INSIGHT

MANCHESTER
CAPITAL MANAGEMENT, LLC

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INSIDE THIS ISSUE:

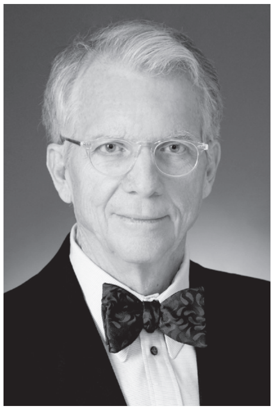
THE COST OF RISK

by Ted Cronin, *Chairman of the Investment Committee*

The last few weeks have reminded investors that the markets can be volatile. The 2% moves in major indices during a single day seem alarming after two years of relative quiet, yet they are also strangely comforting to professional investors. The markets need to consolidate and digest the extraordinary gains achieved over the last several years. Much like a safety valve letting off steam from a boiler, markets periodically need to release the pressure of our animal spirits.

As with any bull market, there will be excesses. This bull market is no different. Our Investment Committee is busy identifying sectors that are overvalued (or fully valued) and reallocating client assets to undervalued segments that may offer better opportunities. We are also looking ahead to higher inflation and higher interest rates and determining which sectors and asset classes to emphasize and which to curtail.

Many financial advisors try to convince customers that there is a mathematical model that they have invented that can be trusted to provide exact guidance on when to buy and when to sell securities. If only it were true. Their claims don't match the truth found in the performance statistics of the



average investor. Academic research repeatedly shows that the average index generates high single-digit returns, around 8%, over reasonable time frames, but the average investor, subject to emotion, manages to make about 2% to 3% returns.

There is always a reason not to invest, or reasons to sell and take some money off the table. I hear the arguments every day, and both understand and respect the emotions behind the decisions. I have recently been reading the history of yearly crises that have dominated the public's attention since just World War II. Year by year there has been a valid reason to be concerned, to not invest, and to—the favorite expression—"raise some cash."

In no particular order, the threats have included overpopulation, widespread species extinction,

MIDTERM ELECTIONS 2014

According to a series of polls released in late October, Republicans would take control of the U.S. Senate if the 2014 midterm elections were held at that time. However, this race is sure to be tightly contested as we head toward General Election Day on November 4, 2014. Republicans need to defend all of their current Senate seats and flip six Democratic seats in order to gain control of the Senate. Look for races in Alaska, Arkansas, Colorado, Iowa, Kansas, Kentucky, Louisiana, and North Carolina to play a significant role in determining the outcome.

Source— International Business Times

peak oil, toxic waste zones, the Cuban missile crisis, polio epidemic, Y2K shutdown of all computers, DDT pesticide, ozone depletion from chlorofluorocarbons, swine flu pandemic, climate change causing devastating weather patterns, excess Internet valuations, mortgage securitization gone crazy, etc. All of these problems are or were real. They all have had an element of truth demanding attention. But each problem also became manageable and had only limited impact on the market's continued advancement. The upward trend of economic growth, continued innovation, improved living standards, and market appreciation remains intact, even if it is often one step back for every two steps forward.

It is important to recognize that the alarms are promoted by vested constituencies, such as media outlets trying to sell dramatic news, nonprofits trying to gather donations, politicians trying to get elected, brokers trying to sell products, and citizen activists trying to address real problems. Humans are biologically programmed to be risk averse, and easily fall prey to overestimating the potential for catastrophe. It's in our genes. A favorite way for brokers to gather business is to enumerate all the ways the world is about to fall apart, prompting less knowledgeable investors to overcome their inertia and follow the broker's advice.

Today, there are a host of frightening threats that deserve attention, endanger our well-being, and are offered as reasons why one should exit the market. An Ebola pandemic is not only possible, but the virus is now within our country and our government seems ill-prepared to address it. The success of the Islamic terrorists in Syria and Iraq seems unsolvable, no matter how many bombs or boots we inject. There is a measurable global economic slowdown evidenced by the potential for European deflation and Chinese debt issues. And reading Eric Schlosser's book *Command and Control* reminds one of the seldom mentioned, but perhaps greatest threat of all—a nuclear accident that could rip our global society apart. We have a right to be afraid, really afraid.

While we shouldn't dismiss our concerns, we should also look to the lessons of history for guidance. History teaches us that risk is the price we pay for returns. If we don't accept the risk of failure, we wouldn't garner the rewards that have been an enduring trend line for every era. Look at any chart that has tracked market performance over more than a decade and the results are evident. At present the fundamentals of the U.S. economy are positive. Though economic growth is slower than we might want, the trend is intact. Even Europe, which presents nothing but bad news, might be the perfect contrarian play offering exceptional value. There is very little evidence for the beginnings of a bear market of extended declines.

At the end of the day, the counterpoint to the multiple threats we face is the enduring effort of humanity to wake in the morning and try to make the world a better place. It is easy to lose faith in the principle when watching the horrors of ISIS or the failure of our government to respond to Ebola, but sitting on the sidelines and hiding isn't an alternative that has ever proven worthwhile for investors.

The recent market declines can be measured by standard deviation, and we can label the result a measure of market risk. We can portray the calculation as providing meaningful insight. Real risk, however, is not volatility, but the possibility of not getting what we need. If you have all that you want, there is no need to invest. If you want to grow your portfolio and net worth, you need to have your money at work in the markets participating in the upward trend. Recognize that the markets are often driven by emotion over the short term, but fundamentals over the long term. Today, the fundamentals are positive; the current mood is what's negative.

According to the World Bank, extreme poverty fell 15% in 2011 from 36% in 1990.

Source— Wall Street Journal

World wide debt as a percentage of GDP has jumped 38% since 2008, and is a factor in global growth slowdown.

Source— Wall Street Journal

THE ROLE OF DEVIL'S ADVOCATE AT MCM

by Brian Vogel, *Wealth Manager*

It is a widely held belief that "two heads are better than one," for almost all situations. There are, in fact, myriad terms related to the benefits achieved from the "many heads" approach, including *collective wisdom* and *diverse experience.* At their core, these boil down to the concept of achieving synergy, which Merriam-Webster defines as "the increased effectiveness that results when two or more people or businesses work together." But there is a potential downfall to the many heads approach—groupthink, which the Oxford English Dictionary defines as "a type of thinking engaged in by a group of people deliberating an issue, typically characterized by the making of injudicious decisions through individuals' unwillingness to challenge group consensus."

In the Manchester Capital Management Investment Committee, we seek to pool the wisdom of many heads—13 individuals with a wide range of backgrounds, experiences, areas of interest, and expertise, including Chartered Financial Analysts, Certified Financial Planners, and a Doctor of Jurisprudence. It is our belief that ideas that are tested by the fire of these individuals and arrived at by consensus will be superior to the narrower decisions of any particular individual. However, in order to make the process work, we need to ensure we are reaping the benefits of synergy without the pitfalls of groupthink.

Frequently in group decision-making situations, there are unspoken pressures that prevent individuals from voicing contrarian opinions. These can involve a perception that your opinion is a minority opinion; that the individual being challenged may take personal offense; that you might create a perception of yourself as difficult, a troublemaker, stubborn, and intractable. Often, there is less personal risk in remaining silent than in voicing an objection—with consensus, everyone will share the glory, or the blame.

One "solution" to the challenge of groupthink is to have a leader, or guru, whose ideas are challenged by the other members of the group—the Bill Gross/PIMCO model. However, this introduces not only "key man" risk, but also the dynamic in which frequently no one wants to make the guru look bad, so efforts at challenging the leader are halfhearted and intended to fail.

Our solution to these shortcomings has been to have the investment committee chairman act not as a guru, but as a referee who speaks last, and to assign an individual the role of devil's advocate. The devil's advocate has the responsibility to research the issue and argue the opposite position. By assigning an individual to the role, we remove the concerns that the particular individual is being obstructionist; instead, we can focus on the substance of his or her arguments. Further, knowing a proposal or suggestion will be formally challenged causes individuals to strengthen their arguments, even to attempt to rebut counterpoints. Well-thought-out and well-presented devil's advocate arguments also allow others more freedom to dissent. The end result is that the presence of a devil's advocate strengthens the entire process.

This was recently borne out, quite effectively, at our annual investment retreat. Pairs of committee members were assigned an asset class—large-cap equities, developed international equities, emerging market equities, hedge funds, real estate, etc. It was their job to report about the current outlook for the asset class and whether they recommended maintaining positions, adding to them, or reducing them. Contra each pair was an assigned devil's advocate who countered their recommendation with his or her own arguments. Boisterous debate ensued, and on more than one occasion, the devil's advocate position managed to garner the consensus opinion, something that would not have happened without formal, assigned opposition.

Assuming the role of devil's advocate has become ingrained in MCM culture. Frequently, during more informal meetings, someone will say, "Let me play devil's advocate," and will proceed to challenge the prevailing opinion. Because it is ingrained in our culture, there is no stigma to the ideological brawl that ensues. In the aftermath, the ideas that survive are battle-tested, and the process produces the best results for our clients—always our ultimate goal.

U.S. GAS PRICES

At the time of writing, the national average price of regular unleaded gasoline has fallen to $3.04 per gallon. This represents the lowest price since December 2010. Gasoline prices fell 1.0% in September, after falling 4.1% in August. This is due, in large part, to the fall in the price of crude oil, which makes up 66% of the cost of a gallon of regular gasoline. Over the last three months, Brent Crude has fallen more than 22% and threatened to cross below $80 per barrel for the first time since 2010. U.S. consumers stand to benefit from the reduction in gasoline and heating bills as they head into the holiday season.

Source— Wall Street Journal

ALIGNING INVESTMENTS TO FAMILY VALUES

by Daniel Goldstein,
Senior Managing Director

At Manchester Capital, we support clients who consciously decide to align their investment portfolios with their values. We understand the factors some clients want to consider beyond rate of return, risk, revenues and P/E ratio, and we stand ready to guide our clients through this often confusing and growing world of opportunity in sustainable and impact investments.

Manchester Capital has been actively involved in impact investing activities for more than a decade. We have researched and analyzed over 100 investment opportunities, which has led us to include about a dozen sustainable investment options on our platform and help individual clients invest in over 20 one-off impact investments tailored to their specific interests. These include investments in U.S. large-, mid-, and small-cap equities; fixed income; mutual funds and ETFs; limited partnerships; community banks and loan funds; and a wide variety of investments in renewable energies, supporting economic enterprise in indigenous communities, organic agriculture, and much more.

Manchester Capital's commitment to sustainable investment strategies also extends into real estate innovations. Two client properties managed by Manchester Capital have achieved Leadership in Energy and Environmental Design (LEED) certification. We have also worked with clients to design sustainable timber harvesting plans and land management programs and obtain conservation easements.

Manchester Capital also supports several family foundations in looking at sustainable social business plans that might return only the capital invested. We assist the foundations in making connections with organizations that can more efficiently structure their grant-making process.

To support our continued commitment to these investments, we have a standing subcommittee of the Investment Committee, which consists of a number of wealth managers and investment associates who thoroughly research, evaluate, and recommend sustainable and impact investments. And, we offer our networks and resources where we can assist in non-investment philanthropic initiatives. We look forward to giving further updates in upcoming newsletters and on the Manchester Capital website. You may also contact us to learn more.

TECHNOLOGY INNOVATIONS AT MANCHESTER CAPITAL

by James Bishop,
Director of Information Technology

With 2015 now just around the corner, those of us at Manchester Capital have many technology innovations we would like to share with clients, friends and families of the firm.

The first is the renovation of our website, www.mcmllc.com. In September 2014, we launched our new website, which has a friendlier and more modern user interface along with improved ease of access in navigation. When you first enter www.mcmllc.com, you are immediately greeted with some short, but very informative, videos on Manchester Capital. These videos give a great understanding of what services MCM offers and what the firm does. The top four videos we selected at our home page are the "Company Overview," our "Real Estate Services" (available to all), "Cultures and Values" of the firm, and lastly, our "Investment Process," which offers a quick peek at how we put your wealth to work. Each video is no more than three minutes long and is well worth a visit to www.mcmllc.com.

Another exciting development at Manchester Capital was that we joined the world of Facebook, LinkedIn, and YouTube in the summer of 2014. These social media sites will never show any client-related dealings (your privacy is always held to the highest standards!) but are used as a method of broadcasting highlights and the goings-on with the firm. We have four offices now that are growing rapidly, so what better way to share the excitement and highlights with all those who subscribe to these social media sites! An example of how this works is with our Facebook account. You will be able to log in to your Facebook account and "like" our page, which gives you an immediate connection as we post articles and announcements such as news and media press releases. Facebook also shows our timeline. Go ahead! Browse the Manchester Capital timeline to see our growth since we were founded and opened our doors on January 1, 1993. So point your browsers to any one of the social media sites listed above and easily locate us by searching for "Manchester Capital Management."

It is all about redundancy! With our offices spread nicely across the United States, what better way to protect our clients' data and conduct our daily business uninterrupted should a disaster strike. Each of the Manchester Capital offices has been recently fitted with a fiber-optic, high-speed private connection that will link all the offices and allow us to operate more efficiently and with greater speed. We're about to go live on this new circuit within the next few weeks, and once it's up, we will be continuously replicating each office's real-time data securely and safely. This will also serve as a productivity enhancer, as Manchester Capital will have faster connections at each employee's terminal.

Stay tuned; more technology innovations will be announced in future newsletter editions!

INSIDE MCM

Some recent firm highlights:

- Manchester Capital's Montecito office recently hosted a presentation given by AIG Insurance titled "Preserving Liquid Assets," regarding the collection and proper storage of high-end wines. Clients and neighbors joined us for the interesting talk as well as a tasting of delicious French and California wines.

- Caglar Somek, a partner from Caravel Management LLC, recently made a presentation to several clients and friends of the firm titled "Argentina to Zambia—A Journey Through the Frontier Markets," in our New York City office.

- Congratulations to Ben Cullop and his wife, Ashley, who recently welcomed their first child, a beautiful baby girl named Elizabeth.

- Greg Dienna is teaching a course this semester at Rutgers University on the topic of ethics.

- Amy MacLeod was recently recognized as a business and community leader by being named to the *Pacific Coast Business Times* class of 2014 "40 Under 40."

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