A NOTE FROM THE CHAIRMAN

Recently a friend of mine asked me a simple, yet penetrating, question that I had, surprisingly, never received in the nearly twenty years of Smithfield's existence: what factors should one consider in the selection of an investment manager? Following is my attempt to answer my friend's question.

Suitability

The maxim of "one size fits all" certainly does not apply to an assessment of a money manager. Some managers, including Smithfield, provide ancillary services which may or may not be important to a prospective customer. These services could include a role as a fiduciary, tax consulting, coordination of legal and insurance matters, plus risk management.

The obvious inference to be drawn from the weighing of the "suitability" factor is that Smithfield itself is not appropriate for every person. For example, if one wishes to be actively involved in the selection of individual stocks and bonds on a continuing basis, I would refer him or her to a low-cost broker.

Chemistry is vital to the assessment of suitability, though chemistry is admittedly a subjective factor. Try to determine whether the culture, philosophy and personalities of the personnel of the members of the investment firm are in harmony with you and your family. Furthermore, learn how your proposed relationship manager is compensated, what his or her experience is and how many customers he or she serves. Do not be shy about asking for references from current customers and ascertain specifically the level of personnel turnover.

Transparency

Every investment manager pays "lip service" to the concept of transparency, but few really provide it.

If an investment firm engages third party managers, is that firm willing to disclose precisely what the external manager is paid? Transparency should also mean that investment firms must be willing to disclose their cost structure to the customer, to delineate what employees in the firms will be working on the customer's account and to state what services those employees will be performing.

Determine with precision how investment performance is measured and make certain that investment performance is not artificially inflated by the firm's jumping from one "hot" external manager to another.

Fees

One of the cardinal sins in our industry is the obfuscation of fees. Fees should be simple and be clearly communicated to the customer.

Mutual funds contribute mightily to this obfuscation. The expense ratio in a mutual fund is often a second fee being paid by the customer. While the expense ratio is disclosed in a prospectus, many investors fail to consider or see it.

All fees and any transaction costs borne by the customer should, as stated above, be disclosed.

Conflicts

All investment managers have conflicts of interest. A manager who tells you that his or her business is devoid of conflicts is lying.

In my view the appropriate way to deal with conflicts is to create a business model which minimizes conflicts to the greatest possible extent. We have done this at Smithfield.

A Rule 12b-1 (named after a section in the Investment Act of 1940) fee is charged by a mutual fund to cover promotion, distribution and marketing expenses. Often a portion of the Rule 12b-1 fee is paid by the mutual fund to a broker or other investment advisor for placing the customer into the fund. Rule 12b-1 fees can create egregious conflicts by incentivizing the advisor to put the customer in the fund paying the greatest portion of the Rule 12b-1 fee to him or her. Smithfield takes no Rule 12b-1 fees. While the current Chairperson of the Securities and Exchange Commission, Mary Schapiro, is proposing to reform the Rule, I'll believe it when I see it.

Ask a prospective investment manager how its business model minimizes conflicts.

Conclusion

I hope that the foregoing gives you some food for thought.

- Bob Kopf