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2020 Investment Strategies

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The True Cost of ETF Ownership

By Scott McKenna

Advisors have increasingly adopted ETFs over the past few years. And why wouldn't they? ETFs are cheaper, more liquid, more transparent, and overall, offer many advantages over traditional mutual funds. However, it is essential to note that there are many complexities that advisors should be aware of when choosing ETFs to put in their clients' portfolios.

When purchasing or selling any investment, certain transaction costs occur during the process. While these transaction costs are relatively low for ETFs – owning an ETF is not an entirely frictionless event.

There are also forces at play "under the hood" that generate costs when holding an ETF, namely: fund management fees, taxes, slippage, trading expenses, and so forth.

This infographic highlights the True Cost of Ownership (TCO) by breaking down some of the common complexities that accompany buying and owning an ETF.

For more help in navigating the ETF marketplace, advisors can sign up for a free consultation with our team to walk through our ETF and portfolio workflow tools. ■

Costs	Items to Check	Questions to Ask
Trade-In Costs	Average Daily Volume	Does the fund trade?
	Premium and Discount	Is the ETF trading near its fair-value?
	Account Type	How long do I expect to hold this and should I do this trade in a taxable or tax-free account?
Expense Ratios	Gross Expense Ratio	What does the fund charge?
	Net Expense Ratio	What do I actually get charged after fee waivers and reimbursements? Do these fee waivers expire in the near future?
	Hidden Fees	Does the ETF own assets like other ETFs, futures or swaps that have their own associated costs? With ETF fund-of- funds be careful that you're not paying two management fees. With futures, rolling near-month expiring futures can cost you the roll yield. This is especially problematic with commodity ETFs.
Fund Taxes	Long-Term or Short-Term Capital Gains	Did the fund have distributions that were classified as capital-gains? These can sometimes be many times larger than regular dividend distribution yields.
	Fund Structure	What is the fund structure I am investing in? Some ETF fund structures do not allow stock lending, which can often help the fund manager boost tracking returns. Other funds may be structured as partnerships, producing a Form K-1 at the end of the tax year.
Dividends	Equity Yield	Does the ETF yield match the basket yield?
Trade-Out Costs	Same as Trade-In Costs?	Are the volume and premium/discount dynamics favorable now as they were when I traded in?
Your Taxes	Time	How long did I hold this for? LIFO or FIFO accounting?
	Capital Gains	What will my tax bill look like?

Why Choosing the Right Custom Benchmark Makes a Difference

By Scott McKenna

Setting your client's expectations around performance and risk is one of the most important aspects of the investment process. A return that could be considered healthy in one market environment might be considered weak in another. That's why you must look at your portfolios against a specified benchmark that best matches the makeup of your portfolio and is sensitive to the asset allocation and risk profile of that portfolio.

When performance metrics are mentioned, it is usually in reference to an index, like the S&P 500 or Russell 2000. Advisors use indices as benchmarks to see how their portfolios compare. But oftentimes, comparing a complex portfolio with multiple asset classes against an index that is composed of only one narrow segment of that asset class is like comparing apples to oranges!

For example, if your moderate 60/40 (an allocation of 60% to equities and 40% fixed income) portfolio is benchmarked to the S&P 500, over the last decade or more it is likely that you would have performed very poorly against this passive benchmark. From a risk perspective, however, it may look like you experienced less volatility. One may even ask whether you took too little risk with respect to the benchmark.

So which benchmark should you choose? The best benchmarks to use against a complex portfolio made of many parts are custom made ones. In other words, the best way to measure a portfolio is with another representative benchmark portfolio.

Items to watch out for when building custom benchmark portfolios:

1. Does the asset allocation mix of the benchmark match or closely resemble my client's portfolio? Thinking about asset allocation shouldn't just be done broadly across equities or fixed income. Sometimes, it is beneficial to break down those exposures further. For example, equities could be further refined by geography: US, Developed or Emerging Markets. Fixed Income could be further broken down by credit grade such as High Hield, Investment Grade or Government bonds.
2. Does the resulting risk profile of this portfolio match the intended risk profile of my client? Within each asset allocation segment, the risk and return profile of representative segments can vary. For example, within US Large Cap exposure, choosing the Nasdaq 100 over the S&P 500 would tilt you aggressively towards technology and growth factors that may be under-represented in your actual portfolio.
3. Stay consistent. Custom benchmarks are a great way to properly measure risk and return in your portfolio. But only if they remain consistent and unchanged throughout the life of the investment process. Changing a benchmark should be done in conjunction with a change in the client's risk profile or asset allocation mix.

Advisors using the Logicly platform are able to easily create custom benchmarks during portfolio analysis. Here, custom portfolio benchmarks can be designed to match your desired allocation exposures and will rebalance with your portfolio. In the resulting analysis, returns, risk, and drawdowns can be carefully measured against each other and provide a much better view of how that portfolio is doing.■

Why ETFs for Tax Loss Harvesting

By Dan Brodsky

Tax loss harvesting is a pretty straightforward concept - cut positions at a loss to lower clients' overall tax bill today. Once out of a position for 30 days, you can get back in. But with stocks, sitting on the sidelines for 30+ days may not be possible or ideal.

That is where ETFs can help. ETFs offer an advantage in navigating tax loss harvesting and the implications of the wash sale rule because there are over 2300 ETFs to choose from. Savvy investors can swap out of a particular ETF and into another that gives them a similar but not identical exposure.

ETFs offer an advantage in navigating tax loss harvesting...

You can use ETFs to replace both mutual funds and other ETFs as long as they are not considered "substantially identical" by the IRS. If you are not certain whether a given ETF is too similar to another, you may be able to reference its index for guidance. If the ETF you wish to sell tracks the same exact index as the ETF you would like to buy, there is a decent chance that the IRS may deem the securities too similar. Luckily, there are usually multiple indices to choose from when trying to get exposure to a particular asset class and/or market sector.

Since there is no shortage of ETF products on the market, you have ample choices when considering a swap for the purposes of tax loss harvesting. Since there may be anywhere from five to ten ETFs that track similar and highly correlated indices, you can trade from one into another.

Here are some ways to pick the right ETF to optimize tax loss harvesting:

- **Look for Correlation.** Correlation is one important element to look at when choosing an ETF to make a tax loss pairs trade. One wants to ensure a high correlation to match the performance of the previous investment as closely as possible.
- **Measure the Active Share.** Active share is a measure of active portfolio management that essentially tells how different a fund is from its benchmark. By choosing an ETF with a moderate degree of active share versus a reference ETF, one can stay within asset allocation guardrails while potentially not falling afoul of the wash-sale.

Tax Matters When it Comes to Performance

When the market is riding high, and everyone is doing well, tax considerations may seem trivial. But as the market softens and tax laws increasingly look to target capital gains, a winning tax strategy can make all the difference between competing advisors.

Of course, consult a tax accountant for guidance on these matters as rules and tax rates are always changing. ■

Why Advisors are Increasingly Using Model Portfolios

By Lindsey Tewell

Whether you are a new advisor who is unsure where to start when it comes to portfolio construction, or one who has been in the industry for years looking to take some of the work off of your plate, model portfolios can be a great tool to help you.

Let's discuss five common reasons that advisors use model portfolios:

Scalability

Advisors have multiple responsibilities to juggle daily outside of investment management, including client service, financial planning, and growing their client base. The ability to outsource portfolio construction to a model provider makes this more manageable. In short, implementing a model portfolio approach allows advisors to achieve growth and scale by:

- Establishing a defined and consistent investment process;
- Simplifying rebalancing across all accounts; and
- Expediting the preparation time for client reviews.

Hence, adopting a model portfolio strategy enables advisors to manage more assets and scale their practice.

Expertise

With so many investment strategies and options to choose from, it is hard not to get overwhelmed. Increasingly more sophisticated and complex products are entering the market. How can advisors stay on top of the evolving choices? They can do so by:

- Utilizing model providers, who have teams of analysts, quants and researchers, to stay abreast of the latest themes and strategies;
- Leveraging model portfolios to gain access to opportunities they may not have been able to implement independently;
- Offloading fiduciary pressure to the model experts who are fiduciaries themselves; and
- Relying on the track record, reputation, and credibility of model providers.

Client Retention

Investment advisors face a mountain of responsibilities and immense time pressure. There simply are not enough hours in the day to do everything. By outsourcing some of the investment management functions, advisors can free up time to engage with existing clients and grow their practice.

Clients expect their advisors to utilize the best-in-class in terms of technology and investment strategies.

Using proven models allows advisors to check that box. It also allows the advisor to focus on client retention and acquisition.

Compliance

Compliance is never a fun subject. Using models allows advisors an extra layer of comfort in managing this critical responsibility. The asset manager providing the model is under the same, or more, regulatory scrutiny as the investment advisor.

Due Diligence

Due diligence is another crucial function that investment advisors must perform. Properly evaluating the risks and opportunities inherent in an investment strategy can be an extremely complex and time-consuming task. Model portfolios facilitate the due diligence function by enabling you to:

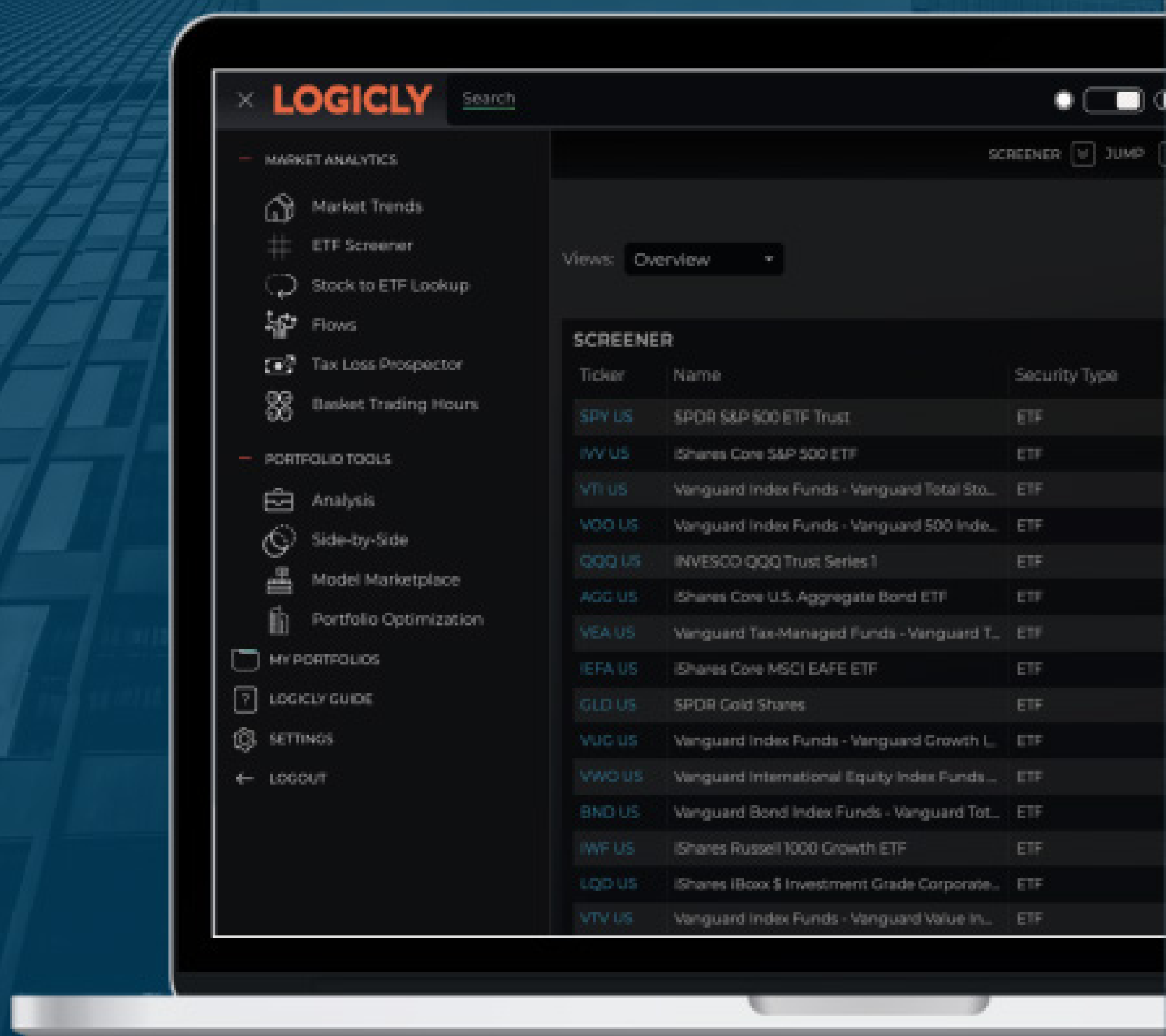
- Leverage the due diligence of model portfolios across multiple client accounts, thereby reducing the number of individual portfolios for which separate due diligence is undertaken;
- Reduce the number of investments you have to track; and
- Quickly run the due diligence analysis to foster the decision-making process and properly communicate one's model choices to clients.

With over 10,000 models out there, advisors need tools that can help them optimize their decisions efficiently and effectively. The Logicly platform can not only help you navigate the model marketplace but also give you the tools to run that diligence quickly. ■

Advisors have multiple responsibilities to juggle daily outside of investment management, including **client service**, **financial planning**, and **growing** their client base.

LOGICLY

All in one portfolio analytics



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The Shifting Risk Landscape: Do You Need to Take More Risk to Maintain Income Targets?

By Emil Tarazi

People always wonder about their nest egg. How much of it will they be able to spend each year without running it down to zero? For those nearing retirement, this question has become an even more pressing concern.

At the Federal Reserve's September 2020 meeting, officials promised to keep short-term interest rates anchored near zero through 2023. Of course, this recent news only helps to cement the low rate environment we have been experiencing in the US for over a decade.

This brings into question even more starkly the age-old retirement rule of thumb: the 4% rule. Generally, the rule says that a portfolio will last for 30 years if you withdraw 4% every year. More specifically, this rule came about by running thousands of simulations on portfolios under different stress scenarios. Retirees start out by withdrawing 4% of their portfolio in the first year. In subsequent years that 4% adjusts based on the rate of inflation. Given such parameters, a typical retirement portfolio would last a minimum of 30 years, and most portfolios would last 50 years.

Unfortunately, the 4% rule is about 26 years old now. It was created in 1994 under different rates and market circumstances. It also assumed that the retirement portfolio would have a 50/50 asset allocation between stocks and bonds at the start.

The analysis behind the 4% rule included one particularly interesting observation about equities. Having too low exposure to equities (less than 50%) would increase the chances of running out of retirement money. If retirees could handle a little bit more risk exposure or had alternate wealth creation goals, a 75% allocation to riskier equities would be acceptable and even favorable for maintaining withdrawal rates.

Burton Malkiel, the American economist and author of A Random Walk Down Wall Street, suggests a few equity allocation changes if you can tolerate the risk. The two leading suggestions are to chase higher-yielding exposures in preferred equities and higher growth potentials in emerging market equities.

The first idea is that preferred equities are somewhat unfairly beaten down in 2020. But in a near 0% rate environment, preferred stocks are a way to achieve yields over 5% right now. To put this in perspective, PFF, the iShares Preferred Income ETF, yields 5.4% to SPY's, the SPDR S&P500 Fund, 1.72%. The volatility is 21% annualized in SPY versus 7.12% for PFF, using a 20-day volatility window in mid September 2020.

The second idea is to invest in emerging markets. High-growth areas of the world, where the demographics skew younger, have an ever-growing and burgeoning middle class that will continue to drive growth whilst the demographics of more developed countries slows. Returns throughout 2020 for the iShares MSCI Emerging Market ETF (EEM) are about -3.81% YTD versus SPY's +3.13% for slightly lower volatility than SPY. (as of mid September 2020). Considering where we started and where we are today, emerging markets have held up quite well. ■

> Having too low exposure to equities (**less than 50%**) would increase the chance of running out of retirement money.

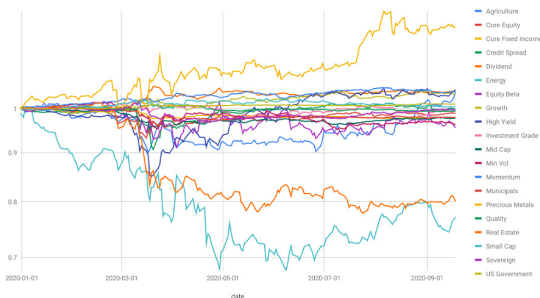
Factor Investing Through the Pandemic

By Boris Drovetsky, PhD

A factor is any feature related to an ETF or stock security that can help explain the return or risk within a portfolio. There has been a lot of research around factors, and there is significant evidence that suggests that long term portfolio performance can be explained by factors.

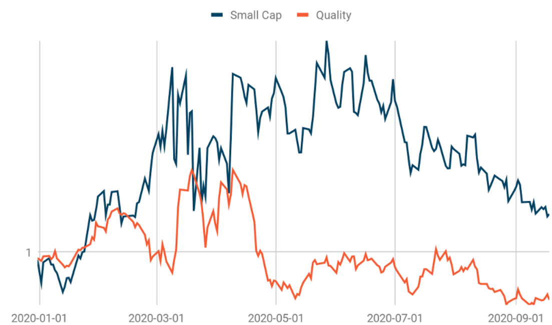
By analyzing these factors within portfolios, advisors can better understand what contributes to risk and performance and can then tilt their portfolios to position them for better investment outcomes.

So how have factors performed throughout the current pandemic situation?



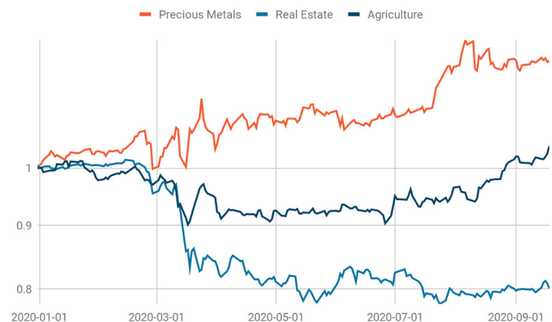
So let's break it down a little bit further:

Dividend, Growth, and Momentum have seen the best year-to-date performance.



Although Quality and Small Cap demonstrated robust performance during the beginning of the crisis, their performance deteriorated over the summer.

Minimum Volatility went through a steep decline in the spring and then experienced a volatile summer period. This factor still has not demonstrated any sign of recovery.



In the "alternatives" category, Real Estate flattened during the late summer, while Precious Metals outperformed all other sectors. This kind of scenario typifies a weakening dollar environment. Agriculture responded to inflationary pressure and started to grow in the late summer. ■

All charts as of mid-September 2020.

Spend More Time With Your Clients by Leveraging Technology

By Dave Connor

There are now more distractions and demands on our time than ever before. As an advisor, you can leverage technology to overcome these challenges in two main ways: to streamline your work activities and to improve client communications.

- **Streamline investment research.** Many advisors spend hours using disjointed technology to screen investments and construct portfolios. By choosing the right investment research tools, advisors can save valuable time that they can redeploy to other activities that strengthen client relationships. Using a platform like Logicly, which offers a comprehensive, all-in-one solution for investment research and portfolio construction, can help save countless hours weekly.
- Reach clients on the platforms they find most comfortable. Whether making a phone call, sending a text, or messaging over social media, try to connect with clients in the ways that they prefer to help strengthen the relationship and reduce communication barriers.

Whenever possible, use interactive tools to share your screen (and insights) with clients.

Gone are the days of treating a client to an in-person dinner or coffee. In this new normal, meetings are primarily conducted via video conferencing tools. Using a live screen share of a platform or portal helps build a sense of trust and transparency with a client. It also helps keep them engaged by showing them compelling visuals and charts. Tools like Logicly are a great resource to share key portfolio statistics with clients in a stimulating online environment. ■

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How to Maximize Client Communication With High Impact Visuals.

By Andrew Holubec

Clients might not always have the same level of understanding of the markets as you do, which makes it essential to gauge their knowledge level so that you can determine the most effective visuals to share with them. To demonstrate that understanding and build better communication channels with clients, we have outlined some tips below to help you select the most appropriate visuals for client meetings.

Leverage Historical Portfolio Metrics

Asset allocation. Show clients exactly what is in their portfolio view. No client wants to hear a vague description of where their family's legacy money is. You are an integral part of their family now, and you can demonstrate that using Logicly's dive into the Top Holdings of the Stock and ETF Basket coupled with a snapshot of their portfolio's trailing returns.

Historical performance. Show them which investments are driving their portfolio's performance. Discussing performance attribution provides an excellent opportunity to explain the investment selection reasoning and demonstrate your understanding of their financial goals.

Use Risk Metrics

Risk profiling is one of the most important ways to understand a client's goals and behaviors. You are probably leveraging risk metrics already for prospecting and client reviews, but using them proactively during volatility events, like what we saw earlier this year, can help strengthen your relationship with a client.

Use Forward-Looking Charts

Risk estimates. You can even go a step further and give them forward-looking estimates up to a year out projecting how their portfolios are likely to perform.

Backtesting. Showing how factors within a client's portfolio performed up to 50 years back is a great way to give clients an idea of how their investments might perform over the next 50 years.

Scenario testing. Probably one of the biggest fears clients have relates to some version of the proverbial "what if" scenario involving the market. Using scenario testing can help answer those "what if" concerns, such as another financial crisis or global pandemic.

Harnessing ESG Criteria to Show You Reflect Their Values

ESG (Environmental, Social, and Governance) criteria are becoming increasingly important, especially among younger investors. Having tools to screen for ESG, to provide portfolio scoring across environmental, social, and governance values, and to provide alerts on potential negative ESG exposures can be a great way to show your clients that you have made investment decisions that reflect their personal values.

Cost Metrics

Use expense ratio averages to show how you chose the right one. Fee compression has been a growing issue, and it's important to be transparent with clients around the fees that they are paying both the fund managers and you. Showing a peer group's average expense ratios is a great way to show you picked a fund with their overall costs in mind.

Fee overlays. It's also essential to be transparent about the costs that you are charging the client. With the Logicly platform, you can show your fee overlay to provide a more comprehensive view of the portfolio after fees.

All of the visuals discussed within this article are available via the Logicly platform and are exportable into customized PDFs for client reporting and presentation. ■