INNOVEST'S RESEARCH REPORT

A NEWSLETTER BY INNOVEST

WINTER | 2018

IN THIS ISSUE:

NEW CLIENTS

Innovest was recently selected to provide investment consulting services for:

Colorado Permanente Medical Group Operating Reserves
Pueblo Water
Taylor University Foundation

It is not known whether the listed clients approve or disapprove of the services provided. The new clients on page one and in the Client Spotlight are listed with their approval and permission.

A GOOD 2017. EXCITED FOR 2018!

Richard Todd
Managing Principal, CEO

Thank you to our clients, employees, and friends for another successful year at Innovest! We just completed our 21st year, believe it or not, and we are happy to celebrate another record year. Our revenue was up just under 10% over 2016 which was an Innovest top line best number.

Our promise to team members is they will benefit from our growth in new opportunities for advancement and responsibility. We have several former analyst assistants that are members of our 11-partner group today! We instill a "pull each other up" culture and we emphasize the best way to be promoted at Innovest is to prepare others to take over current responsibilities. We are client driven, work as a team, and are driven to make each other better!

Giving Back

Another key to the Innovest culture is our involvement in the community. We sponsored four company volunteer events at nonprofits including Junior Achievement, Central City Opera House, Brothers Re-development, and GrowHaus. We also supported July and December giving weeks where we donated clothing and participated in infant and school supply drives, as well as worked at Urban Peak, Glorified Recess, and the Denver Rescue Mission. Once again, our employees will receive a day off on their birthdays in 2018 because of everyone's participation in Colorado Gives Day. Analyst Kathy LaLone did an amazing job leading our philanthropy activity!

The highlight of our work with the community is our corporate work study sponsorship of Arrupe Jesuit High School. Each day, we have an Arrupe student work at Innovest and in turn, we pay a substantial portion of their tuition at this amazing prep school. Students attend school four long days and work the fifth. Students are able to enroll at Arrupe by qualifying for the National School Lunch Program. These inner-city Arrupe students are achieving incredible results and we are fortunate to work with four of them each year!

Growth Continues

Investment results in 2017 were strong as nearly all equity markets finished the year at close to all-time highs. We continue to promise our clients that they will benefit from our firm growth. Adding high quality professionals is one of the best ways we add value to clients. In 2017, nine professionals joined our near 50-employee firm.

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They include Kristy LeGrande, CFA, who was a managing director at Cambridge Associates and Katie Sauer, PH.D., who was director of financial wellness, education, and research at the University of Colorado System Administration Office. Employee retention is over 90% at Innovest. We are committed to continually moving our firm to the next generation of professionals and have no intention of "selling out." We believe this is best for clients and employees alike.

Committed to independence and objectivity, we are confident our business model leads to better client advice and solutions. Selling investment products taints investment advice. 100 percent of Innovest revenue is from the fees our clients pay. Firms that accept commissions (many can be completely hidden for the investor) only do so to line their own pockets at the expense of the client. In other words, commissions only drive up the cost to the client. The Innovest fee-only approach is the right way to do business!

We were pleased to add 27 new clients in 2017, including families and family offices, governmental, corporate, and multi-employer retirement plans, and a number of nonprofit organizations' operating reserves, endowment, and foundation assets. Our diversified clientele keeps us challenged and we are confident our consulting and client solutions are better because of it. For example, our portfolio accounting and custom client reporting is cutting edge in the family office world and is accomplished by the demands of the institutional marketplace and the large technology and database investments that we make at Innovest. Thanks to our great clients and friends of our firm for the referrals; they are important to us!

Our research and due diligence team was busy spending more than 60 days on the road conducting onsite meetings with over 100 managers, products, and strategies! Overall, we held more than 300 meetings with managers in 2017. While crunching numbers is part of the process, our process is much more in-depth, focusing on the health of the organization, consistency in process and philosophy, manager consistency, fees, and fiduciary elements. Ultimately, we believe our due diligence process and approach to capital markets and asset allocation will lead to better client investment results.

Measuring Success

The 2017 client survey results were very strong with our overall score being a 4.7 on a 5.0 scale which is equal to the best score we have ever received. Our highest scores were "Knowledge and Experience of Our Consultants" and "Treatment by Our Entire Team" – each at 4.8.

Innovest is a thought leader in the investment and fiduciary world and we have been recognized with many awards. Founding Partner Wendy Dominguez was a Denver Business Journal Outstanding Woman in Business Finalist and we are proud to be named one of the Best Places to Work nationally in the investment industry by Pensions and Investments for the third time in four years. This award is based on a very comprehensive employee survey to help evaluate ourselves and determine how we can improve and become a better place to work. In addition, our professionals wrote or were interviewed in 16 different articles and presented nine speeches at conferences.

Photo (top and bottom): Innovest employees divide into teams for kickball at the annual company picnic.

From the 2016 employee survey, we spent considerable time and attention on the Innovest mentorship program and will introduce new initiatives based on suggestions in the 2017 survey. Mentorship and leadership training are especially crucial for our younger professionals' success. We are also excited about the progress of our college internship program and employed seven interns in 2017. Several young professionals were all former Innovest college interns in past years including T.J. Berge, Joe Lemming, Thomas Martin, Kristin Lee, Whitney Wilkinson, and Harrison Levin.

Excited for 2018

We are excited about 2018 and have identified some additional areas where we can serve our clients! Market valuations are stretched but the economy is on sound footing, and as we continue to grow, we will add to the professional ranks. Despite a very competitive Denver employment marketplace, Innovest is blessed by our reputation and our ability to attract top professionals into our firm. Thanks to our wonderful clients, professionals, and friends for making last year a successful one!

We wish all of you amazing success in 2018! Happy New Year!

THE BENEFITS OF REBALANCING

Chris Meyer
Vice President

Routinely rebalancing a diversified portfolio of investments can play an important role in helping investors achieve their investment objectives. Other aspects of portfolio management are important, too, of course. It's important to construct a portfolio based on an investor's goals and risk and return objectives. It is also important to use forward-looking return assumptions, suitable asset classes and competent investment managers. With these pieces in place, rebalancing can be a relatively easy way to improve results.

Staying on Target

The most obvious benefit of rebalancing is that it helps a portfolio maintain its return and volatility targets. A properly diversified portfolio will include investments with different return and volatility expectations. In addition, their returns in a given period will not normally match one another—one may be up when another is down, and vice versa. Over time, some investments will outperform others. Without rebalancing, this will cause the portfolio to stray gradually from the initial target allocations.

To take a simple example[1], consider a portfolio that was composed of 60% stocks and 40% bonds in January 2007. Ideally, an investor with this portfolio would have selected the investment mix in order to target a particular level of return and corresponding risk for the portfolio. However, if the portfolio were left alone, by October 2007 it would have been 65% stocks and 35% bonds. In other words, the portfolio would likely have higher return expectations and volatility. Moreover, October 2007 would have been the wrong time to have an overly aggressive portfolio, as the S&P 500 declined by approximately 45% over the following eighteen months. By March 2009, the decline would have reduced stocks to just 48% of the total portfolio, with bonds composing 52%—much less aggressive than the initial 60/40 portfolio. Just as October 2007 was the wrong time to be overly aggressive, March 2009 was the wrong time to be overly conservative. By January 1, 2017 the S&P 500 had risen more than 180% from the March 2009 bottom.

Instead of using this buy-and-hold strategy, we believe the better approach is to rebalance periodically—typically quarterly, semi-annually, or annually. If a portfolio with a 60/40 target allocation became 65/35 after stocks advanced, as in October 2007, the investor would sell the 5% over-allocation to stocks and invest the proceeds in bonds. Likewise, in March 2009, an investor would sell a portion of the bond investment to bring stocks back up to the 60% target allocation.

To be clear, this example focuses on the stock market's peaks and troughs in order to emphasize the point of rebalancing. Implementing a routine rebalancing plan would result in more incremental changes, and sometimes an investment will continue to decline after an investor has brought the allocation back up to target.

Buying Low and Selling High

Rebalancing to the 60/40 mix annually over twenty years would have reduced the standard deviation of the portfolio's annual returns from 9.2% to 9.0%. At the same time, the portfolio's average annual return would have increased from 6.6% to 7.0% for the same period. Together, the increased return and decreased volatility would have increased the portfolio's Sharpe Ratio from 0.47 to 0.52.

One of the reasons for the increase in returns is that rebalancing generally means selling investments after their prices have increased relative to other portfolio investments and buying investments that have decreased on a relative basis. A systematic rebalancing program that is essentially automatic can be particularly helpful when investors' emotions are telling them to buy more of what has gone up and less of what has not. Although an investment to which assets have been added may continue to underperform the rest of the portfolio, over the long run, rebalancing means on average buying low and selling high, improving the portfolio's performance.

The 60/40 portfolio example above illustrates this well. By rebalancing to target in October 2007, an investor would sell part of the stock investment that had outperformed and move the money to bonds. In March 2009, after stocks had fallen, an investor would have moved money from bonds to stocks.

Possible Drawbacks: Transaction Costs and Taxes

So what are the drawbacks to rebalancing? The primary concerns are transaction costs and taxes. Transaction costs, especially for smaller portfolios, can erode value. As a result, it probably makes sense to set a rebalancing threshold so that transaction costs are only incurred when rebalancing would be most advantageous. For instance, rebalancing only when an investment is 5% above or below target might be appropriate for smaller portfolios, while a 3% threshold might make sense for larger portfolios. Additionally, for taxable portfolios, rebalancing can also create realized gains, particularly when it involves selling appreciated stocks. Consequently, before rebalancing, an investor should consider the tax consequences of any trades before moving forward.

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Conclusion

To sum up, rebalancing is a relatively easy way to ensure that a portfolio's expected return and volatility characteristics stay on target. Historically, a systematic, routine rebalancing process has resulted in increased returns and reduced volatility. That is due, at least in part, to selling investments after they have outperformed relative to other parts of the portfolio and buying after they have underperformed. However, before implementing a rebalancing strategy, investors should consider the transaction costs and tax consequences. And finally, investors should keep in mind that sometimes what has underperformed will continue to underperform; the benefits of rebalancing are likely to accrue over several years, not necessarily right away.

Notes

This example is based on research conducted by JP Morgan Asset Management.

Stocks are represented by the S&P 500 Index.

Bonds are represented by the Bloomberg Barclays U.S. Aggregate Index.

NONPROFIT SPOTLIGHT

INNOVEST DAYS OF GIVING

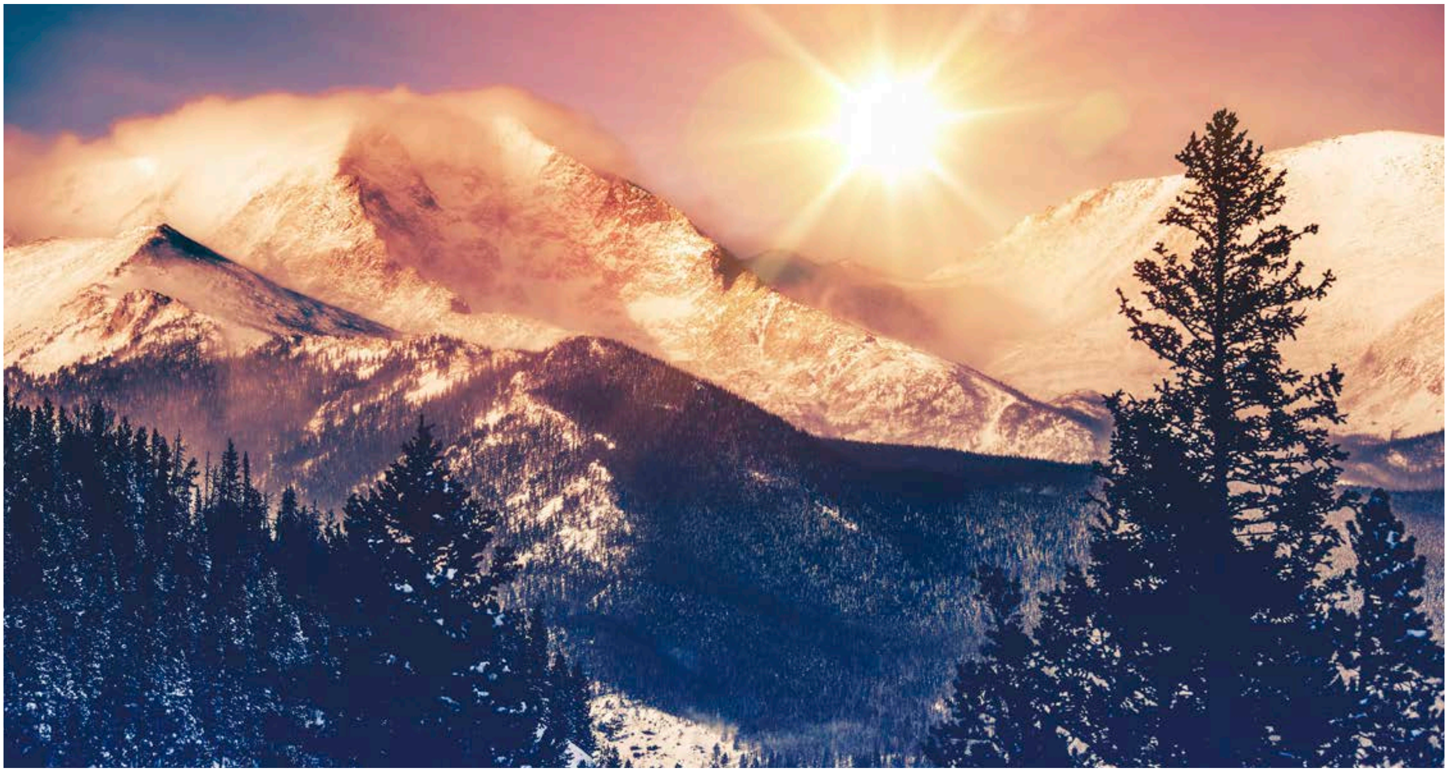
Top Photo: Members of Innovest's Charitable Donation's Committee collect presents for our six adopted families.
Middle Photo: Innovest volunteers pose with Denver Rescue Mission staff after serving lunch.
Bottom Photo: Innovest employees box up the presents to be delivered to the adopted families.

This year Innovest continued our "Winter Week of Giving" tradition. On the first day of giving, Innovest sent to thee: gently used clothing and toil-let-tries. On the second day of giving, Innovest gave to thee: money to the charities we love. On the third day of giving, Innovest gave to thee: decorated Project Angel Heart bags by the tens. On the fourth day of giving, Innovest gave to thee: lunch served and encouraging words. On the fifth day of giving, Innovest gave to thee: gifts for six adopted families we bring.

Photo: Employee-decorated bags for Project Angel Heart.

Organizations Innovest was privileged to serve during this week included the Denver Rescue Mission, Project Angel Heart and Colorado Gives Day. For the fourth year in a row 100 percent of Innovest employees participated in the Colorado Gives Day Corporate Challenge, earning an extra day off for their birthdays. Typical of Innovest, each day employees brought in snacks to incentivize and encourage co-workers to contribute and participate in the designated activities.

We were thrilled to have the opportunity to serve so many deserving organizations in 2017. Not only do these activities provide team-building experiences, but they provide already generous people with new opportunities to give back and find new nonprofits to support and be passionate about. Innovest is proud to be a company full of generous people!



THE NEXT CHAPTER OF RETIREMENT PLAN EXCESSIVE FEE LAWSUITS

Marianne Marvez, RPA
Vice President, Director

It has been more than 11 years since the first retirement plan excessive fee cases were filed by Schlichter Bogard & Denton, against some of the largest corporations in the United States. Prior to 2006, fee cases were usually directed at the financial institutions who provided retirement plan services, not at the plan sponsors. 2006 changed that perspective and put both mutual fund and recordkeeping fees in the spotlight. Most of the complaints filed since 2006 allege a breach of fiduciary duty in violation of ERISA. Several of these claims allege that either excessive fees were charged, imprudent or higher cost investments were offered, or service providers kept undisclosed revenue-sharing dollars as payment for their services. Other claims involved plan sponsors that came under fire for failing to take their plans out to bid on a scheduled basis to ensure that the services received and the fees paid for those services were competitive and in the best interests of participants.

The trend of suing plans for excessive fees has escalated and over the past two years, more than 60 additional excessive fee cases, including 16 involving private university 403(b) plans, have been filed in District Courts across the country. In order to understand the flurry of activity in the courts, let's look at some facts that may be partially responsible for the recent increase in excessive fee lawsuits.

1. **LARGE SETTLEMENTS = LARGE FEES –** Several cases have been settled for tens of millions of dollars, and those large settlements resulted in significant attorney fees. Some examples are Nolte v. Cigna settled for $35 million in October 2015 Spano v. Boeing settled for $57 million in August of 2015 and Abbott v. Lockheed Martin settled for $62 million in July 2015, resulting in approximately $50 million in attorney fees[1]. The lure of big money has brought out local personal injury attorneys seeking new sources of revenue. A highly visible Denver based firm recently launched an advertising campaign encouraging 401(k) participants to call the firm to see if their retirement funds may have been mismanaged and determine if they may be entitled to compensation. It is important to note that most of the previous cases involved very large employers with multi-billion-dollar retirement plans, but recent activity suggests that these claims are moving down market and smaller plans are no longer immune from litigation.

2. **SUPREME COURT DECISION -** Tibble v. Edison International was heard by the Supreme Court of the United States in May of 2015. Tibble is the only excessive fee case to come before the high court.

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The case centered around 17 retail share class mutual funds which were chosen by the trustees and placed in the trust in 2001. Subsequently, the trustees failed to monitor the funds and did not exchange the higher cost funds for lower priced institutional funds when they became available. The Supreme Court unanimously ruled in favor of the plaintiffs and held that the defendants had indeed breached their fiduciary duty under ERISA as addressed under the common law of trusts, which states that the plan fiduciaries not only have an obligation to exercise prudence in the selection of investment options, but have an additional duty to monitor those investment options ongoing, and remove any imprudent investment funds. Finding in favor of the plaintiffs reinforced the importance for plan sponsors of having a prudent process in place for the ongoing monitoring of the plan's investment options.

3

LOWERING FEES POST TIBBLE – Studies indicate that plan sponsors and advisors are understanding of the importance of monitoring fees, utilizing the most cost-efficient share classes available, reducing or eliminating revenue-sharing arrangements, implementing fee equalization and putting prudent monitoring processes in place. In certain cases, making these changes post Tibble has resulted in certain plans coming under additional scrutiny. One major corporation caught in this trap is Starwood Hotels & Resorts Worldwide Inc. Workers allege that the company cut their fees in half post Tibble, but had they done so six years earlier, they may have saved plan participants more than $20 million in fees over that period.

4

PRIVATE UNIVERSITY 403(b) PLANS - Since the summer of 2016, 16 private universities have been sued for excessive fees. Brown, Columbia, Cornell, Duke, Emory, New York University, Johns Hopkins, Massachusetts Institute of Technology, Northwestern, Princeton, University of Chicago, University of Pennsylvania, University of Southern California, Vanderbilt, Washington and Yale. The only 403(b) case to be dismissed to date is the University of Pennsylvania. These cases are somewhat unique as 403(b) plans have a long history dating back to the early 1900s and until 2009 were not highly regulated. These types of plans typically have had multiple recordkeepers and duplicative investment options available from multiple investment providers. There is a growing trend towards consolidation and streamlining of recordkeeping services and investment options, especially for those 403(b) plans that are subject to ERISA.

5

FUTURE TARGETS – Labor Unions may be the next group to be targeted by the tort lawyers. A suit was filed in the District Court of Central California on November 30th involving a 27,178 member, $1 billion dollar, union sponsored multiemployer Supplemental Income 401(k) Plan. The claim is that the Board of Trustees and its individual members breached their duty of loyalty and prudence by offering higher cost retail share class mutual funds when identical lower cost institutional share classes were available and that the plan overpaid the- recordkeeping service providers due to revenue sharing arrangements that led to higher cost retail funds.

The number of lawsuits filed in the last few years plus the addition of other types of plans besides mega corporate 401(k) plans has caused concern for retirement plan fiduciaries. One of the best ways for plan fiduciaries to keep plans out of the headlines is to make sure that plan sponsors and their representatives understand the fees they are paying and how those fees are being paid. The second is to make certain that there is a process in place to monitor the performance, expenses and available share classes of funds in the plan. Plan sponsors who have revenue sharing funds in their plans might consider crediting back any revenue sharing generated to the participants who are invested in those funds, thereby lowering the net expense ratio of those funds. Plan sponsors that charge their recordkeeping fees to the plan, might consider charging a flat per participant fee to any participant with an account balance. In addition, a set percentage based on plan assets could be allocated across all participant account balances. In some cases it might make sense to have both a flat per head fee and an asset based fee. These are just some ideas of how to make the payment of plan expenses more transparent and equitable for all participants.

It is important to remember that neither ERISA nor the Department of Labor requires you to choose the least expensive service provider or fund share class. The least expensive option may not always be the best choice unless cost is the only difference, but acting in the best interests of plan participants is always what really matters. Stay tuned for the next chapter in fee litigation.

1 Source: Bloomberg BNA review of docket files

EMPLOYEE SPOTLIGHT

BECCA ELLIS - MANAGER

Becca is the manager of Marketing, supporting Business Development efforts for Innovest's retirement plan, foundation and endowment and high net worth family practices. Her primary responsibilities are to further Innovest's brand through proposals and presentations, social media, public relations, and events.

WHERE IS YOUR HOMETOWN?

A Colorado native, I was born and raised in Centennial.

TELL US SOMETHING UNIQUE ABOUT YOU.

My husband and I met in the same dorm hallway at Colorado State University (CSU) that my parents did 50 years earlier. Nine of our family members have attended CSU. Go Rams!

WHAT DO YOU LIKE BEST ABOUT WORKING AT INNOVEST?

I can't say enough about the culture at Innovest. There is an emphasis on creating a best place to work through the type of people hired, an emphasis on being stewards, fun morale-building activities, community service opportunities, and including employees' families in the Innovest family.

HOW DO YOU GIVE BACK TO THE COMMUNITY?

I enjoy participating in a number of service projects through my church, at Innovest, or my sister's nonprofit, Awesome Kids Who Care.

WHAT ARE YOUR HOBBIES AND INTERESTS?

My main hobby right now is chasing around my 18-month-old toddler, Miles. He keeps me on my toes, and we love spending time outdoors on walks, at the zoo, or at the park. After his bedtime, you can find me exercising, watching Shark Tank, watching chick flicks, and catching up with friends.

TELL US ABOUT YOUR FAMILY.

My husband, Jason, and I have been married for seven years. We are blessed with a goofy and cuddly son, Miles. We are fortunate to have both sets of grandparents nearby for trips to the mountains, family dinners and holiday celebrations.

AROUND THE FIRM

RECENT EVENTS

Innovest was proud to be named one of the "Best Places to Work in Money Management" by Pensions and Investments for three of the last four years. Employees consistently identified Innovest's stewardship culture as a reason for it being a great place to work.

Vice President Katie Sauer.

Consistently being ranked as a best place to work aided Innovest in attracting Innovest's newest team member, Vice President Katherine Sauer, Ph.D. Katie is working primarily with our university and retirement plan clients, as well as serving as a key contributor on our Capital Markets Team. Prior to joining Innovest, she was the director of financial wellness, education and research at the University of Colorado System Administration Office. Additionally, she previously held faculty positions at Metropolitan State University of Denver and University of Southern Indiana. Katie earned her doctorate in economics from the University of Colorado at Boulder and holds a certificate in change leadership from Cornell University.

Last fall, from August 29 to September 1, 2017, Innovest sponsored and presented at the Colorado Public Plan Coalition Annual Conference in Beaver Creek, CO. Innovest team members Richard Todd, Donna Patch, Jerry Huggins, Gordon Tewell, Scott Middleton, Jared Martin, Marianne Marvez, and Rick Rodgers attended the conference. The conference drew more than 150 participants, including representatives from some of the largest public plans in Colorado.

On December 7, Innovest sponsored the Rocky Mountain Benefit Plans Conference. The conference featured speakers from Innovest, EKS&H, Sherman & Howard, the U.S. Securities and Exchange Commission, TR Solutions and Empower. The conference was attended by more than 100 plan sponsors.

Innovest employees and their families celebrated the holiday season with a gathering at Columbine Country Club. The event included a special visit from Santa, a delicious brunch, and a white elephant gift exchange. Congratulations to Nancy Swanson for winning the Founders Award – representing Innovest's core values of honesty, integrity, hard work, and dedication to the client. Congratulations to Ryan Murphy for winning the 212-Degree Award, in recognition for his commitment to going the extra step for our clients and team. Congratulations also to Kathy LaLone for winning the annual Service to Others Award for focusing on helping the Innovest team and putting others first.

Innovest will host the 18th Annual Rocky Mountain Nonprofit Conference on Wednesday, March 14, 2018. The mission of the conference is to provide an educational forum on topics of interest to enable board members, trustees, and executive staff to improve management of their organizations and their investment portfolios. Registration for the event will open in mid-January. If you have questions, please call Whitney Wilkinson at (303) 694-1900, ext. 331 or wwilkinson@innovestinc.com.

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