THE CONCORD ADVISORY GROUP, LTD.

Dear Concord Friend,

As you know, The Concord Advisory Group, Ltd. was founded on the philosophy that fees matter. Through the years you've most likely heard us say time and again: "high fees are the enemy of good performance." In fact, we feel so strongly about controlling the controllable that efficient execution remains a cornerstone principle and service offering for us today.

We also feel strongly about client education and are pleased to present this Topics of Interest collection, a deep dive into a central portfolio management theme: the impact of fees and resulting active vs. passive management debate. Our conclusion: use your active management budget wisely.

The following selections are timeless and were chosen by our editorial team for their informative value, readability and thought-provoking, yet informal style. We encourage you to don your favorite thinking cap and take a journey into the world of finance…perhaps pausing along the way to ponder the meaning or to consider retracing old paths with newly acquired knowledge.

A changed competitive landscape and "fees matter" are brought to life in "The Loser's Game" via tennis strategy. The concepts are further expanded in "The Arithmetic of 'All-In' Investment Expenses" written by the iconic John C. Bogle, founder of The Vanguard Group, Inc. Next, readers are cautioned not to generalize or accept without question by Scott Vincent; additionally, Mr. Vincent provides a history of modern portfolio management and highlights its flaws. In selection Four, readers are introduced to the "Known, Unknown and Unknowable" and then taken further down the financial path to learn knowing what others deem unknowable is "edge." The final selection, "The Winners' Game," calls attention to "two errors of commission: falsely defining the investment management mission and incorrectly ordering priorities; and one error of omission – the dropping of rigorous counseling."

Our hope is that this Topics of Interest collection provides a timeless vehicle to deepen your investment knowledge and promote conversation with us.

Best regards,

Scott Santin
Partner, Co-Founder

Christopher Cahill
Partner, Co-Founder

ONE

The Loser's Game
Charles D. Ellis

To read the article please Click Here

Mr. Ellis's insightful read was initially published by the Financial Analysts Journal in 1975 and then again in 1995. Drawing examples from tennis, military science and golf (amongst others), readers are introduced to the difference between a Winner's Game and a Loser's Game — and the application to investment management.

In his article, Mr. Ellis asserts the investment management business has undergone a Gin Rummy "phase change" and transformed from a Winner's Game to a Loser's Game. Noted as triggers: a shift in the competitive landscape due to an influx of bright, well-educated and highly-motivated individuals; an increase in expert, institutional competitors relative to amateurs; and an increase in the number of portfolio and market transactions. Additionally, as a result of the phase change, portfolio activity shifted from a profitable activity to a costly one where the efforts of so many to "beat the market" have become the most important part of the problem in doing so.

With its down-to-earth approach, timeless summation and advice, we like "The Loser's Game" for its introduction of a significant concept in portfolio management: trading costs, management fees and high turnover make it challenging for active managers to outperform the market.

Ellis, Charles D. "The Loser's Game." *Financial Analyst Journal* January/February 1995: 95-100. Print.

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TWO

The Arithmetic of "All-In" Investment Expenses
John C. Bogle

To read the article please Click Here

Also thinking about the costs of active portfolio management back in 1975 was John C. Bogle, founder of the Vanguard Group.

Established in late-1974 with a narrow mandate to perform fund administration for Wellington Management Company, the Vanguard Group of today was birthed through some combination of necessity inspiring invention and Mr. Bogle's 1951 Princeton University senior thesis. At the core: the idea that "mutual funds should make no claim to superiority over the market averages." In late-1975, Mr. Bogle brought his concept to life with the debut of the first market index mutual fund: The First Investment Trust (Vanguard 500 Index.)

In the following 2014 article, Mr. Bogle expands upon an essay by another iconic figure in finance, 1990 Nobel-recipient Professor William Sharpe. Furthering the point made by Professor Sharpe in his 2013 article "The Arithmetic of Investment Expenses," Mr. Bogle adds transaction costs, the cost of holding cash (cash drag) and sales loads to Professor Sharpe's calculation. Hence, the title change to include "All-In."

Bottom-line, all things being equal, after costs are taken into account, the average actively-managed portfolio will return less than a passive one. And after taxes, inflation and counter-productive investor behavior (buying high, selling low) are incorporated — the gap becomes even greater, especially over the long run!

Bogle, John C. "The Arithmetic of 'All-In' Investment Expenses." *Financial Analyst Journal* January/February 2014: 13-21. Print.

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THREE

Is Portfolio Theory Harming your Portfolio?
Scott Vincent

To read the article please Click Here

In addition to a very readable historical summary of the financial economic concepts comprising "modern portfolio theory" (MPT) and an upfront acknowledgement that "the data" supports passive (index) investing – Mr. Vincent takes constructive aim.

We are reminded acceptance of the rules that make academic arguments work is required, yet not always practical. And despite the practical adaptations of the MPT body of work to capital markets – a framework for the efficient allocation of capital, the tradeoff between risk and return and the benefits of diversification – *utilizing the same quantitative concepts in active management is flawed*. The result: a large increase in the number of disfigured funds that offer investors quasi-active services at full-service prices and a resulting distortion in "the data" used to measure actively managed funds against passive benchmarks.

Mr. Vincent cites evidence that shows buried within "the data" are funds that outperform market indices, with persistence. These funds tend to be concentrated (contain a lesser number of holdings), smaller (lesser amount of assets under management) and have higher active share (% difference in portfolio holdings from the benchmark.)

And so while diversification can be beneficial, over-diversification is not. And while "variance from the mean" is a convenient input for "risk" in academic models, it has many shortcomings when applied to the fund industry. Although the ability of fund managers to spot inefficiency and see opportunity where others see risk is the value offered investors from active fund management, the trend has been to minimize judgment in favor of quantitative approaches.

Vincent, Scott. "Is Portfolio Theory Harming Your Portfolio?" April 2011: 1-14. Electronic Copy, SSRN.

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FOUR

The Known, the Unknown and the Unknowable
Ralph E. Gomory

Comments on Richard Zeckhauser's Investing in the Unknown and Unknowable
Richard G. Robb

To read the article please Click Here

Published in the June 1995 edition of Scientific American was an essay by Ralph E. Gomory entitled "The Known, the Unknown and the Unknowable." This essay and its catchy title inspired Richard Zeckhauser's "Investing in the Unknown and Unknowable" and follow-on comments by Larry Summers and Richard G. Robb.

Our next selection features the thought-provoking essay written by Mr. Gomory in 1995. And additionally, Professor Robb's comments, which echo those of our previous author — Scott Vincent, in that some managers can outperform passive market indices. Robb, however, adds "...excess returns are available, but unless you have some advantages over other investors in terms of experience, private information, ability or scale, they are not available to you."

Together Zeckhauser and Robb speak to high returns being associated with unknowable and ambiguous situations, unique situations and situations that allow for complementary skill. And while Zeckhauser suggests the uninformed investor invest alongside what Wall Street calls "smart money," Robb and Summers both agree that a side-car strategy of picking managers is most likely no easier than picking good investments.

In conclusion: a link between excess returns and engaging in the unknown and unknowable. And for those who pursue the predictable world of a mechanical process: not only does it seem incorrect to expect to earn excess returns...some advice as well — complexity breeds unpredictability and within the fabric of the artificial world are complex and unpredictable

Gomory, Ralph E. "The Known, the Unknown, and the Unknowable." *SCIENTIFIC AMERICAN* June 1995 Volume 272, Number 6: 120. Print.

Robb, Richard G. "Comments on Richard Zeckhauser's Investing in the *Unknown and Unknowable.*" *Capitalism and Society* Volume 1, Issue 2, Article 8 (2006): 1-11. Print.

FIVE

The Winners' Game
Charles D. Ellis

To read the article please Click Here

Our final selection, "The Winners' Game" by Charles D. Ellis calls attention to three errors made in the profession of investment management. Two errors are those of commission: a false definition of mission and incorrect ordering of priorities; while the third error is one of omission, a lack of rigorous investment counseling.

In 1975, inspired (and dismayed) by a changed competitive landscape, Mr. Ellis wrote "The Loser's Game" — an article that addressed the difficulty in producing returns greater than the market, especially after fees. In today's time, Mr. Ellis finds the competitive landscape even more challenging and thus defines Error 1 as falsely defining the mission of investment management as: "to beat the market."

Mr. Ellis next takes aim at the business of investment management stating that Error 2 arises from an incorrect ordering of priorities with values increasingly dominated by the economics of business.

With sub-titled sections in Error 3 of "We Can Help," "We Should Help," "An Example of Need" and "Helpful Change" the reader is led through the author's view of "the most valuable professional service the industry can provide to almost all investors: effective investment counseling."

We couldn't agree more.

Ellis, Charles D. "The Winners' Game." *Financial Analyst Journal* July/August 2011: 11-17. Print.

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APPENDIX

How Fees and Expenses Affect Your Investment Portfolio
SEC Investor Bulletin

To read the article please Click Here

Proposed Regulation to Require a Guide to Assist Plan Fiduciaries in Reviewing 408(b)(2) Disclosures
US Department of Labor Fact Sheet

To read the article please Click Here