April 2000 –
March 2015

	Two Cycles 4/00-12/14	Correlation To S&P 500
Lanier Balanced	+7.9%	.65
60/35/5	+4.9%	.73
Difference	+3.0%	

Value Added: \$1M over two cycles/15 years



Past performance is no guarantee of future results. Investing entails risk, including possible loss of some or all principal. Historical performance results for investment indices and/or categories have been provided for general comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges. It should not be assumed that your account holdings correspond directly to any comparative indices.

Lanier Asset Management, LLC ("Lanier") is a state registered investment adviser located in Louisville, Kentucky. The firm's CRD number is 150888. Certain Representatives of Lanier hold Series 7, 31, 63, and 65 Securities Licenses. Additionally, producing reps of Lanier are securities licensed in numerous U.S. States with Comprehensive Asset Management and Servicing, Inc., a registered broker/dealer. Member FINRA/SIPC.

Building Confidence and Security in Your Financial Future