

What are Investors Really Looking For?

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Southern Arizona Estate Planning Council
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RMF Consulting, LLC
Empowering Investors with Knowledge

Today's Discussion

- The theory of investment management
- The realities of investors
- A case study that makes it understandable
- The new role of the client advisor

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Investment Management Theory

What is Modern Portfolio Theory ?

- All investors are risk adverse
- Risk must be rewarded
- Reward comes in the form of return
- Maximize return for each level of risk

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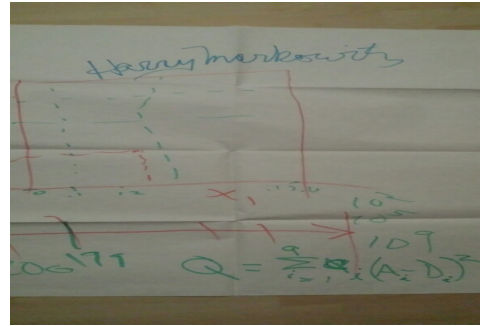
The History of Modern Portfolio Theory

- Dr. Harry Markowitz
- “Portfolio Selection: Efficient Diversification of Investment”
- Doctoral Dissertation in 1950-1951
- Published in 1959
- **Nobel Prize 1990**

- **Concept:** Efficient or optimal portfolio achieves the greatest expected return for the level of risk assumed by the investor

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My Friend Harry



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The History of Modern Portfolio Theory

- Capital Asset Pricing Model – “CAPM”
- William “Bill” Sharpe, 1964, “Capital Asset Prices: A Theory of Market Equilibrium”
- No opportunity to systematically beat “the market”
- **Nobel Prize 1990**

- **Concept:** Beta, a portfolio’s exposure to “the market” is a key determinant in portfolio return

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Capital Asset Pricing Model

$$r_p = r_f + (r_m - r_f)\beta + e$$

r_f - Risk free rate

β - Beta, risk exposure to capital markets

r_m - Market return, risk premium

r_p - Portfolio Return

Risk tolerance: How much Beta do you want?

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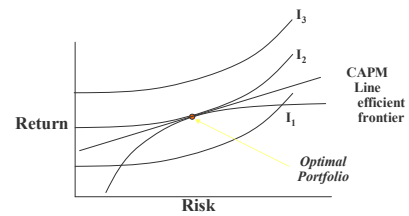
Arbitrage Pricing Theory

- Stephen Ross, 1976, "The Arbitrage Theory of Capital Asset Pricing"
- CAPM too restrictive:
 - Beta is not the only factor which systematically influences return
- **Multiple factors impact portfolio returns:**
 - $F_p = r_f + b_1F_1 + b_2F_2 + \dots + e$
- **Concept: Factors turn into asset classes**

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How Does This All Work?

- **Optimal Portfolio**
- **On Efficient Frontier**
- **On Highest Indifference Curve That is Tangent to Efficient Frontier**



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Investor Realities

What is Reward?

- **Total Return**
- **Total Cash Flow**
- **Tax Efficiency**
- **Net Worth Goal**
- **Just doing better than the other guy**

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What is Risk ?

- Annualized Standard Deviation
- Risk of losing money—Downside Risk
- Risk of losing buying power – Inflation Risk
- Risk of not achieving wealth goal—Wealth Risk
- Risk of unpredictability—Volatility Risk

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Investment Concerns

- ✓ Will I have enough **Growth** to achieve my desires?
- ✓ Will I have enough **Income** to live on?
- ✓ Will I have adequate **Liquidity** for opportunities?
- ✓ Will my assets combat **Inflation**?
- ✓ Will my portfolio survive **Volatility**?
- ✓ Will my portfolio survive a **Catastrophe** in the markets?

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Not A Stock/Bond/Cash World

Asset classes in investment strategies today

Fixed Income	Equity	Alternatives
Cash	Large Cap	REITs
Investment Grade	Mid Cap	Gold
Intermediate	Small Cap	Silver
Municipal Bonds	Growth/Value	Commodities
TIPS	Developed Int'l	Timber
High Yield	Emerging Markets	Currency Hedge
Developed-Market	Frontier Markets	Infrastructure
Emerging-Market		
Preferreds		

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Concerns aren't addressed by one asset

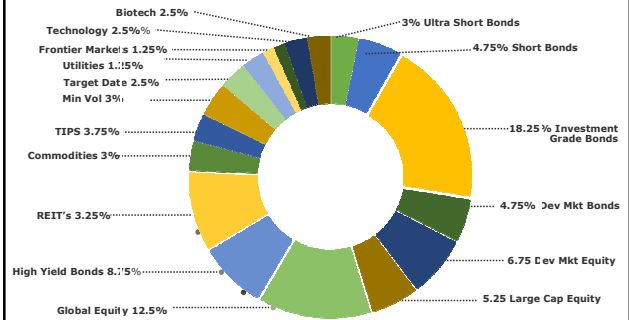
Catastrophe Short Term Bonds Gold Silver US Gov't Bonds	Income Inv Gd Bonds High-Yield Bonds Non-US Bonds Utilities Dividend Equity REIT's	Volatility Short Term Bonds Inv Gd Bonds Target Date Funds Min Vol Strategies
Liquidity Ultra Short Bonds Inv Gd Bonds Dev Mkt Bonds Large Cap Equity Dev Mkt Equity	Inflation Short to Inter. Bonds TIPS Domestic Equity REITs Gold Commodities	Growth High-Yield Bonds Global Equity Silver Frontier Markets Tech/Biotech

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Making it Understandable

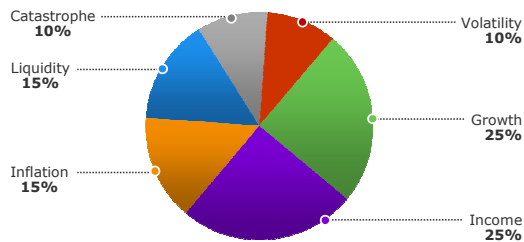
Total Portfolio Allocation

Too much to comprehend



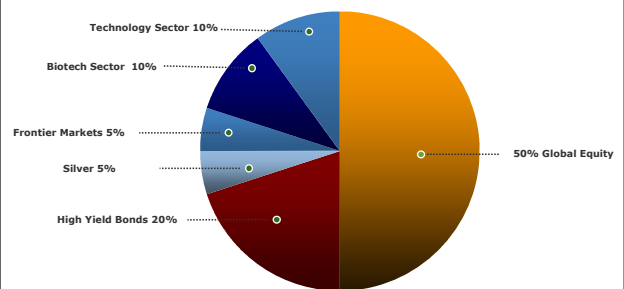
Not Traditional Asset Allocation

Desires Based Allocations



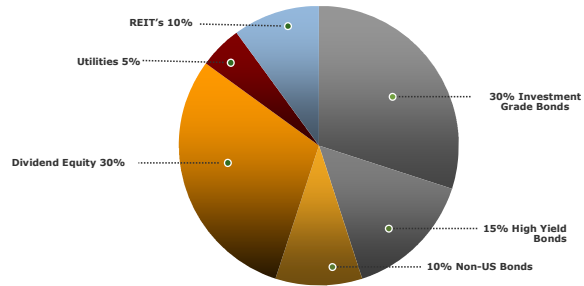
Growth Segment

Helps to provide asset growth for future financial needs



Income Segment

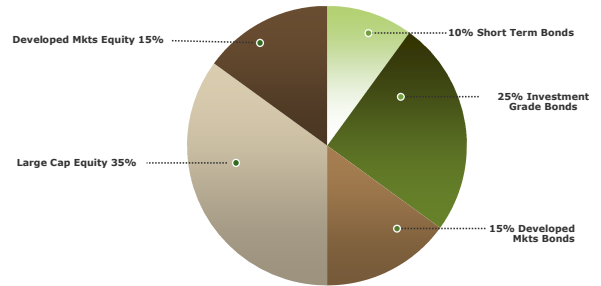
Helps to maintain cash flow for lifestyle expenses



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Liquidity Segment

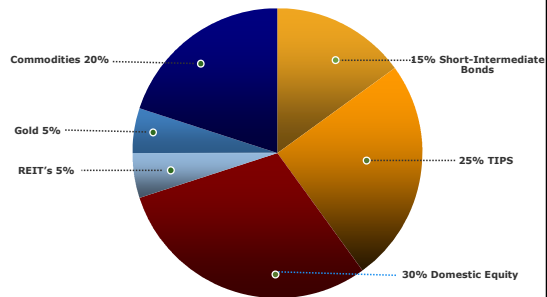
Helps to maintain liquidity for opportunistic investments



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Inflation Segment

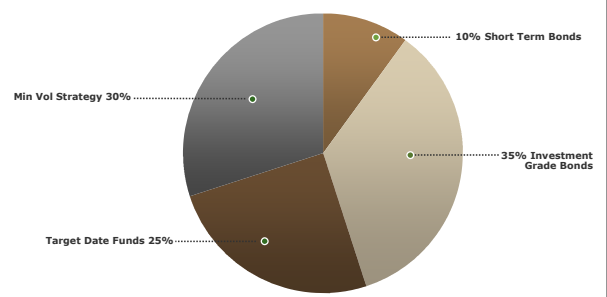
Helps to protect against the corrosive impact of inflation



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Volatility Segment

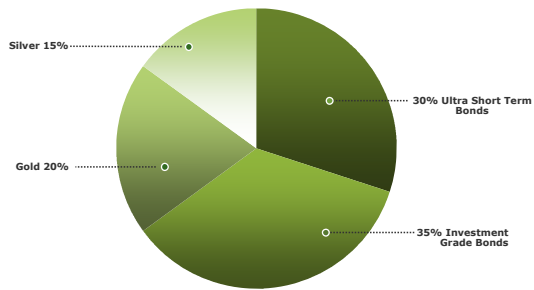
Helps to maintain portfolio value during heightened market volatility



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Catastrophe Segment

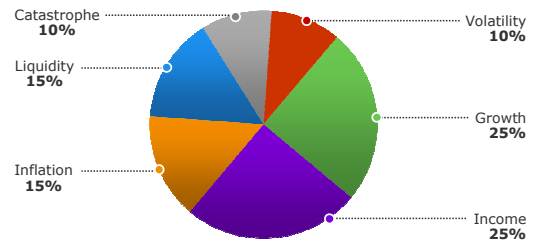
Helps to maintain value and liquidity in market disruptions



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Client Focused Allocation

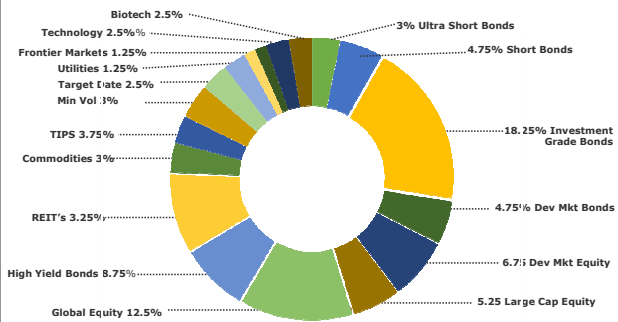
Desires Based Allocations



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Total Portfolio Allocation

Now it is more intellectually manageable



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Other Possible Segments

As clients perspectives evolve, so do their desires...

- Emerging Consumer
 - Infrastructure
 - Global inflation
 - Timber
- Extreme tax efficiency
 - AMT avoidance
 - Low turnover indexing
 - Municipal everything
- Social Impact
 - Pharmaceuticals
 - Emerging markets
 - Natural resources

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The New Client Advisor

Client Advisor's Role

Advisor's role needs to be clearly articulated

- Segmentation Allocation
 - They know the client best
 - Client centric desire/concerns addressed
 - Financial experience to steer client to real issues
- Implementation vehicles
 - Which Investment Solutions to pick?
 - Current market conditions
 - Spreads, valuations, capacity, tax circumstance
- Ongoing monitoring and rebalancing
 - Trading for investment improvement, not just noise
 - Portfolio rebalancing
 - Tax management
 - Client circumstance evolve

Moving from Theory to Reality

Academia is fine, but reality resonates with clients

- What is a client's reward?
- What is a client's risk concerns?
- What Beta addresses what concerns?
- How do specific asset classes address specific concerns?
- Build strategies that emphasize why a client owns an asset.

Change the focus from *WHAT* an investor owns to **WHY** they own it

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