VICTORIA
Capital Management, Inc.

What We Do to Earn Our Fees

We are active investment managers who specialize in two approaches to growing wealth either using a mix of individual bond and equity securities or developing managed portfolios of indexed exchange-traded funds. We are not stock brokers nor insurance agents—we are fiduciaries that means we are required by law to put our clients first in all matters affecting investment decisions. As advisors and portfolio managers with over 77 years of combined investment experience, we recognize our responsibility to clients and other investment advisors as second only to the responsibilities of a medical doctor. We expect to develop a meaningful relationship and make investment decisions that we believe can maintain and increase the value of clients' assets consistent with their individual needs and expectations over reasonable time periods. First, we recognize the importance of an advisor's personal involvement in each client's financial future. We expect that such financial relationships can last a lifetime and beyond. Second, we know that our decisions will affect a client's current and future standards of living. We combine our personal focus with our investment experience and the efficiencies of modern technology to meet and exceed client expectations. Here is a detailed explanation of what we do to earn our fees.

Let's begin with two analogies that characterize how we see our investment management responsibility. The first analogy is the role that a coach plays on a sports team. While an individual player can be a winner, a team's ability to win can be constrained if they don't have a coach guiding all players to work together. The guidance provided by the coach, who takes into consideration other factors besides the skills of each player, can make the difference between winning and losing.

In one sense, we consider ourselves the "coach" of client investments. We manage those assets based on client expectations and concerns. This process includes the selection of individual securities that are expected to meet those objectives (picking the best players for a given position), diversifying among different industries (having the right number of players for each position), and making changes in strategy when necessary (responding to what the other team is doing). Even the direction of the investment "weather" (bull or bear market) can impact a portfolio's structure.

For investors who manage their own assets, the risk of not meeting investment objectives increases because they may not be able to devote enough time or do not have the know-how to navigate during challenging circumstances. Studies of individual investor behavior have indicated that investors are more likely to make errant decisions at market extremes, buying stocks during the euphoria existing near a market high and desperately selling near a market low. We know this fact because equity mutual funds receive record inflows near market tops and experience increased outflows near market bottoms.

The second analogy is the role of a commercial jetliner pilot. The pilot can have thirty or more years of experience yet he still visually checks out the airplane on the ground for problems to make sure that the flight will be as safe as possible. However, once the plane takes off there can be a number of events that can make the flight a disappointment -- with the majority of those events being out of the pilot's control such as unexpected turbulence, poor service, screaming babies, rude passengers, or a movie that fails to work. Of course, most travelers would prefer a pilot with thirty years of experience than one with two or three years of experience or a plane that doesn't even have a pilot.

Like the airline pilot who can't assure a smooth flight, we design each growth equity portfolio to match a client's time horizon for investing and ability to accept short-term volatility. For our four Target Return model portfolios, we structure a mix of indexed exchange-traded funds to target a long-term rate of return that is consistent with the historical returns of each asset class. We recognize that, no matter what we do, the portfolio's valuation on a month-to-month basis can be volatile. We monitor the portfolio's performance in changing market environments and focus on steering it in the right direction. Just as a pilot can change direction to avoid a storm, we can act to avoid certain risks that may affect client portfolios. However, we also recognize that the timing of investments is an important consideration that can impact short-term portfolio performance and that time is necessary for portfolios to achieve long-term investment objectives.

Some market observers have compared the stock market to a casino implying that investing is no different than betting on a game that almost always produces losses for the client. There is some truth to this analogy although an important component is missing. For the client, a comparison in the stock market is the day trader who buys and sells stocks like a gambler who places bets. In the end, he or she is likely to lose. On the other hand, the big winner is the "house" or the casino that relies on the odds that, over time will produce profits. The part of the analogy that is missing is that a long-term investor is like the "house" and benefits from all of the long-term probabilities of meeting or exceeding expectations.

Our primary success as a small investment advisor is that we have restructured portfolios to reduce the impact of difficult market environments. For growth equity portfolios, we have held up to 100% cash for those periods where the market was falling. Once the factors driving the stock market lower dissipated, we began to reinvest those client assets. We are not market timers but employ a proprietary bottom-up stock selection process that affects the size of client stock holdings.

We are fee-only investment advisors and those fees are structured as a percentage of assets under management. We have an incentive to meet and exceed client targets as our success is tied to their excess. We do not charge commissions that encourages increased buying and selling resulting in higher profits for the firm and the broker.

The management of the growth equity portfolio is centered on the identification of investment themes that guide us to companies that are expected either to grow at a substantially higher rate than the overall economy or are expected to provide returns based on moderate appreciation and dividend income.

Our lengthy experience in equity investing has led us to the use of this theme-based approach for many years. While managing portfolios at a regional bank, we avoided the full impact of the energy-induced bear market in the early 1970s. As early advocates of supply-side economics through a working association with Professor Arthur Laffer, we took advantage of the logic behind the impact of tax rate cuts on the economy and financial markets that led to the stock market gains of the 1980s. The successful use of these supply-side themes in managing equity and fixed income mutual funds and large institutional portfolios for a Wall Street mutual fund company provided the basic experience for the founding of our firm.

Diane and Tom began working together in 1991. In May of 1992 while working in the trust department of a regional bank, we documented our expectation that the stock market could triple by the end of the decade (it did). By designing investment portfolios using our strategy in 1994 (we began our business by using these ideas to manage our own money), we implemented an updated thematic approach to investing. At the time, our research pointed to a revolution in the information technology world. We described the environment at that time as the “Gigatrend” of the 1990s[1]. Whether clients are invested in individual bonds, stocks, a combination of the two, or in asset allocation portfolios, our thematic approach continues to drive our investment selection and portfolio management process.

In late 2000, we raised 100% cash in all portfolios and avoided part of the bear market of 2001-2003. Again, we raised 100% cash for both our own and client portfolios in 2008 correctly anticipating the greatest bear market of our lifetimes.

As a small team, we aren’t subject to the bureaucracy of large organizations. We focus on managing client assets. We don’t have layers of management and the endless meetings that characterize such organizations. There has been no personnel turnover that frequently undermines the implementation of a viable investment strategy. We also don’t have a marketing department or spend money on advertising--our clients are our marketing arm! We don’t use “soft dollars” or sell any products where we have a financial interest. We also are not financial planners who get involved in every aspect of a client’s financial picture. We are investment managers who specialize in the design and implementation of investment strategy. We manage our own taxable and retirement portfolios in the same way that we manage client portfolios with similar investment objectives.

While we are small, we maintain the latest information technology to manage client portfolios. Each Monday, we set downside limits (alerts) on the securities that we own. By setting limits on prices, we are given ample warning to take a closer look when a stock hits this level and then proceed to figure out if there is something wrong and what action should be taken, if any. We create a quarterly approved list of stocks where we rate individual securities for attractiveness. Additionally, we have three large screen televisions tuned in to sophisticated investment news channels that can alert us to any political or global event that could impact the financial markets. For distant clients, we maintain multiple applications for visual contact and meetings and conversations. We have also created a website at www.vcm.us.com where both clients and prospects can evaluate our approach to investment management. Our size also gives us the flexibility to be available 24/7 rather than the typical 9/5 weekday strategy provided by our larger brethren.

Under normal circumstances, we review client holdings each week to ensure that the investments are appropriate for each account. We maintain internally-produced reviews of each portfolio and do not rely solely on information acquired from the brokerage firm where the account is located. On a weekly basis, we reconcile client accounts with their brokerage statements. While time consuming, this process has highlighted errors in the brokerage statements that need to be rectified. Few competitors provide such a "double-check" mechanism. In addition to the accounting systems of our administrator and our in-house program, we maintain client accounts using the Morningstar back office system that allows us to measure the characteristics of each client's portfolio or our model Target Return portfolios.

Our associate, Kevin Hilton, is responsible for our back-office accounting systems and data on individual accounts. He is a graduate from the College of Charleston, acquired a series 65 advisor designation and is enrolled in the CFA program, level 1.

We also earn our fees by providing insight into the financial markets and global economy. At the end of each quarter, we prepare our Financial Market Perspective (FMP) -- an analysis of the factors that have influenced global financial markets during the quarter and the implications for future financial market direction. The FMP not only provides an update for clients as to our thinking about the investment climate but also allows us to systematically format our game plan for future investments.

Another reason we earn our fees is our periodic review process. Changing financial circumstances can have a serious impact on the way in which we manage each client's portfolio. For example, an inheritance, a new job or growth in the size of the family should require a review of a client's overall financial situation. Also, changing market conditions can encourage a shift among asset classes to achieve either a higher but more risky return or a lower and safer return than was previously the case. Even changes in the law regarding taxation and modifications in taxable and retirement plan regulations can have an important impact on the investment decision-making process. Large financial institutions just can't provide such a personalized approach to work with clients to achieve an expected outcome.

We are committed to maintaining a rewarding business relationship with each one of our clients and our investment advisors. We hope this commentary can give prospects and clients a better understanding of what we do and why we do it. Our intention is to make the life of our clients better than it otherwise would have been without our guidance.

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[1] A Gigatrend is the primary factor driving the development of an economy that affects virtually every aspect of our lives. This Gigatrend was the emergence of the personal computer and related software that changed our lives forever. A copy of this article is available on request.