

LAZARD CAPITAL ALLOCATOR SERIES

A Fiduciary Tool

Fiduciary

\fi·du·ci·ar·y \n

A person legally appointed and authorized to hold assets in trust for another person.

The fiduciary manages the assets for the benefit of the other person rather than for his or her own profits.

Safety or high returns?

As a fiduciary you are legally bound to act prudently when investing other people's money. But what does that mean—to act *prudently*?

Does it mean to embrace only minimal risk and thus ensure that capital under management is “safe”? To some fiduciaries, it certainly does—with the pursuit of minimal risk and safe investments leading to adequate performance relative to inflation over time.

Adequate, one might say, fulfills the requirement of being prudent—of being cautious and sensible with other people's money. With this in mind, some fiduciaries will place capital in inflation-linked bonds, thereby accounting for future inflation and maintaining purchasing power. But in the ten years since they were introduced, inflation-linked bonds have not met expectations. Does the safety-first (or perhaps safety-only) fiduciary act prudently?

What of the fiduciary who pursues more robust capital growth through equity investments? Obviously, stocks as a group have a much higher return potential versus fixed-income instruments. But what if a significant market correction coincides with a client's need to withdraw cash? Shouldn't that cash be there?

How about hedge funds? High returns and protection when the market turns down, right? In theory, yes, but hedge funds also can deliver a bumpy ride. Over the last several years, hedge funds as a group have underperformed the overall stock market.

A fiduciary can choose among a broad range of investment options, but which are the right ones?



prudent investing

A broader definition of

At Lazard, we believe that prudent investing is achievable when *all* options are on the table, something we refer to as a holistic portfolio approach. In this way our definition of “prudent” diverges from many out there. For us, prudent investing is the pursuit of the highest possible returns for a stated level of risk. To achieve this, we evaluate the broadest capital-market opportunities available in the context of a client’s lifestyle goals and return objectives. In other words, asset allocation matters—with all available asset classes and investment vehicles, selected with each investor’s specific return objectives in mind, forming the “whole” in our holistic approach. By drawing on a wide range of opportunities within the context of a portfolio, we allow investors to incrementally allocate to the appropriate value-added strategies (alpha *and* beta) based on a sound analysis of the current and future economic environment. Rather than a hot-dog, strategy-of-the-moment approach, we offer a total portfolio solution.

By definition, fiduciaries certainly can embrace low risk above all else, and thereby underwhelm their principals with regularity. On the other hand, fiduciaries should never be hot dogs; it’s not their money they’re playing with. Is there a middle ground? A place where risk is moderated and returns are accentuated? Indeed there is—although there is no reason for this “ground” to be so “middle.” It can also be a

place where above-average investment returns are more often than not the norm.

Some successful examples

Look at the Harvard and Yale endowments. With outsized annual gains, these endowments have been outperforming the market for some time. It’s no wonder they have become benchmarks for investing (and fiduciary) excellence. But how do they do it?

To a good extent, both endowments have delivered enviable performance by leaning heavily toward alternative investments, chiefly private equity. This is the realm of venture capital, leveraged buyouts, angels, secrecy, high risk and high return, with many a hot dog in hot pursuit. But it is important to note why private equity investing makes so much sense for these endowments. The Harvard and Yale endowments, unlike most investment institutions, have extremely deep pockets, unlimited time horizons, and—perhaps most significantly—annual net inflows rather than expenditure draw-downs. They have the resources at their disposal to pick their private equity spots, and plenty of time for these investments to deliver.

Private equity noted, it is however, interesting that the Yale and Harvard endowments have been run by individuals who have embraced *total* portfolio risk management. Yale’s David Swenson and Harvard’s Jack Meyer revolutionized



educational endowment management, above all in terms of alpha-generation strategies. (Meyer was so successful that he and several colleagues were forced to step down due to “excessive” compensation.) But their investment decisions historically have been made in the context of a total portfolio. Gunslingers (or hot dogs) these gentlemen are not. Rather, they are highly disciplined practitioners of capital allocation. In managing their respective portfolios, they have provided high returns at acceptable levels of risk, a balance achieved by evaluating a set of pair-wise portfolio decisions: alpha vs. beta, active vs. passive, stock vs. bond, domestic vs. international, and so on down the line.

Diversification is key to managing risk and returns

Private equity investing, when you have the time, skill and resources, can generate wonderful results. But it seems that even the best private equity investors understand that diversification in terms of a total portfolio approach is critical if risk is to be properly managed and returns are to meet expectations.

At Lazard, we embrace many of the components of the Harvard and Yale endowment processes, most notably the concept of total portfolio risk management. In particular, with the Lazard Capital Allocator Series, we look to match a broad selection of capital-market investment opportunities with the unique objectives of our clients. Rather than a

formula, this is a true process. Beyond risk and return, we incorporate liquidity and transparency into this process, taking those two often overlooked variables into consideration as we evaluate and implement investment opportunities for our clients.

In constructing portfolios for our clients, we utilize a progressive, forward-looking asset allocation and vehicle selection methodology that is not biased toward any one asset class, product or style. *All* options are on the table, even the active incorporation of non-traditional investments which can add significant value to a portfolio. We then place this methodology within our top-down framework. Fundamental to our investment strategy is the idea that markets move in cycles—cycles that are brought on by a range of macroeconomic shocks, from shifts in fiscal and monetary policy to the unforeseen natural or geopolitical event. Ultimately, investment decisions are made by Lazard’s Investment Advisory Board, based on its ongoing, clear, and concise analyses of capital-market expectations.

Opportunities beyond traditional asset classes

Our approach goes well beyond the large and traditional asset classes. More than anything else, we advocate broad diversification as a way to improve investment opportunities. The expansion and increased availability of index-related investment products has enhanced our ability to control core

beta risk and gives us significant liquidity and transparency for portfolio allocations and underlying risks. In accessing non-traditional alpha opportunities, we look at any investments that do not correlate with the capital-market indices and can deliver excess returns. These can include hedge funds and private equity opportunities, but also may include investments in discounted closed-end funds and industry-specific sector funds. Finally, our open-architecture platform allows us to allocate to “best in breed” managers in the traditional and non-traditional spaces, as well to high-quality passive vehicles, such as select exchange-traded funds (ETFs).

A prudent approach for above-average returns

We do believe that fiduciaries can consistently provide above-average returns for their principals. But doing so requires a broad, objective view of the world, close-to-the-capital-market thinking, and the wherewithal to embrace a wide range of investment alternatives, from alpha- and beta-oriented strategies to both traditional and non-traditional vehicles. This is exactly what we offer with the Lazard Capital Allocator Series—a holistic and prudent approach for fiduciaries who have the *best* interests of their principals in mind.

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