KEY TAKEAWAYS

- The expertise provided by Strategic Advisers’ Research team drives investment selection for the firm’s managed accounts.

- Strategic Advisers’ proprietary process defines its own investment style categories to seek diversification and a performance edge.

- Each Analyst adds value by identifying managers with consistent strategies and style discipline.

- A key element of the process is Strategic Advisers’ ongoing, face-to-face interaction with Investment Managers.

Investors today face an overwhelming array of investment choices. Selecting among them to create a properly diversified portfolio requires time, experience, and a proven approach for assessing both consistency and performance. This Perspective describes the proprietary process that the Fundamental Research team at Fidelity’s Strategic Advisers, Inc. (Strategic Advisers), Fidelity’s registered investment adviser, follows to identify and monitor the investment choices they recommend to the Strategic Advisers Portfolio Management team.1

Introduction

It’s one thing to recognize the value of diversifying an investment portfolio to achieve a balance of risk and return. It’s quite another to narrow down thousands of available choices to arrive at the right combination of securities for use in Strategic Advisers’ investment strategies that reflect different investor time frames, risk tolerances, and goals. The investment professionals at Strategic Advisers are focused entirely on making these decisions for our clients.

The Portfolio Managers at Strategic Advisers make the investment selections and construct the portfolios. Throughout this process, they work closely with Strategic Advisers’ Fundamental Research Analysts. It’s the Analysts’ job to continuously identify, evaluate, and recommend the most appropriate investments for each Portfolio Manager’s consideration. They bring the skills and experience necessary to execute a rigorous, proprietary investment selection process that is unique in the industry.

A Disciplined, Proprietary Investment Selection Process

The process starts with the Strategic Advisers Portfolio Managers and Analysts working together to define the various approaches to investing (investment styles) within each asset class that will be required to build properly diversified portfolios. They also look at how these styles performed in a variety of markets. From this joint effort, they identify the investment categories that should be represented in Strategic Advisers’
client portfolios. They may also suggest investments that should be included to fill very specific, narrow niches or those considered “opportunistic” in seeking performance through a variety of styles.

For equity strategies, within each peer group (e.g., Large-Cap Value), Strategic Advisers believes the sub-styles serve as complements to one another. When combined appropriately, they can create more cohesive, diversified portfolios.

Within these more specific categories, Strategic Advisers Analysts also understand that investment approaches may still incorporate meaningful differences. For instance, one relative value manager may assess price versus a company’s earnings, while another may measure it against book value. Growth at a Reasonable Price (GARP) managers may vary in how they assess growth—by earnings, cash flow, sales, etc. They also may have different criteria for valuation. It’s important for the Strategic Advisers Analysts to fully understand the performance drivers that the Investment Managers are trying to exploit and to consider them in the evaluation process.

Strategic Advisers’ research looks beyond mutual funds to include subadvisers, separately managed accounts (SMAs), and ETFs. The focus is on finding the right managers, regardless of the investment vehicle.

### Beyond the Square Grid Box
As shown in Exhibit 1 below, the style categories that Strategic Advisers follows in selecting investments are considerably more specific than other industry classifications, such as the Morningstar Style Box methodology. The characteristics that Strategic Advisers Research examines go well beyond those of traditional style boxes.

**Exhibit 1. Beyond the Style Box**
Within each traditional category, Strategic Advisers further defines style by key characteristics.

---

2 The Morningstar Style Box is a proprietary Morningstar data point consisting of a nine-square grid that provides a graphical representation of the “investment style” of stocks and mutual funds. The grid for stocks and stock funds uses different characteristics than the one for fixed income funds. For more details, see http://www.morningstar.com/InvGlossary/morningstar_style_box.aspx.
While great care is taken to define the set of sub-styles that will be used by the investment team, these styles are never static. Strategic Advisers continually looks for new style designations and reassesses current ones to seek the right choices for all market conditions. With these categories in mind, Strategic Advisers Research Analysts begin the time-consuming process of trying to find the most favorable investments and investment vehicles for each style, and preparing recommendations for the Portfolio Managers they support.

"To build investment solutions for our clients, Strategic Advisers Research tries to find the top Investment Managers in each asset class and monitors them to ensure they are adhering to their stated investment objectives and process over time."

Jeff Mitchell, Senior Vice President, Director of Research Strategic Advisers, Inc.

**Digging Deeper: How Strategic Advisers Research Finds Investments**

To make sure all of the investment styles are covered, Strategic Advisers organizes the Analysts into small teams assigned to one or more of the categories, then facilitates collaboration among those teams. So, while each Analyst on the growth team may be assigned a specific set of strategies and managers to cover, he or she also shares insights gleaned from recent interviews and research with the other growth-style Analysts.

Such collaboration greatly strengthens the evaluation process and encourages Strategic Advisers Analysts to regularly interact at Research team meetings, smaller group meetings, and meetings with Strategic Advisers Portfolio Managers. Analysts may also engage in periodic “bull/bear” debates: If one Analyst recommends a particular investment, another may be asked to build the “bear” case. In a team meeting, both the Analysts then debate the buy and sell theses for that investment.

**The Fundamental Research Process: Screening and Visits**

Strategic Advisers’ Portfolio Managers want to know that the investments they choose will perform according to expectations. While past performance is important and no guarantee of future results, considerations such as style consistency and appropriate risk are equally critical in this initial screening. Constructing appropriately diversified portfolios requires identifying Investment Managers whose stated strategies align with their actual execution.

The initial screening phase helps further categorize each manager and identify those who merit a more extensive, qualitative inspection.

With the key investment style categories as a guide, the research process begins with the Strategic Advisers Analysts screening the Investment Manager universe in their assigned categories. This initial assessment is usually quantitative, using software applications that provide a window into the underlying characteristics of each investment portfolio. This helps the Analysts eliminate Investment Managers who frequently shift styles or vary greatly in their level of risk, for example.

After further analysis and preparation, the Strategic Advisers Analyst may visit an Investment Manager. These on-site meetings give Analysts a unique
perspective on each manager’s process, investment philosophy, and approach to portfolio construction. They also provide the opportunity to get a first-hand impression of the culture, values, and interactions of the manager’s investment team and the firm that supports them—all of which are critical to the investment’s style consistency, risk profile, and performance. For example, when an Strategic Advisers Analyst’s meeting with a mutual fund manager reveals that the investment team’s incentives were not aligned with the interests of shareholders, the Analyst will likely recommend that the fund be avoided.

As shown in Exhibit 2, the research process doesn’t end once a recommendation is made. It’s designed to be iterative and ongoing. The Analysts routinely monitor their assigned Investment Managers and regularly visit many of them. They are always on the lookout for new investment styles and processes that may make good additions to Strategic Advisers clients’ portfolios.

Taking a Closer Look: Strategic Advisers Research Criteria
Performance expectations, both absolute and relative to benchmarks, are essential considerations when the Strategic Advisers team researches investments and Investment Managers. Each investment is chosen to play a specific role within a particular portfolio. This is the context for the Strategic Advisers Research Analysts’ evaluation of prospective investments. Expectations must be set not only for performance, but for an Investment Manager’s style, process, philosophy, and risk.

The Firm
One key step in assessing a prospective Investment Manager is to analyze the firm in which he or she resides. It is the responsibility of the Strategic Advisers Analysts, along with Strategic Advisers’ due diligence staff, to identify those firms with the highest fiduciary standards.

The Analysts look for organizations with the resources and structure necessary to support their investment management teams. Stable firms allow their investment professionals to focus their efforts on managing their portfolios. For example, Strategic Advisers’ opinion about a particular Investment Manager weakened substantially after a visit showed that his team was clearly distracted by the potential sale of the company.

The Manager’s Process and Philosophy
It’s easy to pay attention to Investment Managers with strong 1-, 3-, and 5-year
historical returns. Yet all too often, yesterday’s star manager becomes tomorrow’s laggard. For this reason, Strategic Advisers’ investment selection process emphasizes looking forward rather than backward, and seeks consistency, not of performance per se, but of style and process. Strategic Advisers Analysts identify Investment Managers who have a well-defined process, adhere to a steady approach, and offer a sustainable edge in implementing their style of investing in the future.

Investment Managers who stray from their stated objectives or routinely change their investment styles make Strategic Advisers’ portfolio construction much more challenging—and unpredictable. If a manager’s approach is inconsistent or not clearly represented, he or she will not be considered.

Strategic Advisers Analysts also dig deep into the decision-making methodology behind each manager’s investment strategy. Inputs such as idea generation, fundamental research, valuation discipline, quantitative research and development (R&D), and buy and sell disciplines must all make sense for the given strategy. For instance, managers who focus on providing downside protection tend to have a strong sell discipline.

Most Investment Managers cannot outperform in all markets, and Strategic Advisers does not expect them to. But Strategic Advisers Analysts do expect the managers they recommend to make investment decisions that reflect their style. An aggressive growth manager, for example, would not be expected to lead the market when value-oriented strategies are outperforming. At the same time, because the portfolio was likely chosen for its aggressive growth characteristics, Strategic Advisers Analysts would not want to see the manager lose conviction in his or her established strategy and change direction.

Strategic Advisers’ investment philosophy is predicated on being fully invested across the market at all times. So, it is important that each investment provide consistent exposure to the part of the market for which it was selected. An Investment Manager can have a flexible approach, but Strategic Advisers is always looking for a clearly defined set of core beliefs.

A DISCIPLINED ANALYSIS
Strategic Advisers Research Analysts look at more than a dozen factors when screening third-party Investment Managers for Strategic Advisers’ managed portfolios.

<table>
<thead>
<tr>
<th>INVESTMENT FIRM</th>
<th>INVESTMENT TEAM</th>
<th>INVESTMENT PROCESS</th>
</tr>
</thead>
<tbody>
<tr>
<td>High fiduciary standards</td>
<td>Experienced</td>
<td>Robust research and R&amp;D</td>
</tr>
<tr>
<td>Organizational durability</td>
<td>Stable</td>
<td>Disciplined portfolio construction</td>
</tr>
<tr>
<td>Strong resources</td>
<td>Collaborative</td>
<td>Well-defined buy/sell disciplines</td>
</tr>
<tr>
<td>Appropriate incentives and controls</td>
<td>Accountable</td>
<td>Risk awareness and management</td>
</tr>
<tr>
<td>Performance-driven culture</td>
<td>Unified</td>
<td>Aligned with stated objectives</td>
</tr>
</tbody>
</table>
The Investment Team

Strategic Advisers Research Analysts like to find investment teams with experience, stability, depth, and accountability. They look for a team structure that fits logically with the manager’s philosophy, investment style, and stated performance objectives. No single structure is inherently better than another, but cohesion between process and team is important. If they are not all working together with the same clear objective, the investment process may be weakened. So, whatever structure is followed, the Strategic Advisers Analyst looks for teams that are unified in their investment philosophy.

Other indicators of an investment team’s strength include the experience of the team members and the amount of personal assets they have invested in the portfolios they manage. When Investment Managers and their teams are heavily invested in their own process, it’s a strong indication of alignment between the investment team and fund shareholders.

During an Analyst’s site visits, investment team goals and priorities become even more apparent. Strategic Advisers Analysts feel encouraged when they find teams with proper incentives and compensation, whose members are clearly engaged in their work. But they may exercise more caution when an investment team appears too focused on short-term performance or seems distracted by non-investment issues.

Performance

Ultimately, Strategic Advisers’ Analysts seek to identify a manager’s investment skill or “edge” relative to others in the same peer group. So the Analysts’ ratings of Investment Managers are based on their level of conviction that the managers could perform well relative to their benchmarks over a full market cycle. Evaluating performance across a complete market cycle allows the Analysts to look beyond style biases the market may favor in the short term. It also reflects Strategic Advisers’ overall philosophy that it is not prudent to invest with short-term time horizons.

An Investment Manager’s track record is important, but it’s not always a reliable guide for future results and is typically of little use on its own. Strategic Advisers’ Fundamental Research team strives to uncover the reasons for past performance, whether positive or negative. How did a manager beat the benchmark? Was it due to portfolio characteristics the manager designed or was it the result of unintended bets? For instance, Strategic Advisers Analysts would not be encouraged by a manager who claims to have expertise in large caps but outperformed by owning mid- or small-cap stocks.

In short, Strategic Advisers’ Analysts are always on the lookout for repeatability and sustainability. A manager’s investment
process must be clear and logical enough to be replicated in the future.

**Additional Asset Class and Sub-Strategy Assessments**

In addition to developing a deep understanding of each assigned Investment Manager, Strategic Advisers Analysts also look at the manager’s peer group. They maintain monthly peer group performance reports and look at the types of strategies and styles that deliver returns above and below the category average. Through time, the Analysts develop a deeper understanding of the market conditions that may favor particular strategies.

Demonstrating their knowledge of “deep value” strategies, for example, Strategic Advisers value Analysts have put together in-depth reports on what may be the best times historically to have owned deep value investments within the full market cycle. Deep value strategies have historically favored the statistically cheapest stocks in their universe. Their performance is very episodic and can go through periods of drastic over- and underperformance relative to the rest of their value peer group. Determining the market conditions that may favor such a volatile strategy is valuable information for Strategic Advisers’ Portfolio Managers. Other in-depth studies conducted by the Strategic Advisers Fundamental Research team have focused on emerging market equities, momentum strategies, and dividend strategies.

Sub-strategies and their trends are regularly monitored for every style category and its peer group. Research at the asset-class level helps Strategic Advisers Portfolio Managers decide when it may be more advantageous to shift emphasis to a particular area or strategy. It also helps categorize and define managers within each peer group in a more detailed way, creating a framework in which to set performance expectations.

**Conclusion**

The unique, style-based investment analysis process that Strategic Advisers’ Fundamental Research team pursues is essential to the successful construction of Strategic Advisers’ managed account portfolios. The careful consideration that Strategic Advisers Analysts give to their investment recommendations helps Strategic Advisers Portfolio Managers confidently select investments to diversify across asset and sub-asset classes. Such diversification is vital to delivering results and managing risk for clients in a variety of market conditions.
Investing involves risk, including the risk of loss.

Diversification does not ensure a profit or guarantee against loss.

The views expressed herein were prepared by Strategic Advisers, Inc. This commentary is for informational purposes only and is not intended to constitute a current or past recommendation, investment advice of any kind, or a solicitation of an offer to buy or sell any securities or investment services. The information and opinions presented are current only as of the date of writing without regard to the date on which you may access this information. All opinions and estimates are subject to change at any time without notice.

Fidelity Portfolio Advisory Service® is a service of Strategic Advisers, Inc., a registered investment adviser and a Fidelity Investments company. Fidelity® Personalized Portfolios may be offered through the following Fidelity Investments companies: Strategic Advisers, Inc., Fidelity Personal Trust Company, FSB (“FPTC”), a federal savings bank, or Fidelity Management Trust Company (“FMTC”). Non-deposit investment products and trust services offered through FPTC and FMTC and their affiliates are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency, are not obligations of any bank, and are subject to risk, including possible loss of principal. These services provide discretionary money management for a fee.

Brokerage services provided by Fidelity Brokerage Services LLC. Custody and other services provided by National Financial Services LLC. Both are Fidelity Investments companies and members of NYSE and SIPC.

Fidelity Brokerage Services LLC, Member NYSE and SIPC, 900 Salem Street, Smithfield, RI 02917

568151.3.0  1.923086.102