

Parametric Custom Core SMA Strategies

Global Manager Research

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Strategy basic facts

Strategy inception:

Multiple (see table below)

Strategy assets:

Multiple (see table below)

Portfolio Managers:

Thomas Seto; Paul Bouchey, CFA,
Rey Santodomingo, CFA

Sub-style:

Multiple (see table below)

GMR benchmark:

Multiple (see table below)

GMR rating:

Recommended

Key takeaways

- Global Manager Research (GMR) has a Recommended rating on the suite of Parametric Custom Core (CC) strategies (collectively, the Strategies)
- The Strategies are designed to provide pre-tax performance that tracks the assigned index, while minimizing net realized capital gains to provide improved after-tax returns versus the benchmark.
- The after-tax benefit of these strategies is difficult to quantify and will vary greatly depending on investor specific circumstances.

Key strengths

- **Tools/Technology:** Parametric Portfolio Associates (Parametric or the Firm) utilizes proprietary quantitative risk models and an optimization process that may better enable the portfolio managers to capture tax alpha (the difference between excess after-tax return and excess pre-tax return relative to a benchmark) across multiple custom accounts at a low cost.
- **Team/Process Continuity:** Parametric has managed tax-efficient portfolios since 1992, and has delivered tax alpha regardless of team changes.

Considerations

- The Strategies are passive in nature and use a sampling methodology. Combined with fees, this could lead to some minor dispersion from the index's performance.
- As the account ages, especially during a rising market, the tax alpha generating ability will decrease. Other factors such as cross-sectional volatility of the index could also create periods where there is limited tax alpha generating ability.

Performance Expectations

As the Strategies are passive in nature, GMR expects them to track their respective indexes with minimal tracking error (extent to which a portfolio's returns have differed from its index).

Investment and Insurance Products: NOT FDIC Insured ► NO Bank Guarantee ► MAY Lose Value

Below is a list of the GMR Recommended Parametric Custom Core Strategies discussed in this report:

Product Name	Product Benchmark	GMR Benchmark	Strategy Assets (as of 6/30/20)	Inception Date
Parametric CC – Broad Cap	Russell 3000	Russell 3000	\$13.1 B	12/31/1997
Parametric CC – Large-Mid Cap	Russell 1000 Index	Russell 1000 Index	\$5.02 B	3/31/1998
Parametric CC – Large Cap	S&P 500 Index	Russell 1000 Index	\$30.92 B	5/31/1996
Parametric CC – Mid Cap	S&P MidCap 400 Index	Russell Midcap Index	\$235.96 M	1/31/2014
Parametric CC – Small Cap	S&P SmallCap 600 Index	Russell 2000 Index	\$376.33 M	8/31/1999
Parametric CC – Developed International ADR	MSCI EAFE Index	MSCI EAFE Index	\$864.4 M	12/31/1996
Parametric CC – Global ex-US ADR	MSCI ACWI ex-US Index	MSCI ACWI ex-US Index	\$897.05 M	3/31/2015

Firm details

Website:

www.parametricportfolio.com

Location:

Seattle, WA

Ownership:

Subsidiary of Eaton Vance

Assets:

\$297B (6/30/20)

Publicly traded:

No

Firm

Organization

Parametric was founded in 1987 as a subsidiary of Pacific Financial Asset Management Company. Parametric is currently 100% owned by Eaton Vance as an affiliate and operates mostly independently. Parametric has been providing engineered portfolio solutions to institutional and private clients for over 30 years, with a sharp focus on implementation excellence and client-specific customization.

Analyst Assessment

GMR has reviewed the qualifications and backgrounds of Parametric's senior executives and we believe they are well positioned to continue to lead Parametric on its mission. Although there is no direct ownership of the Firm by the employees, key employees participate in the Firm's success by means

of equity-based compensation. There were a number of executive changes in 2019 as the Firm integrated further with parent firm Eaton Vance. Jodi Wong, who was managing director of global equities portfolio management was replaced by Geoff Longmeier effective January 1, 2020. Christine Smith, who was Chief Operating Officer, was replaced by Ranjit Kapila who joined as Chief Technology Officer and Head of Operations. Orison Chaffee, who was managing principal and head of technology and operations of the Minneapolis office has retired. Chaffee's role was absorbed by Kapila. GMR has engaged in conversations regarding these executive changes and believe that the changes were implemented thoughtfully and effectively.

Investment Personnel

Experience & Depth

Due to the passive nature of the investment process, there is no single individual investment person who handles the traditional day-to-day responsibilities of a portfolio manager. The Chief Investment Officer (CIO) and Head of Investment Strategy are responsible for the Strategies. The other portfolio managers are responsible for the implementation of the Strategies including managing client specific restrictions and tax situations and providing a feedback mechanism. As such, the research team creates and maintains the quantitative systems and tools for use across the Firm. Those researchers who have primary responsibility for a strategy are denoted as strategists (or co-strategists), and it is their duty, in conjunction with CIO Paul Bouchey, to lead the evolution of the investment rules which govern a strategy. These rules govern how the portfolios are managed, and are the implementation rules which dictate the actions of the portfolio management team.

Portfolios are managed on a team basis under the direction of Bouchey and Seto. The Custom Core Investment Team meets periodically to review market conditions and accounts with activities. The investment process is implemented with a high degree of automation. However, the responsible portfolio manager guides the process and ultimately ratifies trades. Accounts are peer-reviewed monthly.

Key Employees	Title/Responsibilities	First Year at Firm	First Year in Industry
Paul Bouchey, CFA	Global Head of Research	2006	1995
Thomas Lee, CFA	CIO, Equities and Derivatives	1994	1989
Thomas Seto	Head of Investment Management	1998	1991
Gordon Wotherspoon	Managing Director, Portfolio Management	2004	2000
Rey Santodomingo, CFA	Managing Director, Investment Strategy	2008	2003
Jennifer Sireklove, CFA	Managing Director, Investment Strategy	2013	2006

Stability

The senior investment team has seen very limited turnover in recent periods. Employee turnover in general has been relatively muted at Parametric. The passive nature of Parametric does not rely on the investment perspectives of a single individual. Instead, Parametric uses a team format to manage its strategies, and the investment team structure differs from the conventional Portfolio Manager/Analyst setup seen on teams focused on active management.

Salaries, bonuses and stock-based compensation are also influenced by the operating performance of Parametric and its parent company, Eaton Vance. While the salaries of investment professionals are comparatively fixed, cash bonuses and stock-based compensation may fluctuate from year-to-year, based on changes in financial performance and other factors. Parametric also offers opportunities to move within the organization, as well as incentives to grow within the organization by promotion.

Analyst Assessment

Investment professional turnover has been relatively low for Parametric and is not concerning to us at this time. GMR believes their process is repeatable and not overly dependent on key individuals or groups. The portfolio implementation team is cross-trained and can easily take over tasks when needed. GMR believes the team of investment professionals at Parametric is well equipped to implement their investment philosophy and believes above average stability exists within the team. Additionally, GMR believes that Parametric has implemented attractive compensation and incentive policies for employees which will support continued stability within the investment team.

Investment Philosophy & Process

Philosophy

Parametric’s investment philosophy is based on the Firm’s conclusions from their long-term observations on capital markets, risk, and cost. Parametric believes most capital markets are highly efficient. Outperforming them is difficult and increases risk and costs. Many investors rationally seek these returns, but caution is essential. Risk management can help ensure that an investment program is maintained during diverse market conditions. Costs can mean the difference between success or failure. If the portfolio pays taxes, tax efficiency can be paramount. These observations are at the foundation of all Parametric investment products.

Portfolio Constraints/Characteristics							
Strategy	Parametric CC US Broad Cap	Parametric CC US Large Cap	Parametric CC US Large-Mid Cap	Parametric CC Mid Cap	Parametric CC Small Cap	Parametric CC Dev Mkts Intl	Parametric CC World ex-USA
Strategy Benchmark	Russell 3000 Index	S&P 500 Index	Russell 1000 Index	S&P MidCap 400 Index	S&P SmallCap 600 Index	MSCI EAFE Index	MSCI ACWI ex-US
Number of Holdings	400-450	300-400	250-325	300-400	450-500	300-400	450-525
Individual Security Weighting Maximum	None	None	None	None	None	None	None
Sector Weighting Maximum	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Capitalization Range	Total Market	Large Cap	Large Cap	Mid Cap	Small Cap	Large Cap	Large Cap
Country Weighting Maximum	US only	US only	US only	US only	US only	Developed Markets ex-US	Developed Markets ex-US
ESG Analysis* *Please see General Disclosure section for definitions.	Not Applicable	Not Applicable	Not Applicable	Not Applicable	Not Applicable	Not Applicable	Not Applicable

Process: Approach & Research

The goal for the Strategies is to provide pre-tax performance that tracks the assigned index, while minimizing net realized capital gains to provide improved returns vs. the benchmark on an after-tax basis. This has historically been achieved by utilizing tax-efficient trading methodologies implemented with an advanced portfolio optimization model and highly efficient trading technology.

The investment process is managed utilizing a rules-based model with risk management embedded in the decision-making and portfolio construction process. Since the Strategies are managed with a systematic model, there is no interference from judgment or human error, allowing the Strategies to be managed utilizing an independent risk management and investment process which is ultimately governed by the Investment Committees. GMR believes this process is automated, systematic and repeatable. Parametric’s process allows for the team to alter the model inputs based on client-specific constraints (usually tax oriented); at the same time, the proprietary optimization model analyzes trade-offs between tax losses and tracking error.

ESG Analysis

While Parametric offers the ability to integrate Environmental, Social, and Governance (ESG) factors into the Strategies, the Strategies themselves by default seek to track broad-based indexes.

Process: Portfolio Construction

Securities are selected for purchase based on an optimization process which constructs a portfolio with similar characteristics as the index to Strategies are seeking to track. Similarly, securities are selected for sale based on an optimization process which evaluates portfolio holdings, cash, portfolio risks, client constraints, benchmark characteristics, tax lots and tax rates in an effort to balance the trade-off between the tax cost and portfolio risk. For example, those securities sold at a gain are not sold based on expected low alpha; rather, they are sold to improve index tracking characteristics of the portfolio. In the loss-harvesting process, securities are sold primarily for their ability to reduce the tax impact of other securities being sold at a gain in this portfolio, or due to client request for losses or gains to be realized.

Process: Risk Management

The Enterprise Operational Risk Committee is responsible for identifying and assessing enterprise risks, and prioritizing management's response to identified risks. The Enterprise Operational Risk Committee oversees the firm-wide Vendor Oversight Committee along with corresponding subcommittees covering both the Seattle and Minneapolis offices: Operational Risk, Best Execution, Valuation, and Model Oversight.

In addition, the Internal Audit department is provided by Parametric's parent company Eaton Vance. Internal Audit provides independent and objective assurance and consulting services that oversee the design and operating effectiveness of internal control systems. The Internal Audit Department reports to the Audit Committee of the Board of Directors of Eaton Vance.

Analyst Assessment—Process

GMR believes Parametric has a disciplined, structured approach which has provided transparent, consistent, and repeatable results over time with the potential for more tax benefits than a traditional passive approach. GMR believes Parametric's process in managing the Strategies is robust and highly scalable, supporting our confidence in the Firm's ability to execute on delivering the Strategies' goals.

Analyst Assessment—Performance

The Strategies have demonstrated a similar return and risk profile to the various indexes they seek to track as well as historically low tracking error. Exposure characteristics such as market cap and sector are broadly analogous to the indexes the Strategies seek to track and have caused no major deviation in risk or returns between the Strategies and the particular index they seek to track. GMR believes Parametric can continue to generate index-like returns with minimal tracking error.

Risk Factors

There is no guarantee that the Strategies will meet their investment objectives. All investing involves risk including the possible loss of principal.

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Equity securities are subject to market risk which means their value may fluctuate in response to general economic and market conditions and the perception of individual issuers. Investments in equity securities are generally more volatile than other types of securities.

The prices of small and mid-cap company stocks are generally more volatile than large company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.

Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. These risks are heightened in emerging markets.

GMR's benchmark selection is typically driven by a Strategy's asset class assignment which helps GMR provide a consistent assessment across asset classes. Although GMR may measure the Strategy's performance (gross of fees) against its index selection, the Strategy may measure its own performance against a different benchmark.

Definitions

MSCI All Country World ex US Index (MSCI ACWI ex-US) is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world. It consists of 46 country indexes comprising 23 developed and 23 emerging market countries.

MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada.

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Russell 1000 Index measures the performance of the 1,000 largest companies in the Russell 3000 Index, which represents approximately 90% of the total market capitalization of the Russell 3000 Index.

Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.

Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

S&P MidCap 400 Index is a capitalization-weighted index measuring the performance of the mid-range sector of the U.S. stock market, and represents approximately 7% of the total market value of U.S. equities. Companies in the Index fall between the S&P 500 Index and the S&P SmallCap 600 Index in size: between \$1-4 billion.

S&P SmallCap 600 Index consists of 600 domestic stocks chosen for market size, liquidity (bid-asked spread, ownership, share turnover and number of no trade days) and industry group representation. It is a market value-weighted index (stock price times the number of shares outstanding), with each stock's weight in the index proportionate to its market value.

An index is unmanaged and not available for direct investment.

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*GMR uses qualitative and quantitative methods to assess investment products on their use of ESG (Environmental, Social, Governance) analysis. GMR is not implying that more ESG analysis is inherently better than less ESG analysis. After a full review of the investment product, the product is assigned to one of five categories: Immaterial or Not Applicable, Aware, Integrated, Key Driver, Impact Leader. GMR ESG Analysis categories are generally described as: "Immaterial or Not Applicable", where ESG Analysis is a negligible or nonexistent part of the investment process and decisions. "Aware", where E, S, and G factors are all considered independently to some degree but the factors are just a part of the larger investment discussion. There is likely not a dedicated ESG individual or team. "Integrated", where E, S, and G factors are all fully integrated and applied throughout the investment process. There is likely a formal ESG assessment process that is applied to all securities before addition to the portfolio and on-going ESG monitoring is executed. There is likely a dedicated ESG individual or team and they have a strong relationship with the main investment team. "Key Driver", where all the aforementioned qualifications apply and what is more, the results and findings of the ESG analysis are a key driver of idea generation and investment decisions; and "Impact Leader", where all the aforementioned qualifications apply and the investment product, in partnership with their parent firm, works with companies to improve their ESG profiles and build toward increased company and global sustainability. ESG categories are provided for informational purposes only. ESG analysis is not considered in GMR investment assessment recommendations.

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