Exencial
Wealth Advisors

Defensive Equity Strategy Methodology

This strategy seeks to achieve an average dividend yield approximately 1.5x the current yield of the S&P 500. The portfolio is comprised of common and preferred stocks, ADRs, MLPs, and REITs that trade on US exchanges. The portfolio consists of high quality companies that have sustained track records of positive dividend growth. We have a strong focus on company cash flow generation as an important driver of future dividend growth. We also leverage our time-tested, three-stage research process as outlined below. This strategy typically includes 25 – 35 holdings.

Research Methodology and Process
Our overall research methodology is built upon a time-tested, three-stage process. This process is top-down driven and has a strong emphasis on identifying quality, based on peer-to-peer analysis in each industry and sector. Importantly, we leverage this research process across all of our equity portfolio strategies.

Stage 1: Qualitative analysis:
We define quality as the sustainable competitive advantage a company enjoys over its competition. We have developed a checklist to assess competitive advantage including the following variables: product, price, service, management, cost position, market position, financial strength, strategic planning, technology, and execution. This is a dynamic process whereby different variables are given greater weight in some industries while given lesser weight in others. The key is to determine the critical driving forces in each industry to accurately assess the relative competitive advantages that each company may possess.

Stage 2: Top-Down Analysis:
In this stage we identify long-term market drivers, or secular trends, which determine the sectors of the market likely to outperform and those likely to underperform the overall market. Based on this analysis, we will position portfolios to hold a larger or smaller position in relation to the sector weights in the S&P 500. Actual sector weightings may vary across our different equity strategies reflecting the unique characteristics of each.

Stage 3: Quantitative Analysis:
In the third stage we utilize industry-specific valuation methodologies to determine the upside and downside potential for stocks that pass our qualitative screens. Typically, this involves approximately 200 companies. Valuation parameters include: Price/Earnings (PE), Price/Cash Flow (PCF), Price to Growth (PEG), and Price/Book Value (PBV).

Portfolio Review and Sell Discipline:
Our investment team is continually reexamining the holdings, in all of our equity portfolio strategies, in the context of our three-step investment process. We continually challenge our qualitative assessment as the competitive landscape changes in response to the economy or other market forces. Likewise, we continually retest our overall, top-down strategy through the various stages of the economic cycle. Lastly, through our quantitative valuation models, we monitor the relative upside and downside of each individual stock in the portfolio.

Our sell discipline flows from our three-step process as follows: First, if a company loses its quality – no longer has a sustainable competitive advantage vs. its competition - it would be a candidate for sale. Second, a change in the top-down strategy may lead to increasing exposure in one sector and reducing exposure in another sector. Third, if a stock becomes over-valued based on our valuation analysis it may be a candidate for sale.

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