SEGALL BRYANT & HAMILL

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SBH NEWSLETTER

Thoughts on the Current Environment

Ralph M. Segall, CFA, CIC
Chairman, Investment Policy Committee; Principal

What's it all about, Alfie?

Is it just for the moment we live?

What's it all about when you sort it out, Alfie?

"Alfie,"

Burt Bacharach and Hal David,
writers and producers, March 1967

During the SBH Partners' meetings in February, our Director of Marketing & Business Development Mark Rewey reminded me that our All Cap equity strategy, which I co-manage, is about to mark its 30th anniversary in April. According to data from one of the most prominent investment databases, less than 1% of actively managed U.S. equity strategies have had the same portfolio manager for the past 30 years.[1] As we were talking about how that 30-year milestone should be marked, Mark asked what I would tell the 1987 version of me (the one with hair on the top of his head and none on the bottom, as opposed to the 2017 version).

I immediately thought of one of my favorite movies, *Frequency*, a 2000 science fiction movie starring Dennis Quaid and Jim Caviezel, in which the two men, father and son, are able to talk to each other over an old ham radio across a 30-year time gap. The father talks from 1969 and his son, now grown, responds from 1999.[2] All of this was the result of "freak atmospheric disturbances." As an aside to the plot, the adult version of the son happens to tell the six-year-old version of his best friend (nicknamed Gordo) never to forget the name "Yahoo," and in a concluding scene, we see Gordo's big Mercedes-Benz bearing the vanity plates YAHOO. I have always hoped that Gordo sold a lot of Yahoo back then.

[1] Source: eVestment Alliance. Reflects a universe of actively managed U.S. long-only equity strategies with at least a 30-year track record and open for new investments as of December 31, 2016

[2] *Frequency.* Dir. Gregory Hoblit. New Line Cinema, 2000

At the time the movie was taking place, Yahoo's stock price peaked around 100. Today, it trades at less than half that price. No, I thought. There is indeed an investment lesson in the movie, but sharing stock ideas would not be what I would tell my younger self. I also briefly thought of the Sports Almanac—which contains 50 years of data on who won various sports championships—that the villain Biff Tannen takes from Marty McFly in *Back to the Future Part II.*[3] Ultimately, I discarded that, too, for similar reasons. Knowing the outcome would have made for a very boring professional life.

Which left me not knowing what I would tell my 1987 self.

Experience Teaches, But the Tuition is High[4]

The markets have always fascinated me. The idea of watching the endlessly unfolding world story spooling out, and applying capital to particular ideas or themes at the right time, is a powerful one. The Roman legend of the god Janus with his two heads—looking both out and in at the same time—resonated for me, too. An investment advisor looks out at the world to make judgments about where and how capital should be deployed and looks inward to his (or her) clients to understand the reasons for which that capital is being used. Learning how to do both tasks is not easy, especially the market-facing part. If an investor doesn't know who they are, the market will freely provide lessons. Unfortunately, it will do so unceasingly and without remorse until the lesson is learned. Really good investors, I have noticed, tend to know what they can do well and, more importantly, what they don't do well. They try hard to do what that which they do well, but they avoid like the plague that which they don't do well. Being a professional investor is a humbling experience, and if one does not have the temperament to be wrong—in a visible way—and put it behind them by the next day, then they are in the wrong field. The old saying says that you win some and you lose some, but what is frequently left out is the back end of the phrase: "....but you always come to play."

Of late, I have become interested more in behavioral finance. I always found the work of Amos Tversky and Daniel Kahneman, the pioneers of the field, difficult for me to access. Through Michael Lewis's *The Undoing Project*—the recent excellent book covering the lives and work of Tversky and Kahneman—I have found a pathway into their work.[5] I am also presently working through Kahneman's 2011 book, *Thinking, Fast and Slow*.[6] Behavioral finance combines elements of psychology and economics to explain why people make irrational decisions. Understanding how and why we all fall prey to various biases, simply by virtue of being human, one can hope to at least monitor what we are vulnerable to as one more tool towards knowing how we are likely to react.

Acquiring this understanding is a long and arduous process (which I hope to achieve one day, by the way.) But it's not something I could impart in one conversation with my younger self.

I'm Your Vehicle, Baby.
I'll Take You Anywhere You Wanna Go.[7]

The concept of referring to investments as "vehicles" has been in vogue for many years. When I hear this term, I have an image in my mind of a bustling city with buses running up and down the avenues and streets. Each bus has a sign telling you the kind of fund it is, also known as its route: Traversing all the streets running east and west (for example) are buses that represent various kinds of fixed income investments. One could board the Investment Grade Corporate Bond bus, the Municipal Bond bus, or for a trip to the seedier part of town, the High Yield bus. On the avenues, running North-South, one would have a choice of Equity buses to ride: the S&P 500 Index bus, the Russell 2000 bus to the hipper parts of town, or the Dow-Jones Industrial bus to the older, establishment sections. One is free to get on and get off the buses at any moment. They run daily, except for holidays, and they will take all comers. Traveling out of town? There are buses to International markets as well. In recent years, a variety of new bus lines have opened. Circling the city in concentric circles are target retirement funds. And a new type of bus service has opened in competition with the traditional buses. The new entrants, called ETFs, provide the same services at much lower fares and have become quite popular.

It may seem paradoxical, but at a certain level of assets, it can be actually cheaper to have your own car and driver who can transport you (and your portfolio) in a more efficient and effective manner—for you—than the public

[3] *Back to the Future Part II.* Dir. Robert Zemeckis. Universal Pictures, 1989

[4] Thought to be a Norwegian folk phrase

[5] Michael Lewis, *The Undoing Project: A Friendship That Changed Our Minds.* New York: W.W. Norton & Company, 2016

[6] Daniel Kahneman, *Thinking, Fast and Slow.* New York: Farrar, Straus and Giroux, 2011

[7] "Vehicle," The Ides of March, Warner Brothers Music, 1970

"vehicles" can. For example, it is much more efficient to "tax trade" individual municipal bonds than to do the same with a municipal bond mutual fund or ETF. Or, if a plan sponsor wants exposure to international equities through our International Small Cap Equities strategy—but wishes to exclude holdings in a particular country (or countries)—Scott Decatur and his team have the ability to customize a separate account to meet those guidelines. Indeed, a concierge service like this, in which we work with clients to help them plan out the best route to get them where they wish to go, may seem like it ought to be more expensive, but in truth, that may not be the case. But this is still not what I can tell a younger Ralph from 30 years ago. Like learning to be an investor, learning how to navigate bad streets and foul weather to help clients get to their destination is a process of experience.

Still no lesson to pass on.

Of Clients and Customers and Marathons and Sprints

I have a bone to pick with the way the "consumers" of our work output are described. I have just about fully lost the battle outside the firm. Inside the firm, most of our staff will use the word I prefer (at least when I am in earshot), probably more because they don't want to hear a harangue from me and just possibly because the message is seeping in. The word I dislike so intensely is "product." We constantly hear references to the range of investment products a firm "sells." Many other examples will quickly come to mind with a moment's thought.

The reason I dislike the use of "product"—versus my preferred word, "strategy"—in this way is simple. If one provides a product, one makes a sale. A sale is made to a customer. It is a transaction, and it is complete unto itself. On the other hand, if one provides a service such as an investment strategy, one is providing that to a client, and the compensation to the service provider is not a commission, it is a fee.

The importance of that breakdown, to me, is that one has an ongoing relationship with (and obligations to) a client that one does not have with a customer, with whom the relationship essentially ends at the point of sale. Now, to be sure, there are products we buy so repetitively that the relationship with the vendor may verge on becoming a permanent relationship. Conversely, some service providers might not be seen for long periods of time (think of the treatment by a medical specialist.) Nonetheless, the point I try to make in calling out this distinction is that we must never forget we are providing an ongoing and continuous service to our clients, one that we and they expect will last a long time over a wide range of market experiences and account circumstances. Of the clients that moved to SBH with us from our old firm, one-third of accounts (by number) remain clients as of the date of this essay, 22½ years later. Deaths, re-organizations, mergers, and liquidations account for the bulk of the decline in number. Through up markets or down markets, these relationships last because they work for both sides.

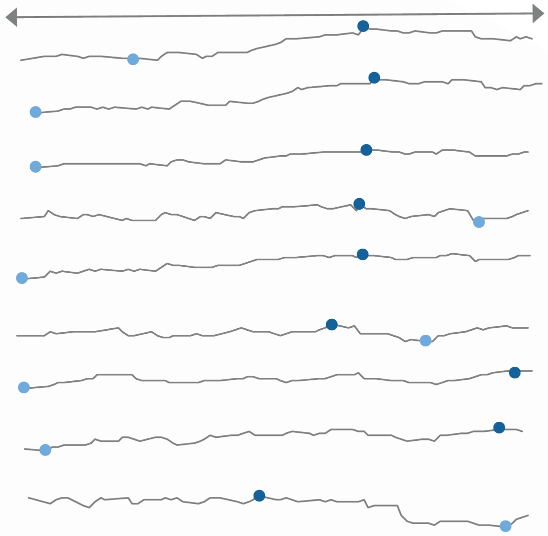
We were 13 strong the day the firm opened. As we have grown, we have invested back into the firm. In our case, "investing" generally means hiring people. At the professional level, we have always looked for people whose bedrock investment principles matched our own and whose passion for investing and whose appreciation of the client relationship was consistent with ours. Today, we are almost 80 in number. The median age of our staff is 42, younger than when we started. Our growth in staff has been more than matched by our growth in client assets we manage. The faith we asked of our original clients to have in us has been augmented by the faith and confidence of clients we have added, for which we are grateful and humbled.

When our original outside partner withdrew in 2014, to be replaced by our current partner, Thoma Bravo, I was frequently asked what my plans were. I told all who asked that I was quite excited. We had invited people in the firm into the partnership over the first 18 years, and they were roughly the age that Al Bryant and I were when we started the firm. As (the late) Jerry Krause said of hiring Phil Jackson in 1989 to coach the Bulls of the Michael Jordan era, "Doug Collins [the coach who was fired] took us from Point A to Point B. We need someone to take us to Point C." I have no doubts this group of younger (well, to me) Partners, led by Phil Hildebrandt, will take us there, and I will be happy to make that journey with them. I hope that you are as happy, too. It is only because of you, our clients, that we are able to do this work that we all so passionately enjoy. For that, we say thank you.

Which finally gives me the answer to what I would tell my younger counterpart in 1987: Continue to keep your clients and the duty you owe them foremost in mind. Associate with and hire people who share those values to join you. And remember to say thank you freely to both clients and colleagues.

MARKET BAROMETERS
AS OF MARCH 31, 2017

	Dec 31, 2016	1Q17	Mar 31, 2017	Low	High
Dow Jones Industrial Index	19,762.60		20,663.22	**19,732.40**	**21,115.55**
S&P 500 Index	2,236.20		2,359.20	**2,236.20**	**2,390.10**
Russell 3000 Stock Index	1,331.72		1,401.50	**1,331.72**	**1,422.33**
Russell 2000 Stock Index	1,357.13		1,385.92	**1,345.60**	**1,413.64**
Russell Midcap Growth Index	782.97		834.61	**782.97**	**840.06**
Barclays Cap Aggregate Index	1,967.23		1,983.30	**1,957.61**	**1,988.13**
Barclays Cap Muni Bond Index	1,139.51		1,157.49	**1,139.51**	**1,157.94**
Gold (Price/Oz) London AM Fix	1,159.10		1,241.70	**1,148.65**	**1,256.90**
Goldman Commodity Index	2,417.31		2,295.19	**2,226.93**	**2,428.42**



Source: Bloomberg

SEGALL BRYANT & HAMILL
540 West Madison Street
Suite 1900
Chicago, IL 60661

Phone (312) 474-1222
Toll Free (800) 836-4265
Fax (312) 474-0521

www.sbhic.com