HAMILTON POINT
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So Hot it Must Be a Quarter of 380 Degrees

One of our passions at Hamilton Point is to lay bare insincere Wall Street habits—one of which is for firms to brag about how many assets they manage. One such trick is to express assets managed as a fraction of something much larger—like, "we manage half of a trillion dollars." Our point goes beyond the unnecessary embellishment and includes our strong belief that many firms—when boasting about their size—are actually advertising their biggest weakness, which is that they are too big to serve clients effectively.

With apologies for having discussed related points in previous newsletters, our general disdain continues for the "too big to fail" institutions that, we feel, have morphed into "too big to succeed" providers of investment services. Time and again, we meet with prospective Hamilton Point clients who have monies managed by some of these competitors. We learn that investors are frustrated when they do not know:

1) what they own (too many funds to make sense of),
2) how much they are paying (underlying fees and commissions), or
3) who is actually in charge of making decisions on their portfolio.

Cool Off in the Schadenfreude

We sympathize with some large institutions, recalling that the 2008 financial crisis forced many into mergers "for the good of the country" that left them with a somewhat random portfolio of businesses and conflicts. Specifically, Wells Fargo bought Wachovia, JP Morgan absorbed Bear Stearns, and Bank of America had to take over the failed Merrill Lynch. To this day, the investment approach offered by these giants is influenced by those somewhat coerced inheritances. This is one reason why the trust departments of these banks may operate differently than their affiliated brokerage arm—which, in turn, is unlike how the private wealth advisory division does business.

What we do not understand is why the big banks continue to fight actions like the recent Federal Department of Labor rules insisting that they act in their clients' best interests when managing retirement accounts. Why the outrage from them at such a notion? It must be quite a challenge for the executives of these banks and brokerage firms to keep a straight face while arguing that it is impractical for them to look out for their clients' best interests. By contrast, registered investment advisers—like Hamilton Point—have always had the fiduciary responsibility to place our clients' interests first for all investment accounts managed (not just retirement accounts).

Feelin' Berned

While large institutions may be hampered by having too many moving parts and conflict-ridden business models, they also manage so much money that they are mathematically challenged to be special in any meaningful way to their customers. For perspective, the largest investment firm manages assets of around $4.5 trillion—as in $4,500,000,000,000. Measured spatially, if you were to lay $100 bills on top of each other in a stack, a $4.5 trillion pile would be 2,764 miles high (the distance from New York City to Los Angeles).

These firms not only manage too much money, they also have a lot of employees. One name brand firm has roughly 43,000 times more employees than the six we have at Hamilton Point. It is no wonder that humans

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pick up the phone when it rings at Hamilton Point while the "too-big-to-answer" organizations often subject clients to a perennially updated phone tree.

100 Fire Hoses When a Straw Works Better

We see a number of issues that would trouble us were we managing "just a trillion" dollars in equities. If, like most money managers, they prefer to limit their top holdings in any one company to around 5% of the portfolio—or $50 billion in this case—very few stocks are worth enough to absorb such exposure. If these investment firms were selective, it would cause them to control more than 10% of even the largest stocks — companies like **Microsoft, Google** or **Exxon**. With so much money to invest, these firms must own nearly every stock in the index—leaving no flexibility to invest, like Hamilton Point, with quality as the hallmark.

Hamilton Point is of a size that allows us to side-step many larger companies that we view as low quality (i.e. **Citibank** or **Hewlett Packard**) in favor of meaningful positions in companies worth $2-20 billion (i.e. **Church & Dwight** or **Roper Industries**[1]). To have our relative impact, the big guys would have to buy these smaller companies entirely—making it impossible for them to own like allocations to similar-sized companies for all of their clients. And let's not forget that these "smaller" companies are plenty big—worth many billions—and are only viewed as small because Wall Street firms are too big. To make the point another way, the 50 most valuable public companies comprise ~50% of the S&P 500's market capitalization. In Hamilton Point's Global Core and Equity Income strategies we own only 14 of them—while we suspect the giants own shares in most all of them due to the mathematical limitations of investing trillions in the stock market.

The Heat Index, Qualified

This discussion begs the ultimate question of relative investment performance. Proponents of indexing are quick to point out that many active managers do not beat their benchmarks. We agree to some extent, but those studies typically evaluate *large* managers that struggle to beat benchmarks because, as we have discussed, they are closet-indexing and charging high fees—so underperformance tends to be chronic. On the other hand, if one measures the performance of managers that are truly active (as opposed to closet-indexed), they do, on average, tend to outperform indices, at least partly related to the fact they usually have a reasonable amount of assets such that they *can* be active[2,3]. Hamilton Point computes composite performance based on actual client accounts in representative investment strategies and feels that our diversified approach, underpinned by quality, has satisfied our objective to meet or beat relevant benchmarks over longer periods of time while taking lower risk[4].

At Hamilton Point, we manage approximately $325 million with an uncommon emphasis on quality. Within that total, we have roughly $150 million in individually purchased stocks that we select in equity strategies based upon valuation and other merits, not because we must stuff money somewhere. We believe we can effectively manage these strategies on a high quality basis until our assets exceed a few billion dollars, so we have a runway for sufficient flexibility. Incidentally, we are also confident that Hamilton Point clients know what they own and why; how much our approach costs; and that we are making decisions using a reasoned, tested formula with their best interests paramount—half of 200% of the time.

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Hamilton Point Investment Advisors, LLC is an independent and independent-minded wealth advisory firm. Please contact us for a complimentary review of your portfolio. In addition, visitors to the firm's website, www.HamiltonPoint.com, can read past investment newsletters.

1) For a free list of all recommendations made by Hamilton Point during the last year, please contact us.
2) Martijn Cremers, Antti Petajisto, *How Active is Your Fund Manager? New Measure That Predicts Performance*, Review of Financial Studies, 2009, 22(9) 3329-3365
3) Petajisto, Antti. *Active Share and Mutual Fund Performance*, Financial Analysts Journal, 2013, 69(4):73-93.
4) As measured by standard deviation; detailed composite strategy performance available upon request.