

Changing the Investment Perspective

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RMF Consulting, LLC
Empowering Investors with Knowledge

Today's Discussion

The Theory of Investment Management

The Realities of Philanthropic Portfolios

A Case Study of Desires Based Allocations

The 5 Pillars of Fiduciary Investments

2015 Investment Themes

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**

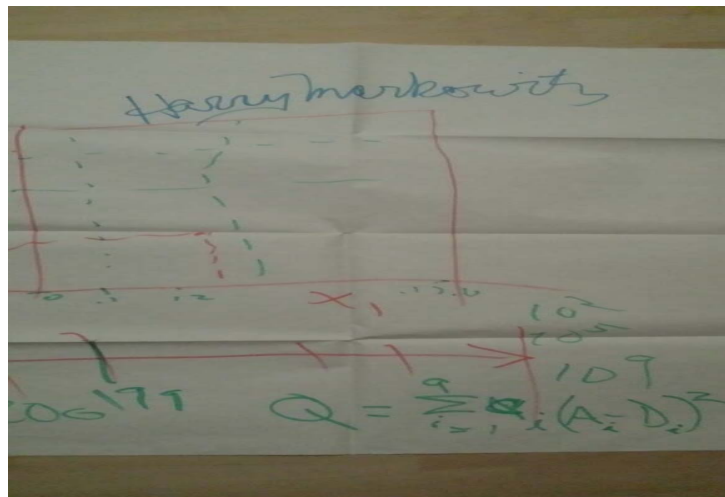
The History of Modern Portfolio Theory

- 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**
- **Implications : Investment Policy Statements**

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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**
- **Implications: risk tolerance**

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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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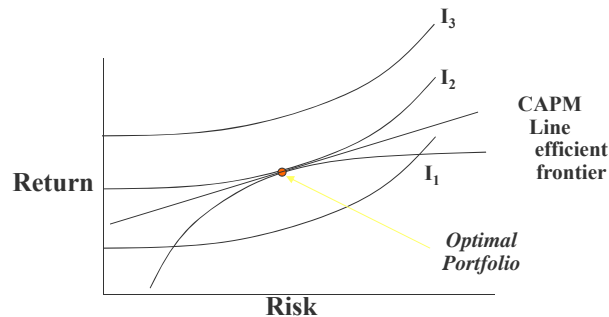
Arbitrage Pricing Theory

- 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**
- **Implications: asset classes to consider**

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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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Philanthropic Investment Realities

What is Reward?

- **Total Return**
- **Total Cash Flow**
- **Maintaining Buying Power**
- **Net Worth Goal**
- **Just doing better than the others**

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 Desires

- ✓ Will there be enough **Growth** to achieve aims?
- ✓ Will there be enough **Income** to distribute?
- ✓ Will there be adequate **Liquidity** for opportunities?
- ✓ Will the assets combat **Inflation**?
- ✓ Will the portfolio tolerate **Volatility**?
- ✓ Will the 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 Municipal Bonds	Small Cap	Silver
TIPS	Growth/Value	Commodities
High Yield	Developed Int'l	Timber
Developed-Market	Emerging Markets	Currency Hedge
Emerging-Market	Frontier Markets	Infrastructure
Preferreds		Hedge Funds
		Private Equity
		Private Debt

Some alternative investments and complementary strategies may be available to pre-qualified investors only.

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Mapping Investments to Desires

It is not about active vs. passive

Or

Traditional vs Alternatives

Or

In-house or outsourced

What kind of Beta do you want?

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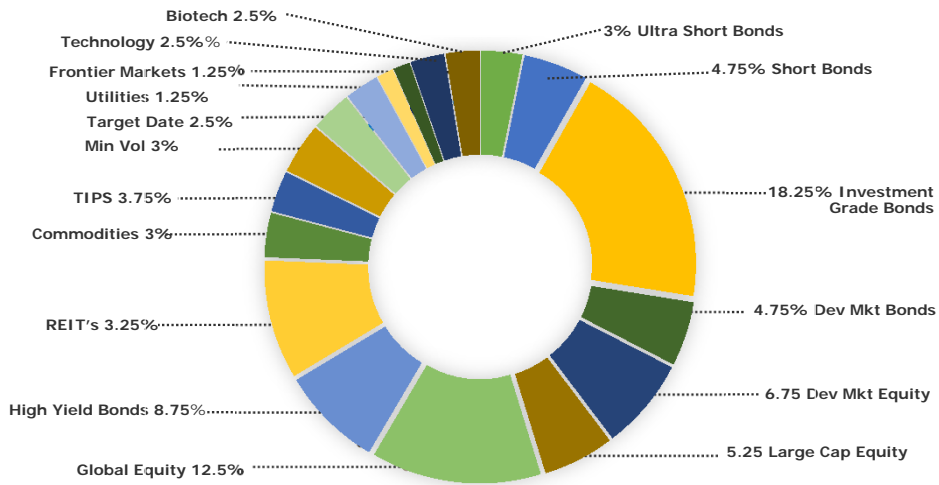
Concerns aren't addressed by one asset



Desires Based Allocations

Total Portfolio Allocation

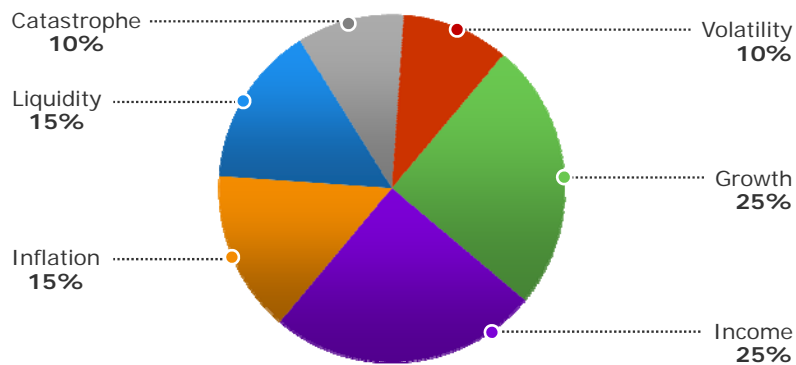
Too much to comprehend



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Not Traditional Asset Allocation

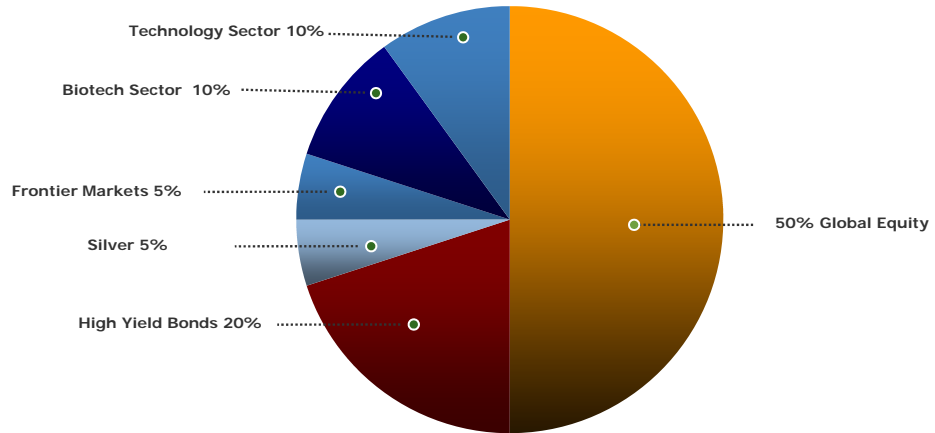
Desires Based Allocations



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Growth Segment

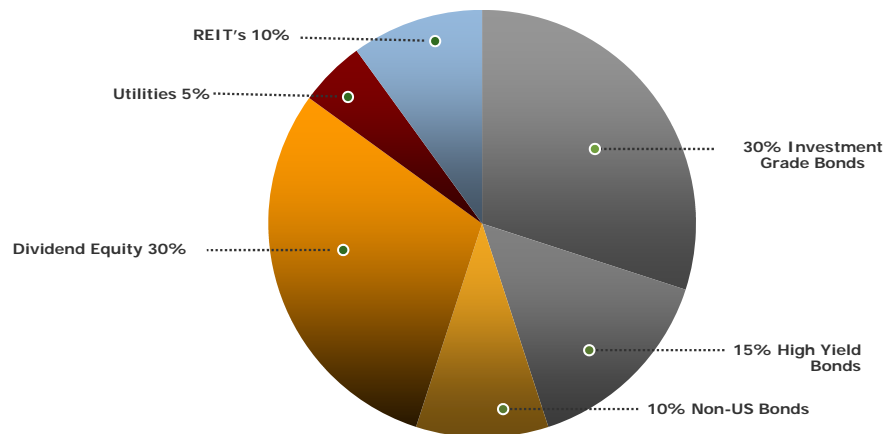
Helps to provide asset growth for future financial needs



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Income Segment

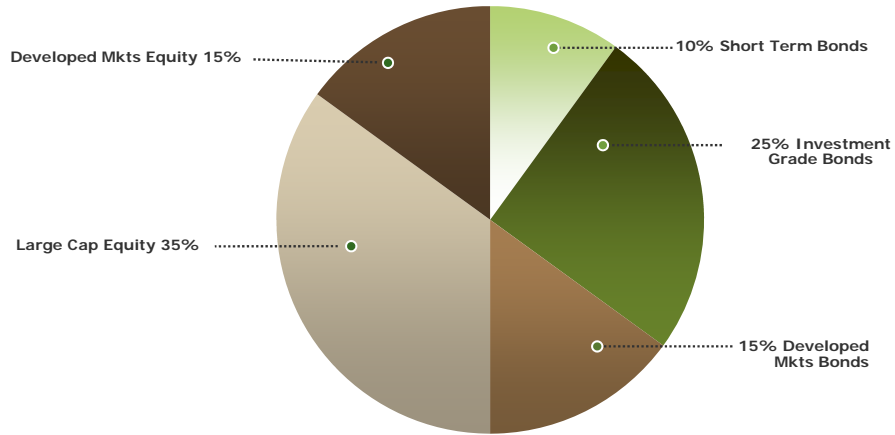
Helps to maintain cash flow for distribution needs



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Liquidity Segment

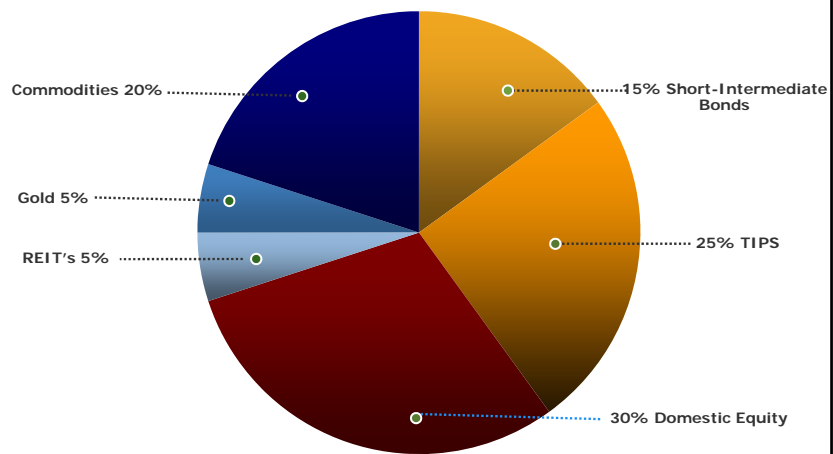
Helps to maintain liquidity for opportunistic investments



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Inflation Segment

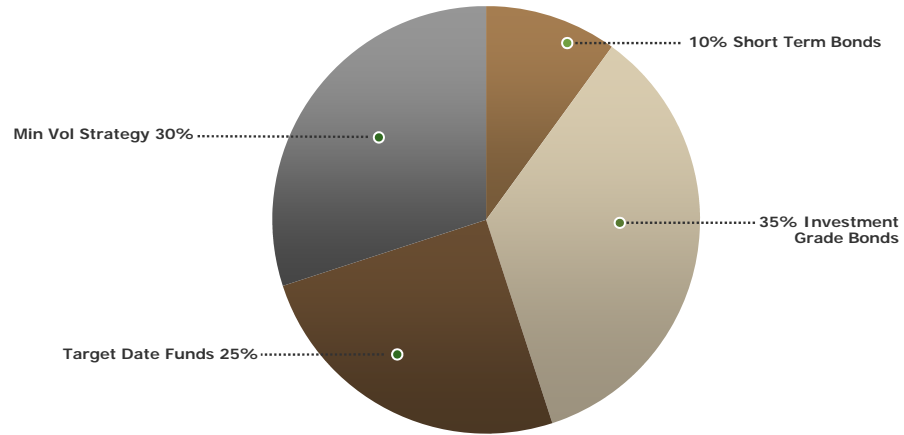
Helps to protect against the corrosive impact of inflation



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Volatility Segment

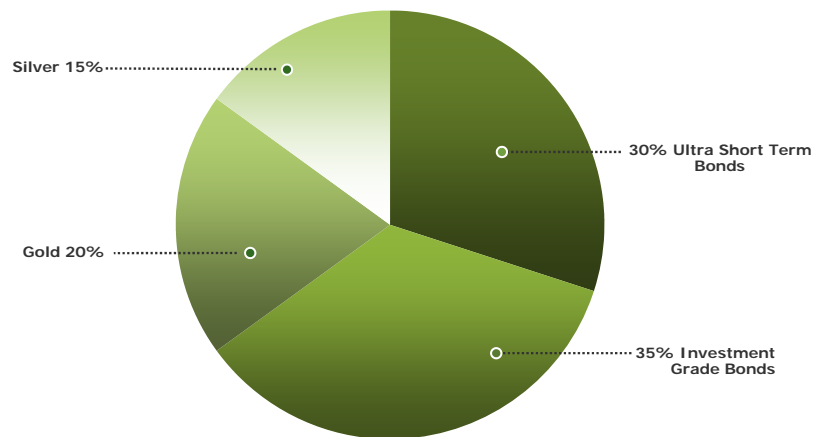
Helps to maintain portfolio value during heighten market volatility



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Catastrophe Segment

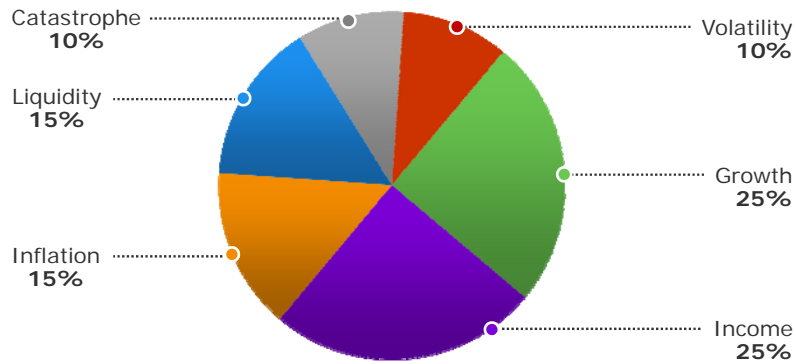
Helps to maintain value and liquidity in market disruptions



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Client Focused Allocation

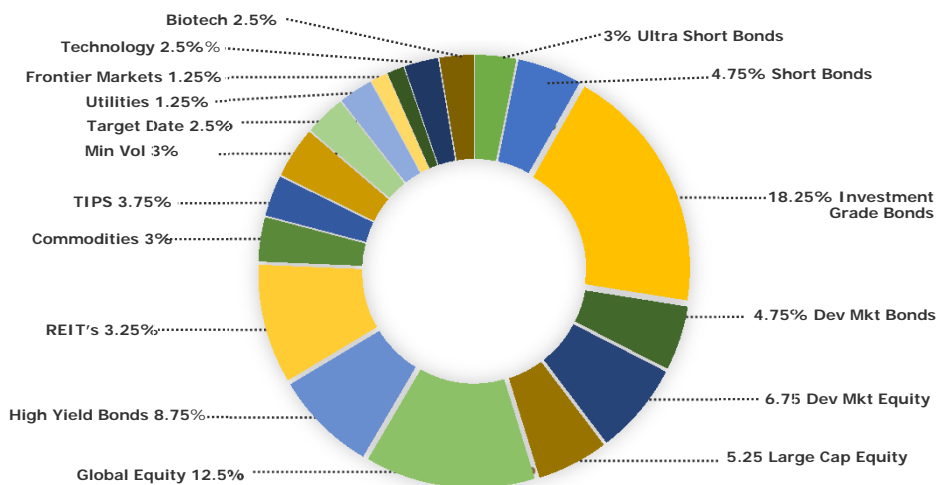
Desires Based Allocations



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Total Portfolio Allocation

Now it is more intellectually manageable



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Other Possible Segments

Desires can also map to philanthropic goals...

- Emerging Consumer
 - Infrastructure
 - Global inflation
 - Timber
- Environment impact
 - Green energy
 - Technology innovations
 - Waste management
- Social Impact
 - Pharmaceuticals
 - Emerging and Frontier markets
 - Natural resources

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Fiduciary Perspectives in 2015

- Segmentation Allocation
 - Go beyond traditional asset allocation
 - Desires/concerns addressed in strategy
 - Financial experience to focus on real issues, not hype
- Implementation vehicles
 - Which vehicle to pick?
 - Current market conditions
 - Spreads, valuations, capacity, tax circumstance
- Ongoing monitoring and rebalancing
 - Trading for investment improvement, not just noise
 - Portfolio rebalancing
 - Regulatory changes
 - Evolution of philanthropic needs

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The 5 Pillars

① Liquidity keeps you on track

The level of liquidity that is needed to stick with the long-term investment plan.

“The market can stay irrational longer than you can stay solvent.”

~ *John Maynard Keynes*

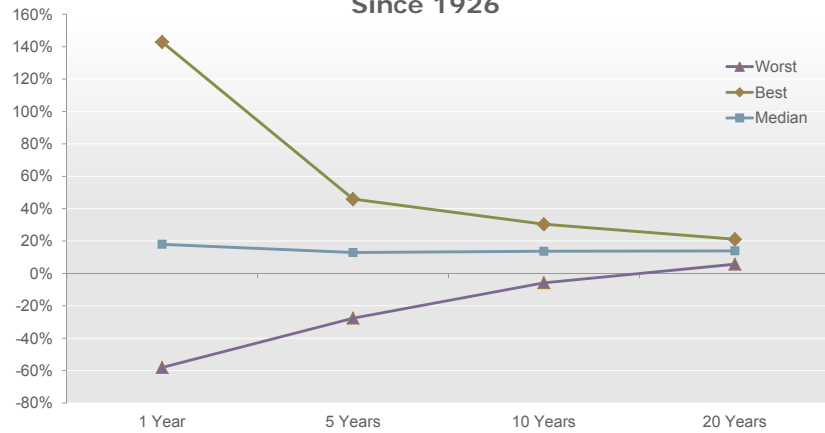
Source: “The Life of John Maynard Keynes”, R.F. Harrod, 1951

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2 Match time horizon with investments

Uncertainty about returns generally diminishes over time.

S&P 500 Best and Worst Returns Since 1926

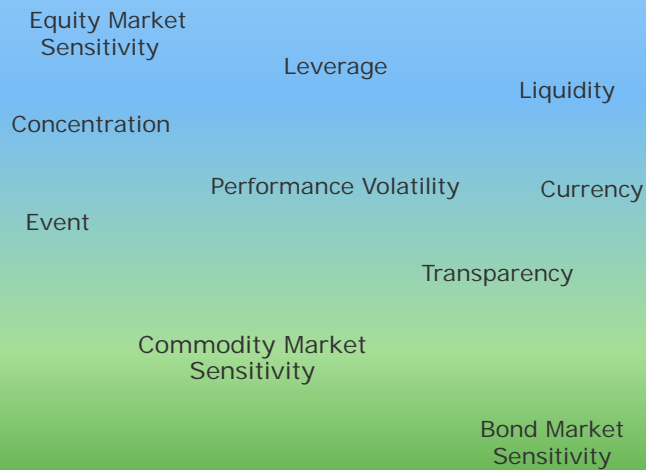


Source: Morningstar EnCorr, 12/31/2012
Past performance is no guarantee of future results.

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3 Risk is Far More than Volatility

Understand all the risk the portfolio is facing.



Source: Wells Fargo Wealth Management Group, 6/08

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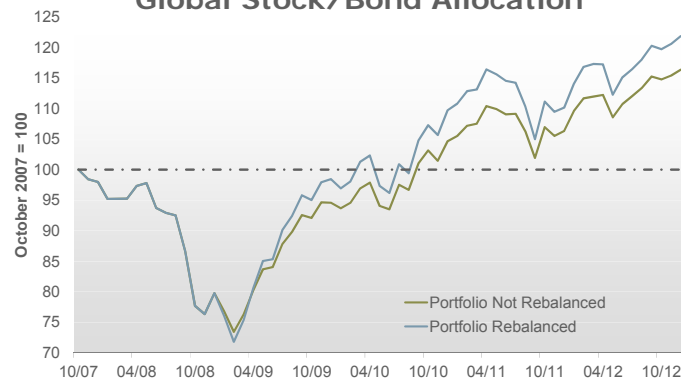
4 Rebalancing controls risk and....

Not rebalancing can cost a portfolio dearly.

Scenario 2007-2012:

Two portfolios with similar weights. One rebalanced annually and the other allowed to drift from its target weights.

Global Stock/Bond Allocation

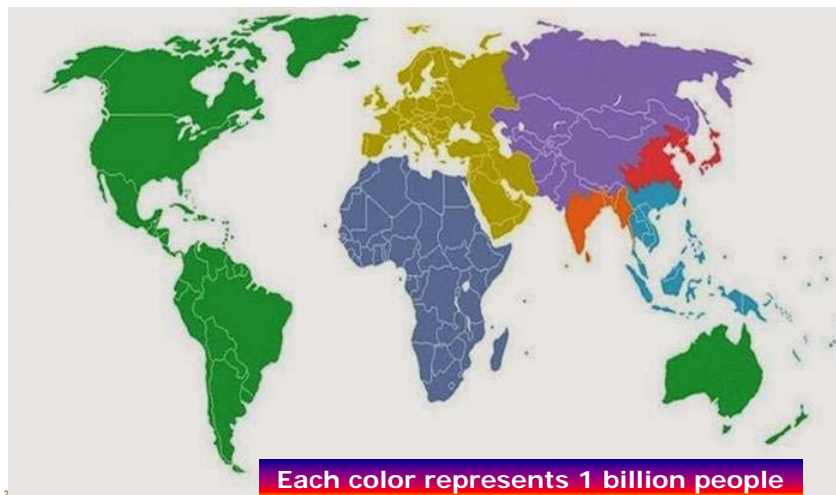


50% Bonds – Barclays US Aggregate 1-3 Index; Barclays US Intermediate Aggregate Index; Barclays US Corporate High Yield Index; JPM GBI Global Ex US Index;
50% Stocks – S&P 500 Index; Russell Mid Cap Index; Russell 2000 Index; MSCI EAFE Index; MSCI Emerging Markets.

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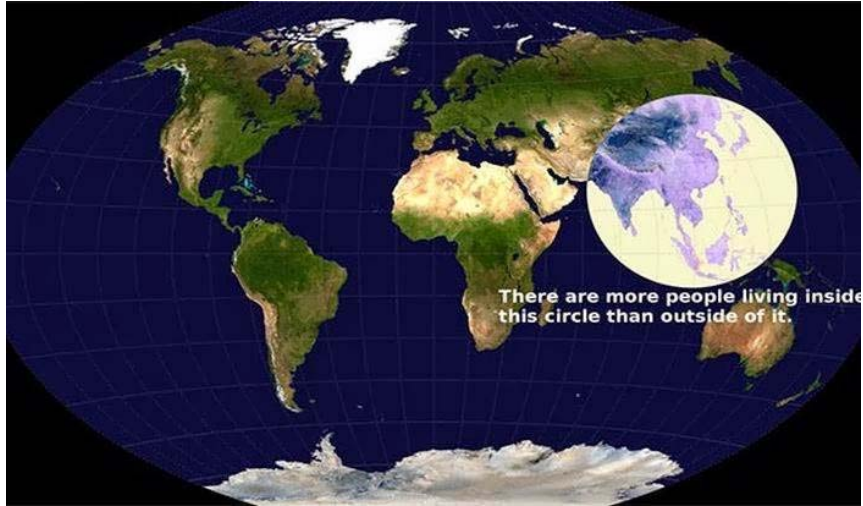
5 The global economy has evolved

Are you invested by geography or demography.



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5 Where is everybody?



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Five Pillars of Asset Management

- 1 Have adequate liquidity at all times
- 2 Investment time horizons are critical
- 3 Risk is far more than volatility
- 4 Rebalancing controls risk and improves return
- 5 The global economy has evolved, has your portfolio?

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2015 Themes

- 1 Interest rates rising by 100 bp
- 2 With Russia on the ropes, India/Japan fill void
- 3 Lame duck Congress
- 4 Health care moves from ACA to global perspectives
- 5 Frontier Markets become the new emerging economies
- 6 If it doesn't rain in California,.....

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