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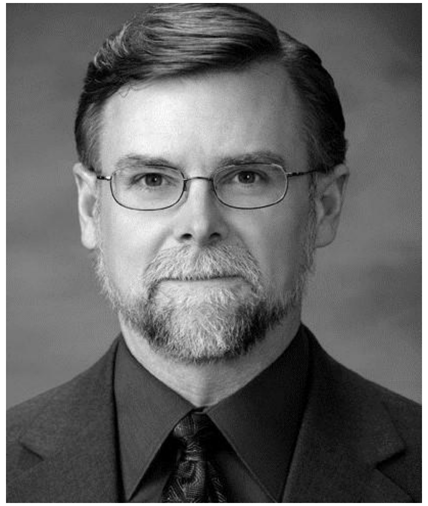
Setting logical performance objectives

Rob Brown, PhD, CFA

Julex Capital Advisory Board Member, Website www.robbrownonline.com



40 Grove Street, Suite 140, Wellesley, MA 02482
Phone 781-489-5398
Email info@julexcapital.com
Web www.julexcapital.com

Setting logical performance objectives

Beat a benchmark . . . or achieve life-goals?

Setting logical performance objectives

Beat a benchmark . . . or achieve life-goals?

Maybe it's a bit of both?

What performance objective should be used?

- What's your value prop?
- You charge a fee . . . and in exchange, deliver value
- What's your value?

- So select a set of performance objectives that . . . enhance your ability to deliver on your value prop

But your client needs three questions answered

- Am I OK
- Are you earning your fee
- Do we need to make any changes

- In figuring out how best to address these . . .
  - Use tools that enhance your value prop
  - Avoid tools that confuse, distract from, or undermine your value prop

Possible measures - to answer your client's questions

- S&P 500
- Several of the most popular benchmarks
- Custom fitted benchmark - exactly matching client portfolio's asset mix
- Peer universe
- Specific comparative portfolio(s)
- Constant return . . . 5%, 6%, 7%
- No benchmark
- Compare to spending requirements over the next "25 years"

Possible venues - to answer your client's questions

- Quarterly client statement
- Written report you prepare and send them
- Annual (or more frequent) client meetings

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First . . . Never place the S&P 500 in a client statement

Chart 7: Record percentage of SPX market cap held by just 5 stocks

Source: BofA Global Research, Bloomberg

Should I suppress benchmarks on client statements

- If benchmarks appear in custodial statements
- The client can only conclude
  - You put them there
  - They must be important
  - They must be the best possible measure for determining success/failure

- Are they relevant
- Now you look like an idiot
- Now you've powerfully undermined your value prop

- Purge them from your quarterly custodial statements
  - SEC absolutely does not require or expect them
  - FINRA discourages them . . . sort of

FINRA

Even industry watchdog FINRA nudges investors away from using returns as a measuring stick. On its website, FINRA provides investors with a guide for interviewing a broker, and the only place where returns come up is to warn against brokers that tout high returns:

"Be cautious of any investment professional who promises you above-average account performance or says you'll be making risk-free investments. Nobody can guarantee that your investments will grow at a particular rate or that you won't lose money."

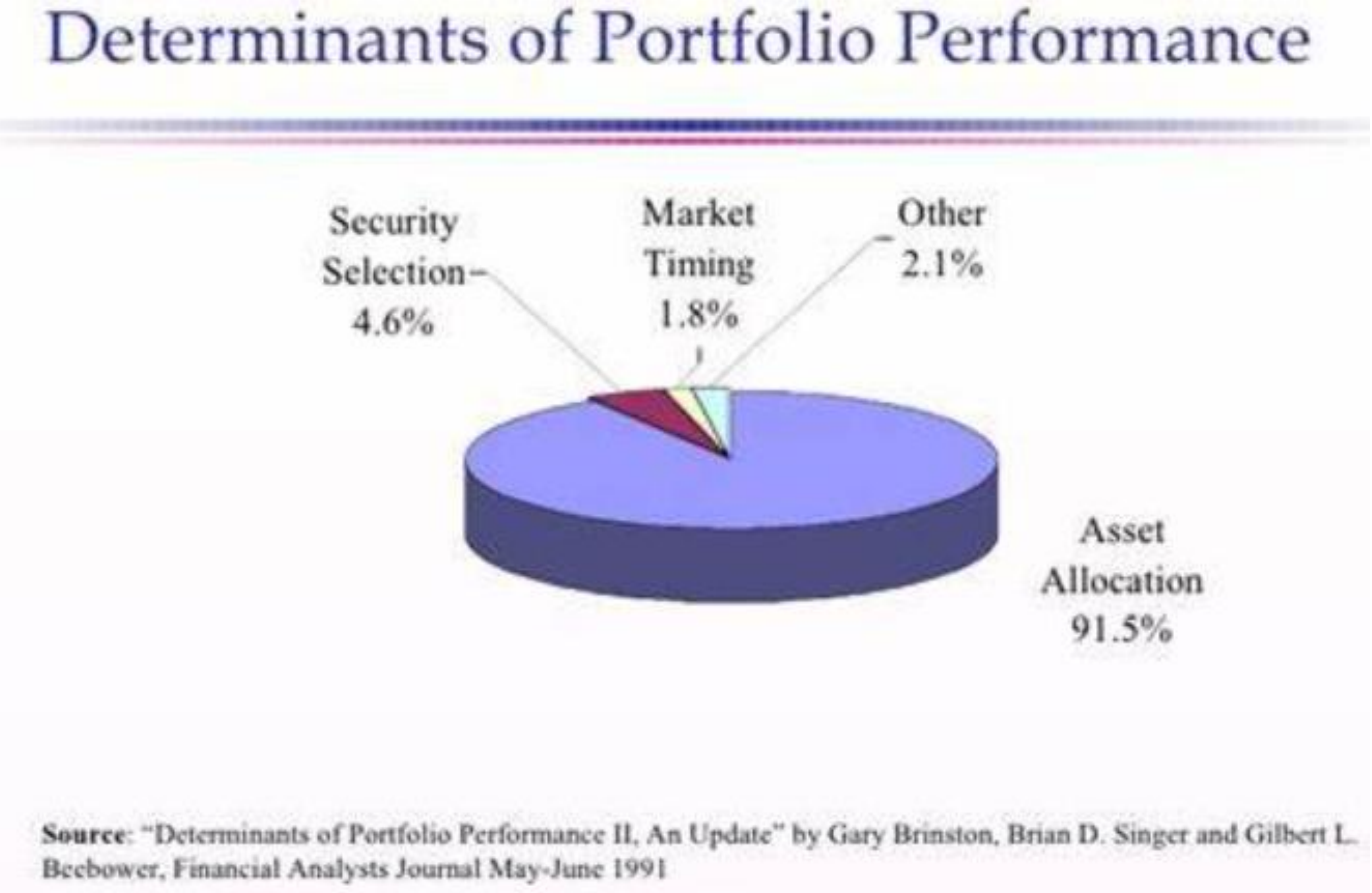
When we spoke with FINRA's vice president of investor education, Gerri Walsh, she echoed that sentiment, saying that "focusing on past performance can get you into a danger zone."

If you compare to a performance benchmark . . .

- If you compare to a performance benchmark . . .
- Then you're saying . . . that the difference is important

- But, is it?
- Or . . . did you just make something up?

Just 8% (out of 100%) is due to manager skill



So, if you draw conclusions based on the last 1-7 years

- So, if you are encouraging your client to draw conclusions based on the last
  - 1 year
  - 3 years
  - 5 years
  - 7 years

- Then you are probably encouraging them to focus on pure NOISE

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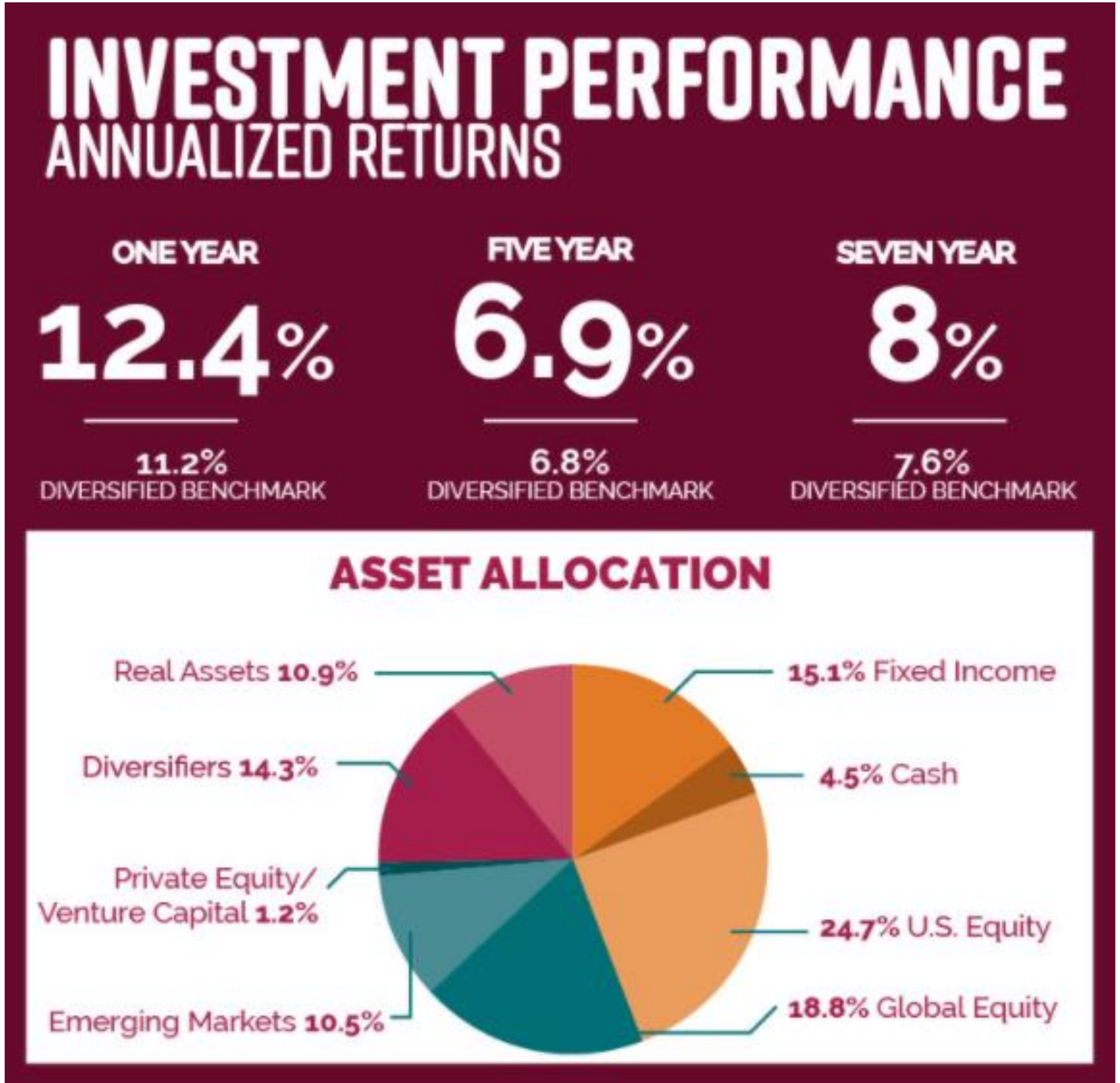
I understand that our industry doesn't help



The whole approach of benchmark comparison is so screwed up

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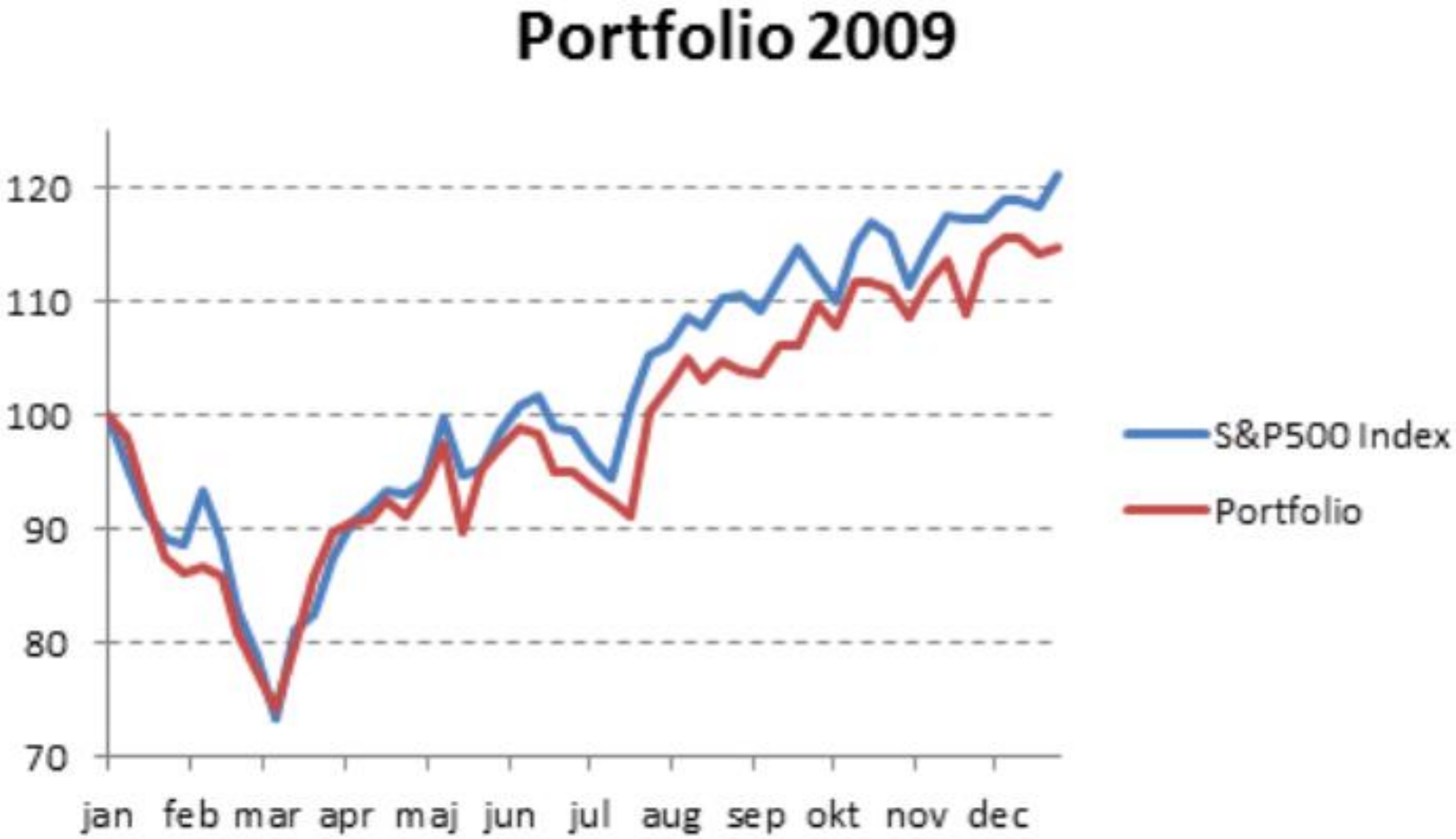
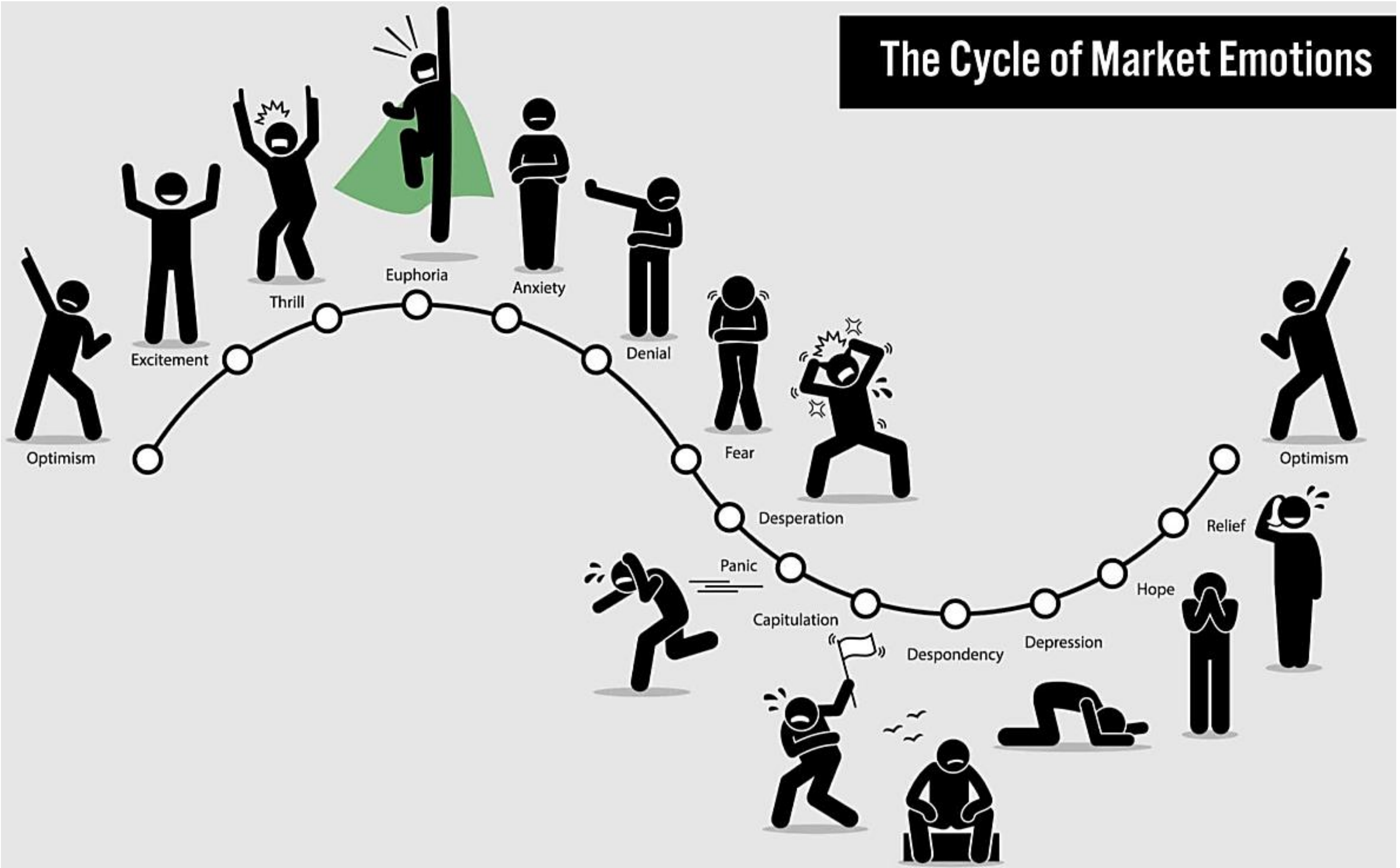
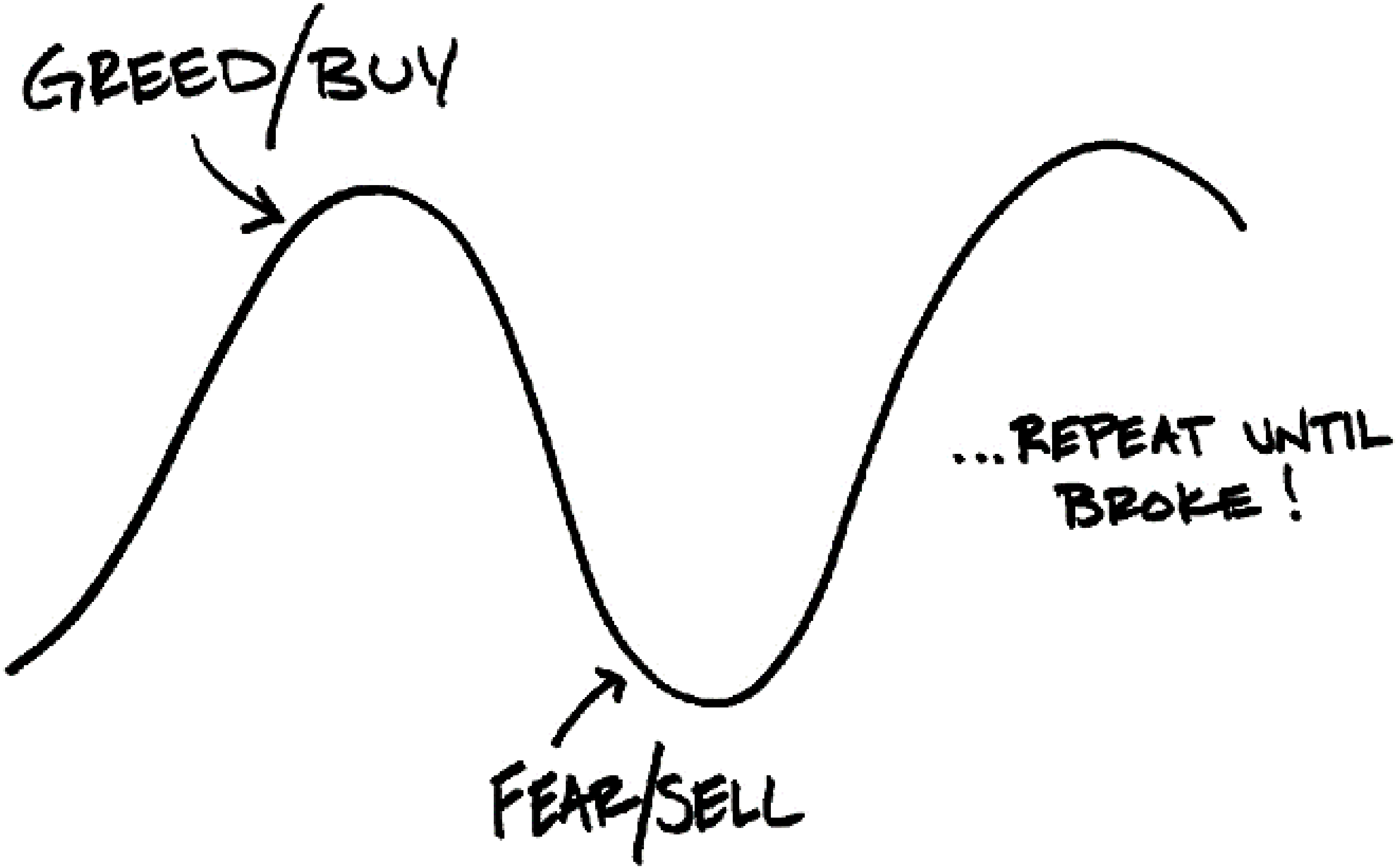


And it plays to the most destructive behavioral attributes



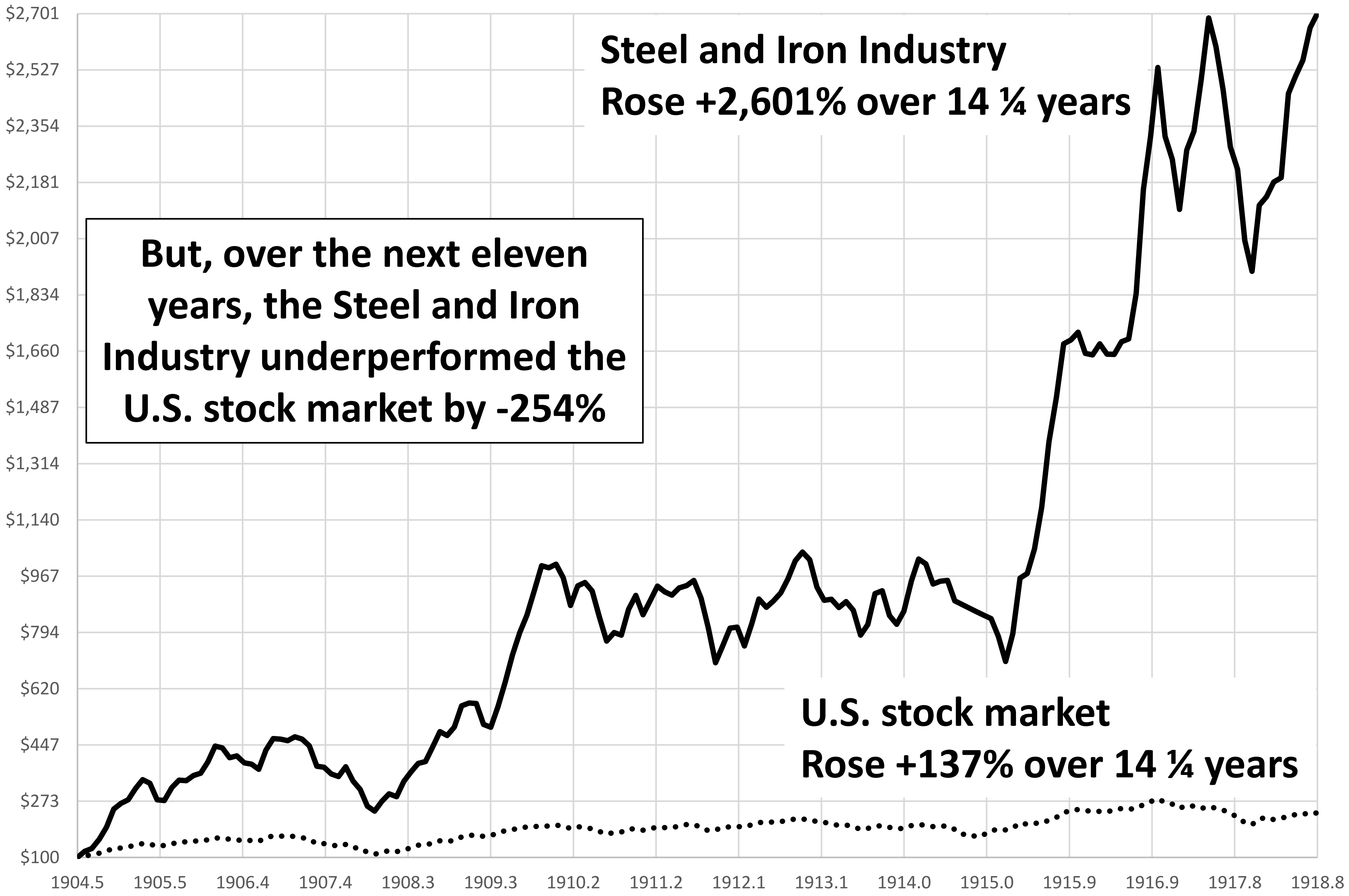
Encouraging us to chase performance . . . to our ruin



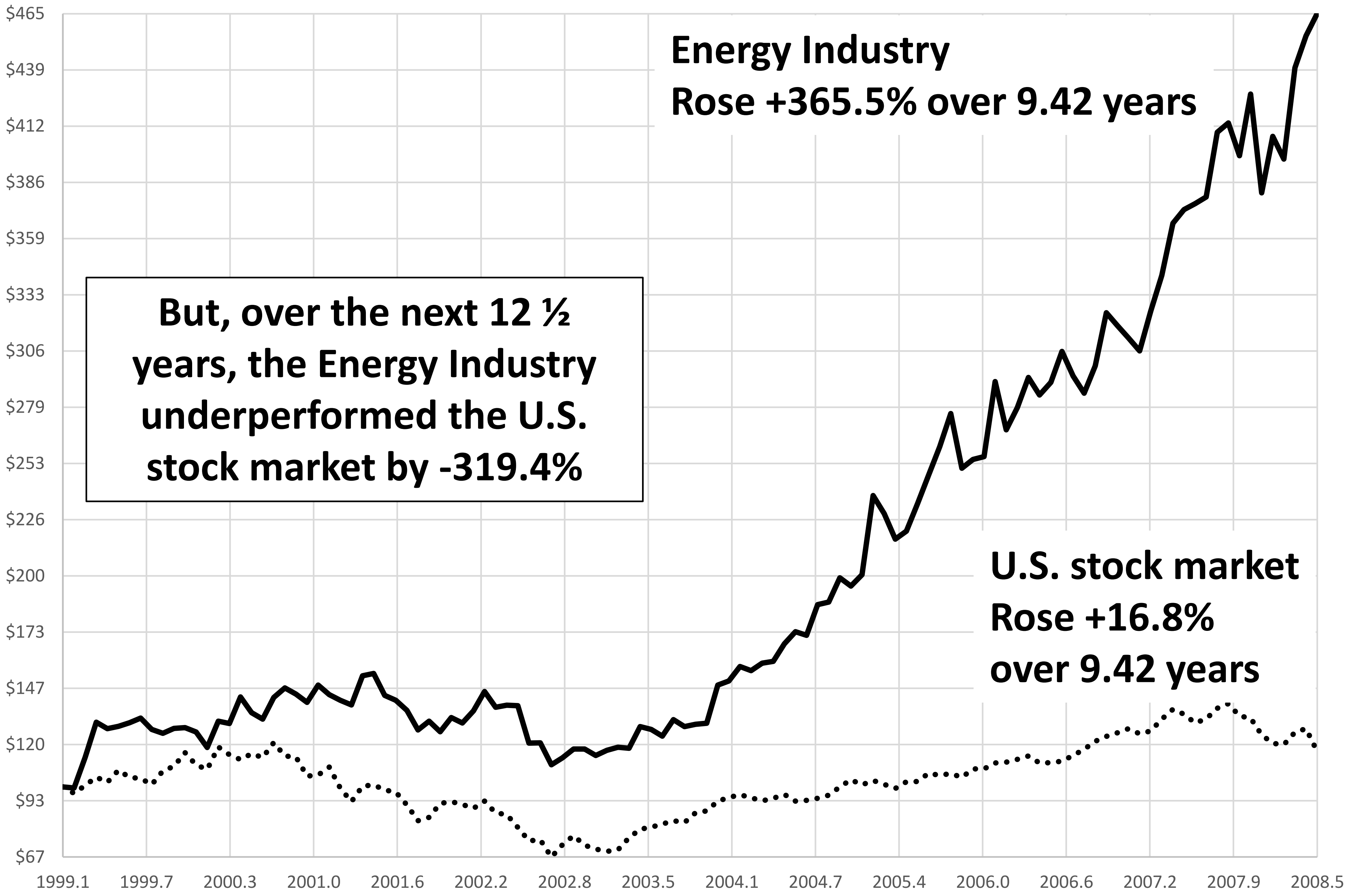
To maximize our value added . . . we most overcome the carnival barkers

And break the destructive link with performance chasing

Break the link . . . It is so destructive



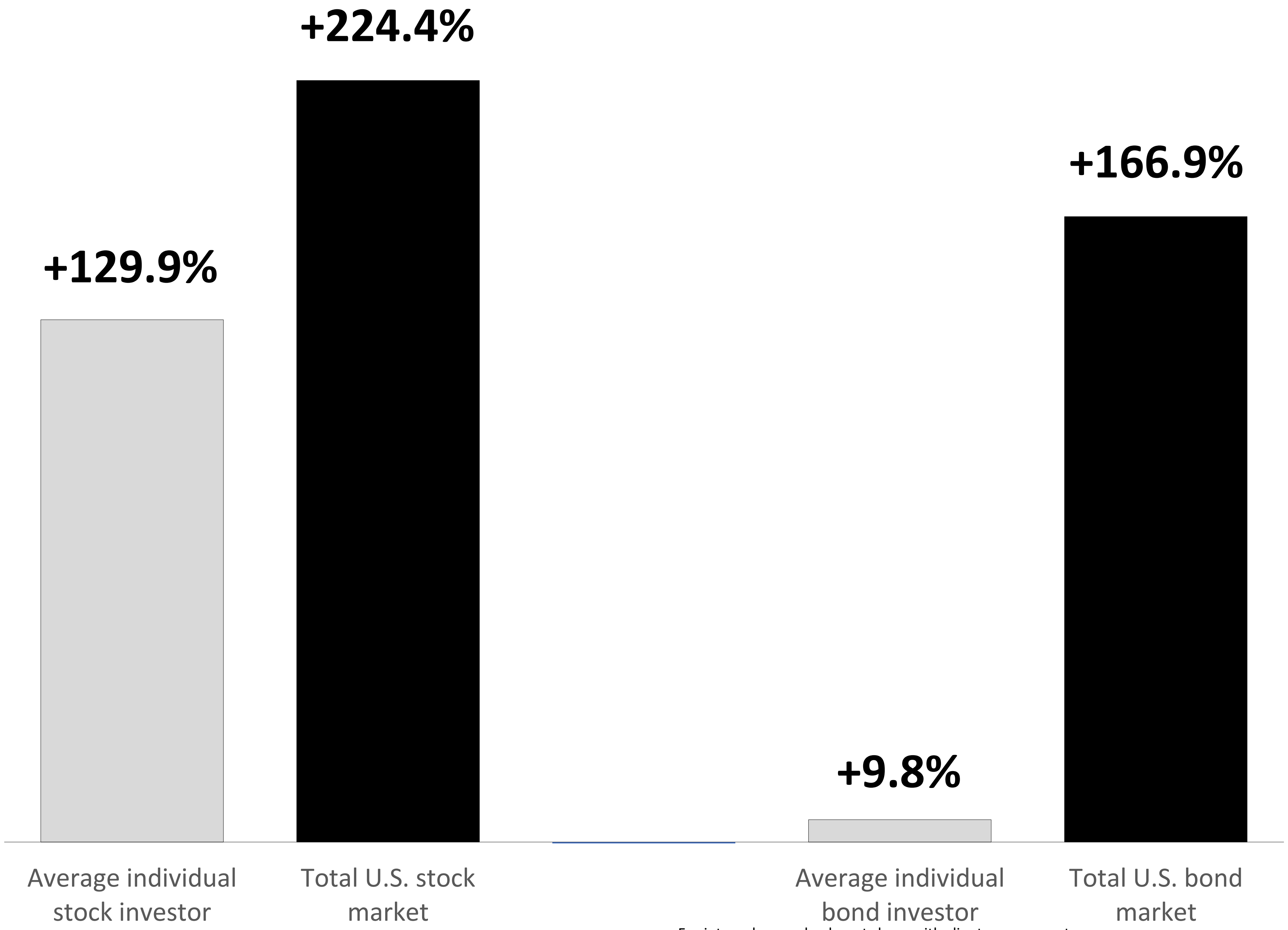
Break the focus on past performance



A focus on past performance has never worked

1999	2000	2002	2003	2007	2008	2011	2012	2015	2016
MSCI Emerging Markets 66.8%	**Russell 2000 Value 22.8%**	**Bloomberg Barclays Aggregate 10.3%**	MSCI Emerging Markets 55.8%	**MSCI Emerging Markets 39.4%**	Bloomberg Barclays Aggregate 5.2%	**Bloomberg Barclays Aggregate 7.8%**	**MSCI Emerging Markets 18.2%**	**S&P 500 Growth 5.5%**	**Russell 2000 Value 31.7%**
Russell 2000 Growth 43.1%	Bloomberg Barclays Aggregate 11.6%	Bloomberg Barclays High Yield -1.4%	**Russell 2000 Growth 48.5%**	MSCI World ex USA Stocks 12.4%	Bloomberg Barclays High Yield -26.2%	Bloomberg Barclays High Yield 5.0%	Russell 2000 Value 18.1%	S&P 500 LargeCap 1.4%	Russell 2000 SmallCap 21.3%
S&P 500 Growth 28.2%	S&P 500 Value 6.1%	MSCI Emerging Markets -6.2%	Russell 2000 SmallCap 47.3%	S&P 500 Growth 9.1%	**Russell 2000 Value -28.9%**	S&P 500 Growth 4.7%	S&P 500 Value 17.7%	Bloomberg Barclays Aggregate 0.6%	S&P 500 Value 17.4%
MSCI World ex USA Stocks 27.9%	Russell 2000 SmallCap -3.0%	Russell 2000 Value -11.4%	Russell 2000 Value 46.0%	Russell 2000 Growth 7.1%	Russell 2000 SmallCap -33.8%	S&P 500 LargeCap 2.1%	Russell 2000 SmallCap 16.4%	Russell 2000 Growth -1.4%	Bloomberg Barclays High Yield 17.1%
Russell 2000 SmallCap 21.3%	Bloomberg Barclays High Yield -5.9%	MSCI World ex USA Stocks -15.8%	MSCI World ex USA Stocks 39.4%	Bloomberg Barclays Aggregate 7.0%	S&P 500 Growth -34.9%	S&P 500 Value -0.5%	MSCI World ex USA Stocks 16.4%	MSCI World ex USA Stocks -3.0%	S&P 500 LargeCap 12.0%
S&P 500 LargeCap 21.0%	S&P 500 LargeCap -9.1%	Russell 2000 SmallCap -20.5%	S&P 500 Value 31.8%	S&P 500 LargeCap 5.5%	S&P 500 LargeCap -37.0%	Russell 2000 Growth -2.9%	S&P 500 LargeCap 16.0%	S&P 500 Value -3.1%	Russell 2000 Growth 11.3%
S&P 500 Value 12.7%	MSCI World ex USA Stocks -13.4%	S&P 500 Value -20.9%	Bloomberg Barclays High Yield 29.0%	S&P 500 Value 2.0%	Russell 2000 Growth -38.5%	Russell 2000 SmallCap -4.2%	Bloomberg Barclays High Yield 15.8%	Russell 2000 SmallCap -4.4%	MSCI Emerging Markets 11.2%
Bloomberg Barclays High Yield 2.4%	S&P 500 Growth -22.1%	S&P 500 LargeCap -22.1%	S&P 500 LargeCap 28.7%	Bloomberg Barclays High Yield 1.9%	S&P 500 Value -39.2%	Russell 2000 Value -5.5%	S&P 500 Growth 14.6%	Bloomberg Barclays High Yield -4.5%	**S&P 500 Growth 6.9%**
Bloomberg Barclays Aggregate -0.8%	Russell 2000 Growth -22.4%	S&P 500 Growth -23.6%	S&P 500 Growth 25.7%	Russell 2000 SmallCap -1.6%	MSCI World ex USA Stocks -43.6%	MSCI World ex USA Stocks -12.2%	Russell 2000 Growth 14.6%	**Russell 2000 Value -7.5%**	MSCI World ex USA Stocks 2.8%
Russell 2000 Value -1.5%	**MSCI Emerging Markets -30.7%**	**Russell 2000 Growth -30.3%**	**Bloomberg Barclays Aggregate 4.1%**	**Russell 2000 Value -9.8%**	**MSCI Emerging Markets -53.3%**	**MSCI Emerging Markets -18.4%**	**Bloomberg Barclays Aggregate 4.2%**	MSCI Emerging Markets -14.9%	Bloomberg Barclays Aggregate 2.7%

Clients have hurt themselves so much



Over the 20 years

Ending 1/1/2020

Every time you compare to a benchmark - you undermine your value prop

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Myth 4: Advisors can beat the market. One of the biggest misconceptions investors have is they think an advisor will help them outperform the market or know when to get them out of a bear market, Kinniry says. "That is really hard to do."

Advisors know that chasing "the next best investment" rarely pays off, says Daren Blonski, principal at Enso Wealth Management in Sonoma, California. "Investors end up moving their money around and miss the benefit of having their money appreciate with expected market returns," Blonski says. "The rule of thumb for successful investors should be invest in quality, low-cost, diversified investments and stay in for the long term."

And it's just not necessary, advisors can and do deliver so much value

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A financial advisor can act as your saving or behavior coach, he says, encouraging you to save more or helping you navigate volatile market swings, like those during the dot.com collapse or the global financial crisis, that might require staying the course.

So, what’s to be done?

Focus on the original mutually agreed upon objectives

Answer the client’s three questions . . . before they ask them

Isn't it about financial life goals?

Isn’t about advisors helping clients identify and make specific those goals

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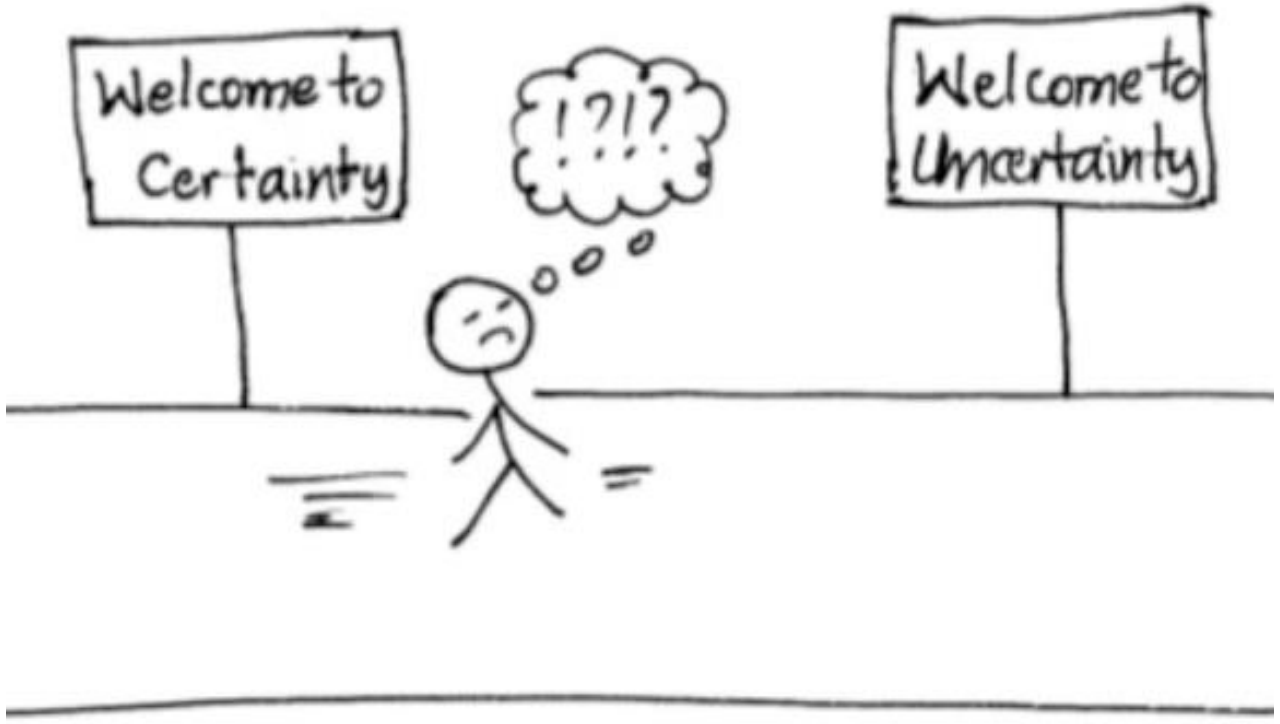
The definition of a fulfilling life . . . Set goals, strive, achieve a few of them

The brilliance of “buckets”

Or what I call “Time Segmentation Investing”

We “have” uncertainty . . . but we “want” certainty

- Time Segmentation Investing is about only one thing
- Moving from uncertainty to certainty



Time Segmentation Investing - two powerful benefits

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- Client
  - Behavior modification
  - Patience
  - Making “time” your friend
  - Breaking the dysfunctional/slavish focus and reliance on benchmark comparisons
  - Encourages measurement of what really matters
    - What do I need to earn
    - How much time do I have to earn it
    - Is this reasonable/logical given today’s valuations and opportunities
- Investments
  - Different investments have radically different “maturation cycles”
  - Size of the investment opportunity is often directly associated with the length of the maturation cycle

Old Chinese proverb

- *"If your plan is for 1 year, plant rice. If your plan is for 10 years, plant trees. If your plan is for 100 years, educate children."*

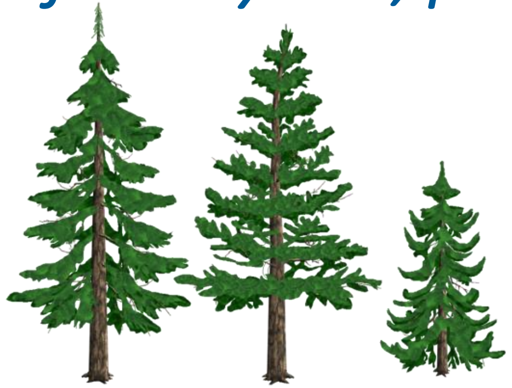
- This proverb's lesson for investments is three-fold:
  - Every goal . . . has a specific time destination in the future
  - The best solution . . . for each time destination is different
  - Investors . . . must bring the required patience to any investment . . . giving it the time it requires to sprout, grow, mature, and eventually be harvested

Old Chinese proverb

- *If your plan is for 1 year, plant rice*

Ultra-diversified U.S.-Dollar bond portfolio with an average effective duration < 4.3 years

- *If your plan is for 10 years, plant trees*



Global tactical asset allocation based on a fully-transparent, testable, quantitative set of rules

- *If your plan is for 100 years, educate children*

Distressed private debt and private venture capital structured inside an illiquid limited partnership

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Structural example - Time Segmentation Investing

	Time segment 1	Time segment 2	Time segment 3	Time segment 4	Time segment 5
Serves investor needs that arrive this number of years in the future	0 to 5 years	5 to 10 years	10 to 15 years	15 to 20 years	More than 20 years
Minimum required net return	3%	4%	5%	6%	7%
Destination (this number of years in the future)	2 ½ years	7 ½ years	12 ½ years	17 ½ years	22 ½ years
Invested in	Bond Portfolio	Short-Term Portfolio	Moderately Short-Term Portfolio	Moderately Long-Term Portfolio	Long-Term Portfolio
Policy asset allocation	100% bonds with average effective duration < 4.3 years	62% to 75% bonds	50% to 59% stocks	75% stocks	100% stocks

Bucket approach - traditional concept

Bucket 1

Years 0 to 5

100% bonds

Bucket 2

Years 6 to 10

“25% stocks”

Bucket 3

Years 11 to 15

“50% stocks”

Bucket 4

Years 16 to 20

“75% stocks”

Bucket 5

Years 21 and Greater

100% stocks

Me . . .

- Use buckets . . . . Time Segmentation Investing with 100% of my clients
- Help prospects who don't want it . . . to find a more comfortable adviser
- Suppress benchmarks from quarterly custodial statements
- In every client meeting
  - Refresh mutually agreed upon goals
  - Measure past progress towards those goals
  - Identify future required progress to achieve stated goals
  - Interpret what is required in the future . . . In the context of today's
    - Opportunities
    - Risks

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Never lose sight . . . it's all about these few items . . . their questions and your value prop . . . don't make it more complicated by comparing to the S&P 500, that's just plain lose/lose

For more information contact

Jeff Megar, CFA
Email jeff.megar@julexcapital.com
Office 781-772-1378

Bob Peatman
Email bob.peatman@julexcapital.com
Cell 617-875-9316

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