



**DISABATO  
ADVISERS**



**THE METROPOLITAN WATER DISTRICT  
of SOUTHERN CALIFORNIA**

# **Evaluation of External Managed Accounts** *Hillswick and Reams Asset Management*

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# Manager Summary



	Hillswick	Reams
<b>Location</b>	Stamford, Connecticut	Columbus, Indiana
<b>Firm / Account Inception</b>	1987 / 2002	1981 / 2002
<b>Ownership Structure</b>	Former Bank Sub Independent since 2004	Sub of UMB Financial Since 2010
<b>Assets – Firm / Account</b>	\$1.3B / \$160M	\$19B / \$170M
<b>Investment Manager, Year at Firm</b>	Anders Ekernas, 1987	Mark Egan, 1990
<b>Style / Strategy</b>	<ul style="list-style-type: none"> <li>• Top-down primary driver for security selection</li> <li>• Duration management primary value add</li> <li>• Significant allocation to government securities</li> <li>• 70% of excess return from duration and 30% from sector</li> <li>• Duration limited to <math>\pm 1.5</math> yrs</li> </ul>	<ul style="list-style-type: none"> <li>• Bottom-up security selection, with top-down sector &amp; duration mgmt</li> <li>• Security/sector primary source of value add</li> <li>• Security selection based on total return analysis</li> <li>• 60% of excess return from sector/security and 40% from duration</li> <li>• Duration limited to <math>\pm 0.5</math> yrs</li> </ul>

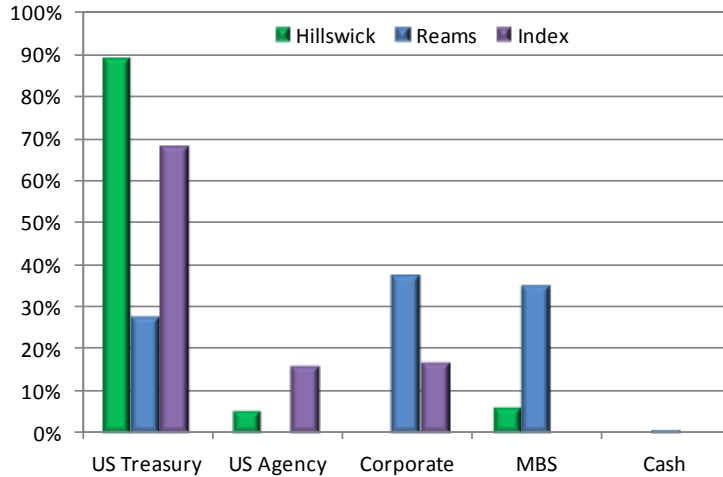
# Account Characteristics

- **High quality intermediate fixed income**
  - ◆ Characteristics consistent with policy
  - ◆ Effective diversification (low correlation) between managers

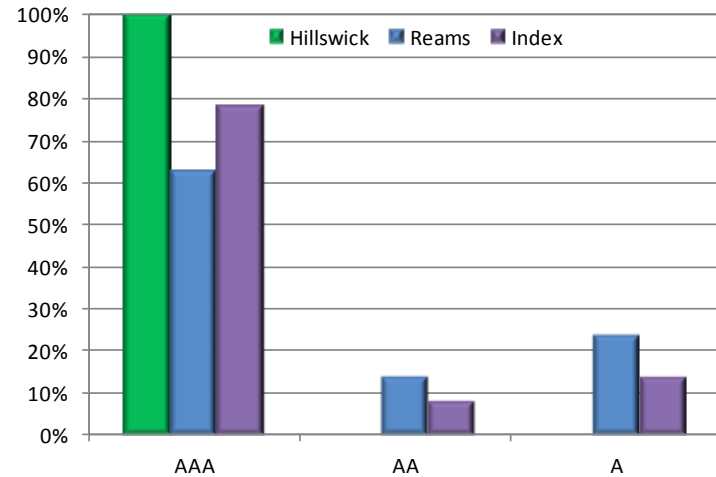
	<b>Maturity (years)</b>	<b>Duration (years)</b>	<b>YTM</b>	<b>Coupon</b>	<b>Securities Held</b>
<b>Hillswick</b>	3.6	3.2	1.0%	2.9%	23
<b>Reams</b>	2.3	2.2	1.1%	1.5%	62
<b>ML Index</b>	2.8	2.7	1.1%	2.2%	2,372

# Account Characteristics

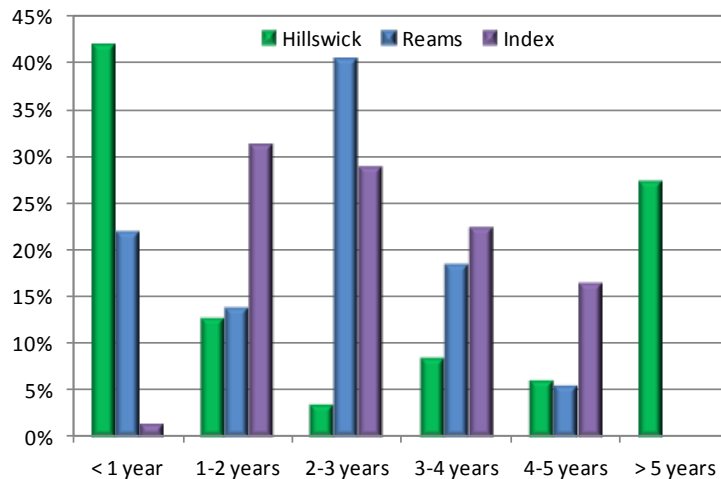
## Sector Allocation



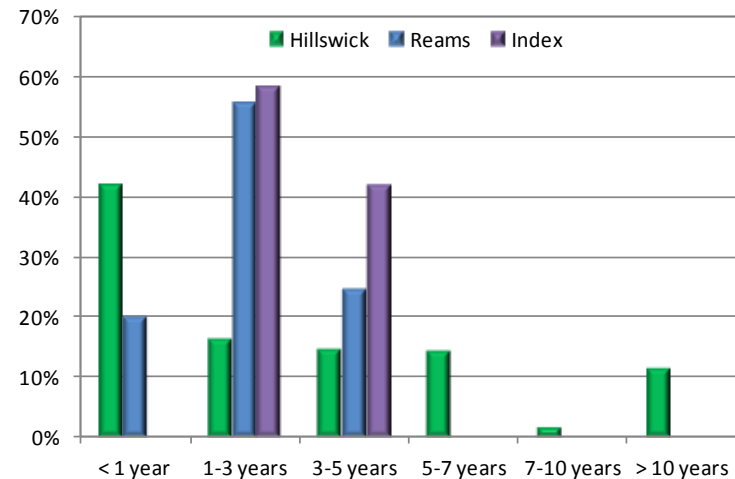
## Quality Allocation



## Duration Distribution



## Maturity Distribution



## Example of Diversification Benefits

	<u>Mgr A</u>	<u>Mgr B</u>	<u>A + B</u>
Year 1	8.6%	3.5%	<b>6.1%</b>
Year 2	1.0%	9.4%	<b>5.2%</b>
Year 3	<u>5.2%</u>	<u>2.9%</u>	<u><b>4.1%</b></u>
Return	4.9%	5.2%	<b>5.1%</b>
Risk (Std Dev)	3.8%	3.6%	<b>1.0%</b>

- ◆ The result, lower risk and higher return: 50% A + 50% B has more return per unit of risk than 100% of either A or B.

# Account Performance

- Hillswick and Reams have outperformed
  - ◆ Both managers have positive “alphas” after fees
  - ◆ Reams has lower variability of returns

	YTD	2013	2012	2011	2010	2009	2008
Hillswick	1.9%	-1.3%	2.0%	5.2%	4.4%	0.9%	8.6%
Reams	1.1%	0.6%	3.4%	2.9%	4.5%	9.4%	3.5%
Hillsw+Reams	1.5%	-0.3%	2.7%	4.1%	4.5%	5.0%	6.0%
ML Index	0.9%	0.1%	2.0%	3.0%	3.9%	3.3%	5.6%

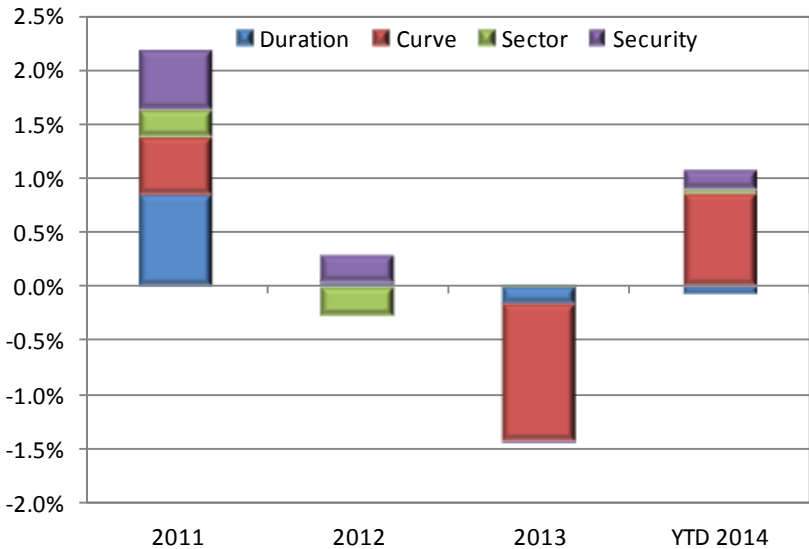
	5-year Return	Std Dev	Alpha	Beta	Up Mkts	Down Mkts
Hillswick	2.4%	1.9%	0.1%	1.12	113%	107%
Reams	2.7%	1.3%	0.9%	0.86	103%	55%
ML Index	2.0%	1.4%	0.0%	1.00	100%	100%

# Performance Attribution

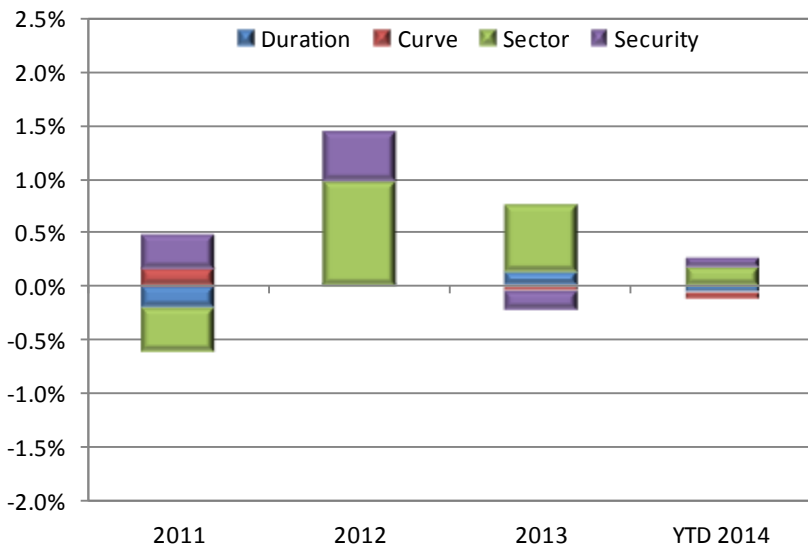
## ■ Excess Return is Determined by:

- 1. Duration management (blue)
- 2. Yield curve management (red)
- 3. Sector allocation (green)
- 4. Security selection (purple)

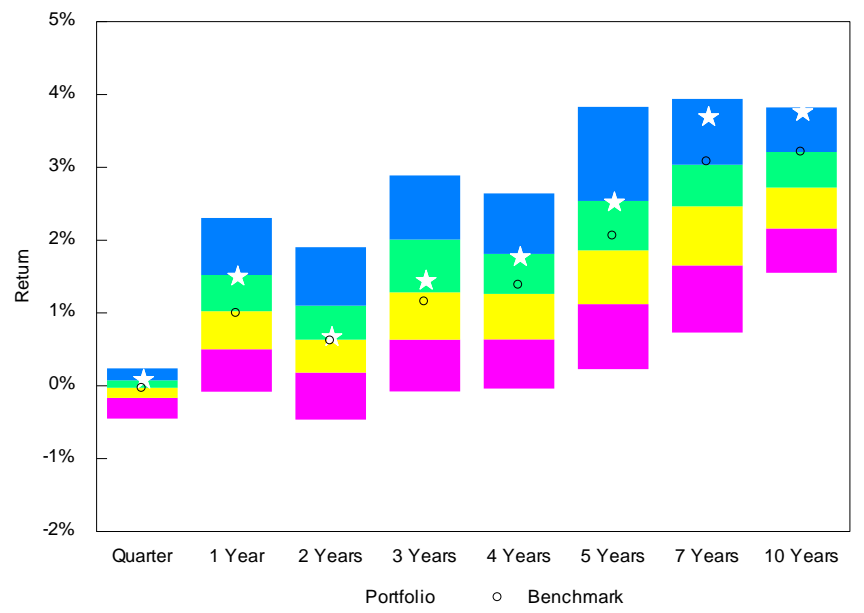
### Hillswick Account



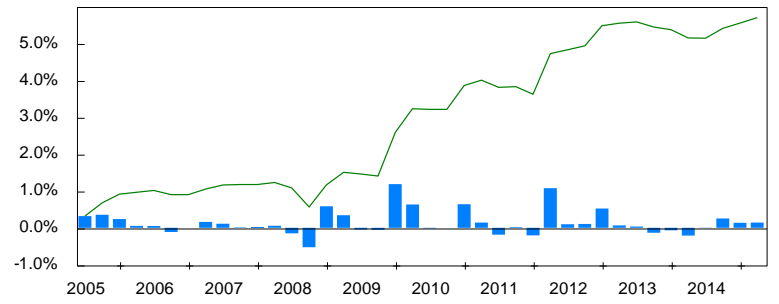
### Reams Account



## External Managers vs. Similar Portfolios



## Quarterly Value-Added vs. Benchmark





# Strengths, Weaknesses, Opportunities, Threats

	Hillswick	Reams
Strengths	<ul style="list-style-type: none"> <li>• Conservative philosophy and effective macroeconomic (top-down) approach</li> <li>• Well suited for portfolios dominated by government bonds</li> </ul>	<ul style="list-style-type: none"> <li>• Well-developed credit and mortgage teams with a strong history of good bond selection</li> <li>• Effective use of top-down duration and sector management</li> </ul>
Weaknesses	<ul style="list-style-type: none"> <li>• Excess returns come with higher volatility, resulting in lower alpha</li> <li>• High barriers to credit risk</li> </ul>	<ul style="list-style-type: none"> <li>• Willingness to take positions that are contrary to market consensus, but impact limited by policy constraints</li> </ul>
Opportunities	<ul style="list-style-type: none"> <li>• Can react quickly and defensively to higher interest rates</li> <li>• Willingness to deviate from the benchmark</li> </ul>	<ul style="list-style-type: none"> <li>• Strong value-added from credit sector</li> <li>• Opportunistic approach to trends in the bond market</li> </ul>
Threats	<ul style="list-style-type: none"> <li>• Top-down decision (right or wrong) will have an impact</li> <li>• More susceptible than Reams to a sharp reversal in interest rates</li> </ul>	<ul style="list-style-type: none"> <li>• Reversal in credit spreads</li> <li>• Strategy bias to higher interest rates</li> </ul>

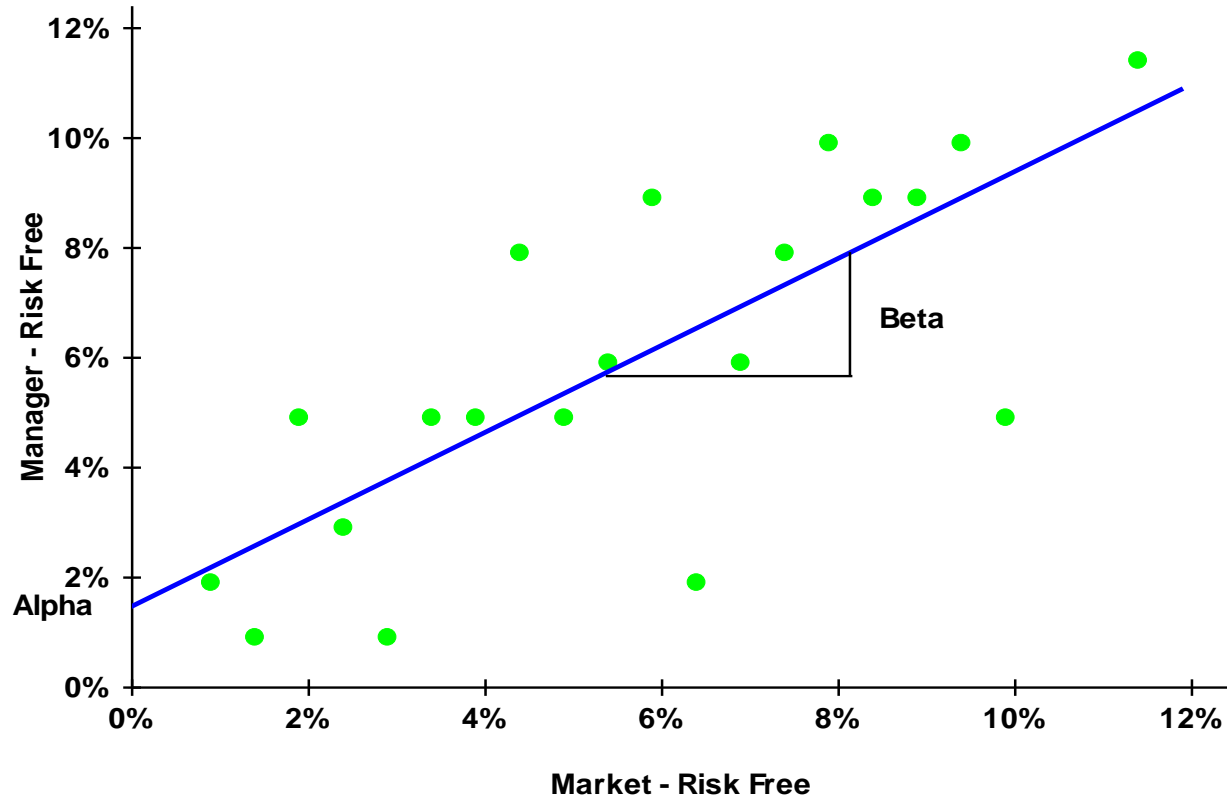
# Questions & Answers



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# Alpha & Beta



## ■ Alpha

- ◆ Alpha is a measure of the value added (or the excess return of a portfolio versus the benchmark - adjusted for risk). It is generally interpreted as a measure of a manager's skill as the result of security selection and asset allocation.

## ■ Beta

- ◆ Beta is a measure of a portfolio's risk vs. the benchmark. A beta of 1.0 indicates that a portfolio has roughly the same volatility as the benchmark. A beta greater than 1.0 indicates that the portfolio is more volatile or sensitive to changes in the market, and a beta less than 1.0 indicates that the portfolio is less volatile.