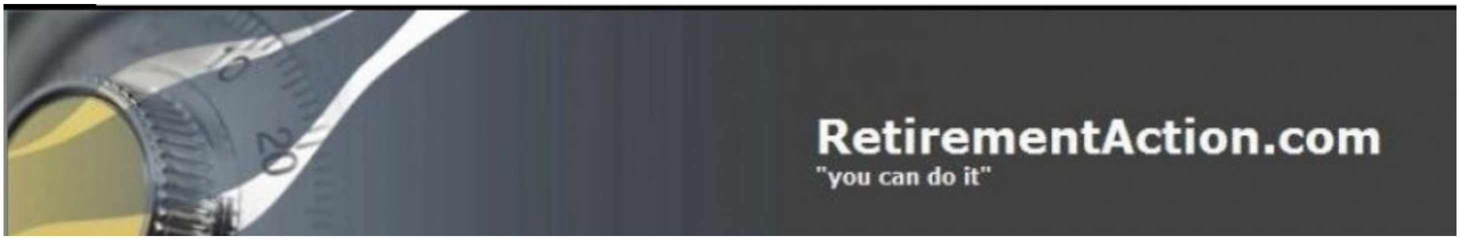

"YOUR PORTFOLIO IS BROKEN" BY CHRIS TURNBULL- A BOOK REVIEW

October 15, 2014 · *by* peter benedek · *in Advisors/Fiduciary, Books · Leave a comment*

In a nutshell

In **"Your Portfolio is broken"** Chris Turnbull looks at what's wrong with the advice, investment management practices and business models in the Canadian context. The advice model tabled in this book is based on CFA Institute best practices then using a portfolio implemented using a passive/index based approach which is then delivered in a "portfolio manager" business wrapper with a fiduciary level of care. If you can access this model at a reasonable 'all-in-cost', it might be a workable solution for those needing advice.

The author describes an investment philosophy focused on controlling what you can, developing an Investment Policy Statement based on the client's needs/objectives, defining the asset allocation to meet those needs/objectives, implementing with passive/index funds, tax-smart asset location and withdrawal, minimizing costs, then rebalancing periodically and professional performance reporting. So you get all the high value things that an advisor can offer, without having to pay for the low/no-net-value stuff like market timing and stock selection. If this approach can be delivered at a reasonable 'all-in-cost', yet allowing the portfolio manager a reasonable income after costs (e.g. custodial, liability coverage, administrative and professional costs, etc) then it could revolutionize the Canadian advice industry from what's good for the asset manager to a client advice centered model.

The details

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As the title indicates, Turnbull start his book (a real quick read of only 90 pages) by looking at some of the causes of "broken portfolios" and then he explains his "non-predictive commonsense approach to investing- controlling what you can control, eliminating unnecessary risk, understanding sources of returns and capturing those". He argues that private council "portfolio manager" model is the top of the hierarchy of investment services business models followed by brokers, mutual fund sales and then banks being on the bottom. The key differentiating elements of such private council portfolio manager being: complete fee disclosure, discretionary portfolio management (i.e. manager has full authority over client's portfolio) and fiduciary duty (required when registered as "portfolio managers" in Canada)

His list of causes of broken portfolios is extensive and includes: a "self-serving industry" with emphasis on sales/transactions/asset-gathering rather than advice, varying ethical standards, rarely delivered-on promise of prediction-based market out-performance, focus on sales and product creation (IPOs, structured products, mutual funds…), active vs. passive investing almost guaranteed to underperform market (due to management fees, transaction costs, taxes…), highly competitive market with many smart players, conflicts of interest, taking uncompensated non-market risk (company, industry, un-diversifiable risks), unclear/unspecified benchmark and return, not knowing the full extent of fees/costs, high turnover, buying high and selling low, and no consolidated view of household portfolio

-Turnbull suggests a simple solution to "broken portfolios": understand client's objectives/needs/circumstances/constraints, generate the required/appropriate asset mix (though risk tolerance was not explicitly mentioned, it is no doubt part of the process), summarize in an Investment Policy Statement (IPS), implement with a passive/index approach to capture market returns, lower fees, rebalance portfolio as required, report regularly on performance and costs and delivered at a fiduciary level of care.

-he has some great illustrations demonstrating the impact over time of asset allocation on return and standard deviation of portfolios of differing stock/bond allocation, and reminds his readers that about 90% of performance differences are attributable to asset allocation (the rest to stock picking and market timing)

-a simple portfolio in the Canadian context suggested for consideration is:

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40% fixed income, 20% Canadian equity, 20% US equity and 20% international equity. He also suggest a small allocation to REITs and Emerging Market equities which may be implemented as: 40% fixed income, then the equity component allocated as Canadian 18%, US 15%, international 15%, emerging market 6% and REITs 6%. He demonstrates the value of adding fixed income to an otherwise 100% equity portfolio to reduce volatility (and maximum draw-down in a crisis) with only a relatively small reduction in return.

-overall his approach is a Total Return Portfolio strategy, which he argues as being superior to investing for income which generally leads to be a less diversified portfolio; if/when it is necessary to sell assets to meet spending requirements then taxable assets should be sold first and only sell enough to meet needs

-the portfolio implementation appears to be based on DFA and iShares funds (though I gather that Vanguard funds are also used)

-a number of wise quotes from Charles D. Ellis (author of ***Winning the Loser's Game***) are also delivered, such as: "The field of investment management really has two major parts. One is the profession- doing what is best for investment clients- and the other is the business- doing what's best for investment managers.

- He also raises an important question for many DIY investors: "who makes investment decisions in your household, and could your spouse/children take over should it become necessary (i.e. do they have the capability, willingness, interest and time)? (The attributes of the fiduciary "portfolio manager" business model with a passive/index implementation might be a useful solution.)

Bottom line

This book is well worth reading by both financial industry insiders and potential clients since Chris Turnbull, who runs TheIndexHouse using the principles/approaches described in the book, shows a practical way for the Canadian advice industry to deliver the high value components of what clients need. While I don't know Turnbull personally and thus cannot endorse his services, his book describes a passive index-based implementation using CFA Institute best practices (similar to what I use for

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my personal investments) delivered in a Canadian “portfolio manager” business wrapper which comes with a fiduciary level of care. The intersection of these best-practices with a low-cost passive index fund implementation and fiduciary level of care can revolutionize the Canadian financial industry. The book title doesn’t do it justice with the emphasis on the “broken portfolio” rather than the solution delivered.

The real challenge is how to deliver these high value components at a low ‘all-in-cost’ given our significantly lower return environment. Robo-advisers are aiming for a 0.3% (somewhat higher in Canada) cost target, albeit with little or no personalization of service delivered. Vanguard in the US is offering (or is about to offer) a 0.3% price point with the level of personalization of advice determined by the assets under management (I have not seen any reference to such a service from Vanguard Canada). One could see over time a segmentation of the advice industry into a low automation based robo-adviser driven services all the way to highly customized/individualized advice for higher net worth investors, and even something more menu driven in between the two extremes. As the models for delivering investment advice shift, the challenges for those in the ‘advice business’ will be substantial, but so will the opportunities for those who are able to deliver the value added components for the clients in a cost-efficient manner.

By the way PMAC is a Canadian association of those delivering their portfolio management services with a fiduciary level of care, personalized portfolio management, fee transparency, professional qualifications and an Investment Policy Statement. Their website also has a list of portfolio managers who deliver advice within these parameters; obviously clients must meet certain minimum portfolio sizes and fees charged tend to be graduated. There may others on the PMAC list who might be offering index based portfolio implementation. The Canadian “portfolio manager” model sounds similar to Registered Investment Adviser model in the US.

Such a “portfolio manager” model might also be an answer to DIY investors who need a successor to manage their portfolios should they be unable to do so at some point.