



CYPRESS ASSET MANAGEMENT

**A Registered Investment Advisor**

**Providing tailored  
solutions to qualified  
retirement plans**



# Fiduciary Responsibility

- ♦ **Has your investment advisor acknowledged that they are a co-fiduciary?**
  - Is it acknowledged in writing
  
- ♦ **Has your investment advisor provided a written investment policy statement?**
  - All plans are required to have an investment policy according to ERISA
  
- ♦ **Are you liable for the results of your participants' investment selections?**
  - ERISA 404(c)
  - Plan sponsors may be liable for participants' losses if the plan is not ERISA 404(c) compliant



# Fiduciary Responsibility

- ♦ **ERISA 404(c) protects the plan sponsor from the results of investment choices that participants make within the plan's options. It does NOT protect the plan sponsor from the fiduciary decision of which funds to include in the plan.**
- ♦ **Do you know the total cost of the investments offered in your plan?**
- ♦ **What is your process for monitoring fund performance, style and turnover?**
- ♦ **Do you adhere by the Prudent Investor Rule?**



# What is ERISA 404(c)

- ♦ **ERISA 404(c) provides plan sponsors protection from the the results or investment decisions that plan participants make within the plan's option**
- ♦ **ERISA 404(c) plan sponsor requirements (partial list)**
  - Provide at least three different investment options that have substantially different risk and return characteristics
  - Provide "sufficient" information for participants to make their investment decisions
  - Allow participants to switch investments at least quarterly
  - Explain that the plan is intended to be 404(c) compliant
  - Provide a Summary Plan Description
  - Describe each investment alternatives
  - Identity of a designated investment manager
  - Describe additional information a participant may obtain upon request and the name, address and phone number of the plan fiduciary responsible for providing the requested information



# Prudent Investor Rule

**The American Law Institute (ALI) creates model legislation for states to adopt. The Prudent Investor Rule was drafted by the ALI to give fiduciaries direction as to how to invest participant's and beneficiary's assets. The vast majority of states have adopted the Prudent Investor Rule.**

- The American Law Institute adopted Modern Portfolio Theory (MPT) as the standard by which fiduciaries should invest assets
- Plan performance will be measured as a portfolio rather than individual funds or managers
- Fiduciaries can share liability if they exercise reasonable skill and care in making a delegation to an agent that will be held to the same standards as the fiduciary
- In May 1992 The American Law Institute published the Third Restatement of the Prudent Investor Rule



# Prudent Investor Rule Third Restatement

**“Active strategies, however, entail investigation and analysis expenses and tend to increase general transaction costs... Additional risks also may result from the difficult judgments that may be involved and from the possible acceptance of relatively high degree of diversifiable risk. These considerations are relevant to the trustee initially in deciding whether, to what extent, and in what manner to undertake an active investment strategy and then in the process of implementing any such decisions.”**



# Prudent Investor Rule Third Restatement (continued)

**“If the extra costs and risks of an investment program are substantial, these added costs and risks must be justified by realistically evaluated return expectations. Accordingly, a decision to proceed with such a program involves judgments by the trustee that...”**

- a) Benefits out weigh the costs
- b) There is a justifiable reason to choose such investments in the plan
- c) The trustee has access to a manager with the competence necessary to implement and monitor these investments



# Prudent Investor Rule Third Restatement (continued)

**“The greater the trustee’s departure from one of the valid passive strategies, the greater is likely to be the burden of justification and also of continuous monitoring.”**



# The 4% Solution

## The Hurdles of Active Management

$$\begin{aligned} & 1\% \text{ Operating Expenses}^1 \\ & 1\% \text{ Cost of Cash} \\ & 1\% \text{ Transaction Costs}^2 \\ & + 1\% \text{ Market Impact Costs}^3 \\ \hline & = 4\% \text{ Hurdle of Active Management} \end{aligned}$$

Source: <sup>1</sup>John Bogle, *Common Sense on Mutual Funds*, p. 206

<sup>2</sup>Charles Ellis, *Winning the Loser's Game*

<sup>3</sup>New York Times, July 11, 1999



Account	Investment	Symbol	Current Value	Annual Fund Exp %	Cash \$	Turnover		
401(k)	Putnam Classic Equity Fund	PXGIX	232,886.30	0.97	2,259.00	2.00%	4,657.73	81%
	Putnam Europe Growth A	PEUGX	7,193.93	1.23	88.49	0.00%	-	89%
	Putnam High Yield Trust A	PHIGX	14,407.83	0.99	142.64	1.00%	144.08	77%
	Putnam Internatioinal Growth A	POVSX	383,039.79	1.13	4,328.35	3.40%	13,023.35	74%
	Putnam Investors Fund A	PINVX	603,524.21	0.89	5,371.37	1.80%	10,863.44	94%
	Putnam MM		8,603.95	0.50	43.02	0.00%	-	0%
	Putnam New Opps A	PNOPX	596,107.35	0.89	5,305.36	2.10%	12,518.25	68%
	Putnam S & P 500		4,465.06	0.15	6.70	13.50%	602.78	0%
	Putnam US Govnt Income A	PGSIX	201,000.31	0.87	1,748.70	13.50%	27,135.04	133%
	Putnam Vista Fund A	PVISX	5,434.28	0.89	48.37	1.10%	59.78	109%
	Putnam Voyager A	PVOYX	414,218.09	0.88	3,645.12	0.08%	331.37	140%
	George Putnam of Boston A	PGEOX	153,708.82	0.92	1,414.12	0.00%	-	333%
Money Purchase	Putnam Classic Equity Fund	PXGIX	69,545.01	0.97	674.59	2.00%	1,390.90	81%
	Putnam Europe Growth A	PEUGX	3,187.64	1.23	39.21	0.00%	-	89%
	Putnam High Yield Trust A	PHIGX	1,323.58	0.99	13.10	1.00%	13.24	77%
	Putnam Internatioinal Growth A	POVSX	126,187.03	1.13	1,425.91	3.40%	4,290.36	74%
	Putnam Investors Fund A	PINVX	187,099.81	0.89	1,665.19	1.80%	3,367.80	94%
	Putnam MM		8,879.57	0.50	44.40	0.00%	-	0%
	Putnam New Opps A	PNOPX	196,056.89	0.89	1,744.91	2.10%	4,117.19	68%
	Putnam S & P 500		3,038.84	0.15	4.56	13.50%	410.24	0%
	Putnam US Govnt Income A	PGSIX	21,693.76	0.87	188.74	13.50%	2,928.66	133%
	Putnam Vista Fund A	PVISX	3,625.32	0.89	32.27	1.10%	39.88	109%
	Putnam Voyager A	PVOYX	150,640.22	0.88	1,325.63	0.08%	120.51	140%
	George Putnam of Boston A	PGEOX	38,444.49	0.92	353.69	0.00%	-	333%
			<b>3,434,312.08</b>	<b>0.93</b>	<b>31,913.40</b>	<b>2.50%</b>	<b>86,014.60</b>	<b>107%</b>

\* S&P 500 infromation not available .15% is an aproximate average for an S&P Index Fund

Data from Morningstar as of Aug 31, 2002.

Data from sources deemed reliable; however, accuracy cannot be guaranteed.



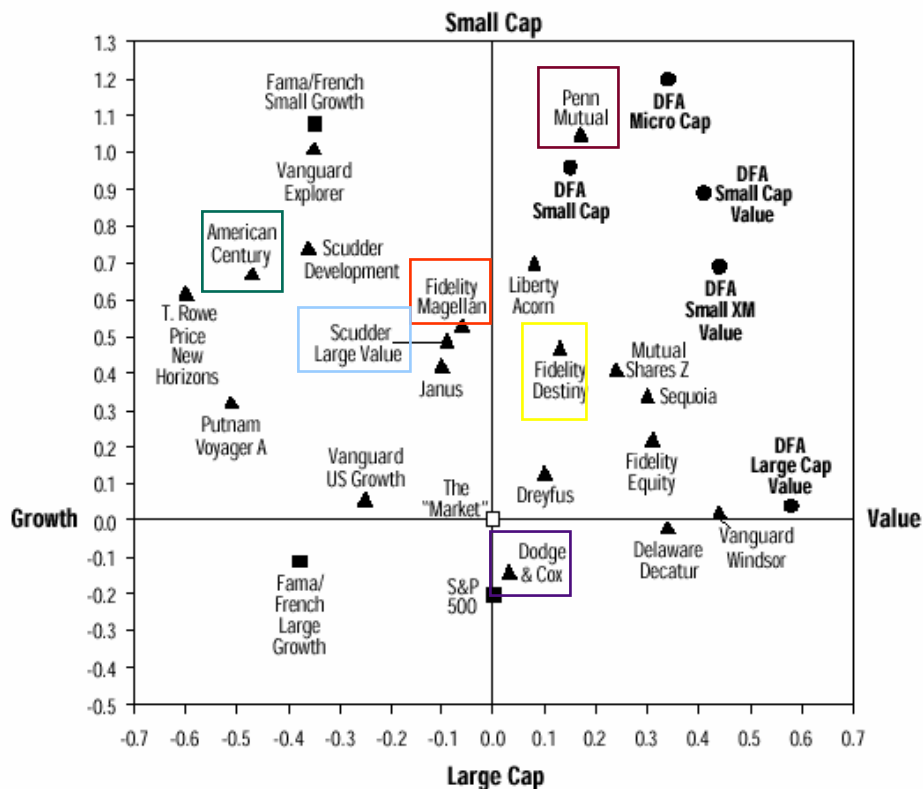
# Concerns With Active Management

- ◆ **Justifying Costs**
  - The Prudent Investor Rule states that costs in a retirement plan must be justified.
  - Do the benefits of active management outweigh the costs?
- ◆ **Due diligence burden**
  - Plan fiduciaries must document the initial and ongoing due diligence process performed on all investment options.
- ◆ **Style Drift**
  - Active managers have the tendency to allow style drift in their portfolio construction.
  - Are plan participants getting the ongoing diversification they expect?

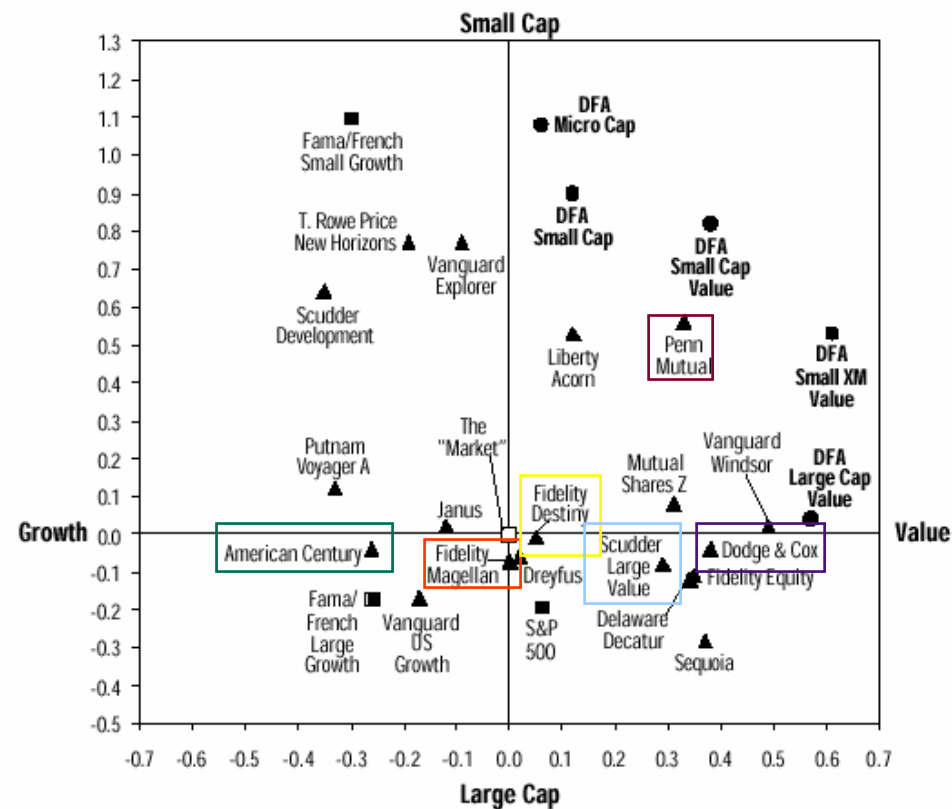


# Style Drift

January 1976-December 1988



January 1989-December 2002



Data Courtesy of CRSP, Morningstar Inc.  
Funds frequently change their loadings on size and book to market

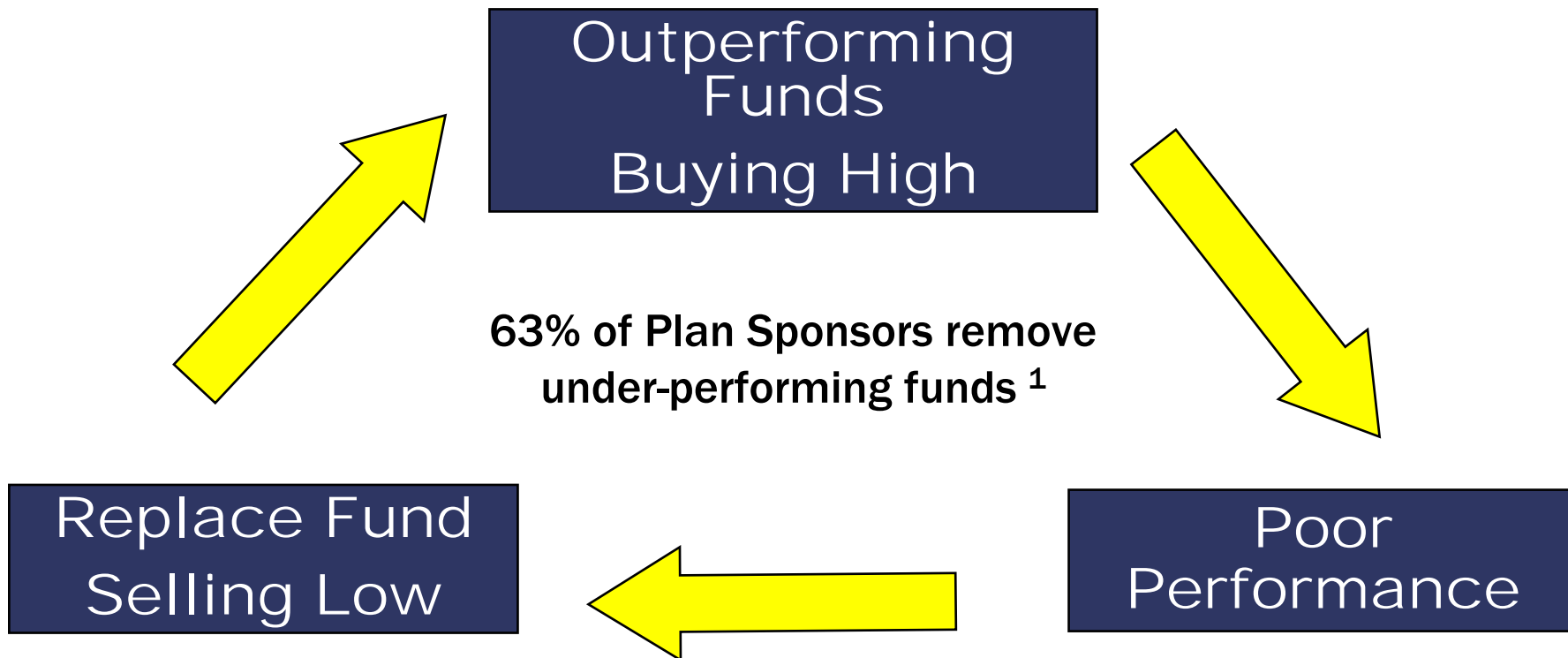


# What Differentiates Providers?

- ♦ **Advertising**
  - Roger Carlock, the SVP and Director of MFS advertising said: “Fund managers are finding it increasingly difficult to beat the market averages, so name recognition serves as another weapon in the battle for customers. When looking for a fund, you feel better when a company is out there advertising.” <sup>1</sup>
- ♦ **Website bells and whistles**
  - Providers don’t stand out with performance so they offer creative and cosmetic 401(k) platforms to differentiate themselves from the competition.
  - A majority of 401(k) platform features do not increase performance or the participants chances of achieving their retirement goals
- ♦ **Services**
  - Education
  - Fund monitoring services



# Fund Monitoring Services: The Active Cycle:

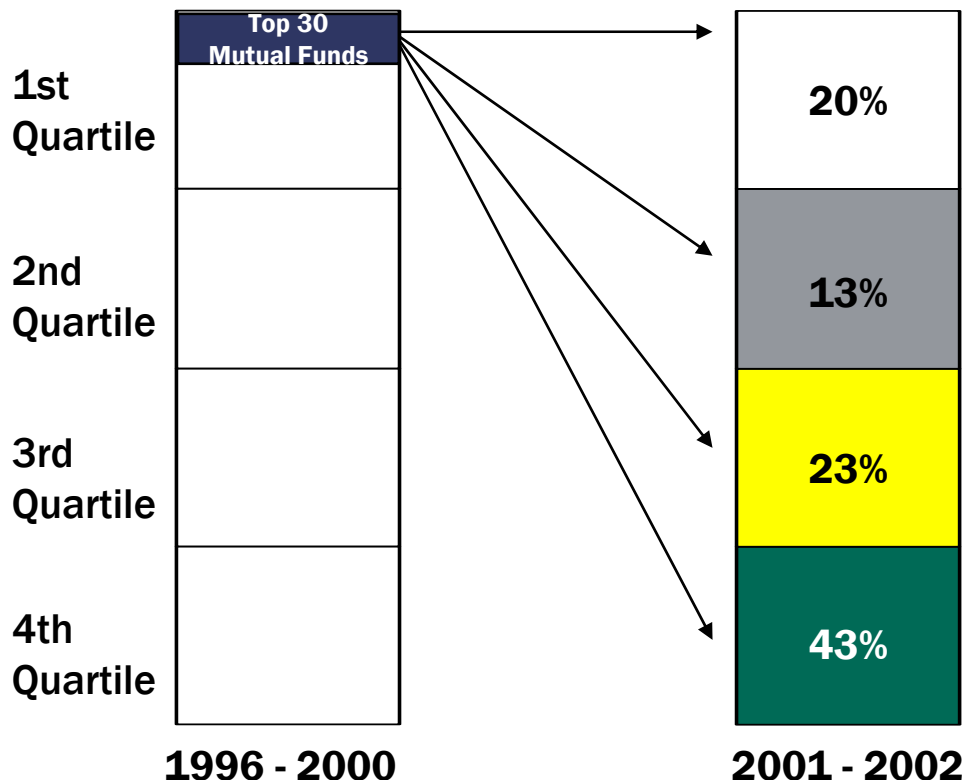


Source: <sup>1</sup> Deloitte & Touche 2002 Annual 401(k) Benchmarking Survey.



# The Fallacy of Past Performance as a Predictor of Future Performance

## Subsequent Performance of Top 30 Mutual Funds



Source: Micropal™ (excludes international, balanced and specialty funds).  
Performance is historical and does not guarantee future results.  
Information from sources deemed reliable but its accuracy cannot be guaranteed.



# Why Passive?

- ♦ **Compliance with the Prudent Investor Rule**
- ♦ **Avoid the active cycle of selling low and buying high**
- ♦ **Consistency**
  - Receiving benchmark returns
  - No style drift
- ♦ **Minimizing Costs**
- ♦ **Only way to play with the “House’s Odds”**



## XYZ Savings & Retirement Plan 401k Plan Fee Analysis

Current Provider			
<b>Plan Data</b>			
Enter the number of participants	67		67
Enter the amount of assets	\$ 400,250		\$ 400,250
Enter the Advisor/Broker Fee	0.90%		0.80%
Enter the average fund expense ratio	2.34%		0.38%
<b>Investment Advisory</b>			
Broker Fee	\$ 3,602		\$ 3,202
<b>Mutual Fund Fees</b>			
Internal Fund Expenses	9,366		1,521
Custodial Services (Security Trust)	-		400
Mutual Fund Reconciliation at Participant Level	12,968	included in fund fee	1,401
			6,524
<b>Administration and Compliance</b>			
Reporting at Plan Level			-
Compliance Services (Form 5500) and Testing	1,822	TPA portion	2,500
	1,822		2,500
Annual fees coming out of plan assets	3.24%		1.63%
<b>Total Cost (Annual)</b>	<b>14,790</b>		<b>9,024</b>

Advisor Fee

(institutional class funds)  
(.10% of assets) Security Trust  
(.35% or assets) Daily Valuation at participant level

**Participant Education (Waived)**

	Before	After	Diff	New bps
Broker/Advisor	\$ 3,602	\$ 3,202	\$ (400)	-0.10%
Mutual Funds	\$ 9,366	\$ 1,521	\$ (7,845)	-1.96%
TPA	\$ 1,822	\$ 2,500	\$ 678	0.17%
BenefitStreet	\$ -	\$ 1,401	\$ 1,401	0.35%
Custodian	\$ -	\$ 400	\$ 400	0.10%
<b>Total Cost</b>	<b>\$ 14,790</b>	<b>\$ 9,024</b>	<b>\$ (5,766)</b>	<b>(0.0144)</b>



# Participant Misdirection

- ♦ **Lack of diversification**
  - 80% of participants use four or fewer funds and 50% invest in one or two <sup>1</sup>
- ♦ **More Investment options results in lower participation**
  - According to a 1999 Hewitt Associates study, participation is at its highest level with three to four investment options <sup>2</sup>
  - Participants can be overwhelmed
- ♦ **Rebalancing vs. chasing returns**

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**Source:**

<sup>1</sup>The Vanguard Group, Inc. *The Challenges of Choice*. Pg 3.

<sup>2</sup>Ibid.



# How Costly is Overconfidence?

- ♦ For the 15-year period ending in 1998, the S&P 500 returned almost 18% per year. The average investor earned just over 7%.
- ♦ The average individual investor in the study earned a cumulative return of 140%. If they had simply invested in the S&P 500, their cumulative return would have been 820%.



# Portfolio Construction and Implementation

- ◆ **Fewer choices with much greater diversification**
  - Pre-constructed lifestyle portfolios
  - Higher expected return for a given level of risk
  - Lower standard deviation for a given level of risk
  - Participants who desire more options can be accommodated
- ◆ **Automatic rebalancing**
  - Education
  - Discipline



**How We Help Implement This :**

**Solutions for 401(k)  
Retirement Plans**



# Bundled 401(k) Solutions Make it Easy for Plan Sponsors and Participants

## 1. Investment freedom

- Choose lifestyle portfolios or from thousands of mutual funds
- Set up self-directed brokerage accounts

## 2. Time saving technology

- Online and paper enrollment
- Secure web-based payroll and census gathering software
- Call Center and Web Conference Support for trustees and HR managers
- Voice response 800 number
- Online reporting and transactions
- Automated rebalancing of account investments

## 3. Scalable

- Multiple locations; unlimited growth
- In-house or outsourced TPA services to any TPA in the nation
- Ease in making changes to plan and investment options

## 4. Investment Education

- On-site educational seminars
- Easy-to-understand investment education
- Long-term retirement objectives
- Fund selection by risk tolerance



# Simple Enrollment Process

## Enrollment Options

• Choose a dollar amount or percentage for salary deferrals

• Select automatic rebalancing

• Enroll in lifestyle portfolio options

or

• Customize your own portfolio

### Enroll In 2 Minutes

**Kenneth Walls Enrollment and Investment Elections**

**Participation**

To change your participation option select from the choices below.

I elect NOT to participate in the Plan at this time.  
 I elect to participate in the Plan and authorize a deduction from my paycheck in the amount of  pre-tax and  post-tax per pay period.  
 I elect to participate in the Plan and authorize a deduction from my paycheck in the amount of  pre-tax and  post-tax per pay period.

**Automatic Rebalancing**

Your plan allows you to participate in automatic, scheduled rebalancing in order to keep your account in line with your investment objectives. For more information about rebalancing see [The Importance of Rebalancing](#). If you select a custom portfolio for your contributions, your account is not eligible for automatic rebalancing.

Your plan automatically rebalances accounts QUARTERLY and will next be processed on 5/5/2003.

I elect to have my portfolio automatically rebalanced on the scheduled dates.  
 I elect NOT to participate in automatic rebalancing at this time.

**Investment Portfolios**

Choose an investment portfolio from the options below. Should you choose 'Custom Portfolio', you will be given an opportunity to provide the election percentages for the funds composing your portfolio. To see a distribution diagram for an investment portfolio click the portfolios description.

I hereby authorize and direct the Trustees of the Plan to invest my funds as follows:

[Aggressive Growth / Highly Risk Tolerant](#) (Stocks 100 / Fixed Income 0)  
 [Moderately Aggressive Growth / Generally Risk Tolerant](#) (Stocks 80 / Fixed Income 20)  
 [Moderate Approach / Greater Need For Security](#) (Stocks 40 / Fixed Income 60)  
 [Custom Portfolio](#) (Stocks 100 / Fixed Income 0)

**Click 'Submit' when you are done making selections.**

The above portfolios have been designed for retirement plan participants and represent a wide spectrum of investment objectives, including investment time horizon and volatility.



# Pre-Constructed Lifestyle Portfolio Details

## Portfolio Details

Portfolio	Description
"Highly Aggressive Portfolio" (100/0)	You have a lengthy time horizon to accommodate market cycles. Growth is very important and you are willing and able to accept the market risks generally required to accomplish growth over time.
"Aggressive Portfolio" (80/20)	Growth is important and you are prepared for market volatility to achieve potential higher long-term returns.
"Moderate Portfolio" (70/30)	A balance between growth and security is important. You are willing to accept some risk to have the potential for higher returns over time, but your time horizon may be an issue.
"Conservative Portfolio" (60/40)	Your desire to protect your assets is a primary concern in your investment approach. You are willing to take some risk to achieve a growth component in your portfolio, but more moderate growth with less volatility is desirable.
"Risk Averse Portfolio" (40/60)	Protecting your assets is of greater concern to you than is the risk of your assets not growing in pace with inflation. You may be approaching retirement, or you may simply desire a high level of security or a decreased level of market volatility in your retirement portfolio.
Custom Portfolio (0/0)	Build a custom portfolio if none of the above preconfigured portfolios meets your specific investment objectives and/or risk tolerances.



# Available Funds

## Fund List

### Available Funds

**Information Regarding Links To Third-Party Sites:** The links in this area will let you are not responsible for the contents of any linked site or any link contained in a linked site to you only as a convenience, and the inclusion of any link does not imply our endorsement

#### US Large Cap Stocks

[DFA US LARGE CO. INST. INDX \(DFUSX\)](#)

[MFS EMERG GROWTH B \(MEGBX\)](#)

#### US Large Cap Value Stocks

[DFA US LARGE CAP VALUE III \(DFUVX\)](#)

#### US Small Cap Stocks

[DFA US MICRO CAP \(DFSCX\)](#)

#### US Small Cap Value Stocks

[DFA US SMALL CAP VALUE \(DFSVX\)](#)

#### Diversified Emerging Mkts

[DFA EMERGING MARKETS I \(DFEMX\)](#)

[DFA EMERGING MARKETS VALUE \(DFEVX\)](#)

#### International Large Cap Stocks

[DFA LARGE CAP INTERNATIONAL \(DFALX\)](#)

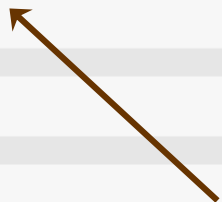
#### Int'l Large Cap Value

[DFA INTERNATIONAL VALUE III \(DFVIX\)](#)

#### Foreign Stock

[DFA INTERNATIONAL SMALL CAP VALUE \(DISVX\)](#)

[DFA INTERNATIONAL SMALL COMPANY \(DFISX\)](#)



- Asset Classes
- Fund symbol
- Prospectus Link
- Fact Sheet

DFUSX | 254-340-823

### U.S. Large Company Institutional Index Portfolio



#### Investment Objective

The U.S. Large Company Institutional Index Portfolio ("the Portfolio") is a no-load mutual fund designed to approximate the investment performance of the S&P 500 Index, both in terms of the price of the Portfolio's shares and its total investment return. The Portfolio intends to invest in all of the stocks that comprise the S&P 500 Index in approximately the same proportions as they are represented in the Index. The S&P 500 Index is comprised of a broad and diverse group of stocks most of which are traded on the NYSE. Generally, these are the U.S. stocks with the largest market capitalizations and, as a group, they represent approximately 70% of the total market capitalization of all publicly traded U.S. stocks.



# Self-Directed Brokerage Accounts

Balances By Fund Report				
The list below shows the current funds in your portfolio grouped by Asset Class.				
Asset Class	Fund Name	Election %	Actual %	Balance
<b>US Large Cap Stocks</b>				
	<a href="#">DFA ENHANCED US LARGE COMPANY (DFELX) Prospectus</a>	25.0%	7.0%	\$429.62
<b>Other</b>				
	<a href="#">Charles Schwab PCRA (SCHWBPCRA) Trade Positions</a>	0.0%	70.2%	\$4,332.06

Account Positions						
The list below shows the positions contained in your self directed brokerage account.						
<a href="#">Return</a>						
Fund Name	Ticker	CUSIP	Shares	Price	Price Date	Market Value
MERCK & CO INC	MRK	MRK	15.66	\$55.57	5/2/2002	\$870.23
CHARTER COMMUNICATIONS	CHTR	CHTR	80	\$8.40	5/2/2002	\$672.00
ORACLE CORPORATION	ORCL	ORCL	59	\$8.55	5/2/2002	\$504.45
DOBSON COMMUNICATIONS	DCEL	DCEL	40	\$2.47	5/2/2002	\$98.80
CISCO SYSTEMS INC	CSCO	CSCO	97	\$13.64	5/2/2002	\$1,323.08
ECOLLEGE.COM INC	ECLG	ECLG	50	\$3.40	5/2/2002	\$170.00
PEPSI BOTTLING GROUP INC	PBG	PBG	60.149	\$29.53	5/2/2002	\$1,776.20
GENERAL ELECTRIC COMPANY	GE	GE	25.456	\$31.60	5/2/2002	\$804.41
TEPPCO PARTNERS L P	TPP	TPP	40.296	\$32.55	5/2/2002	\$1,311.63
CELL GENESYS INC	CEGE	CEGE	28	\$12.87	5/2/2002	\$360.36
SAFEWAY INC	SWY	SWY	32	\$41.00	5/2/2002	\$1,312.00
KINDER MORGAN ENERGY LP	KMP	KMP	57.793	\$36.20	5/2/2002	\$2,092.11
LOWES COMPANIES INC	LOW	LOW	48	\$43.49	5/2/2002	\$2,087.52
SWMXX	SWMXX	SWMXX	511.26	\$1.00	5/2/2002	\$511.26
METROMEDIA FIBER NETWORK	MFNXE	MFNXE	1000	\$0.04	5/2/2002	\$42.00
<b>Total Market Value:</b>						<b>\$13,936.05</b>

Self-directed brokerage accounts available through more than twenty brokerage firms including:

- Charles Schwab
- Fidelity
- Ameritrade