

# Asset Allocation Program

## A managed account program seeking to minimize risk and earn above market returns

The Asset Allocation Program is the underlying investment philosophy that helps to determine capital allocated to the Cornerstone Fixed Income Program, the Risk Controlled Equity (RiCE) Programs and alternative assets. We carefully assess the risk/return profile of the entirety of a client's asset base and income stream to optimize allocation for each client's requirements.



### About Brookstone

Brookstone is focused on providing its clients with investment advice that clearly defines and attempts to limit risk. The goal is to ensure that over time our clients are well compensated for risk and understand the risk and return parameters of their investments. The firm is committed to transparency in all of its investment strategies.

### Philosophy

At Brookstone, we believe that markets are efficient in the long term, but from time to time undergo periods of extreme over-valuation (bubbles) and under-valuation (panics). Brookstone's goal is to design portfolios with the goal of protecting investors' capital from these periods of extreme over or under-valuation and provide a less volatile path to exceed market returns over market cycles.

We also carefully study asset correlations in up and down markets and work with clients to identify hidden risks and correlations that may provide a false sense of diversification.

### Brookstone Partners

Brookstone Partners focuses on a "sleep at night" approach to investing and asset allocation. This does not mean we target low, boring returns, only that we understand the risk we are taking and expect to get paid for it.

Every five years or so (2007, 2002, 1998...) many money managers claim that their performance has been affected by a once in a lifetime 100 year flood. We believe that our clients' investment approach can plan for this and avoid much of the fallout.

The result is that we strive to reduce risk, maintain liquidity and seek to over time out-perform most comparable investment approaches.

### Portfolio Construction Principals

Brookstone constructs portfolios to control risk. When risk is taken, modest sums are invested with limited downside risk and strong upside potential.



#### Cornerstone Fixed Income Program – The Portfolio Anchor

The Cornerstone Fixed Income Program focuses on low credit and interest rate risk.

+



#### Risk Controlled Equity (RiCE) Program – Next Generation Indexing

RiCE Programs focus on tracking respective equity indexes with limited downside.

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#### Private Equity, Venture Capital, Mezzanine and Other Alternative Funds

For appropriate investors, modest sums (5-15% of assets) should be invested with the goal of significantly increasing wealth.



#### Brookstone Partners Asset Management Balanced Portfolio

A balanced portfolio can be achieved with the Cornerstone Fixed Income Program, next generation equity indexes in the RiCE Program and alternative investments.

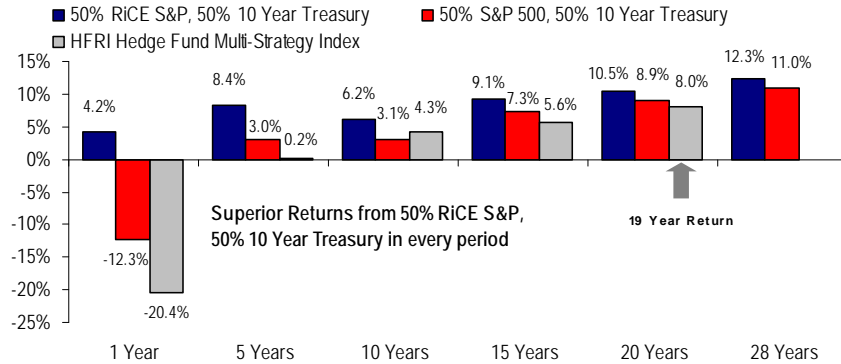
### Sample Portfolio Illustration

Any asset allocation program should be thoughtful and highly customized. By analyzing a simple 50/50 allocation to the Brookstone Risk Controlled Equity (RiCE) program and its Cornerstone Fixed Income program, we show that "sleep at night" investing provides half the volatility and higher returns than an S&P 500 and bond portfolio.

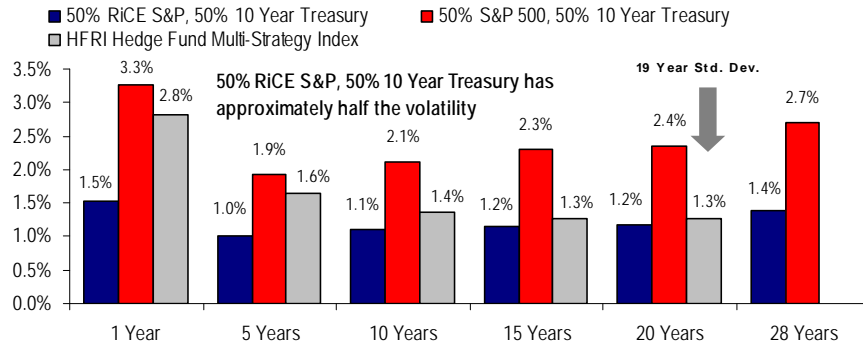
Below, we compare a 50/50 portfolio of the S&P 500 and 10 year treasury to the RiCE S&P 500 with the 10 year treasury. Please note that since the Cornerstone Fixed Income program is highly customized, we use the 10 year treasury as a proxy. Therefore, we are assuming no benefit or increased return from the fixed income program.



**50% S&P 500, 50% 10 Year Treasury vs. 50% RiCE S&P, 50% 10 Year Treasury**  
Trailing Annualized Returns as of 12/31/08<sup>A</sup>

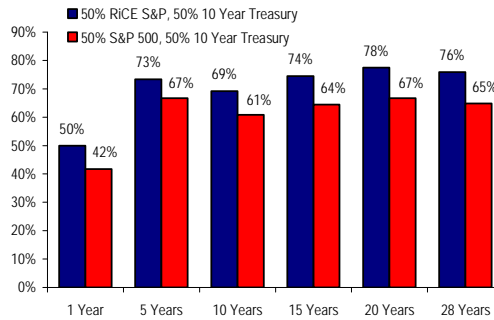


**Standard Deviation of Monthly Returns as of 12/31/08<sup>A</sup>**

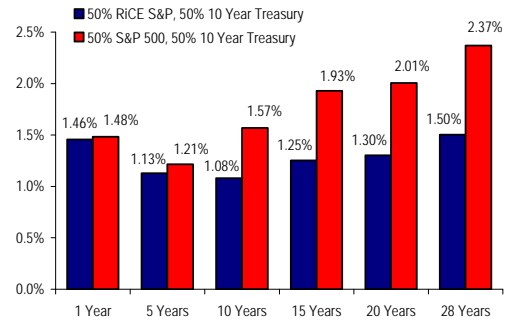


**Positive Monthly Returns As of 12/31/08<sup>A</sup>**

**Months with Positive Returns**

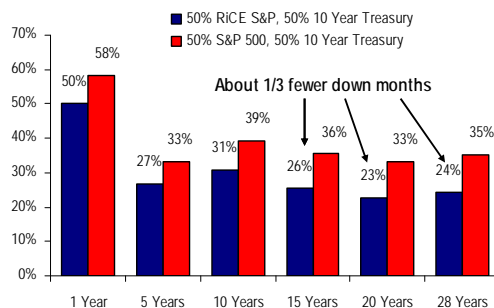


**Average Monthly Return of Positive Months**

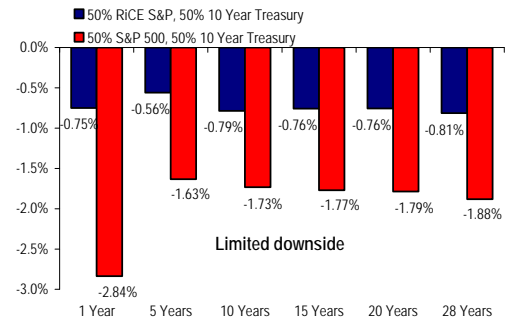


**Negative Monthly Returns As of 12/31/08<sup>A</sup>**

**Months with Negative Returns**



**Average Monthly Return of Negative Months**



Note: (A) Back-tested model returns - data represents the portfolio strategy's returns, had they been implemented since 1980 and does not predict future performance.

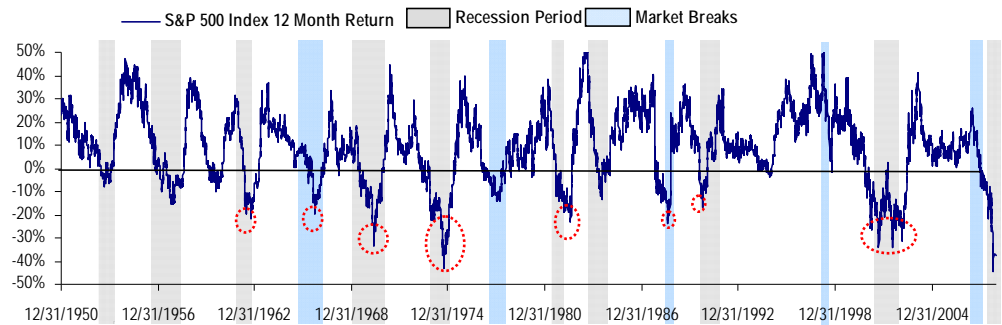
1) Market Breaks

**Guiding Principals For Successful Asset Allocation**

**Plan for market breaks every five years**

Market breaks or recessions have historically occurred about every five years and must be accounted for when creating a real world portfolio. We provide clients with "sleep at night" risk management and over a market cycle, the full benefit of market exposure.

**Historical S&P 500 Index Value**  
1/1/1950-12/31/2008

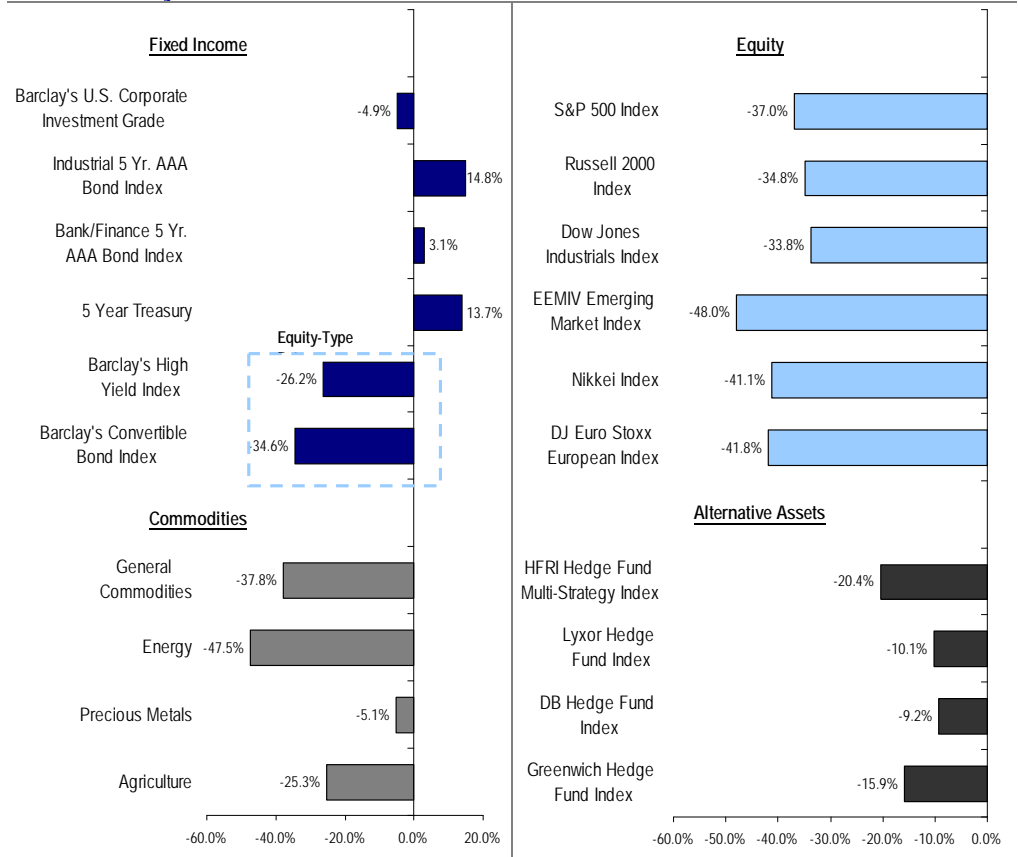


2) Real Diversification

**Diversification depends on what you own, not how many different things you invest in**

Diversification is important, but many investors who in 2008 owned 20 to 30 funds and ETFs thinking they were diversified found out that in down markets (2008), most historical correlations become irrelevant and all risky assets decline in value. Diversification must be done carefully and can at times be accomplished with three to five asset classes. Simply owning 20 to 30 funds and ETFs can provide a false sense of diversification.

**2008 Returns by Asset Class**



3) Bonds Become Equity-Like

**In down markets, bonds can be the source of risk surprises**

Investors must be compensated for risk and understand the risk parameters of their investments. Many investment products offered are constructed solely for the benefit of the bank, not the client. For example, many investors believe that they have a significant and safe set of fixed income investments. These can include high yield bonds and convertible bonds. However, over time both of these asset classes behave more like equity and should be treated more like equity, not fixed income, for the purpose of asset allocation.

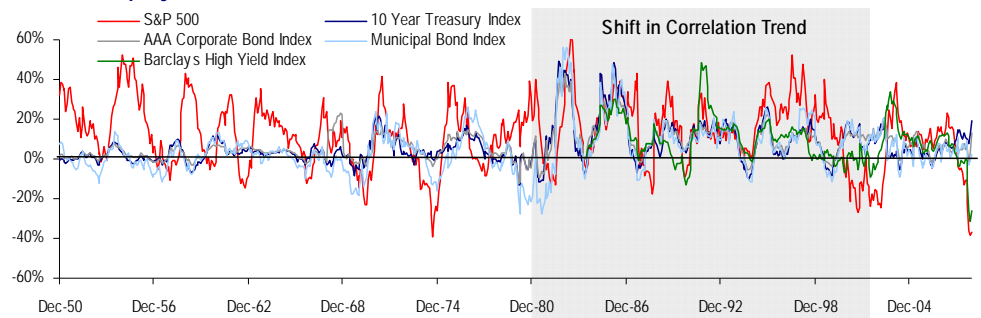
4) Correlations Shift

**Relationships among asset classes change over time**

Beware of managers making definitive statements about how to measure risk and correlations of asset returns. Relationships between asset classes change over time, act differently in up versus down markets and can be easily skewed by measurement periods which can vary from one month, quarter, year or three years.

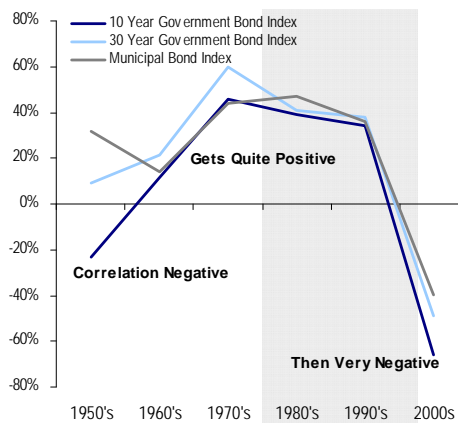
*Correlations to S&P 500*

**Bond and Equity Year Over Year Total Returns (1950-2008)**

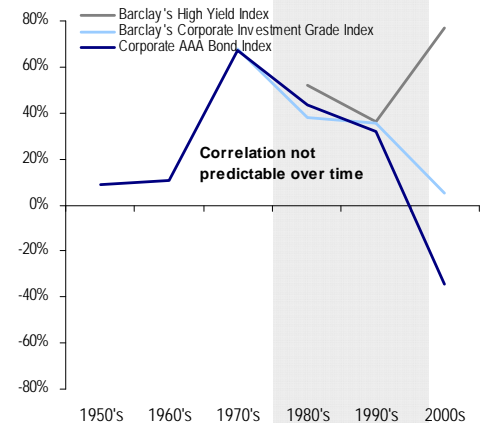


**Correlation to S&P 500 By Decade**

**Government Investments**



**Corporate Investments**



Correlations to S&P 500 Index						
Index	1950's	1960's	1970's	1980's	1990's	2000's
10 Year Government Bond Index	-23.1%	11.3%	45.6%	39.0%	34.3%	-66.2%
30 Year Government Bond Index	9.4%	21.6%	59.6%	41.0%	37.7%	-49.1%
Municipal Bond Index	31.8%	13.9%	43.8%	47.0%	35.8%	-39.6%
Corporate AAA Bond Index	8.8%	10.4%	67.4%	43.7%	32.0%	-34.6%
Barclay's Corporate Investment Grade Index			68.1%	38.1%	35.5%	5.5%
Barclay's High Yield Index				52.3%	36.2%	76.9%
Barclay's Convertible Index						98.4%

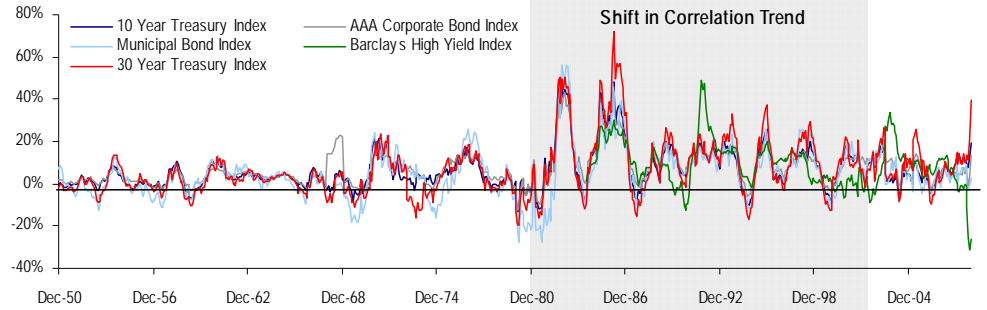
*Correlation to 30 Year Treasury*

**Long Term Bonds Overview**

Although long term corporate and treasury bonds are relatively safe, the fact that they may be 30 year securities also introduces a significant element of risk.

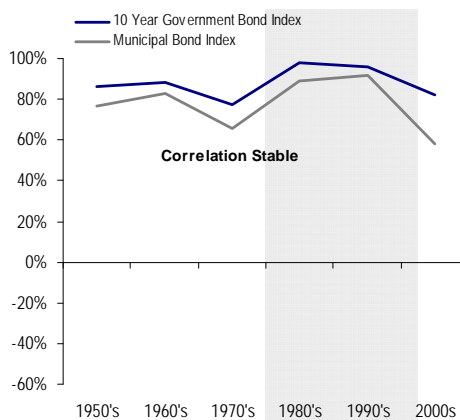


**Long Term Treasury and Corporate Bond Year Over Year Total Returns (1950-2008)**

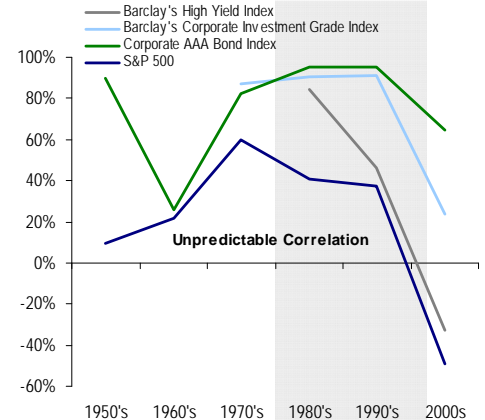


**Correlation to 30 Year Treasury Bond By Decade**

**Government Investments**



**Corporate Investments**



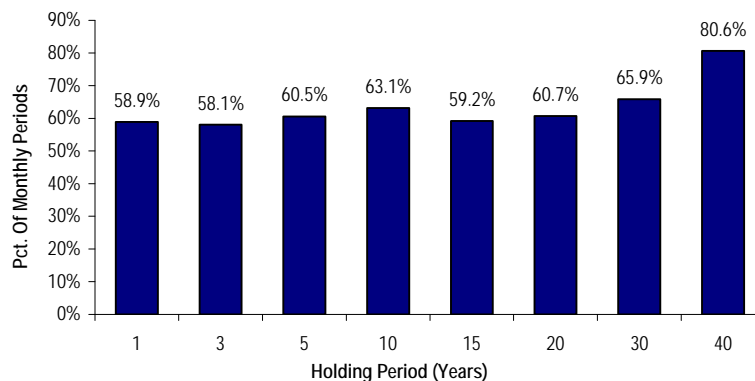
Correlations to 30 Year Government Bond Index						
Index	1950's	1960's	1970's	1980's	1990's	2000's
S&P 500	9.4%	21.6%	59.6%	41.0%	37.7%	-49.1%
10 Year Government Bond Index	86.6%	88.6%	77.5%	97.8%	96.1%	81.9%
Corporate AAA Bond Index	89.6%	25.6%	82.5%	95.3%	95.3%	64.6%
Municipal Bond Index	76.6%	83.0%	65.8%	89.2%	91.7%	57.9%
Barclay's Corporate Investment Grade Index			87.3%	90.6%	90.9%	23.5%
Barclay's High Yield Index				84.2%	46.1%	-32.6%
Barclay's Convertible Index						-59.5%

**5) Equities and the Long Run**

**Stocks are for the long term...in the long term we are all dead**

To be 80% sure that an equity investment will out-perform 10 year treasury bonds, an investor must have a 40 year holding period. To be 65% sure that an equity investment will out-perform 10 year treasury bonds, an investor must have a 30 year holding period. This means that if an investor bought equities today, to be sure he was compensated for the risk, he must hold for 40 years.

**Number of Times S&P 500 Return Exceeded 10 Yr. Treasury Return (Rolling Periods from 1950 through 2008)**



Source: S&P 500 and 10 Year Treasury returns from Global Financial Database

## 6) Measuring Risk

### \* There is not one best way to measure risk

Even William Forsyth Sharpe, the creator of the Sharpe ratio for risk measurement believes that most investors use his statistic improperly and out of context. For example, the entire hedge fund world brags about and attempts to manage their Sharpe ratios, while its namesake does not believe the Sharpe ratio is an appropriate method to measure portfolio risk (Please see Wall Street Journal article from August 31, 2005 Page C1 titled Sharpe Point; Risk Gauge Is Misused).

Brookstone Partners Asset Management provides investment advisory services through Partnervest Advisory Services, LLC, an investment advisor registered with the Securities and Exchange Commission. Results relating to the RiCE S&P 500 account performance are based on back-tested model data and do not represent actual results realized by any individual investor. There may exist better benchmark comparisons than those offered herein for modeled performance data. Modeled returns are shown gross of fees. Fees associated with the RiCE and Cornerstone products will vary by investor based on each investor's assets with Brookstone Partners Asset Management and each within each respective product account. Material economic events or conditions will have positive or negative impacts on the performance of both Cornerstone and RiCE accounts. While RiCE accounts seek to limit losses to 15% when components are held to maturity, the market value of a RiCE account can from time to time have mark to market losses in excess of 15%. The RiCE or Cornerstone account model performance shown includes the value of re-investment of interest and dividends from prior periods. Consider the investment objectives, risks and charges and expenses of the Brookstone Partners Asset Management managed account investment programs carefully before investing. For this and other information about Brookstone Partners Asset Management investment programs, please contact Brookstone Partners Asset Management at (212) 302-7667; on the internet at [www.BrookstonePAM.com](http://www.BrookstonePAM.com) or by mail to Brookstone Partners Asset Management, 317 Madison Avenue, Suite 405, New York, NY 10017.

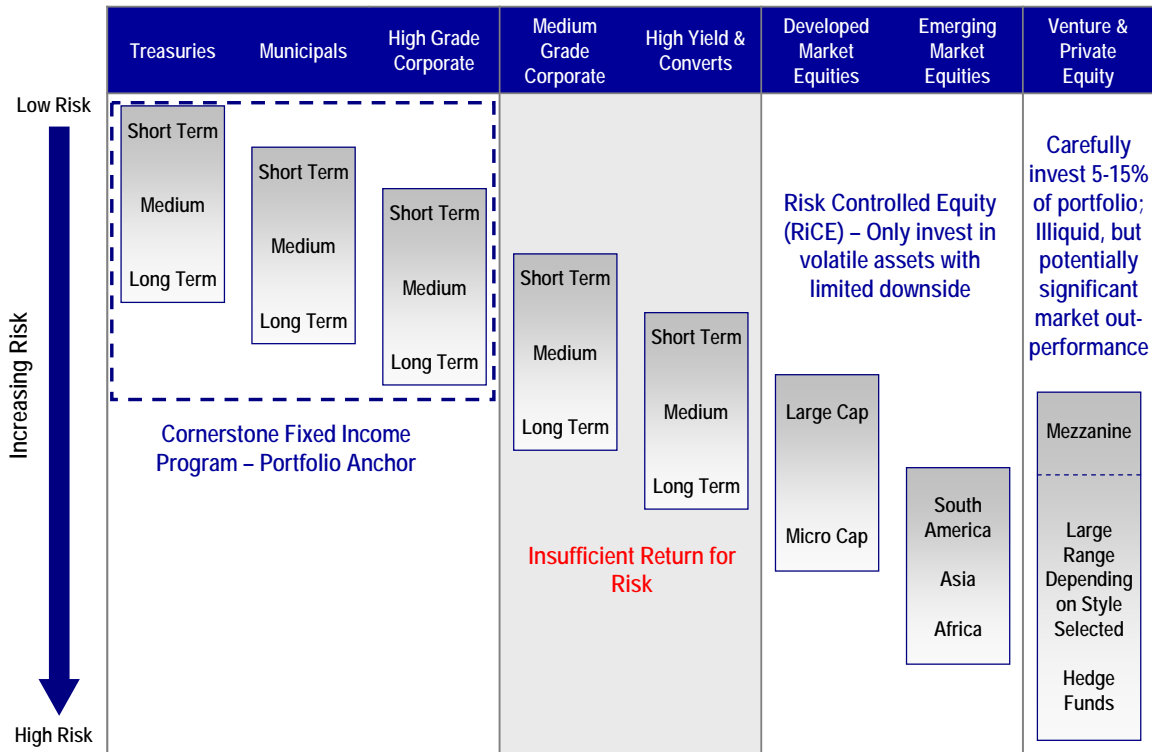
# Frequently Asked Questions

1. How do I evaluate my risk tolerance?

## Understanding The Risk Of Your Current Portfolio

Let's begin to map an abridged version of the universe of securities to highlight their partial risks and how they may be properly employed to achieve your investment goals.

### Overview Selecting Asset Classes



After we understand what securities you own in your portfolio we begin to discuss the following:

- I. **Personal** – Age, children, potential short term and long term family commitments, target retirement income
- II. **Financial** – Income projection and risk surrounding projected income, other illiquid assets owned such as businesses, real estate, private equity funds and hedge funds and the size of any contingent liabilities that are associated with the assets
- III. **Risk Tolerance** – Ability to withstand fluctuations in portfolio value

2. How do you suggest my portfolio should be constructed?

We suggest that a portfolio consists of three building blocks:





### Fixed Income Component – Cornerstone Fixed Income Programs

Our fixed income program tailors its investment in corporate, municipal and treasury securities to meet your individual requirements when selecting securities. We seek to take into account interest rate risk, credit risk, tax specific issues and current income requirements. We usually assemble a diversified portfolio of laddered securities with a portfolio duration typically three to five years but in some circumstances would recommend longer durations. We typically recommend that United States domiciled investors focus on dollar denominated fixed income products, but if a client has an underlying need for currency diversification we recommend investing in a portfolio of globally diversified fixed income securities.



### Equity Component – Risk Controlled Equity (RiCE) Products

We believe that investors with finite timeframes should only invest in equities through a RiCE program. This places a cap on annual returns of 30%, but limits the downside risk, typically to 15% per year. Investors such as endowments with infinite timeframes can have the 20, 30 or 50 year time horizons required to invest past the variability of equity returns. We offer RiCE products for the S&P 500, MSCI Emerging Market Index, MSCI Japanese Index, MSCI Europe, Far East and East Asia Index, and FXI China Index.



### Alternative Asset Component – Brookstone Partners Private Equity

Properly selected over time, private equity, venture capital, mezzanine, real estate, hedge fund and other alternative assets can significantly increase portfolio returns with only a small increase in incremental risk. Each of the aforementioned alternative assets can be invested in directly or through funds. Even within private equity or real estate funds, for example, strategies exist with relatively high and low risk. Depending on a client's circumstances, we recommend a 5% to 20% weighting.

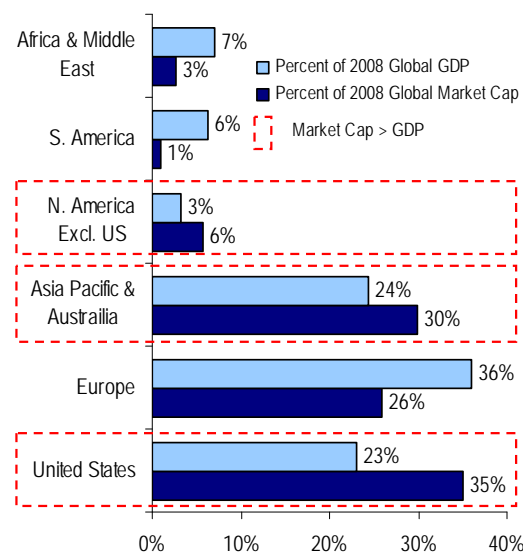
### 3. How should I allocate the equity portion of my portfolio?

Global diversification must be appropriately calibrated. An equity investor's goal should be based upon creating a portfolio that is representative of the global economy. Most indexes weight each market by its market capitalization, which often times forces a portfolio overweight in the potentially overvalued markets.

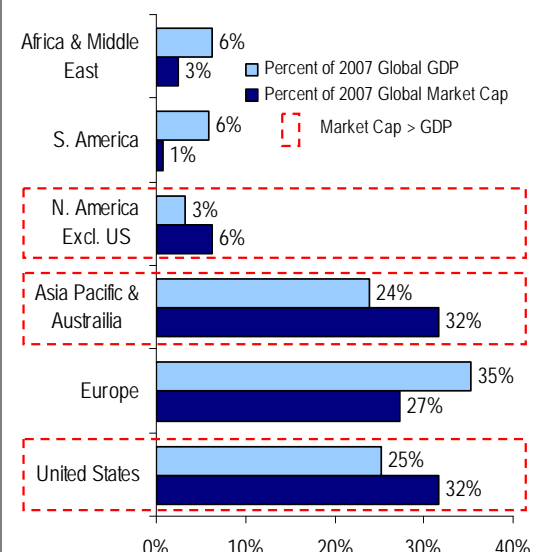
Since the goal is to create a portfolio that represents the global economy, a weighting based on GDP makes a great deal more sense and helps to avoid market bubbles.

### Global GDP and Market Cap by Region

Global 2008 GDP and Market Cap Distribution



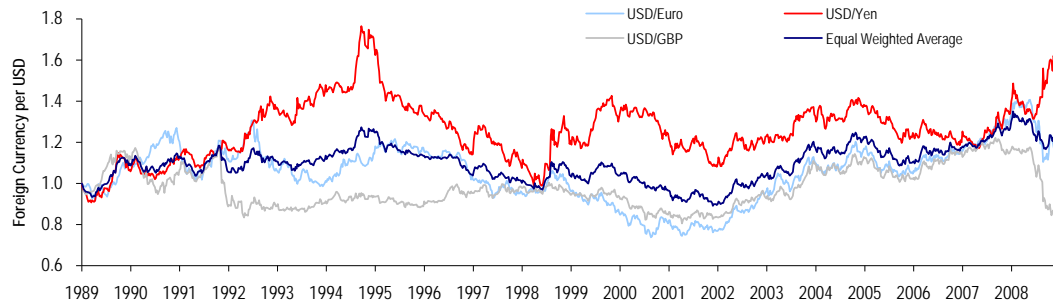
Global 2007 GDP and Market Cap Distribution



Source: Market Capitalization data from World Federation of Exchanges Database

Global GDP exposure also offers the appropriate level of currency exposure. Currency exposure should mirror GDP weighting in the equity portfolio. Many investors seek to speculate in currency exposures as an overlay for their portfolio when in fact many major currencies fluctuate along extended market cycles but are not an asset class that taken together appreciates. As one currency gains, another loses and if a global basket of equity securities is held, a portfolio is naturally insulated.

### Historical Exchange Rates (Indexed: 1.00 in 1989)

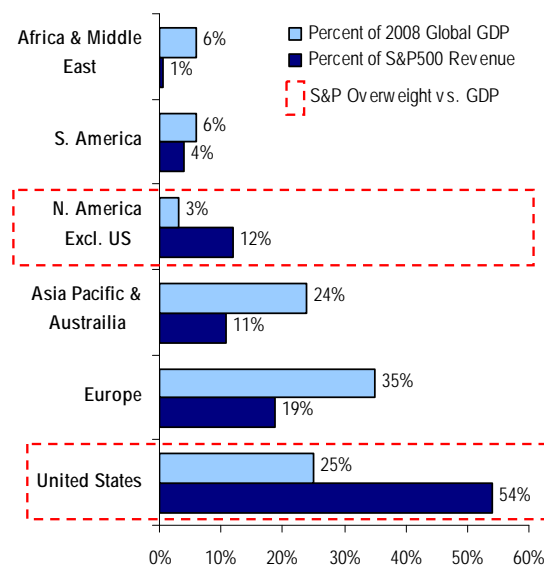


### How to Put this Concept Into Practice

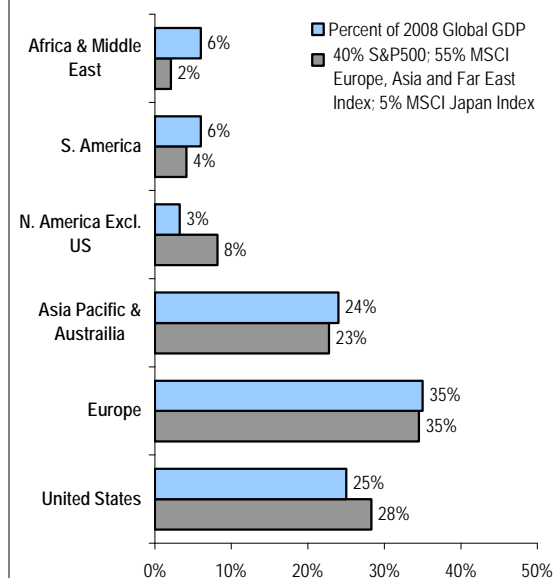
A GDP weighted portfolio would ideally be effectuated by beginning with an equity investor's home market index. For a US investor one can begin with the S&P 500. Many of the companies in the index are global with the top 20 companies (30% by weight) earning 50% or more of their income from overseas. These companies already offer a built in level of global GDP and currency diversification. To more closely align a portfolio with global GDP, a variety of weightings may be employed, one of which is illustrated below.

### Global GDP and Revenue Distribution For Varying Portfolios

#### S&P 500 Only Portfolio



#### 40% S&P 500; 55% MSCI Europe, Far East and Asia Index; 5% EWJ Japan Index

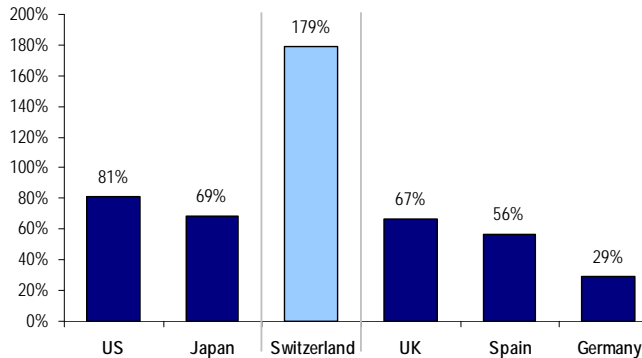


Source: Bloomberg data

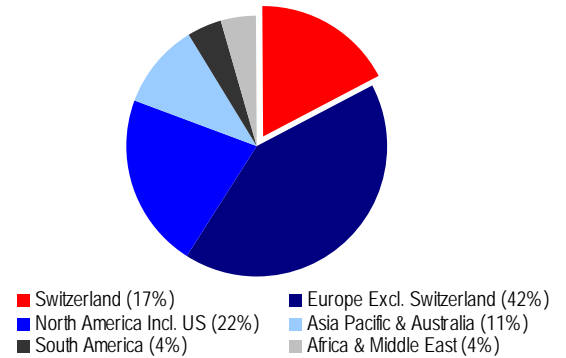
The simplest example of global exposure achieved by investment in one country is the Swiss Exchange (SIX) market in Zurich. Investing in that index really offers an investment in globally focused multi-national companies and not in the local market.

**Overview of Switzerland SIX Exchange**

**Total Market Capitalization as a Percentage of 2008 GDP**



**Revenue Distribution of SIX Member Companies**

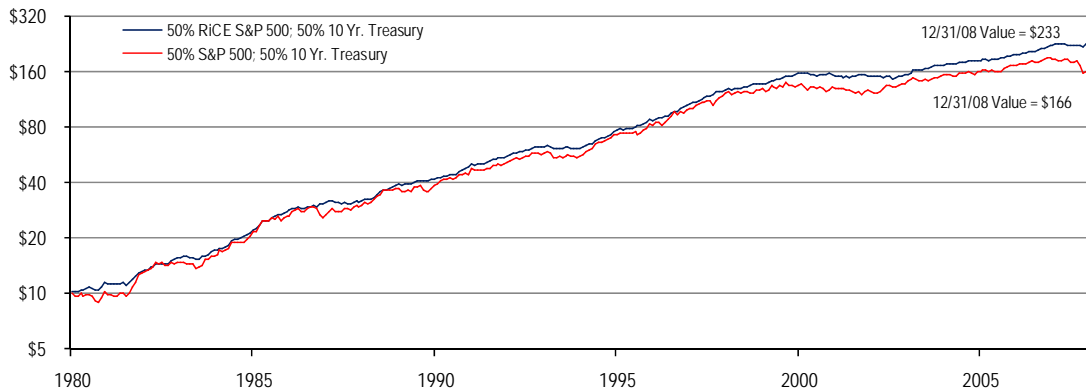


4. What role can the RiCE S&P 500 product play in my asset allocation program?

The RiCE S&P 500 product should be considered as equity exposure in your asset allocation program. When matched with BPAM's Cornerstone fixed income program, the RiCE S&P 500 product provides investors with a high returning, "sleep at night" portfolio. (Please see our literature on the **Risk Controlled Equity Program**)

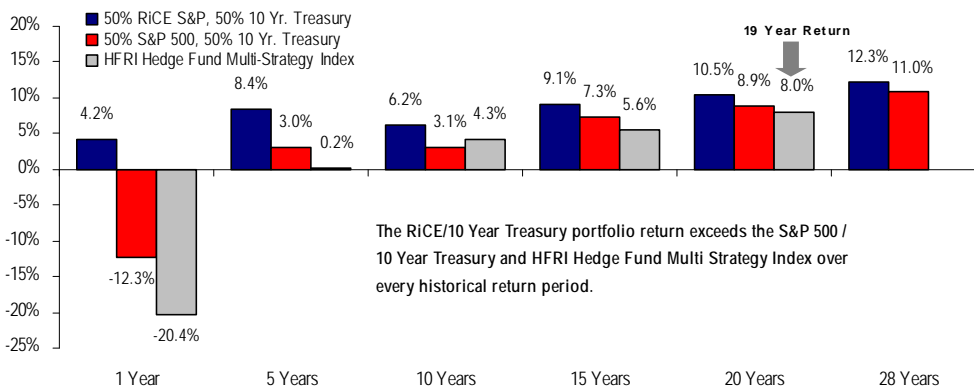
For illustration purposes, if 50% of a portfolio were invested in the BPAM fixed income program and 50% were invested in the RiCE S&P 500 product, the following returns could be achieved:

**Comparison of Value of \$10 Investment from 1980 through 2008<sup>A</sup>**



Note: Due to the custom nature of the Cornerstone Fixed Income product, the 10 year treasury was used as a proxy

**50% RiCE S&P 500, 50% 10 Year Treasury Return Comparison (As of 12/31/08)<sup>A</sup>**



The RiCE/10 Year Treasury portfolio return exceeds the S&P 500 / 10 Year Treasury and HFRI Hedge Fund Multi Strategy Index over every historical return period.

Notes: (A) Back-tested, model return data. Due to the custom nature of the Cornerstone Fixed Income Product, the 10 year treasury was used as a proxy.

As demonstrated above, the BPAM Fixed Income and RiCE programs can serve as integral components of any asset allocation strategy and outperform the passive indexes as well as the Hedge Fund Index.

<p><b>5. Where is my money held?</b></p>	<p>All funds are handled by Fidelity Investment Services. They provide custody, accounting and administrative services. They hold all customer assets but each investor's assets are invested at our direction.</p> <p>Investors will have a separate managed account that is invested in accordance with parameters we agree upon. It is highly customized and you are not forced into a specific type of "model" portfolio.</p> <p>A managed account offers specific benefits which include:</p> <ul style="list-style-type: none"> <li>I. <b>Safety</b> – You own all of the securities in your account. With one call to Fidelity you can remove us from having discretion on the account and do with the assets as you wish.</li> <li>II. <b>Transparency</b> – You see all of the securities you own and are able to understand exactly how returns are generated.</li> <li>III. <b>Liquidity</b> – All of the assets in the program are exchange traded, easily marketable and valued by Fidelity every day.</li> </ul>
<p><b>6. Can you help me invest in private equity and hedge funds?</b></p>	<p>Yes. We manage a series of private equity funds that could be appropriate to your investment goals. In addition, we have access to a number of other managers we know well. Also, if there is a particular manager you have in mind, we can assist you to evaluate whether that manager is well-suited for your investment goals. We have also been active investors in a variety of hedge funds and if appropriate can make recommendations or assist with evaluations.</p>
<p><b>7. If I like some of my managers can I keep them?</b></p>	<p>Of course. It would be helpful to us if we reviewed your entire financial profile to make sure that the assets under management by our firm worked harmoniously with the risk and return characteristics of assets held by other managers.</p>

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