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ALL AMERICANS

The 10th annual SMA Managers of the Year differ in size, process and ZIP code, but they're all at the top of their investment game

By James J. Green and Savita Iyer-Ahrestani

This year's SMA Managers of the Year are a diverse lot, with portfolios focused on different sectors and cap sizes and built by investment management teams scattered across the country.

However, they're very similar in their consistency, especially in their outperformance over many years and through various business and market cycles. They hew to their own sustainable and repeatable investment processes. They're also clearly members of a team.

While the lead managers of these strategies are undeniably brilliant, those managers are also cognizant that they don't stand alone, and shouldn't, in forming and monitoring portfolios for the ongoing benefit of advisors' end clients.

For the 10th straight year, *Investment Advisor* has partnered with Envestnet | PMC to research, identify and honor those managers in the separately managed account space who we deem to be outstanding and worthy of advisors' consideration.

What are we looking for? Performance above their peers over time, significant assets devoted to the strategy, well-tenured management, great customer service, tax efficiency and wide availability to advisors (the complete process and criteria can be found at ThinkAdvisor.com).

Tim Clift, chief investment strategist at Envestnet | PMC and a member of the judging committee, said that when considering finalists for these awards, "it generally boils down to trying to evaluate an alpha thesis: What differentiates them from other managers in the universe? What's unique and sustainable? What's their edge over other managers? What can they replicate going forward?" And finally, "Where are the returns coming from?"

Gib Watson, vice chairman of Envestnet and a member of the committee for all 10 years, put it this way: "It's much more than historical performance reviews, and more than just holdings-based analytics on the managers."

According to Watson, the overall SMA marketplace continues to grow. He cited Cerulli research that found as of the end of Q1 2014, "the SMA market went past $900 billion in AUM, in both traditional SMAs and model-based SMAs." While SMAs were traditionally more of a "wirehouse type of product line, now we're seeing a lot of growth in the independent BD space, among RIAs, regional broker-dealers, and bank and trust channels," he said. Why? "Much of it has to do with an SMA's features: The individual investor owns the cost basis of the securities in the portfolio, so advisors can engineer better tax-efficient strategies, more restrictions and can build globally diversified SMA accounts," Watson said.

Clift argued that renewed demand for SMAs "has come from higher tax rates" but also SMAs' customization, since specific equities (or bonds) can be excluded at the owner's request. "We'll see more asset managers come up with more specialized strategies to meet the needs of the markets," Watson said of the future of SMAs, while Clift pointed out that values-based investing is "becoming more and more important; the main way to do that is through an SMA—you can say 'I don't want any tobacco or firearms'" in your account.

That's why next year we'll be adding another category to the SMA Managers of the Year—an "impact" award honoring a particular portfolio that considers environmental, social, corporate governance or faith-based criteria in its investment process, reflecting Envestnet's partnership with Veris Wealth Partners in building an Impact Investing Solutions program.

But this year, we honor those outstanding managers in our traditional categories in the pages that follow, highlighted by the intermediate fixed income strategy offered by Oklahoma City-based Tom Johnson Investment Management, this year's overall SMA Manager of the Year.

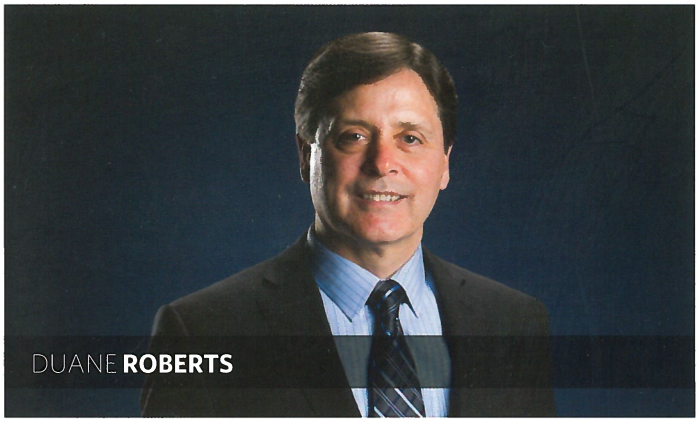
Watson said the intermediate fixed income strategy team at TJIM, led by Richard Parry, CIO, and portfolio manager Doug Haws, "was really impressive in that they were able to preserve capital and generate positive returns" in an otherwise dreary 2013 for fixed income. Clift pointed out that the team at TJIM, which is 100% employee-owned, "proved their worth" last year, with a portfolio featuring "a conservative investment process, very liquid" with a "flexible mandate, being able to adjust to market conditions."

Read on to learn more about this year's SMA Managers of the Year. You can find extended profiles and video interviews on ThinkAdvisor.com.

2014 SMA 10TH ANNUAL MANAGERS of the YEAR

U.S. EQUITY LARGE-CAP

DANA INVESTMENT ADVISORS' LARGE-CAP EQUITY STRATEGY



DUANE ROBERTS PHOTO BY TIM EVANS

The first of two SMA Managers of the Year in this category is Dana Investment Advisors for its Large-Cap Equity portfolio. Duane Roberts, who has managed the strategy since its inception in 1999, said Dana's process "is designed to give us some consistency to outperform in most market environments," and outperform it has, only underperforming the S&P 500 in two calendar years. The story behind those two years tells you why the strategy is so successful. "Our process is designed to be consistent, but there's a weakness to any investment process," Roberts said. "Because of our belief in equal-weighting holdings, which help us avoid volatility risk when performance is heavily concentrated in mega-cap companies" or when the index is being led by lower-quality companies, the Dana portfolio will underperform in comparison. Year in point, 2009, when "you had a lot of low-quality 'rebound' companies that were on the verge of bankruptcy before the recovery started in March, and then you saw 200% to 300% returns," said Roberts.

Another time when the strategy will underperform for good reasons? "When you have speculative growth companies leading the markets," which Roberts said "might not be low-quality per se but at valuation levels we don't like."

So what is the process? "First and foremost, we approach the stock selection process from a value perspective; there's a consistent value tilt to our portfolio," said Roberts. While the Dana team's securities selection process "is consistent with a value manager's approach, growth is an important part of valuation. So we emphasize the growth piece—we want to make sure people don't miss that when they talk about us." On the value side, however, "you'll never see us compete with deep discount managers; we have a relative value approach, without sacrificing growth."

Dana also has learned the lessons of behavioral finance. "On the quant side," Roberts said, value might be "expectational," but when focusing on valuation, you should remember that "some stocks are cheap for a reason." And growth? "There are many behavioral characteristics tied to high-momentum, high-growth stocks," which he said Dana tries to avoid. "We sometimes view momentum as indicating why the market is excited" about a given stock, but that "doesn't make it a long-term" prospect.

Roberts said, "We want to be long-term investors. If you find companies valued correctly you can hold them for a long time, but markets are dynamic and companies are dynamic. We'd love to buy and hold companies forever, but we're not afraid to sell, even if we like them. We want to be in long-term relationships, but we're not married to the stocks" in the large-cap portfolio. **—James J. Green**