ALPHA MATTERS

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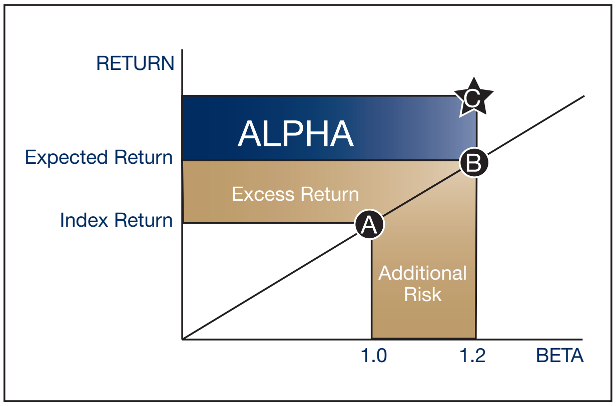
The search for a manager should begin — and end — with A, for alpha.



- As with many things in life, risk and reward go hand in hand. The greater the potential reward, the greater the risks you have to take to get that reward. Investing is no different — the higher the potential return of an investment, the greater the risk of failure or loss. The best investors use their knowledge and skill to produce greater returns than would be expected for the amount of risk assumed. That is alpha.

- Alpha is a true measure of the value a portfolio manager adds. Why? Alpha measures the excess return portion that is attributable to skill, not risk. Risk in this case is defined in terms of beta, which measures the volatility of an investment compared to the rest of the stock market (for our purposes here, the S&P 500). Alpha takes into account both excess return and beta, which is why alpha is often called "beta-adjusted return." Alpha managers are those that use their skill and experience, not beta, to generate true excess returns — a real measure of expertise.

- Portfolio Manager A is an index fund manager with a beta (market risk) of 1. His return is exactly what is expected.

- Manager B clearly delivers a higher return than the index, but he also takes on additional risk. He generated excess return, but did he generate alpha? The answer is no, he simply delivered what was expected for the higher level of risk.

- However, Manager C is a different story. She delivered more than the expected return for the risk she took. That difference — the difference between what was expected for the risk she took and what she actually achieved — is alpha. Investors need to be compensated for the risk taken. In alpha terms, managers only get credit for that portion of the excess return that is left after they compensate their clients for risk.

Defining alpha

Alpha: the part of an investor's return that is due to the skills of the investment manager, as distinct from the return of the market as a whole.

The key to finding exceptional portfolio managers

At Eagle Asset Management, our goal is to select exceptional portfolio managers to manage our separately managed accounts. These are managers with the skill and expertise to deliver performance without taking excessive risk. In other words, we look for managers who deliver alpha, which is the true measure of investment skill and stock-picking expertise.

Eagle managers

- Strive to generate long-term value compared to their benchmarks and peers over multiple time periods
- Aim to produce returns without taking excessive risk for which investors are not compensated
- Can repeat and sustain these results

For detailed information about Eagle's separately managed accounts, please visit eagleasset.com.

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Excess return versus alpha

	MANAGER B	MANAGER C
Index	10%	10%
BETA	1.2	1.2
Expected Return	12%	12%
Manager Return	12%	14%
Excess	2%	4%
ALPHA	0%	2%

- Let's take a closer look at Managers B and C. Manager B produces a 12 percent return. Since the portfolio has a beta of 1.2, the expected return is 12. Manager B didn't produce any alpha because for the level of risk taken, the expected return and the manager's return are equal. Though he ensured that his investors were being paid for the amount of risk taken, he didn't generate any extra returns beyond that. Clearly, then, adding more risk to achieve greater return does not lead to alpha.

- What leads to alpha? Consider Manager C. Based on this portfolio's beta of 1.2, the expected return is 12 percent. The manager returned 14 percent. The extra 2 percent was generated because of something the manager did, not because of the extra risk assumed. So, if it's not risk that drives alpha, what does? It really comes down to one thing: skill. Manager C's skill resulted in performance beyond compensating her investors for risk, thus translating into long term value.

Why alpha matters

- The real test of a portfolio manager is the success of his or her long-term stock selection, and that stock selection is driven by skill. Some managers increase their beta or change their style behavior to chase excess returns. But, when skill, and not risk, drives performance, it becomes more consistent, increasing the chances of clients reaching their financial goals on time. Alpha matters because it isolates the skill factor from the risk factor of performance — a critical element for building successful portfolios.

That's why we consider alpha to be a true measure of portfolio manager skill.

Eagle understands alpha ...

- When indices produce double-digit returns, positive alpha improves returns incrementally.
- When indices produce single-digit returns, alpha contributes a substantial portion of the overall return.
- And, perhaps most importantly, positive alpha protects investors' downside when indices post negative returns.
- Properly done active management can – and does – provide positive alpha and relative excess returns. Furthermore, we believe managers who demonstrate over time that they can consistently produce a significant amount of alpha should be included in an investor's overall asset-allocation strategy, regardless of management style.

Past performance is no guarantee of future results. Investing in securities may result in a loss of capital.

There is no assurance that a separately managed account will achieve its investment objective. Separately managed accounts are subject to market risk, which is the possibility that the market values of securities owned will decline and that the value of the securities may therefore be less than what you paid for them. Accordingly, you can lose money investing in a separately managed account.

E1954 5/11 exp. 1/31/12