

# Clientel



*The central message of Clientel is that I value my clients.  
I'm as close as your telephone, and available  
and delighted to serve you.*

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Welcome to another edition of *Clientel*. In this issue I shall discuss:

- A review of the Model Portfolio Initiative (with a fee-based component) that I introduced last year.
- A preview of a “client appreciation” event.

## The Model Portfolio Initiative

This initiative was introduced in my February 2004 edition of *Clientel*. (If you would like another copy of this newsletter, please do not hesitate to call me or one of my staff, or view it on our website at <http://www.rogersgroup.com> — click on Financial Advisors, then David, then Clientel Newsletters).

Following introduction of this initiative in February 2004, the first clients to adopt the new approach did so in early 2004. Thus, we are at the Model Portfolio’s one-year anniversary and an appropriate point in time for a review.

## An Overview of the Model Portfolio Initiative

One’s investment portfolio should be formulated in conjunction with a long-term financial strategy. To this end, I gather information from each client so that I can make appropriate investment recommendations. I also (as noted in previous newsletters) am happy to prepare a long-term financial projection for each client that simulates their long-term income, asset and estate position based on reasonable economic assumptions. These projections provide valuable management information for formulating an asset allocation strategy.

### Asset Allocation

Each client’s investment assets should first be divided into two categories:

- Short-term assets for cash needs, liquidity and emergencies or opportunities.
- Long-term investment assets.

### Short-term Assets

Short-term assets are kept in a combination of cash, money market funds, high-yield bank accounts (such as ING Bank and Manulife Bank) and redeemable term deposits or treasury bills.

The objective is to have enough money in short-term assets to meet liquidity needs, but to try to avoid having “too much” in this category. The expectation is that the lowest investment return would be earned by this category. (We still try to maximize returns within this category by using providers such as ING Bank and Manulife Bank that pay relatively high interest rates).

### **Long-term Investment Assets**

The purpose of long-term investment assets is to build future wealth and provide capital from which income can be drawn. This category is divided into two subcategories:

- Fixed-income Investments
- Equity Investments

#### **FIXED-INCOME INVESTMENTS**

The basic strategy that I am using is establishing a “ladder” of individual fixed-income investments such as guaranteed investment certificates or government bonds. The purpose of the “laddering” strategy is to provide an average interest rate over the long term. The purpose of using individual GICs or bonds (rather than a bond fund) is based on my belief that it will be difficult over the long term for bond fund managers to provide any significant extra value relative to the holding of the individual products. By holding the individual products, we minimize cost (as bond funds have management fees). The minimization of costs is very important (especially in a low interest rate environment).

#### **CASH AND FIXED-INCOME INVESTMENTS**

##### **VS. EQUITY INVESTMENTS**

We are expecting a lower return on cash investments (high-yield bank accounts are generally paying about 2.5%) relative to fixed-income investments (5-year interest rates are about 4%). Thus, if interest rates never change, a ladder of fixed-income investments will yield about 4%. We are expecting both categories to produce a lower return over the long term than

equity investments. If we knew for sure that equity investments would produce the highest return over the long term, we would hold nothing but equity investments. The purpose of holding fixed-income investments and cash is to provide a margin of safety for each investment portfolio. The proportion of the assets that should be held in these very conservative investments varies for each client based on individual financial circumstances and risk tolerance.

#### **EQUITY INVESTMENTS**

The equity component of my Model Portfolio Approach is divided into three major components:

(1) Managed funds – I am using mutual funds and pooled pension funds for this investment category. (There may be other types of managed funds that I introduce in the future). I have subdivided the category into the following types of investments:

- Canadian large company funds
- Canadian small company funds
- Global large company funds
- Global small company funds
- Global contrarian funds
- Common share dividend funds
- Preferred share dividend funds
- Income trust funds

Within each of these categories, I (with the assistance of my associate, Nathan) have tried to find the best investment fund managers. While there are several parameters under which we have analyzed managers, the basic measurement that we are using is to look for those managers who over the long term have provided very good investment returns and have protected capital when times were bad. (We have not looked for the managers that have provided the highest investment return, as sometimes those managers also produce large losses when markets turn against them).

By allocating monies to each of these categories, we end up with a very diversified managed portfolio.

(2) Index securities – These investments (also known as “exchange-traded funds” or “ETFs”) are investment pools that reflect the performance of an underlying stock market index or sub-index. For this category, we use “I Units” issued by Barclays Bank. There is an ongoing debate in the financial services industry as to the relative merits of “active” investments such as managed funds versus “passive” investments such as index securities.

Those in favour of the index approach point out:

- Only a small percentage of active managers beat their benchmark indexes over the long term.
- It is difficult to determine in advance which of those managers will beat the index.
- Index securities are very inexpensive (no management is being done; money is simply allocated amongst a pool of stocks in the same weighting as those stocks hold in the index).

Those in favour of managed funds point out:

- Some managers do consistently beat the index (notwithstanding the management fees attached to their funds).
- Many managers have produced much lower volatility (and thus greater safety) than comparable index investments.
- Managed funds provide administrative ease, as one can make systematic deposits or withdrawals (which one cannot do with index securities).

Having examined both sides of this debate, I have concluded that many clients with substantial investment portfolios should include both categories. Some clients should also include “alternate strategy funds” in their portfolios.

(3) Alternate strategy funds – These funds (also referred to by some as “hedge funds”) are a complex (and potentially risky) investment class. Nathan and I have selected several funds where the managers are employing a strategy with the intention of producing good investment returns. The important element of these strategies, however, is that the results of the funds will be uncorrelated to stock markets in general. Thus, a hedge fund might have a positive return while stock markets are losing money, or vice versa.

I note that a fund that always moves in the opposite direction of stock markets is “negatively correlated” to those markets. A fund that is “uncorrelated” is one who’s performance has borne no defined relationship to stock market performance. We are seeking “uncorrelated” rather than “negatively correlated” funds. (If stock markets go up, we would also like there to be some possibility that the alternate strategy funds might also go up).

We are also recommending for some clients that a portion of the monies in this category be allocated to funds that invest in precious metals or resource funds. Our theory here is:

There is likely to be a long-term rise in the price of natural resources due to the increasing consumption of the Earth’s riches.

A rise in energy-producing resources such as oil could cause a corresponding drop in stock markets; therefore, one is hedged somewhat by investing in the energy sector.

There is the possibility of the return of strong inflation, which might cause a significant drop in stock markets, coupled with a significant rise in the price of gold or other precious metals.

The positioning of a small portion of one's portfolio of gold or precious metal stocks adds an element of insurance to that portfolio.

### **Model Portfolio Summary**

The objective is for all clients to have that combination of cash, fixed-income investments and equity investments that is suitable for their individual economic circumstances and long-term financial objectives. The cash and fixed-income components of the portfolio are relatively straightforward. The equity component is more complex and contains a combination of managed funds, index securities and alternate strategy funds. Our objective is to have a diversified portfolio that allows the opportunity for good long-term investment returns and provides reasonable protection against negative market results.

### **The Fee-based Component of the Model Portfolio Approach**

Traditionally, I (and a high proportion of other financial advisors) have placed financial products that have commissions embedded in their price.

As I formulated the Model Portfolio Approach, I realized that I would be constantly recommending a number of products that do not have any commissions embedded in their price. I have therefore added a portfolio management fee for each client who adopts this approach in order to compensate for the absence of embedded commissions.

I have also designed the fee structure to try to minimize the potential conflicts of interest that I (and other financial advisors) have. The level of embedded commissions varies by products type and thus an advisor could have the temptation of formulating an investment portfolio in order to maximize his or her commissions. I have tried to reduce such potential conflicts through the structure of my fee-based model.

Finally, I have designed the fee-based model (and chosen many of the investment products) so as to provide a fair overall cost for clients. Many of the managed portfolios that are offered in today's market place (by various financial institutions and advisory firms) have overall expenses of 2.5% to 3% per year. I feel that this is excessive and thus have designed my model to carry overall costs (inclusive of the portfolio fee) at approximately one-half of this level.

Most clients who have adopted the fee-based approach have seen a small reduction in their overall expenses.

### **For Which Clients is the Model Portfolio and Fee-based Initiative Appropriate?**

As there is a certain amount of complexity with the Model Portfolio and Fee-based Approach, I am reserving this approach for those clients who have investment assets of \$250,000 or more invested through me. For those clients who have smaller portfolios, I shall continue to recommend an appropriate combination of fixed-income and equity investments. For the equity component, I shall continue to use managed funds that provide for an embedded commission payment.

I have a number of clients with larger investment portfolios for whom the Model Portfolio and Fee-based Initiative is not appropriate. These include clients with a very high percentage (or an entire account) in fixed-income investments. I also have a number of clients for whom significant changes are not appropriate due to their age or health. (Some clients simply prefer not to make changes.)

For those clients for whom the Model Portfolio and Fee-based Approach is not appropriate, I shall continue to recommend a suitable combination of cash, fixed-income and equity investments.

I shall still embrace the concepts of using the best investment managers we can find for the

equity component of these clients' portfolios, and I shall continue to recommend a diversified group of investment funds.

### **Ongoing Monitoring and Due Diligence**

I shall be monitoring portfolios for all clients both at the macro level (the examination of the products and strategies used in the Model Portfolio Approach) and at the micro level (the examination of each individual client's portfolio).

The review of individual client portfolios will take place as we meet throughout the year.

There are several components to the macro review:

- A periodic review of the managed funds that we are using to see whether they performed as they should have performed given the economic environment and stock market results. (For example, I am not disappointed by the results of the Global Equity Funds last year, as it would have been reasonable to have had a somewhat poorer year in 2004 than in prior years due to the rise in the Canadian dollar).
- The continual search for other products that should be added to the portfolio or should replace existing elements of the portfolio. (For example, we are considering the addition of another alternate strategy fund managed by a Montreal-based investment counsel firm).
- An overall global economic review (to adjust the Model Portfolio in accordance with changing economic times).
- Enhancements to client portfolios. We are considering an additional subcategory to accommodate some specialty investment funds and also to accommodate a strategic approach to some individual securities.

For clients who have not adopted the Model Portfolio/Fee-based Approach, we will still continue to monitor the appropriate allocations of cash, fixed-income and equity investments. We'll continue to review the investment funds that make up the equity component.

### **Client Fees and Expenses**

As noted earlier, it is important to deliver a high quality diversified portfolio to clients at a fair and competitive cost. This is a primary objective of the fee-based component of the Model Portfolio program.

Similarly, I want costs to be fair and competitive for those clients who do not transition to the Model Portfolio/Fee-based Approach.

### **Summary**

It is important that all clients have suitable portfolios that are developed in conjunction with a long-term financial strategy.

The Model Portfolio/Fee-based Approach that I have introduced allows for an enhanced level of diversification for clients, combined with some potential reductions in overall expenses. A large number of our clients have now adopted this approach. Nathan and I will continue to monitor and refine this process.

We shall use the same principles of suitability and diversification for all clients, regardless of whether or not they adopt the Model Portfolio/Fee-based Approach.

For those who do not adopt this approach, we will continue (as we have done in the past) to generally recommend financial products that have some form of embedded compensation.

## A Client Appreciation Event

I am planning an “appreciation event to which all of my clients will be invited. The tentative arrangements are as follows:

I have reserved Science World for the evening of Thursday, August 18, 2005. Here is our tentative program for the evening:

From 6:00 to 7:00 PM, refreshments will be served in one of the Science World galleries, where you will have a chance to mingle and interact with the exhibits.

At 7:00 PM, we will adjourn to the theatre (I will make a few brief remarks...mostly thank you to everyone for your ongoing business). Then we'll play a movie...tentatively *Everest*. The name is self-explanatory, and this should be a treat to watch in the Omnimax Theatre. Clients are welcome to attend the reception only, the movie only, or both.

I will put an official invitation in my next newsletter (or in my annual “Andex Chart Letter” that should be published in May or June). I will be asking for RSVPs at that time.

It would be very helpful for me to get a rough idea of the potential attendance at this event. So (without it being an official RSVP), it would be great if you could contact Jeanette Dirksen (604-732-6551/jdirksen@rogersgroup.com) and let us know if you're likely to attend.

## Clientel

Thank you for reading this edition of *Clientel*. As always, the central message of this newsletter is that we are deeply appreciative of our client relationships and we are always as close as the phone.

Please don't hesitate to contact any one of my support team if we can be of assistance to you.

Sincerely,

ROGERS GROUP FINANCIAL



David N. Chalmers  
Financial Advisor

*David N. Chalmers is a Financial Advisor with Rogers Group Financial. The views expressed are those of the author and not necessarily those of Rogers Group Financial, which makes no representations as to their completeness or accuracy.*

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