SAVANT®

As the World Turns, So Does Everything Else

Close your eyes for a second and take yourself back 10, 20, or 30 years – what did life look like back then? Did you have any idea where life would take you? Did you end up where you thought you would be? For most of us the answer is no, and this is not necessarily a bad thing! Change is one of the only constants in this world and it also applies to financial markets and investments. For example, if you had opened an investment account 20 years ago, your choices for investment would have probably been limited to stocks, bonds, or cash.

As the world has evolved and markets have expanded, so too have the investments that are available to mainstream investors; enter alternative investments.

Alternative investments have been around for decades but historically were only available to the ultra-wealthy in the form of hedge funds and private placements. These investment vehicles often require large investment minimums and restrict investors from accessing their money for an extended period of time, often ten years or more. For many mainstream investors, these restrictions are simply not feasible. Over the past decade financial markets have experienced the rise of liquid alternatives, which are alternative investments in the form of mutual funds or exchange-traded funds under the Investment Company Act of 1940 ('40 Act). The '40 Act structure ensures that these investment vehicles remain transparent, have regular liquidity, and are subject to regulatory oversight by the Securities and Exchange Commission. While this short list does not capture all the benefits posed to mainstream investors under the '40 Act structure, it does capture key characteristics that make it possible to gain exposure to alternatives and further diversify traditional portfolios of stocks and bonds.

So what exactly do we mean when we say "alternative"? Alternative investments are those in which the actual investment is not in stocks, bonds, or cash. Alternatives expose investors to sources of risk outside of traditional stock or bond markets, and long-term returns for alternatives will depend on factors other than those that drive returns in stock and bond markets. Two examples that you may already be familiar with are Real Estate Investment Trusts (REITs)

and commodities. REITs are companies that develop and manage income-producing real estate properties. Commodities such as industrial metals, corn, and oil are raw materials that factor into the production of consumer products. Two additional alternative investments that may not be as familiar are managed futures and reinsurance. The managed futures strategy used by Savant is a diversified "trend-following" strategy based on academic research which asserts that momentum exists and is pervasive across global asset classes. In other words, asset classes that have recently been rising (or falling) in value will continue to do so in the future. Reinsurance represents diversified exposure to global perils such as windstorms, earthquakes, and non-natural events (e.g. marine or aviation accidents). The asset class allows investors to access the premiums that are paid to reinsurance companies for protection against large losses related to those events.

Combining a diversified allocation to alternative investments with a traditional portfolio of stocks and bonds has the potential to reduce risk and enhance returns over time (see Exhibit 1 below).

Exhibit 1

Index Portfolio	Historical Return	Historical Risk	Historical Growth of $10,000
Diversified 70[1]	10.7%	10.4%	$873,228
Diversified 70 with Alternatives[2]	11.1%	10.0%	$1,029,547
Improvement	+0.4%	-0.4%	+$156,318

Source: Morningstar Direct. Historical risk and return are from 1/1/1973 - 12/31/2016. Returns are annualized and risk is represented by annual standard deviation. Returns are gross of advisory and fund fees.

Adding an allocation to alternatives in this Diversified 70 Index Portfolio would have improved return by 0.4% and reduced the volatility by 0.4% over the time period shown. **Looking at the improvement in dollar terms, an original $10,000 investment would have grown to be over $156,000 larger!**

For more background on the world of alternative investments and how they're used in Savant's strategy, please see our most recent whitepaper, "Alternative Investments – Building Better Portfolios One Asset Class at a Time," located at www.savantcapital.com.

RESEARCH TEAM TRAVELS TO THE EAST COAST

Amidst a busy first quarter, two members of Savant's Investment Research Team went on a three-day, intensive alternatives due diligence trip. The first two days were spent in New York City with Stone Ridge. Our third day was spent at AQR Capital Management headquarters in Greenwich, Connecticut.

Our first day with Stone Ridge focused on an asset class not currently in our portfolios – alternative lending. We learned a great deal by hearing from the founders and CEOs of firms that specialize in alternative lending, including SoFi, Square Capital, and Lending Club. This asset class is best implemented when it is hyper-diversified across short-duration, high yield loans to prime borrowers. This strategy provides exposure to consumer credit while minimizing default and interest rate risk. We still must conduct a much deeper examination on this intriguing asset class, but day one certainly jump-started our due diligence process.

Having recently added an allocation to reinsurance, hearing from the CEOs of leading reinsurers as well as the Chief Research Officer from RMS, a leading risk modeling firm, was extremely beneficial to our ongoing diligence. Each CEO discussed how integral third party capital (from investors) is and will continue to be within their business model. Their partnership with Stone Ridge allows them to write additional contracts which help grow their business and allow more people globally to be insured against catastrophes. Additionally, advances in modeling will help insurers and reinsurers write contracts on new, uncorrelated risks such as droughts and aviation interruption which would further diversify our reinsurance allocation.

Our first meeting at AQR concentrated on a review of the managed futures strategy as well as a discussion on current research intended to improve implementation. An AQR principal and portfolio manager led this in-depth dialogue regarding evidence they are focusing on to improve the strategy. Despite struggling in 2016, the long-term thesis remains intact for managed futures as a diversifying alternative in our portfolios.

Stone Ridge, AQR Capital Management, and Savant are very similar in that we all share the philosophy that investment strategies must be based on evidence. There is no doubt we learned a great deal while discussing valuable ideas with these extremely knowledgeable industry minds on this rewarding due diligence trip.

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[1] *The Diversified 70 Index Portfolio with no alternatives is comprised of the following components. Bonds: 9.9% Short-Term, 9.9% Intermediate-Term, 3.0% TIPS, 7.2% International. Stocks: 17.8% U.S. Large Cap, 15.8% U.S. Large Value, 3.7% U.S. Small Cap, 6.4% U.S. Small Value, 4.4% International Large Cap, 5.6% International Large Value, 5.0% International Small Cap, 5.0% International Small Value, 6.3% Emerging Markets. Source: Morningstar Direct.*

[2] *The Diversified 70 Index Portfolio with alternatives is comprised of the following components. Bonds: 7.3% Short-Term, 7.3% Intermediate-Term, 2.2% TIPS, 5.3% International. Stocks: 16.6% U.S. Large Cap, 14.7% U.S. Large Value, 3.5% U.S. Small Cap, 5.9% U.S. Small Value, 4.1% International Large Cap, 5.2% International Large Value, 4.6% International Small Cap, 4.6% International Small Value, 5.9% Emerging Markets. Alternatives: 2.6% Global REITs, 3.5% Commodities, 3.5% Managed Futures, 3.5% Reinsurance. Source: Morningstar Direct.*