A VALUE ADDED FOR INVESTMENT ADVISORS: THE INVESTMENT REVIEW

Finalytix

Jean Maltais, Finalytix, Dec 2015

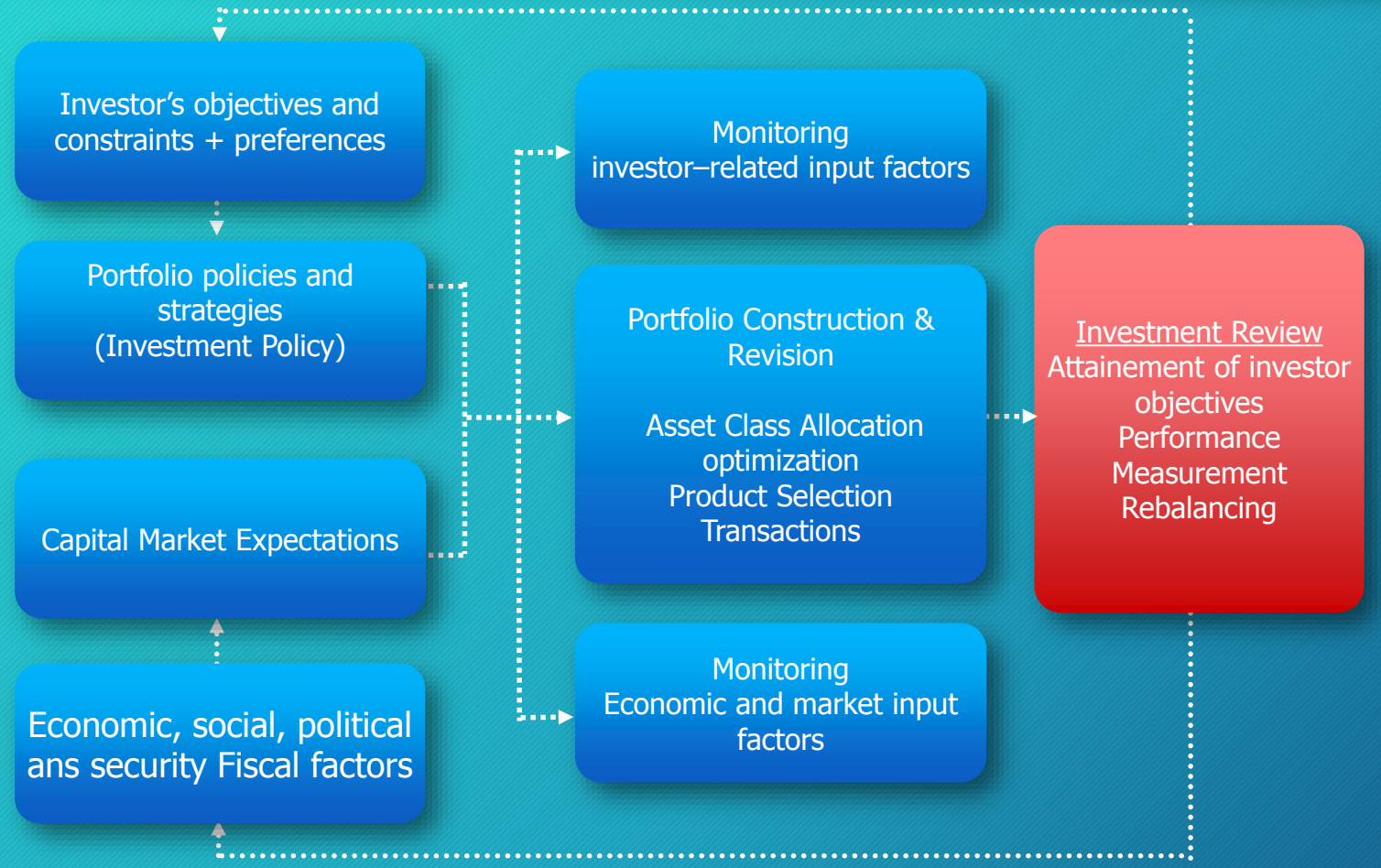
Agenda

- Investment Process: the Investment Review
- 12 Best Practices
- The Investment Review value added
- Appendix A - Value Added of Rebalancing you Asset Allocation
- Appendix B - Value Added of monitoring your Selection
- Appendix C - Suggested Investment Review Agenda

“Plans are of little importance,
but planning is essential.”

-Winston Churchill

Investment Process: the Investment Review



- The Investment Review: This is the culmination, the final step of a process by which we measure our results, we compare with the target and we adjust if needed.
- Here we measure the quality of 2 decisions we made: the allocation and the selection
- This is an opportunity:
  - to renew the mandate of trust with our client,
  - to update their status,
  - to measure their appreciation for the services we provide them
  - and this is the best moment to ask for references.

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12 Best Practices

1. Do your homework
   - Gather materials necessary to conduct a productive meeting: investment policy statement (IPS) objectives, portfolio review report, market results and outlook, data to support your views (see Appendix C for a suggested agenda)
2. Be honest
   - Most common question clients ask is "Am I on track to meet my goals?" so the key is to respond with honesty, transparency. We recommend to compare the target asset allocation return distribution with portfolio return.
3. Control what you can
   - Instead of focusing only on short term market performances, it's better to emphasize on what will help your clients attain their long term objectives. Explain how your wealth management approach, your value added (behavioral management, cost-efficiency, tax efficiency, rebalancing, periodic investment reviews, etc…) will increase probability to reach their target (keeping them invested, lowering volatility, increasing return, etc…)
4. Be transparent
   - Discussing fees (ex: CRM2) should not be a problem once you have clearly identified your added value in the investment process so its recommended to provide clear, candid fee disclosure
5. Uncover important changes
   - Ask your clients to describe any financial or personal changes that could effect their required return/risk tolerance, etc… One easy way is to sign an new investment policy statement.
6. Share your recommendations
   - Identify any strategy, allocation, or holdings adjustments you see necessary and explain their potential benefits

Sources: Vanguard, Finalytix

Best Practices (cont'd)

7. Offer extra assistance
   - A change in a portfolio may have fiscal impacts. Establishing working relationships with members of your client's advice network (fiscalist, accountant, lawyer, etc...) makes implementing changes more efficient and build stronger support. This could even trigger new opportunities.
8. Reaffirm expectations
   - Revisit the philosophical and practical wealth management approaches you and your client may have agreed to in order to manage future expectations.
9. Wrap up the meeting
   - Summarize the key discussion points and agreed-upon plan of action. Provide reading materials that support your recommendations will support your transparency, boost engagement and facilitate implementation of the plan
10. Ask for feedback
    - Ongoing reviews should be the
11. Ask for referals
    - Investment review it the IDEAL time to ask for recommendations. Highlight a specific service the client appreciate and use it to ask for referals
12. Send a thank-you note
    - Acknowledge your appreciation for your client's time and partnership with a brief thank-you note. Use this opportunity to summarize the highlights or your review, recall the action plan. Create a template to speed up this process.

The Investment Review Value Added: 2 Tasks

Rebalancing the portfolio

- The primary objective of rebalancing the allocation is to reduce the volatility. It can also increases return during market downturns
- By reducing volatility of your client's portfolio, you increase their chances to stay committed to their asset allocation strategy and remain invested in the markets increases the probability of their meeting their goals.
- Vanguard has estimated that investment advisers can potentially add up to 0.35% when risk-adjusting annually a 60 Eqy/40 Bd portfolio versus a not rebalanced portfolio

Sources: Putting a value on your value: Quantifying Vanguard Advisor's Alpha, Vanguard Nov. 2014

Reviewing the Selection

- In our study, we determined that, on average, only 39% of managers selected for their superior performances 5 years ago still deliver superior performances today (median 5 yr return: 9.9%)
- So more than 60% of managers were downgraded because of their poor performances (median 5 yr return: 6.9%)
- Thus, not reviewing the selection periodically can have significant impact on your clients' performances
- Over 5 years, the average yield spread between the 2 groups was significant: 2.9%
- For an investment of $ 100K, this is a loss of more than $ 20,000

Sources: Cost of Inaction, Finalytix, Dec. 2015

Investment Review
Total Value Added

Investment Review

Rebalancing	0.35%
Reviewing selection	2.90%
Total	3.25%

- *Investment advisers who provide total investment review services to their customers, provide significant value added to them. They stand out from the competition by demonstrating professionalism, rigor and transparency*

CONCLUSION: Une valeur ajoutée du conseiller

- Although the Investment Review is one of the crucial stages of the investment process, it is too often evaded because of lack of time/resources;
- As demonstrated above, there is a significant opportunity for the investment advisor to add value;
- The financial adviser, who has a full periodic monitoring portfolio provides is to maximize the quality of their decisions in terms of both asset allocation (rebalancing) than stock selection and this for the benefit clients

Appendix A

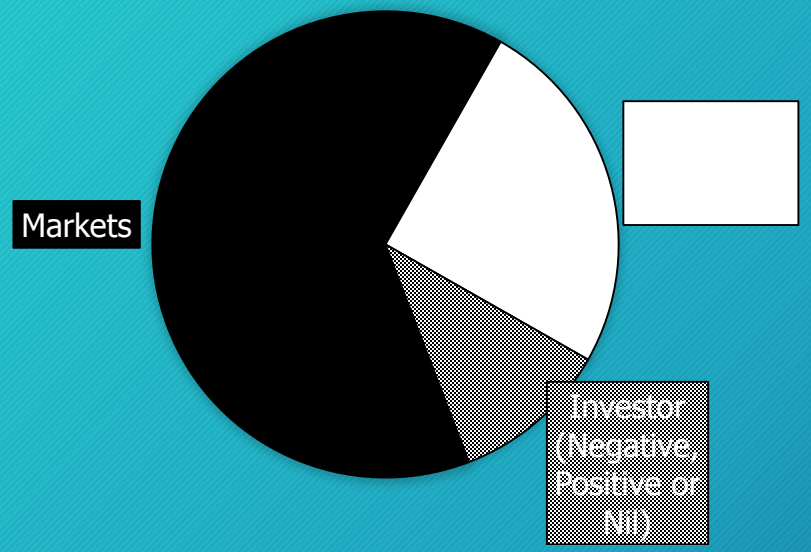
Investment Advisor's value added:

Rebalancing

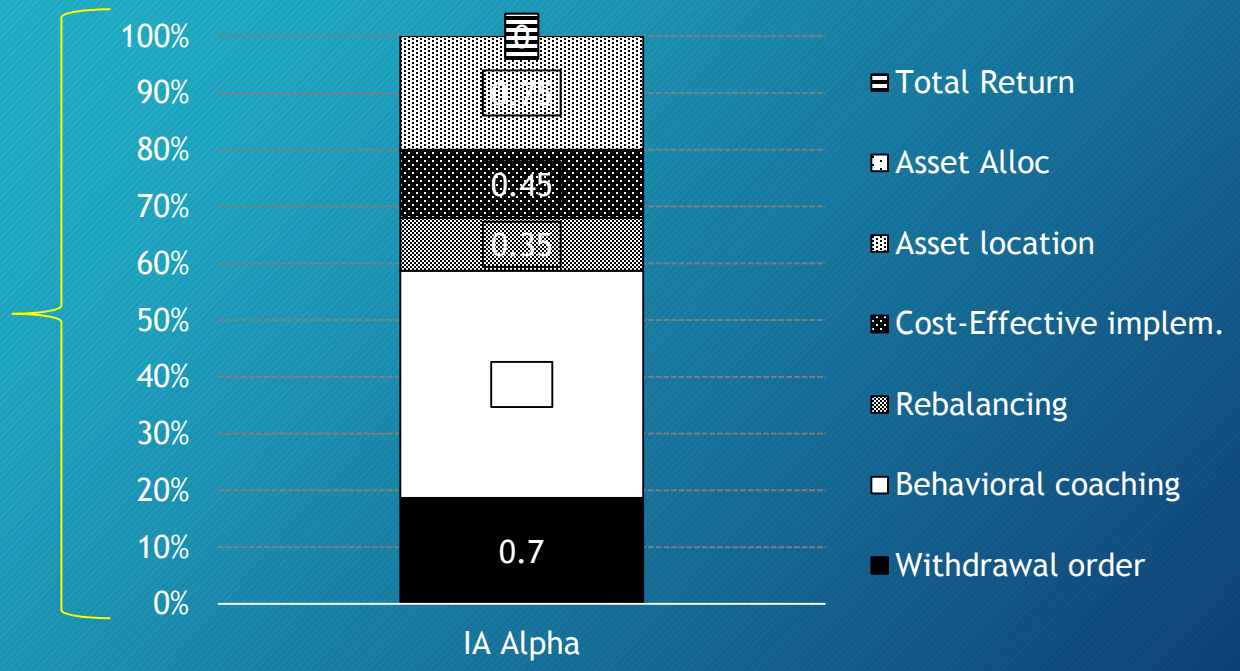
Sources: Putting a value on your value: Quantifying Vanguard Advisor's Alpha, Vanguard research March 2014, *Francis M. Kinniry Jr., CFA, Colleen M. Jaconetti, CPA, CFP®, Michael A. DiJoseph, CFA, and Yan Zilbering*

Investment Advisor's Alpha = +3%

CONTRIBUTORS / DETRACTORS OF PTF RETURN



IA's Alpha



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Annexe B

Investment Advisor's value added:

Selection Review

Sources: Cost of inaction, Finalytix, Dec 2015

Jean Maltais, M.Sc.

Measuring the impact: Investment Review

- Measure the impact of 2 decisions: Asset allocation and Selection decisions
- Asset allocation (rebalancing) SEE APPENDIX A

  The impact of rebalancing asset classes on the volatility of a portfolio vs. a non-rebalanced portfolio is well documented :
  - Reduced volatility (investor's favorite)
  - Decrease (increase) return during Bull (Bear) market
  - IA's Value Added : 0.35 % *
- Selection

  What if we don't monitor the portfolio components? What is the impact for the client?
  - How many managers, selected 5 years ago, are on our selected list today?
  - Would we make the same selection?
  - How much a customer can loose if there's no monitoring?
  - How much value can you add by monitoring your portfolio?

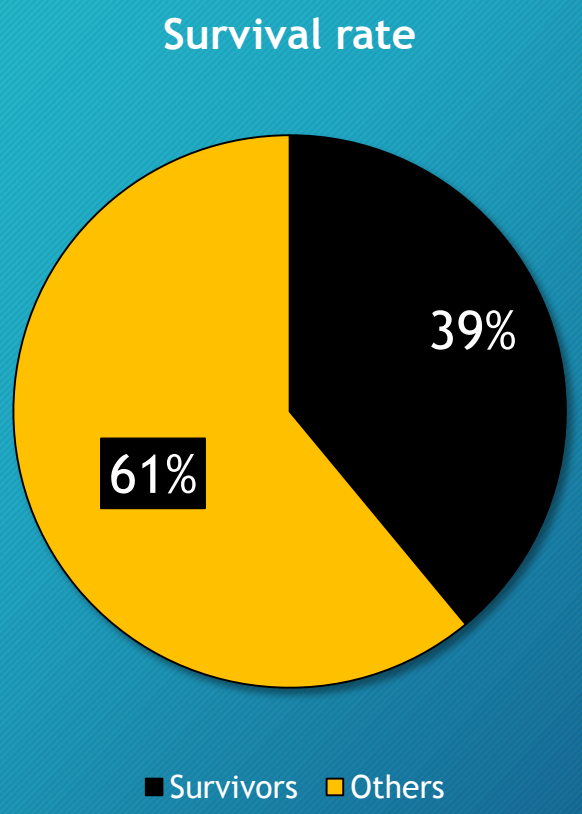
*: Putting a value on your value: Quantifying Vanguard Advisor's Alpha, Vanguard research March 2014,
Francis M. Kinniry Jr., CFA, Colleen M. Jaconetti, CPA, CFP®, Michael A. DiJoseph, CFA, and Yan Zilbering

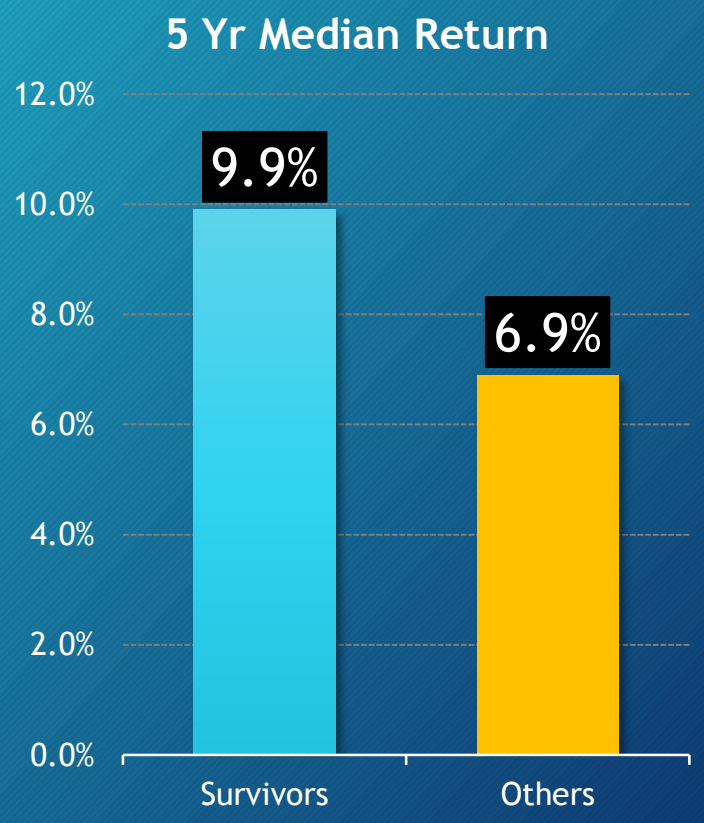
Methodology

- December 2010
  - We picked the best money managers / category
  - Section criteria: Historical Morningstar™ Ratings
    - ★★★★★
    - ★★★★
- November 2015
  - For the selected funds, we check the current Morningstar™ Ratings
  - We split the group in 2 categories:
    - Survirors: funds that maintained their ratings 4+★
    - Others : funds that were downgraded <4★
  - We compared 5 year median returns of the 2 categories to measure the investor's potential loss (or the potential IA's value added)

Summary

- More than 60% of managers with top performances 5 years ago, now have performances ranging from mediocre to average
- Q. What is the impact of not reviewing our selection?
  - The yield spread between the two categories is huge : 2.9% on average over five years (Min 1.5%, Max : 4.3 %)
  - For a $100K investment, this is the equivalent of loosing $20,700 over 5 years (see next slide)





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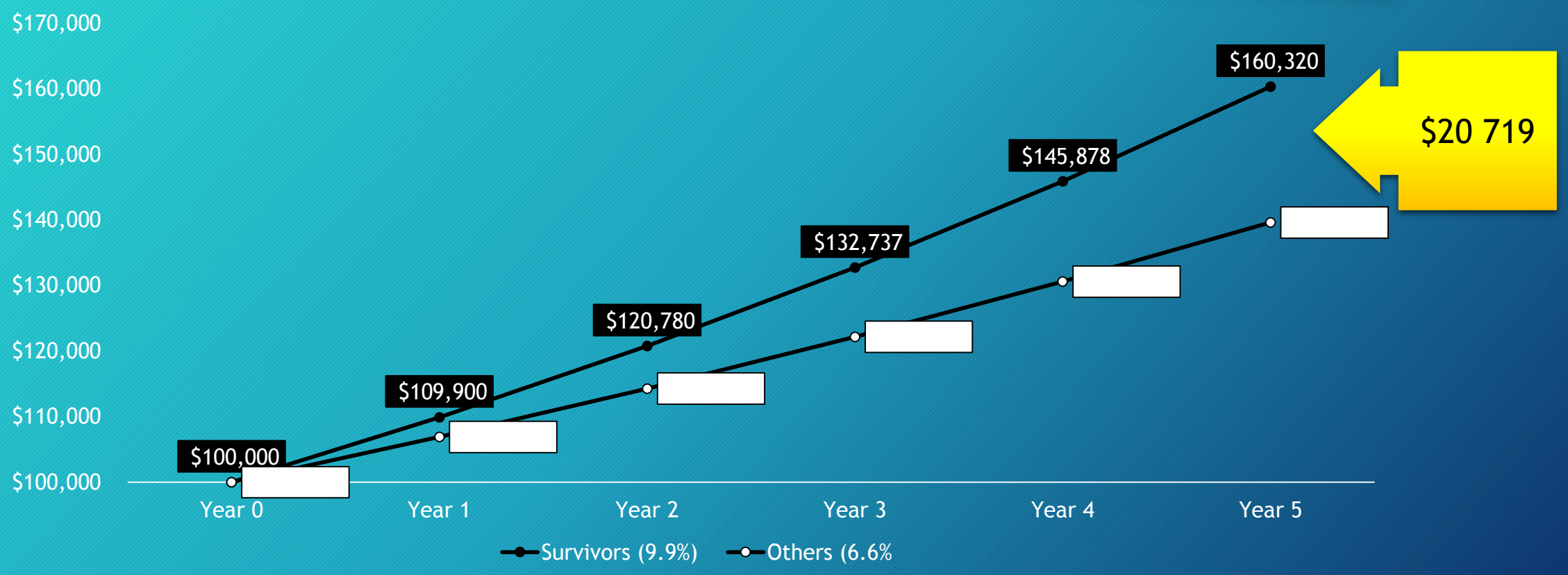
Impact of reviewing selection



Summary (cont'd)

Fund Category	Survivors 4,5 ★	Others <4 ★	Median 5Yr Return Survivors	Median 5Yr Return Others	Difference (%)
Cdn Focused Eqy	52%	48%	8.7	4.4	4.3
Cdn Div&Inc Eqy	36%	64%	8.3	5.4	2.9
US Equity	52%	48%	17.6	15.7	1.9
Global Eqy	35%	65%	12.7	9.1	3.6
Cdn Ntrl Bal	36%	64%	6.6	5.1	1.5
Cdn Eqy Bal	33%	67%	7.2	3.8	3.4
Global Ntrl Bal	39%	61%	8.2	6.1	2.1
Global Eqy Bal	30%	70%	9.6	5.9	3.7
Average	39%	61%	9.9	6.9	2.9%

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Appendix C

Investment Review Meeting- Suggested Agenda

Investment Review Meeting- Agenda

CLIENT'S OBJECTIVE

Review the client's objectives and constraints (refer to client's investment policy statement)

- Any significant changes to client's situation that would require to change the plan (objectives / constraints)?
- Risk tolerance:
  Target Asset Allocation: _____
  (useful to select the most suitable portfolio benchmark)
- Required return (long-term target + short-term distribution of return)
  Required return: _____
- Make sure client's target asset allocation derived from risk tolerance and required return are compatible
- Sign a new investment policy statement (IPS)

CLIENT'S PORTFOLIO RESULTS

Past year

- Validate that the portfolio results were aligned with the strategy stated in the IPS
- Discuss last year results, show your value added using your investment review report

Coming Year

- Review allocation and selection decisions vs.
  - Current market conditions and the economy
  - Most recent IPS
  - Investment Review Report
- Explain (if applicable) the need to change allocation / selection / strategy