

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

Customized Portfolio Investment Strategies



CHRISTOPHER M. WHITE, Vice President and Chief Investment Officer at Fiduciary Trust Company, joined the firm in 2000. He was appointed Chief Investment Officer (CIO) in early 2007. Prior to serving as CIO, Mr. White was the Chair of the Alternative Investment Committee. Prior to joining Fiduciary, Mr. White had worked at several banks and investment firms, managing individual and institutional money. He worked as an equity analyst for several years immediately after graduating from business school. He holds an AB from Washington University in St. Louis, an MS in Geology from the University of Massachusetts at Amherst and an MBA from Columbia Business School. He has earned the Chartered Financial Analyst designation and is a member of the Boston Security Analysts Society and the Boston Economics Club.

TWST: Would you please give us a quick sketch of Fiduciary Trust's history? What makes it so unique?

Mr. White: Fiduciary started as a family office here in Boston in 1885, well over 100 years ago. It has deep roots in serving families in the areas of wealth advisory services, wealth preservation and intergenerational wealth transfer. All of these strengths are the essence of a family office. In 1928, it was incorporated as a Massachusetts bank with trust powers. This gave Fiduciary an important foundation to serve as an investment manager and a corporate trustee, thus appealing to a broader base of clients beyond the founding families. Today we offer a broad array of complementary asset classes for investment purposes through an open architecture base in order to meet client investment objectives.

We are privately owned by our current and former employees, by our Directors and by the founding families. This ownership structure means that we enjoy tremendous consistency in our client service due to high employee retention. Often, families who have been here for many years are known not only by the investment of-

ficer managing the relationship, but also by many other professionals in the firm who have handled estate settlement and tax preparation for the family for a generation or more.

Our size is a very important and distinguishing feature. We are a mid-sized investment management and trust company. We have about \$5 billion under direct management and another \$5 billion under custody. We are large enough to offer a broad array of wealth advisory services on an open architecture base, but we are small enough to know our clients well. While we are based in Boston, our clients live worldwide. In terms of services, we provide investment management, financial and tax planning, estate settlement and trust services to individuals and families. We also have a number of charitable institutions for whom we manage money, but the predominant focus is really on individuals and families.

We do not draft legal documents for clients. Our legal work is consultative. We have a staff of five attorneys who specialize in estate and financial planning. They work closely with clients and their outside advisors to help with planning issues. Our tax special-

ists not only prepare tax returns, but can also serve in the same consultative role in working with our clients and their own outside tax preparers and CPAs. Finally, we are well recognized as a client-oriented provider of custodial service for those clients and outside managers who want superior service and attention to detail.

TWST: You mentioned open architecture as a base for offering wealth advisory services. Would you elaborate?

Mr. White: Fiduciary has a long history of managing portfolios constructed with mid- to large-cap US stocks and laddered bonds. We understand that by themselves such portfolios do not represent an optimal asset mix when looking at the broad array of asset classes available to investors today. Fiduciary has invested significant resources in its processes to be able to bring to clients a wide range of asset classes that complement our own investment work in

in governing how a portfolio's assets are to be invested. Risk, return, liquidity needs and time horizon are all important considerations in determining which asset classes are employed. Fiduciary also believes that wealth preservation and wealth creation are the critical issues for the client. To this end, we are very focused on reducing risk while providing above-average returns in portfolios. While diversification in and of itself may be important, it is the selection of the appropriate asset classes in the optimal weights that is most important to meet the client's goals and objectives. Fiduciary has adopted its open architecture platform in order to achieve the broadest mix of asset classes and subadvisors. This gives us tremendous leeway to offer both Fiduciary-managed investments as well as outside managers, depending upon client preference. These client-centric solutions are what we try to achieve in meeting our clients' needs.

“Fiduciary has invested significant resources in its processes to be able to bring to clients a wide range of asset classes that complement our own investment work in US stocks and bonds. Our goal has been to choose an optimal asset mix to reduce the risk of client portfolios while maintaining above average-returns in good markets and bad.”

US stocks and bonds. Our goal has been to choose an optimal asset mix to reduce the risk of client portfolios while maintaining above-average returns in good markets and bad. Our fee structure ensures that our clients receive objective advice since our interests are congruent with those of our clients. We have opened up our process so we can work to bring to the client top-tier outside managers ranging from timber to international fixed income, all customized to meet the client-identified investment objectives.

The markets over the past 12 months have been difficult, but for us they have been exciting. They have given our work a test. We have been able to show that our approach has outperformed on the upside and, when the going got tough, it outperformed on the downside. We have been able to reduce the portfolio risk and still outperform the S&P 500 over the 1-, 3-, 5-, and 10-year time frames. While we are pleased that we have been able to achieve this, it has been especially gratifying for our clients.

TWST: Would you tell us about Fiduciary Trust Company's investment philosophy?

Mr. White: Our investment philosophy starts with the client. We believe that the client's goals and objectives are first and foremost

TWST: Asset allocation must be an important step in the process. Would you take us through a typical way the firm decides to allocate the assets for its individual clients?

Mr. White: There is much research which states that most of a portfolio's return is due to asset allocation. It is far more important than sector weights or stock selection. At Fiduciary, we take all three activities very seriously, but it is asset allocation that is first and foremost.

The most important part of the strategic asset allocation process is in-depth communication with our clients. Our first step is to understand each client's risk tolerance, cash and liquidity needs, investment time horizon and return expectations. The customized asset allocation strategy resulting from this process helps us to construct a more efficient portfolio that is tailored to the client's stated investment objectives.

Internally, the Investment Committee is responsible for setting asset allocation strategy. When we started our asset allocation work a number of years ago, we used sophisticated simulation tools to review a large volume of historical investment performance data. The purpose was to identify the impact of different asset classes on portfolio efficiency.

Based on this work, we developed three groups of asset allocation for clients: aggressive, moderate and conservative. We set as our objective that a client with an aggressive portfolio was willing to accept the risk of a 100% equity portfolio while a client with a conservative portfolio was willing to experience half the risk of the aggressive portfolio. The moderate investor's risk tolerance was halfway between the aggressive and conservative investor. From these goals, we established three different model portfolios based on historical parameters of risk, return and correlation that would be "all-weather" portfolios. These portfolios would perform well during a variety of macroeconomic conditions and in up and down markets, but were not optimized for any one market environment.

Today, each account's return and risk profile is evaluated and matched against the model portfolios. Accounts are designated as conservative, moderate or aggressive and can be customized to accommodate specific client considerations. Portfolios are periodically rebalanced back toward the strategic allocation with sensitivity to the individual tax situation of the client.

The Investment Committee reviews its capital market assumptions annually. These assumptions include the risk, return and correlation expectations for each asset class for the coming 5-year period. These are the foundation of our work. The Committee meets quarterly to tactically over- or underweight individual asset classes relative to the long-term strategic asset allocation based on a 12-month market outlook and the attractiveness of each asset class.

TWST: Please provide an overview of your investment process once the asset allocation work is completed. Please also discuss the investment criteria employed in the decision-making process.

"Fiduciary focuses on those outside managers with a superior track record who have demonstrated the ability to be creative yet be intelligent in their risk-taking as they create that track record. We look for managers who are complementary to our own investment style and to the objectives of our clients."

Mr. White: Our investment process is overseen by the Investment Committee which I chair. The Investment Committee has as its members the Chairs of Fiduciary's four investment subcommittees: Equity, Fixed Income, Alternative Investments and Institutional plus one additional member. The members are senior investment of-

icers with diverse educational and business backgrounds. The role of the Investment Committee is to set investment policy, establish capital market assumptions and asset allocation targets, and focus on risk control for Fiduciary. Regarding its general investment process, Fiduciary has long used a disciplined, consistently applied and balanced approach combined with a long-term investment perspective, whether it involves allocating client capital to equities, fixed income or alternative investments.

The Equity Committee is responsible for the selection of mid- to large-cap core growth US and US-listed foreign (ADR) stocks for inclusion in our clients' portfolios. This Committee seeks to identify industry-leading companies with a proven track record of generating consistent above-average revenues and earnings growth, maintain strong balance sheets and provide a high and improving return on invested capital. We use quantitative screening to identify promising stocks, focusing on capital allocation, profitability, earnings quality and revisions, cash flow generation, financial strength, and valuation metrics. Qualitative analysis includes an assessment of management, quality of the business plan and competitive advantages. Diversification across economic sectors is used to help control risk.

Our fixed income process focuses on providing clients with appropriate liquidity and a predictable income stream utilizing diversified, laddered portfolios of high-quality fixed income instruments, including inflation-protected securities. On the fixed income side, we do not believe in taking undue credit risk. We utilize four major sectors of the domestic credit markets: US Treasuries, government agencies, investment-grade corporate bonds and high-quality municipal bonds.

Our Alternative Investment Committee is responsible for the evaluation, selection and monitoring of alternative investment strategies and external managers. These would include managers for all domestic equity and fixed income funds, international equities and fixed income, private real estate, real estate investment trusts

(REITs), hedge and absolute return funds, and private equity funds. Fiduciary focuses on those outside managers with a superior track record who have demonstrated the ability to be creative yet be intelligent in their risk-taking as they create that track record. We look for managers who are complementary to our own investment style and to the objectives of our clients.

“We build our hedge fund component around a core of low volatility, non-directional hedge funds, such as the Absolute Strategies Fund and the Hussman Strategic Growth Fund. These are both mutual funds that gives our clients the additional benefit of using SEC-registered funds and daily liquidity. We will add other hedge funds that demonstrate greater volatility and directionality according to the client’s risk appetite.”

TWST: How do you define risk and would you elaborate on the risk management techniques that you use in your process at the portfolio level and at the individual security level?

Mr. White: We look at risk from a variety of perspectives. Technically, risk can be measured as a portfolio’s volatility, traditionally represented by standard deviation which measures the degree of variation of returns around the average return over time. The higher the volatility of returns is, the higher the standard deviation. While mathematically satisfying, standard deviation shows the volatility on the upside and the downside. Our clients really are most concerned about the downside volatility since that represents loss. Thus, we really want to measure the potential for loss or for drawdown.

Our ever-present goal is to provide our clients with a portfolio that strives to truncate downside risk without sacrificing its long-term return potential. Such portfolios are important especially for those clients who depend upon their investment portfolio as a primary source of financial support. Withdrawals from a portfolio that has experienced a significant drawdown can permanently impair the future buying power of a client’s assets. Our proprietary software helps us pursue this goal by calculating both the traditional and these more relevant measures of risk as we construct our clients’ portfolios.

At the portfolio level, asset allocation is really our most important tool. Our three asset allocation schemes for aggressive, moderate and conservative investors are run through proprietary computer models to determine the optimal mix of asset classes given each client’s appetite for taking on risk relative to their return objec-

tives. This process leads to building a well-diversified portfolio across a dozen different asset classes.

Within equities, fixed income and alternative investments, we look to the diversification of holdings as an important risk-mitigation tool. On the domestic equity side, for example, we focus on sector diversification. Internationally, our subadvisors will look for

diversification across countries and sectors. When appropriate, we want our outside managers to actively manage currency risk for the capital they manage.

On the fixed income side, we diversify across issuer type and maturities within a bond portfolio. We rarely hold maturities beyond 10 years. When investing fixed income overseas, we expect our managers to diversify across issuers, issuer type and countries. We expect duration risk and currency risk to be carefully and actively managed.

An important role of alternative investments is to help control the portfolio risk by adding assets with a low correlation to bonds and stocks. For example, both public and private real estate have historically been very helpful in reducing risk and maintaining or improving return in a portfolio over the long term. We see private equity, timber, commodities and hedge funds contributing to a portfolio in the same fashion.

Hedge funds are perhaps the most controversial part of this picture. We build our hedge fund component around a core of low volatility, non-directional hedge funds, such as the **Absolute Strategies Fund** (ASFIX) and the **Hussman Strategic Growth Fund** (HSGFX). These are both mutual funds that give our clients the additional benefit of using SEC-registered funds and daily liquidity. We will add other hedge funds that demonstrate greater volatility and directionality according to the client’s risk appetite.

Throughout the process, we concentrate on the risk/return trade-off when adding asset classes to client portfolios. We know from having served individuals and families for generations that

capital preservation is just as important as growth of capital for clients when they come to Fiduciary. Yes, we can provide good returns, but it is risk control and the resulting capital preservation that is important to them.

TWST: What are your views on the investment climate for fixed income and equities at this time?

Mr. White: We would broaden the discussion to include not only US stocks and bonds, but also alternative investments. The recent turmoil in the equity and bond markets has shown our clients the benefit of having different types of alternative investments in their portfolios. Why is this? Many of the alternative asset classes have been chosen because they demonstrate a low correlation to stocks or to bonds. When considered together, they allow us to provide a more stable platform where downside risk is reduced and the upside potential is preserved. The resulting construction of the portfolio is designed with this purpose in mind.

In the fixed income area, we are concerned about a resurgence of inflation on a secular basis with all of the easing that we see going on with the Fed and fiscal stimulus of the government. We have shortened the duration of actively managed fixed income portfolios.

their own and give us the added advantage of providing us with an inflation hedge going forward. We also use outside managers for exposure to commodity and currency markets to take advantage of the increased volatility we see there. Our hedge funds actively pursue market dislocations and investment opportunities created by mis-priced assets.

In terms of the equity area, we are defensive. Ordinarily, the fourth year of a presidential cycle is bullish, but today our equity markets are burdened by fears of recession, the unwinding of credit market excesses, and the uncertainty of the political scene with all of the potential changes to economic and tax policies next year. We think that even as our economy begins to respond to the current monetary and fiscal stimulus, the recovery will be anemic due to these multiple concerns. Our investment style has always been to focus on high-quality companies and management, so we tend to be fairly defensive in that regard anyway. We are overweight in consumer staples, health care and utilities. We are underweight in consumer discretionary and in financials. We continue to be very concerned about the large regional, superregional and money center banks. We specifically recommend an underweight in those industry segments.

“Amphenol specializes in unique electrical connectors such as those found in airplanes for passenger in-flight entertainment. Since its products are designed for specific applications, they tend to be higher margin and less like a commodity. In addition, connectors for their military applications have long product lives, lasting 7 to 9 years.”

We see that Treasury Inflation-Protected Securities (TIPS) are an attractive way of hedging against inflation, and we use employ inflation-protected securities where we can in the fixed income area. Municipal bonds, as long as they are of high quality, are also attractively priced, especially relative to Treasuries. We are wary of corporate bonds because many corporate credits are still exposed to the credit market problems we are witnessing today. Clients are not getting an adequate reward in terms of yield in the corporate market relative to Treasuries and municipal bonds. We do like the global bond markets, especially those that have a currency tailwind and where the central bank of the sovereign debt issuer has yet to cut rates.

In the alternative space, we use several vehicles to give us exposure to real assets, such as commodities, timber and real estate. These asset classes and funds provide the promise of solid returns on

1-Year Daily Chart of Amphenol



Chart provided by www.BigCharts.com

TWST: Let's turn to individual stocks. Would you tell us about some of the equities that you have in the portfolio that you feel represent your general investment approach?

Mr. White: I have three I would like to mention. One would be **Amphenol** (APH), which is in the technology area. It specializes in unique electrical connectors such as those found in airplanes for passenger in-flight entertainment. Since its products are designed for specific applications, they tend to be higher margin and less like a commodity. In addition, connectors for their military applications have long product lives, lasting 7 to 9 years.

“Teva Pharmaceutical is the Israeli-based generic manufacturer of drugs, the world's largest in fact. No matter what happens to the political scene, the demand for generics will increase, and Teva is well positioned to take advantage of that increased demand. In addition, we see that there are a number of pharmaceutical products that will come off patent in the next several years, which will directly feed into Teva's product line and will be very beneficial to their earnings growth in the next several years.”

1-Year Daily Chart of Teva Pharmaceutical



Chart provided by www.BigCharts.com

The second, in the financial area, is an example of the fact that while we want some exposure in that sector, we don't want to have exposure to the banking industry. So, as an example, we use **Aflac** (AFL), which is a disability insurance company. They have successfully rolled out their disability insurance policies in the US and have enhanced their Japanese franchise with new distribution channels and an increased sales force.

The third is an energy play, **National Oilwell Varco** (NOV). The stock has sold off recently in part due to their announced acquisition of **Grant Prideco** (GRP), which focuses on drill bits and drill stems. **National Oilwell Varco** has a solid earnings outlook due to the growing need for efficient oil and gas exploration and production. **NOV** has a terrific balance sheet and it has a great market share presence in the drill rig industry. **NOV** stands to benefit from the demand/supply imbalance of drill rigs caused by how few rigs were built over the last 20 years. While that imbalance is beginning to be corrected today, **NOV's** 60% market share in supplying equipment to

the drill rigs puts it in a very attractive position, causing its orders and backlog to climb dramatically.

TWST: You are overweight in utilities. Is that partly because of their dividends?

Mr. White: It is really their defensive nature and the dividends help in that regard. An example of such utilities might be **Qwestar** (STR) or **Equitable Resources** (EQT).

TWST: Are they deregulated utilities?

Mr. White: **Qwestar** and **Equitable** are gas utilities. They manage both regulated utilities and deregulated E&P businesses. Their regulated utilities provide steady cash flow to support the dividend, and the deregulated natural gas operations provide attractive growth in the companies' earnings.

TWST: What areas of health care have you been finding attractive in this environment?

Mr. White: **DENTSPLY** (XRAY), which is a pure play on baby boomers, provides supplies and materials to dentists. They have seen terrific growth not only in the US, but also in Europe. **Johnson & Johnson** (JNJ), we think, continues to be attractive and is an extremely well-managed, diversified and well-positioned company.

Teva Pharmaceutical (TEVA) is the Israeli-based generic manufacturer of drugs, the world's largest in fact. We see that no

matter what happens to the political scene in this country next year or at the end of this year, the demand for generics will increase, and **Teva** is well positioned to take advantage of that increased demand. In addition, we see that there are a number of pharmaceutical prod-

We also look very actively at the investment thesis for our holdings to make sure that, in fact, it is still valid, and we look carefully at the quality of management. If we see deterioration or loss of confidence in management, then that will also trigger a sell.

“In terms of the overseas play, there are several companies that are direct beneficiaries of a weak dollar. Many of these opportunities lie in the technology sector and include companies such as Autodesk and Mettler-Toledo. Autodesk earns 60% of its software revenues from outside the US. These revenues are growing at double-digit rates. We are particularly excited about the move from 2D to 3D software for Autodesk.”

ucts that will come off patent in the next several years, which will directly feed into **Teva**'s product line and will be very beneficial to their earnings growth in the next several years.

As a slight tangent to the health care area, we use **CVS Caremark** (CVS). We think it is attractive because of their acquisition of Caremark. Future earnings growth will come from their new on-site medical clinics.

TWST: Have you become more interested in stocks with a lot of overseas operations that are taking advantage of the weaker dollar?

Mr. White: Most certainly. In terms of the overseas play, there are several companies that are direct beneficiaries of a weak dollar. Many of these opportunities lie in the technology sector and include companies such as **Autodesk** (ADSK) and **Mettler-Toledo** (MTD). **Autodesk** earns 60% of its software revenues from outside the US, which is an important part of the investment thesis. These revenues are growing at double-digit rates. We are particularly excited about the move from 2D to 3D software for **Autodesk**. **Mettler-Toledo** generates 62% of its sales from outside of the US, with Europe growing 7% a year and Asia and the rest of the world growing at 20% plus. **Mettler-Toledo**'s margins continue to expand as it moves further into high-end weighing and scale technology.

TWST: What is the sell process? Do you set sell targets for your stocks?

Mr. White: We do look closely at valuation. In that regard, if the prices advance beyond our price targets, then yes, we will advise our officers to start trimming or scaling back on positions. We also have targets in terms of portfolio weights since we do not want to see a position grow too large if it has been successful.

1-Year Daily Chart of Autodesk



Chart provided by www.BigCharts.com

TWST: Are there problems or challenges of a more general nature that you may have regarding the markets as a whole about which investors should be concerned?

Mr. White: Yes, there are most certainly larger issues that concern us with respect to the markets, whether they be the stock market, the bond market, domestic or overseas. These center on the developing and spreading problems in the credit markets. They are with us on a daily basis and they have grown significantly since last summer. Because we have our ear to the ground in so many markets, we are aware of just how extensive the credit market problems are. We hear a great deal that suggests that we will not see a resolution of these credit market problems in the near future and that the negative news is likely to continue for months. One of the main issues is that no one really knows where all of the problems exist or how extensive these problems really are.

A few weeks ago, we saw the problems that **American International Group** (AIG) had reported because their auditors refused to go along with the market values that management claimed their positions to be worth. Subsequently, this required significant asset value write-downs on **AIG's** books when it reported its fourth quarter earnings. We think that is emblematic of the problems that we are going to be seeing this quarter and during the balance of this year as auditors scrub balance sheets and investment portfolios and are unwilling to simply adopt the management's claim of market value.

The problems that we are seeing just recently in terms of the auction-rate securities may represent just the tip of the iceberg. These matters call into question potential problems within the derivatives market, which is vast and broad. This highlights the antiquated regulatory structure of our financial system and begs the question of what needs to be done to better respond to these problems.

We expect that further problems will arise over the next several months. Eventually, the credit markets will sort out these problems and investors will begin to commit additional capital to some of these markets. I would caution, though, that we do not see that happening soon.

TWST: What gives Fiduciary Trust Company its edge? What are the defining features that distinguish your investment approach compared with other firms that use customized portfolio investments?

Mr. White: Let me broaden the question, if I may, because the distinction is really the quality of our investment work and, just as important, the close personal relationships that we find our clients really treasure. We treasure these relationships too. We often see that the client's experience of this quality of relationship deepens over

time and only becomes more meaningful. In fact, a major source of growth for Fiduciary is by word-of-mouth and client referrals from our existing clients. This represents a key testimony as to the value we are able to create for our clients.

With regard to our investment work, many other firms will have a one-size-fits-all approach to their asset allocation. The portfolios we develop for our clients are specifically designed to meet our clients' needs — now and in the future. Because of our experience, we take the time to listen carefully to what our clients want so we can give them solutions that are tailored to their needs.

Sometimes clients find it difficult to verbalize their goals initially. This is where the passage of time can be important. It is only by working with our clients over the years and listening carefully to them that we build a greater understanding of these intangible concerns and are then able to refine and fashion investment solutions that truly meet their needs.

TWST: Thank you.

Note: Opinions and recommendations are as of 3/4/08.

CHRISTOPHER M. WHITE, CFA
Fiduciary Trust Company
175 Federal Street
Boston, MA 02110
(617) 574-3412