HEDGEYE CAPITAL ALLOCATION PRO

Getting Structured For Investment Success

Mini-Tutorial #1

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The Gist

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- Big differences in their other elements aside, all effective investment programs (EIPs) embody four elements: (1) explicit recognition of risks that must be incurred to achieve satisfactory returns; (2) actionable constraints on such risks (3) return goals consistent with such constraints and (4) rank ordering of constraints and goals.

    - Rank ordering is crucial—because constraints and goals inevitably conflict.
    - Ineffective investment programs typically embody price-insensitive buys or sells.

- EIPs also embody time time horizons for assessing total fund results materially longer than the average holding period for individual positions.

    - Hedgeye's "Full Cycle Investing" aces the test just referenced, its "Core" components' relatively long holding periods notwithstanding.

- EIPs also embody exclusively investment processes amenable to effective execution by players at hand: asset owners or hired guns who know their circles of competence and stay within them.

    - Like risk, which depends on its beholder, an investment program's soundness depends on (a) the skills, temperaments and incentives of the person(s) executing it and (b) its responsiveness to the evolving wants and needs of its ultimate owner.
    - Mimicking the mindset of world-class investors often pays rich dividends; mimicking or rather attempting to mimic their specific moves seldom does.

How Did We Get From A to B?

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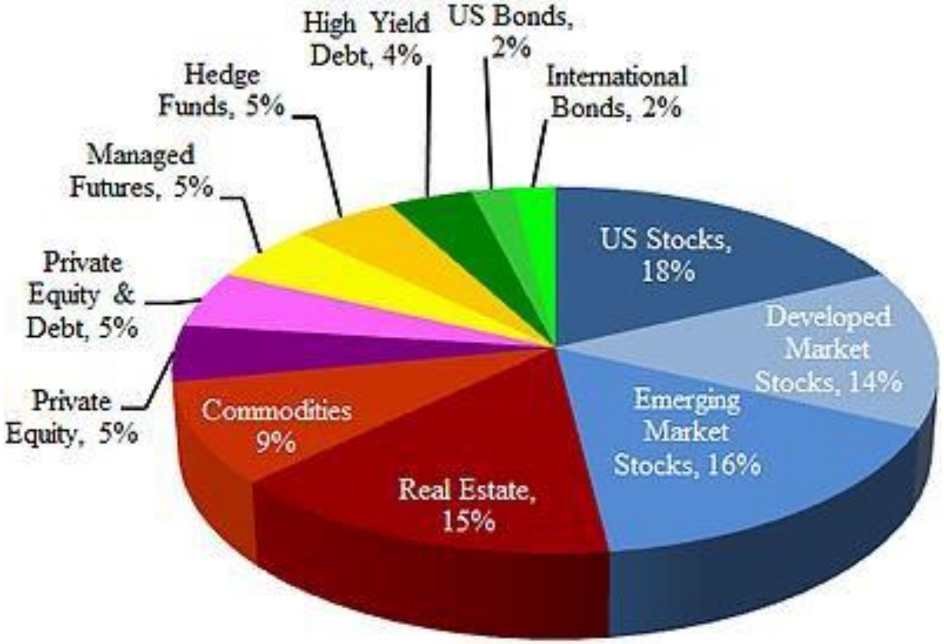
A
Institutional Paradigm
circa 1980

B
Institutional Paradigm
circa 2020



Key Drivers of Asset Class Proliferation

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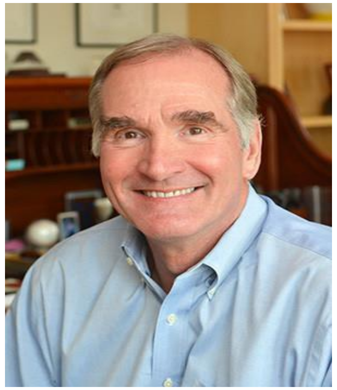
Samuel Putnam

Author of *Harvard College v. Amory* (1830), establishing the "prudent man" (lemming?) rule

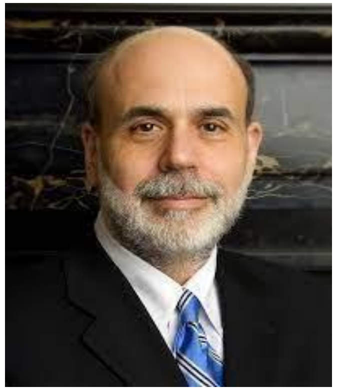


David Swensen

Chief Investment Officer of Yale University 1985-2022

Alan Greenspan

Chair of the Federal Reserve Board 1987 - 2006



Ben Bernanke

Chair of the Federal Reserve Board 2006 - 2014

Janet Yellen

Chair of the Federal Reserve Board 2014 – 2018

U.S. Treasury Secretary 2021 - Present

Discerning and Designing Effective Investment Programs (1 of 2)

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Disqualifying Attributes

- Policy allocations to contractual arrangements or marketing schemes masquerading as asset classes, e.g., “Hedge Funds”.
- Policy frameworks comprising fund segments whose constituent parts embody vastly different return drivers and risks, e.g., “Alternative Investments”.

Unfavorable Attributes

- Non-zero minimum allocations to assets held for total return as distinct from hedging purposes, e.g., venture capital.
- Operating procedures, governance protocols and other verbiage whose inclusion in policy statements renders them unmanageably prolix and whose codification is best done via separate docs.
- Rebalancing protocols driven by calendar intervals rather than price
- Total fund benchmarks comprising uninvestable elements, e.g., mean returns for PE or VC funds.

Discerning and Designing Effective Investment Programs (2 of 2)

Favorable Attributes

- Clear and concise statements of the aim(s) that asset classes or sub-classes seek to advance, with each such segment sorted ideally into one of two categories based on its aim: (1) total return **or** (2) hedging.

Essential Attributes

- Codification of the types of risk that **must** be incurred to achieve the ultimate owner's goals coupled with tolerable maxima for such risks
- Return goals consistent with agreed-upon risk parameters—**rank ordered** to facilitate sound decision-making when such goals' simultaneous pursuit becomes infeasible, with **time horizons** specified for each.

~~Good~~, Bad ~~and~~ ~~Ugly~~

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Current (2023) Investment Guidelines—University of [Redacted] *

	Current Policy Allocation	Long-Term Target Allocation	Allowable Ranges	
			Minimum	Maximum
U.S. Equity	18.5%	13.5%	13.5	23.5
Developed Non US Equity	16.0	8.0	11.0	21.0
Emerging Mkt Equity	6.0	7.0	4.0	8.0
Global Equity	2.0	0.0	1.0	3.0
US Fixed Income	5.75	5.0	2.75	8.75
High Yield Fixed Income	3.0	2.5	2.0	4.0
Emerging Mkt Fixed Income	3.0	2.5	2.0	4.0
TIPS	4.0	2.5	2.0	6.0
Private Equity	9.0	9.0	6.0	12.0
Absolute Return – Diversified	23.5	23.5	18.5	28.5
Cross Asset Class	2.0	5.0	0.0	7.0
Opportunistic Equity	0.0	10.0	0.0	12.0
Real Assets	1.25	3.0	0.25	2.25
Real Estate	6.0	8.5	3.0	9.0
Liquidity	0.0	0.0	0.0	10.0
TOTAL	100%	100%		

* University's identity redacted to avoid embarrassing its trustees and officers.

~~Good~~, ~~Bad and~~ Ugly

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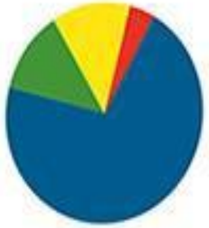
"Model" Portfolios Offered by Prominent Variable Annuity Vendor *

MODEL 1: Conservative



Objective: Preservation of Capital

PIMCO Total Return Portfolio	42%
PIMCO Real Return Portfolio	16%
High Income Bond Portfolio	9%
Invesco V.I. Balanced-Risk Allocation Fund	6%
Legg Mason Dynamic Multi-Strategy VIT Portfolio	6%
PIMCO Global Bond Portfolio (Unhedged)	4%
Goldman Sachs Large Cap Value Fund	3%
Strategic Value Portfolio	3%
Bristol Portfolio	2%
Franklin Flex Cap Growth Securities Fund	2%
Lazard Retirement International Equity Portfolio	2%
Royce Small-Cap Portfolio	2%
Templeton Foreign Securities Fund	2%
PIMCO CommodityRealReturn® Strategy Portfolio	1%

Domestic Equity	13%
International Equity	4%
Fixed Income	71%
Managed Volatility Portfolios (MVPs)	12%

MODEL 2: Moderately Conservative

Objective: Moderate Growth

PIMCO Total Return Portfolio	33%
PIMCO Real Return Portfolio	11%
High Income Bond Portfolio	7%
Invesco V.I. Balanced-Risk Allocation Fund	7%
Lazard Retirement International Equity Portfolio	6%
Legg Mason Dynamic Multi-Strategy VIT Portfolio	6%
Goldman Sachs Large Cap Value Fund	5%
Templeton Foreign Securities Fund	4%
Royce Small-Cap Portfolio	3%
Strategic Value Portfolio	3%
Bristol Growth Portfolio	2%
Bristol Portfolio	2%
Fidelity® VIP Mid Cap Portfolio	2%
Fidelity® VIP Real Estate Portfolio	2%
Franklin Flex Cap Growth Securities Fund	2%
PIMCO CommodityRealReturn® Strategy Portfolio	2%
PIMCO Global Bond Portfolio (Unhedged)	2%
Bryton Growth Portfolio	1%

Domestic Equity	24%
International Equity	10%
Fixed Income	53%
Managed Volatility Portfolios (MVPs)	13%

MODEL 3: Balanced

Objective: Steady Growth in Asset Values

PIMCO Total Return Portfolio	21%
Lazard Retirement International Equity Portfolio	9%
Invesco V.I. Balanced-Risk Allocation Fund	8%
Legg Mason Dynamic Multi-Strategy VIT Portfolio	8%
Goldman Sachs Large Cap Value Fund	7%
PIMCO Real Return Portfolio	7%
Templeton Foreign Securities Fund	7%
Strategic Value Portfolio	5%
Franklin Flex Cap Growth Securities Fund	4%
High Income Bond Portfolio	4%
Bristol Portfolio	3%
Fidelity® VIP Mid Cap Portfolio	3%
Lazard Retirement Emerging Markets Equity Portfolio	3%
Royce Small-Cap Portfolio	3%
Bristol Growth Portfolio	2%
Bryton Growth Portfolio	2%
Fidelity® VIP Real Estate Portfolio	2%
PIMCO CommodityRealReturn® Strategy Portfolio	2%

Domestic Equity	33%
International Equity	19%
Fixed Income	32%
Managed Volatility Portfolios (MVPs)	16%

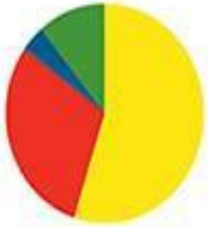
MODEL 4: Moderate Growth

Objective: Moderately High Growth in Asset Values

Lazard Retirement International Equity Portfolio	11%
Goldman Sachs Large Cap Value Fund	10%
PIMCO Total Return Portfolio	10%
Templeton Foreign Securities Fund	10%
Invesco V.I. Balanced-Risk Allocation Fund	7%
Legg Mason Dynamic Multi-Strategy VIT Portfolio	7%
Royce Small-Cap Portfolio	7%
Strategic Value Portfolio	7%
Franklin Flex Cap Growth Securities Fund	6%
Fidelity® VIP Mid Cap Portfolio	4%
Lazard Retirement Emerging Markets Equity Portfolio	4%
Bristol Portfolio	3%
Bryton Growth Portfolio	3%
PIMCO Real Return Portfolio	3%
Bristol Growth Portfolio	2%
Fidelity® VIP Real Estate Portfolio	2%
High Income Bond Portfolio	2%
PIMCO CommodityRealReturn® Strategy Portfolio	2%

Domestic Equity	46%
International Equity	25%
Fixed Income	15%
Managed Volatility Portfolios (MVPs)	14%

MODEL 5: Growth



Objective: High Growth in Asset Values

Lazard Retirement International Equity Portfolio	13%
Templeton Foreign Securities Fund	12%
Goldman Sachs Large Cap Value Fund	11%
Royce Small-Cap Portfolio	10%
Strategic Value Portfolio	9%
Franklin Flex Cap Growth Securities Fund	7%
Invesco V.I. Balanced-Risk Allocation Fund	6%
Lazard Retirement Emerging Markets Equity Portfolio	5%
Legg Mason Dynamic Multi-Strategy VIT Portfolio	5%
Bristol Portfolio	4%
Fidelity® VIP Mid Cap Portfolio	4%
Bryton Growth Portfolio	3%
PIMCO CommodityRealReturn® Strategy Portfolio	3%
Bristol Growth Portfolio	2%
Fidelity® VIP Real Estate Portfolio	2%
High Income Bond Portfolio	2%
PIMCO Real Return Portfolio	2%

Domestic Equity	55%
International Equity	30%
Fixed Income	4%
Managed Volatility Portfolios (MVPs)	11%

* Vendor's identity withheld in hopes of attracting it as a Hedgeye patron. 😜

Good Investment Program

Adapted from *The Aspirational Investor* by Ashvin Chhabra (Harper Collins, 2015).

Aspirational Goals

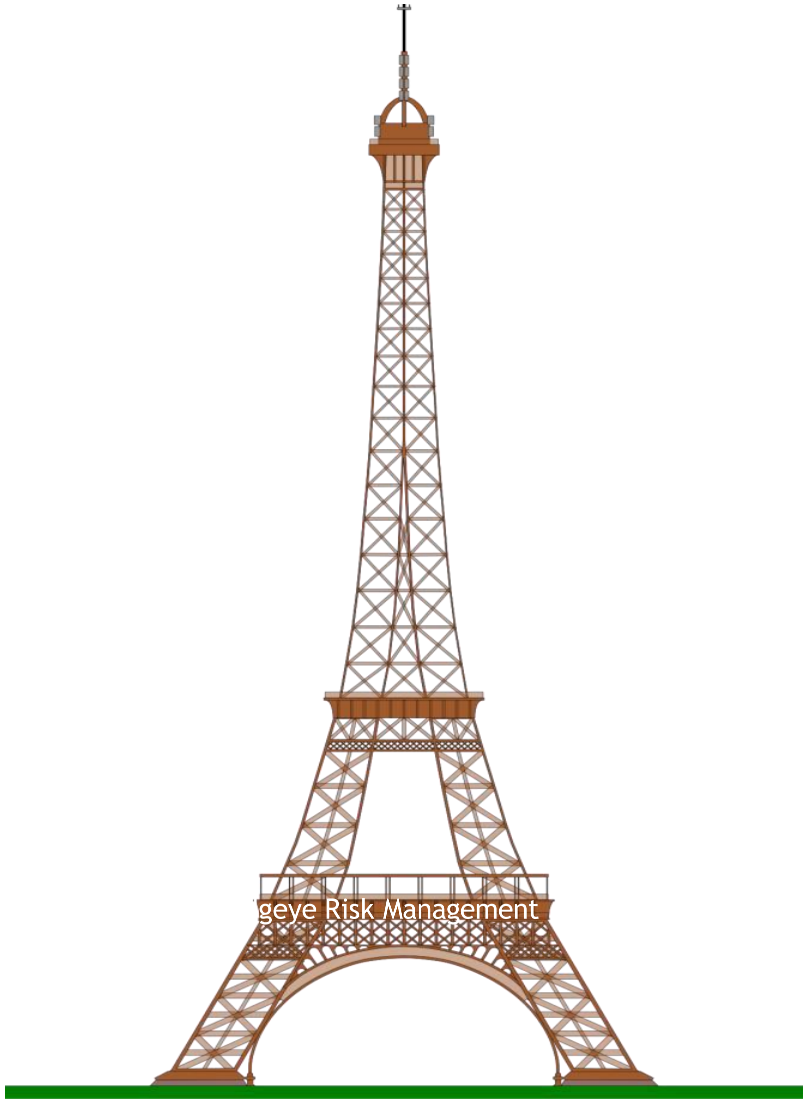
- Concentrated Stocks & Stock Options Investment Real Estate
- Human Capital
- Cash Reserves

Important Goals

- Core Equities (Marketable or Private) Core Investment Real Estate
- Core Fixed Income
- Active Strategies
- Cash Reserves

Essential Goals

- Pension Assets and Receipts
- Life and Disability Insurance Owner-Occupied Real Estate
- Cash Reserves



Good (?) Investment Policy Statement [1]

Risk Parameters. The Portfolio's capital shall be deployed in a manner that seeks to avoid 25% or greater peak-to-trough declines in inflation-adjusted unit values measured in real time based on best available data. While adhering to the primary risk parameter just described, the Portfolio's deployment shall also (a) seek to avoid annualized underperformance of the mean return of $1+ billion endowments as reported by NACUBO exceeding 3% over 5-year rolling periods and (b) satisfy at all times the liquidity constraints specified in the table below.

Readily Reducible to Cash Within:	Minimum Allocation
One business day	5% of net assets
One month (defined as 20 business days)	15% of net assets
12 months (defined as 240 business days)	25% of net assets
36 months (defined as 720 business days)	50% of net assets

Return Objective. The Portfolio's return objective is to maximize annualized returns net of all costs over 5- year rolling periods without violating the foregoing risk parameters.

Performance Evaluation. To facilitate the Board's ongoing evaluation of Portfolio performance, staff shall provide the Board with quarterly reports detailing the evolving returns and drawdowns of a diverse range of mutually agreed upon investible benchmarks. The benchmarks so tracked shall as a group comprise the broadest identifiable universe of readily exploitable opportunities within which conscientious fiduciaries and investment professionals employed and overseen by them are deploying capital. Reported drawdowns for each benchmark shall reflect at a minimum the largest peak-to-trough decline it has undergone since the Board's initial ratification of this Statement. In assessing total fund results, the Board and staff shall focus on measurement periods comprising full market cycles, defined in peak-to-trough-to-peak or trough-to-peak-to-trough terms.

[1] This IPS comprises 272 words—the precise number Abraham Lincoln used in crafting what is arguably the best policy statement ever devised: his famed Gettysburg Address (1863).