



INVESTMENT SELECTION METHODOLOGY

Commonwealth's Mutual Fund Recommended List is one of many tools at your advisor's disposal. But like any tool, to be effective it requires a consistent, well-thought-out methodology that is rigorous in analytical nature but receptive to the specific needs of the community using it.

To this end, the investment analysts at Commonwealth produce the Recommended List as an indispensable service for advisors seeking to receive high-quality investment research that will ultimately increase the time they spend with clients and lessen the time they spend doing hardcore research, which, to a certain extent, is already provided by Commonwealth's in-house Research staff.

Three principles drive the creation of the Mutual Fund Recommended List

Independence and Objectivity. The Recommended List is created with the understanding that all decisions are made on an independent and objective basis. Commonwealth strives to free ourselves from all outside influences to add or delete mutual funds. Additionally, our unbiased advice is never intended to pressure investors to buy/sell certain funds within their portfolio. Our advice is centered around the basis of merit within each client's financial situation.

Investor Needs. No list can serve or anticipate the needs of every investor. A list that is carefully created and meticulously crafted can serve the needs of many, however. The Recommended List is built on this premise by making the assumption that there is a beneficial tradeoff in creating a list for many, as opposed to one. In general, the list is designed to offer something for every investor, or better yet, to meet the needs of the average investor.

Longevity. Fund additions are made because there is a deep-seated belief that the fund will stay on the list until it closes. "Funds of the Month" or even "Funds of the Year" do not receive considerable attention due to empirical research, which asserts that such funds are more than likely to underperform the market in the following year. With that said, for the Recommended List to be effective, turnover must be kept to a minimum.

What makes Commonwealth's Recommended List different from lists offered by other firms?

Unbiased Advice. It is never the analysts' intent to pressure advisors to offer certain funds to their clients. Analysts advise or recommend funds on the basis of merit and client situation. They have no interest in steering advisors to sell any fund, especially if a particular fund does not meet the stringent requirements that make up the selection process. This is also consistent with the analyst staff's position on being independent in all decision-making.

Platform for Additional Research. Because the list is geared for the average investor, it should not be regarded as the end of an advisor's research needs. Granted, the Recommended List is designed to be a timesaver, but this does not eliminate the need for your advisor to conduct independent research.

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Furthermore, since the list makes no mention of optimal asset mixes/asset allocations, your advisor must conduct additional research or seek out additional counsel from analysts to decide whether particular recommended funds will be optimal within your asset allocation framework.

The Art of the Analysis. Though the Recommended List is constructed in a rigorous fashion, using a combination of quantitative and qualitative research, it can still be construed as an artistic creation because, ultimately, the analysts make decisions on what variables to analyze, weigh, consider, or include in a particular analysis. This does not imply that a process does not exist—because a process is definitely in place—but that the selection of inputs that is integral to the overall process and subsequent selection of mutual funds can be somewhat subjective in nature.

Manager Selection Process

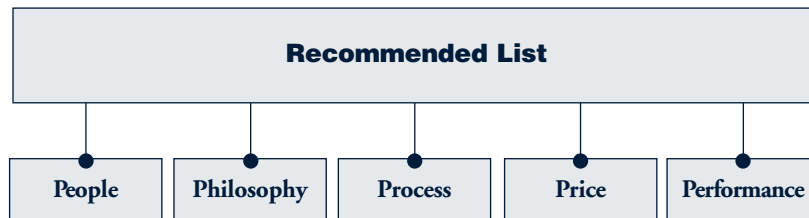
The mutual fund manager selection process describes the many considerations that Commonwealth makes when deciding what funds deserve to be included or removed from the Recommended List. The process has four distinct parts: (1) Screening, (2) Evaluation, (3) Analysis, and (4) Final Consideration.

Step 1: Screening

Before any serious analysis can be conducted, an initial screening takes place. The purpose of this screening is to concentrate on the stronger relative performers within a given category or asset class. To do this, managers performing below category median returns over a three- to five-year period are eliminated. Also of note, all current Recommended List funds are included for benchmarking purposes. Following this, more screens are conducted to ensure that a fund is available for purchase, has a sufficient long-term track record, and is not hybrid product or product that invests a significant portion of its assets in bonds or categories that are different from its Morningstar definition. This step is taken to ensure that funds within a particular category meet investors' expectations.

Key Screening Influences

- Rate of return vs. beta (volatility)
- Manager track record
- Top 1/3 ranking among the peer group (asset class)
- Performance reaction in both up and down quarters
- Investment style consistency
- Investment sector diversification



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Step 2: Evaluation

After screening, funds are evaluated by applying a risk-adjusted returns scoring system to the remaining mutual funds. The intention of this step is to draw attention to candidates more likely to be selected for the Analysis stage. It also serves as a monitoring tool for mutual funds already on the list. Other tools that are used for evaluation purposes include rolling three- and five-year excess returns. These measures are meant to supplement the risk-adjusted scoring system with additional objective measures.

Step 3: Analysis

The next step is to cherry-pick funds that are worthy of final consideration. This is done by considering the quantitative data collected, as well as any fundamental information that is acquired from fund fact sheets, analysts, conferences, portfolio manager/fund company visits, and/or conference calls. The objective of this step is to build a solid understanding of how a mutual fund operates. In general, this step requires careful attention to the five P's of manager or fund analysis: philosophy, process, people, performance, and price. Ideally, the Recommended List includes mutual funds that are strong in all areas, as such funds will have the greatest chance of performing to expectations and a smaller likelihood of being eliminated.

Step 4: Final Consideration

Only a few funds will make it to this stage. But making it to this stage does not necessarily mean that a mutual fund will be added to our Recommended List. In fact, the state of the current list is what influences whether a mutual fund addition is needed. Once again, for the list to be useful, turnover must be kept to a minimum or the list will resemble a high-octane stock portfolio.

At any rate, the intent of this stage is (1) to produce high-quality fund names that can be added to the list; (2) to serve as a short list for advisors requiring one-off recommendations that meet a specific client need; (3) to act as a monitoring system for high-quality funds that are likely to be added in the future (contingent upon certain conditions being met); and (4) to further justify why current Recommended List funds deserve to stay on the list.

It is also worth mentioning that, at this stage, fund finalists are compared with current Recommended List funds on a quantitative and qualitative basis. Fundamental mutual fund factors are discussed in greater detail and more quantitative data is examined, including upside/downside capture, benchmark tracking, style analysis, and rolling three-year universe ranks.





Investment Selection Methodology continued

Manager Monitoring

Mutual funds that are already on our list are continuously monitored to ensure that they continue to deliver strong relative and absolute performance. But monitoring is more than just performance. It involves the framework already set forth in the five P's. Careful attention to the five P's, and to whether a particular variable has changed, are paramount to the manager monitoring process because performance is directly related to the strength of these variables. Specific issues falling under the five-P framework and receiving special attention include manager turnover, style inconsistency, significant outperformance or underperformance, process changes, and fund mergers.

To communicate information that is garnered from the regular monitoring of funds, the Recommended List Quarterly Review, as well as Fund Fact summaries, are enlisted. The Quarterly Review provides summaries and quarterly performance information for every Morningstar category and fund on the Recommended List. Its objective is to provide advisors with historical information on funds that can be conveyed to clients. Fund Facts provides fund-specific profiles as well as up-to-date quantitative graphs and charts, which are not readily available to the investment community.

Efficacy of the List

On a quarterly basis, the efficacy of our Mutual Fund Recommended List is evaluated. Questions concerning how well the list performed since mutual funds were added or deleted, as well as how well the list performed on a risk-adjusted basis, are answered. Overall, our Recommended List's performance is treated like a stock portfolio. When a mutual fund is added, its performance contributes to or detracts from the performance of the list. Lastly, the benchmark for performance is the median for each respective category.



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