

Paul T. Remack
President, RG Financial Partners, Inc.
Registered Principal, FSC Securities Corporation

INVESTING LIKE INSTITUTIONS

Retail investors manage their investment portfolios without the benefit of a well-defined process. This causes them to look at their portfolios without a comprehensive focus and a business plan for their assets. Many times retail investors have little or no asset allocation along with excess security and sector concentration and make decisions based upon short-term market trends. This results in a portfolio that fails to represent the investor's goals and objectives. This approach can also produce a portfolio that does not effectively manage risk and, in fact, can produce a portfolio that may be too aggressively or conservatively invested for the individual client needs.

Institutions such as endowments, foundations, and qualified retirement plans have traditionally invested their funds using a well-defined, structured and disciplined investment process. This process is based upon the strict guidelines set forth in the Uniform Prudent Investors Act (UPIA), the Employee Retirement Income and Security Act (ERISA) and state trust laws governing investment guidelines. These bodies of law have one common similarity....they make the assumption that trustees, investment professionals and others associated with the management and implementation of these funds are acting in the role of a fiduciary. A fiduciary standard requires that all actions taken are solely in the best interest of the investor/institution.

This entails the development of a systematic, well-defined and documented investment process that includes a complete analysis of the current situation of the investor, formulation of an appropriate investment policy statement, determination of appropriate diversification among asset classes, implementation of the investment policy statement, and on-going monitoring of the investment portfolio within the guidelines set forth in the investment policy statement.

This disciplined process produces a portfolio with more consistent returns that effectively controls investment risk and lowers portfolio volatility. It also accurately represents a client's goals and objectives and provides objective criteria upon which to make investment decisions.

Institutional investors have followed this process and improved upon it for years. These investors know that intelligent and prudent investment management decisions require that a rational, disciplined investment program be maintained and followed.

In the recent past, high net worth investors began to embrace this process as a way to prudently invest the portfolios of their families and implement the fiduciary standards that institutional investors have required for years.

Development of the Investment Process

Review of Current Situation

The first step in developing a comprehensive investment process for your family's portfolios requires a complete review of your current situation. This includes defining both short and long term goals for these portfolios, determining specific needs of any family members and estimating the timing of those needs, reviewing the current investment portfolio relative to your goals and objectives, evaluating current service providers and service agreements, and defining duties and responsibilities of all service providers.

Formulate Investment Policy Statement

The Investment Policy Statement (IPS) becomes the essential tool for directing the activities of the investment portfolios. The IPS becomes the blueprint for the overall process. This is the "business plan for assets" as we like to call it. It is integrated into all multi-generational family planning. The IPS documents the process and provides the detail necessary to implement the specific strategies for the investment portfolios. It defines the duties and responsibilities of all parties involved and provides guidelines for addendums, changes and on-going maintenance. The IPS will also define diversification and re-balancing guidelines within the portfolios.

A well-crafted Investment Policy Statement will outline the due diligence criteria for all investment portfolios. It will provide the discipline and framework for the investment process. Typically this includes search, screen, selection and on-going monitoring criteria for the overall investment portfolio and the individual investment managers. The IPS will also provide guidelines for periodic re-balancing of both the investment managers and the overall asset allocation when necessary. Guidelines will be documented for manager watch and removal.

The Investment Policy Statement will define all investment guidelines and restrictions you would want in the overall portfolio and within the individual investment managers. Examples of these would be-maximum percentage in a single position within the portfolio; maximum percentage within a particular sector or industry within the portfolio; quality, duration and maturity restrictions with the fixed income portion of the portfolio; and any social restrictions within the portfolio.

Allocation Among Asset Classes / Diversification

Once the Investment Policy Statement is drafted and approved, we begin to develop an overall portfolio design by using generic asset classes. These could include, but not be limited to, domestic large, mid and small capitalization stocks, international developed and emerging markets, domestic taxable and tax-free fixed income, high yield fixed income, international fixed income, and selective sector investing. Investment manager

Consideration is given to portfolio modeling developed based upon your risk tolerance, goals, objectives and time horizon. We look at active and passive management; asset classes that are consistent with goals, objectives and risk tolerance; core/ satellite positions; correlation and non-correlation within the portfolio; and selecting of the appropriate managers/positions for the overall portfolio. The overriding goal is to maximize investment opportunities while limiting the portfolio risk through proper diversification.

Implementation of the Investment Policy Statement (IPS)

The implementation of the Investment Policy Statement (IPS) begins with the investment manager search and screening or due diligence process. This is performed with the required level of prudence to be compliant with a fiduciary standard. It is based upon stated goals, objectives, risk tolerance, time horizon and resources.

Manager search criteria include peer group, index comparison for relative performance, risk adjusted performance, standard deviation, beta, alpha, tracking error, and information ratio. Managers are also reviewed for firm structure, continuity, size and growth of investment management mandate, substantial in changes to the size of the overall firm (increases or decreases) and any meaningful management changes.

Once managers are identified for each asset class, they are reviewed with the client to ensure that they are a good fit and adhere to the IPS. All service contracts and fee schedules are reviewed and disclosed prior to any implementation.

On-going Portfolio Monitoring and Supervision

Once implemented, managers and the portfolio as a whole are reviewed and monitored two times a week. Formal reviews in writing are conducted quarterly or semi-annually depending upon client requirements. This on-going monitoring and analysis is based upon the criteria developed and documented in the IPS and will include peer group, index and investment policy statement criteria.

Some criteria used for this monitoring are as follows:

- Performance on a relative basis for peer group and comparable index for 1,3, and 5 year time periods.
- Manager's 3 year risk-adjusted performance (Alpha and/or Sharpe).
- Change in professionals managing the portfolio.
- Deviation from the stated style or strategy.
- Extraordinary events that could interfere with the manager's ability to fulfill its role in the future.
- On-going monitoring of fees, fee structures and overall expenses in the portfolio are documented in each formal review.
- By utilizing and following a structured process such as this, investors are able to more effectively and efficiently build a true "business plan for assets" and integrate it into their generational planning.

Using this approach, the investor employs a process that large institutions have used for many years and through which by they have experienced more consistent and predictable investment results in their portfolios.

There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment.