

Strategy Performance Indicators

Purpose

The purpose of Blue Heron's Strategy Performance Indicator (SPI) series is to enable efficient and accurate assessments of investment manager biases that result from specific investment philosophies and their related strategies. The series is designed for use in returns-based style analysis.

Many equity investment managers use a set of investment strategies that is unique to their investment processes and philosophies. We call this set of strategies a manager's "Strategy Profile" and it can be considered the fingerprint of their investment activities. Distinct profiles result in very different performance over short time periods. Specific strategies are rewarded differently depending on market environments. Since separate strategies can result in meaningfully different performance patterns over short time periods (e.g. three years or less), an accurate understanding of a manager's strategy biases is essential to correctly assessing the manager's level of skill and their role in a multi-manager mix.

An accurate assessment of a manager's strategy profile will help a manager's prospects and clients develop more realistic performance expectations and help them to be more patient during periods of poor performance that can be attributed to their investment fingerprint. Greater patience on the part of their clients will make it easier for managers to adhere to their strategies as they experience inevitable periods of poor relative performance.

Description

Each Blue Heron SPI reflects the mean return (gross of fees) of managers that focus on implementing a particular investment strategy. Blue Heron identifies these managers through qualitative analysis in addition to an analysis of portfolio characteristics and holdings. Each indicator represents the mean return of typically 5 to 15 managers.

Our goal is to develop a return figure that is most representative of managers that adhere to a particular investment strategy. Blue Heron:

- Determines the membership of each SPI group. We manage the membership of the group over time to provide the best indicator of strategy return.
- Includes managers that are focused and adhere to the identified strategy regardless of the market environment.
- Avoids managers that hold stocks simply for diversification reasons.

While the Blue Heron SPI can be thought of as universe means, there are key features that differentiate a SPI from traditional universe means.



Blue Heron Strategy Performance Indicators	Typical Manager Universe Means
<ul style="list-style-type: none"> • The SPI return is the single best possible indicator of a specific strategy. • SPI members are selected to represent the subset of managers that employs a particular strategy. We favor strategy purity over universe breadth. • Blue Heron will restate historical returns from time to time to correct classification errors and to exclude portfolios that do not fit our criteria (e.g. high cash levels, a change in portfolio manager that produces a change in strategy). • Blue Heron produces daily SPI returns. 	<ul style="list-style-type: none"> • Universes are developed to reflect the entire opportunity set of a particular type of manager or portfolio at a specific point in time. • Typically, historical returns are not restated to correct classification errors or when there is a change in portfolio managers. • Most universes means are available only in a monthly return series.

The Strategy Performance Indicators (SPIs) for twelve US equity strategies currently available are listed in the following table.

Value	Core	Growth
BH Value-Deep Value SPI	BH Core-Value SPI	BH Growth-Consistent Growth SPI
BH Value-Dividend Yield SPI	BH Core-Neutral SPI	BH Growth-Earnings Momentum SPI
BH Value-Discounted Value SPI	BH Core-GARP SPI	BH Growth-MidCap Growth SPI
BH Value-MidCap Value SPI	BH Core-Growth SPI	
	BH Core-MidCap Core SPI	

Descriptions of the qualities of each strategy can be found on www.blueheronconsulting.com. The Blue Heron Strategy Performance Indicators consist of monthly returns beginning in July 1993. We also maintain a daily return series that begins May 1, 1997.

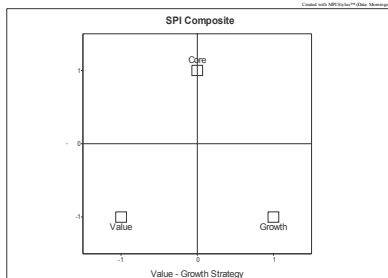
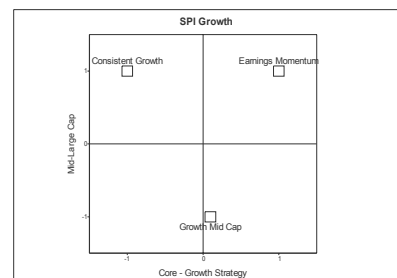
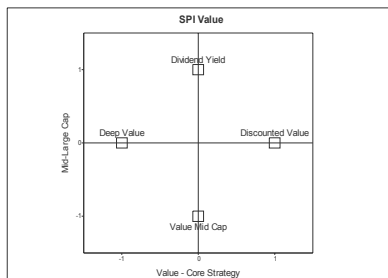
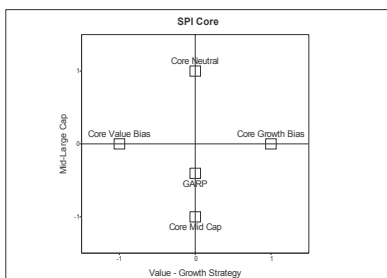
Conceptually, the different strategies may be arrayed in the following manner along the dimensions of growth orientation (horizontal axis) and company market capitalization (vertical axis).



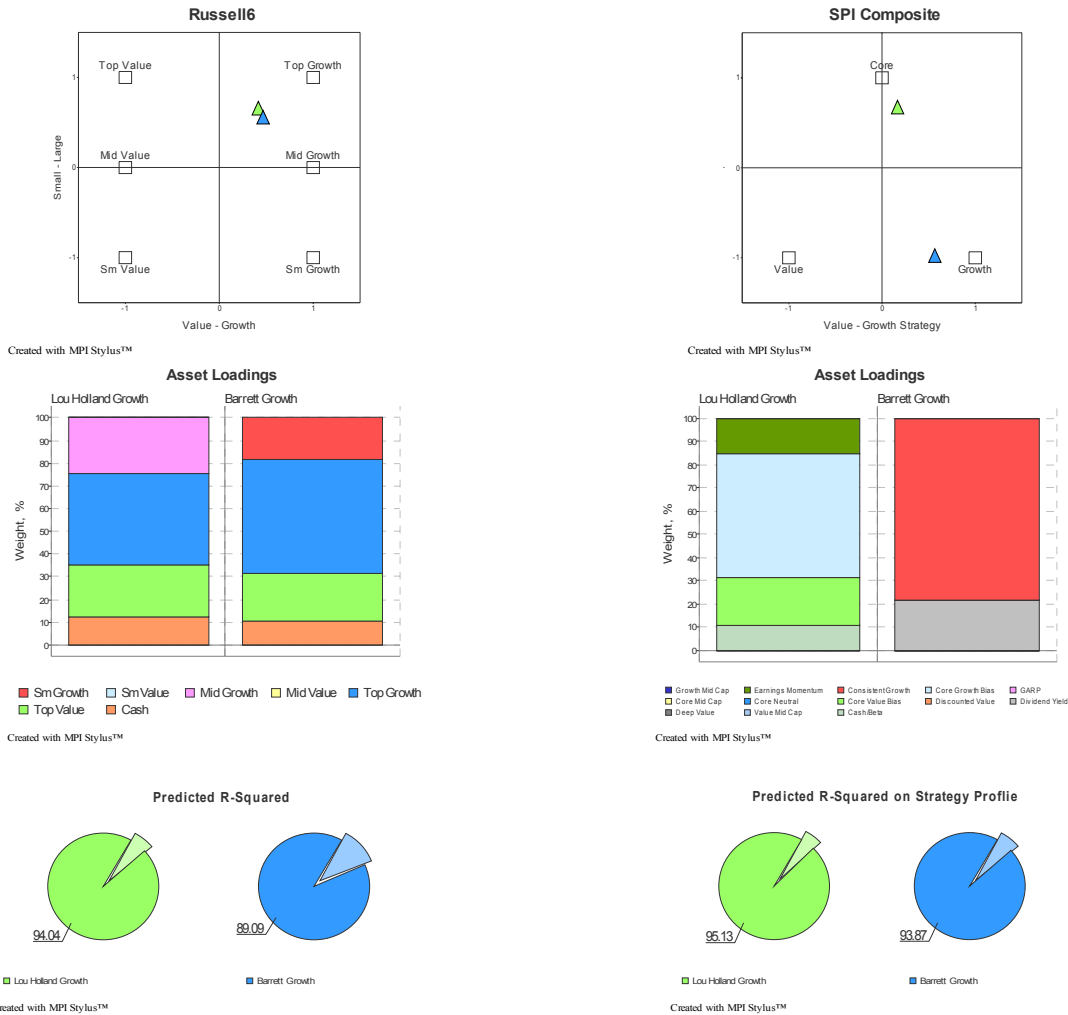
Strategies by Capitalization and Growth Orientation

	Value	Core	Growth
Large Cap	Dividend Yield Discounted Value	Core - Value Bias Core - Neutral Core - Growth Bias	Consistent Growth Earnings Momentum
Mid Cap	Deep Value Value - Midcap	GARP Value - Midcap	Growth - Midcap
Small Cap			

The general relationships shown below are based on portfolio characteristics and performance correlations. Alternately, the SPI indices can be conceptually shown in MPI Stylus Style Maps as follows:



Style Profile Comparison



Proximity on the Russell style map indicates similar investment styles. Yet the funds are shown to be quite distinct when viewed on the Blue Heron Strategy Composite map. This implies that while the general styles may be similar, the underlying investment strategies may differ.

The more detailed view of asset loadings reinforces the observations on the two maps. One can see that the Blue Heron Strategy Performance Indicators break performance down into greater detail. This detail suggests different investment strategies at play in the management of the funds.

Predicted R-Squared is the best test of the validity of a style analysis. The analysis of both funds reveals a notably higher Predicted R-Squared using the Blue Heron SPI series. These statistics confirm the results of Blue Heron studies that show better return predictions using SPIs compared to style indexes.

