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Investment tune-up

Take a good look under the hood of your portfolio

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All too often, the investment portfolio is a magic box we throw money into hoping it grows large enough to come in handy in the future. Like a car -- push the gas pedal and go -- most people sort of understand how their portfolio works. It holds the RRSP, TFSA and maybe an RESP. It's likely got a few mutual funds, GICs and a few stocks and bonds. It goes up in value; it goes down.

Yet, when it comes to figuring out if we're getting our money's worth, we might be better off trying to repair our own car.

A FIRM GRIP?

Vancouver-based Steadyhand Investment Funds started up in 2007 and has been reasonably adept enough at its job to survive the financial sector's near-extinction event in 2008 and 2009. The firm's president, Tom Bradley, says Steadyhand prides itself on being small and nimble so its fund managers can quickly adjust to changing market conditions. The firm has six funds: a North American equity offering, a savings fund, an income fund, a small-cap fund, a balanced fund and a global equity fund -- all of which have fees under two per cent a year. They also have no back-end or front-end load fees. All of the funds have only a few dozen investments, unlike many other funds these days that can have as many as 200 different securities. "Not having hundreds of stocks in the fund is an indication of

A recent report published by a boutique mutual fund firm headed up by a former Winnipegger may offer some guidance if you want to peer under the hood of your portfolio.

Pointedly titled How is your portfolio doing? And what you should do about it, the report provides a basic anatomy lesson of a portfolio and offers easy-to-understand tips to figure out if it's performing as well as it should, says Tom Bradley, president of Steadyhand Investment Funds.

Bradley says the report's impetus arose from consistently meeting clients who, despite having a good understanding of markets, couldn't say with certainty if their portfolio was any good.

This ignorance is troubling for a number of reasons, he says. One of the biggest is it's a little like driving blindfolded.

"People are making decisions on the portfolio without knowing how their past decisions turned out."

Yet, finding out your portfolio's performance can be devilishly difficult. It's not as easy as 'I invested $100 10 years ago and today it's $120, so it has increased in value by 20 per cent.'

During that time, you may have made contributions or withdrawals that affect the math. Secondly, you don't know how it performed compared to a benchmark. Then again, what your conviction and it's also not diluting our best ideas," he says. "You don't want to put your money into someone's 200th best idea." The firm's overall investment philosophy is also fairly unique. "We're style-agnostic," he says. "If a slow-growing, high-yielding stock is screaming at us, we buy it. If really high-grow stock with a high multiple and no dividend looks really cheap, we can buy that, too."

An adviser interrogation primer

Karin Mizgala at Money Coaches Canada says investors have to ask their adviser the right questions when they review their portfolio at least once a year. Below is a list of questions that may be helpful if you're looking to recruit a new adviser or figure out whether your current sage of market magic has good money mojo. Mizgala says it's important you understand the answers they provide. If you don't, it's not your fault. They're advisers; making you understand is their job:

For a potential adviser:

Can you describe the type of clients you serve?

Do you have a minimum investment or net-worth requirement?

What are your qualifications?

What are the fees for your services and any products/investments you sell?

How are you compensated?

What products and services do you offer?

How often will we meet and how much

do you compare it with?

Furthermore, how are the parts -- often mutual funds -- performing under the hood?

Some will have done well and others not so well. The obvious answer is to get rid of the bad and keep the good. But even that isn't as clear as you might think.

You need to understand the market context.

"That comes down to really understanding what the environment was like over the period that you're measuring performance against," he says.

Winnipeg-based, for-fee only financial planner Lyle Atkins says we have entered a period of time where understanding the broad risks and tectonic shifts in the playing field is fundamental.

Fund categories -- like international funds -- that may have performed badly over the last decade may be poised for recovery.

"You start with the bad performers and try to assess whether there's any reason to keep them," says Atkins, who's with Independent Financial Counsellors. "I try to give them the benefit of the doubt if I can because I don't want to blow off a fund that has a pretty good track record that hasn't done too well in the last few years."

One-year performance is a poor measurement, the Steadyhand report states. "Short-term returns are as random as you can get."

Fund analyst Adam Fisch at Morningstar Canada says you need a much broader timeline to measure performance.

"Even over two or three years, there could be one or two decisions that a manager made that were a mistake or something that hasn't been realized yet that hampers short-term performance, but it would take a much longer period to get a real sense of how the manager is doing compared to his or her peers," he says.

The longer the track record for a fund is, the more meaningful understanding you'll have of its value to your portfolio.

But how do you measure long-term performance?

"It's very important to understand the time frame and whether it's an annualized return or a cumulative return," Karin Mizgala, a Vancouver-based certified financial planner and CEO of contact will we have?

Will I be working with you or with your assistant?

How will I know how much money I'm making?

How is my rate of return reported to me?

How often will I receive my statements?

Will you explain them to me?

For a current adviser:

What is my portfolio asset allocation?

Why do you recommend this investment?

What is the return on my portfolio?

What is the performance of investments in the portfolio?

How do my investments compare in performance and cost to others?

How do they compare to their benchmarks?

What is the investment style of each fund I own?

Who are the fund managers?

What is the return on my portfolio?

Money Coaches Canada.

Today, most returns you'll see posted in reports provide annualized return performance after fees. These provide you with year-by-year returns or losses and often an overall average of those years. But it's easy to get mixed up.

Take the previous example of $100 becoming $120 over 10 years. As a cumulative return over that period, it's 20 per cent. That doesn't sound so bad, but when it's measured in terms of annualized returns, the average annual return is actually two per cent. Then it's also important to look at each individual year over the decade. It could be the portfolio did well eight out of 10 years, but 2008 and 2011 were the pits. That doesn't excuse performance, but it provides context.

Performance, however, is just one of many measuring sticks. Morningstar uses a five-pillar approach to assessing funds: the manager, the parent company, performance, style and price.

Pricing looks at the fees you pay for management, often expressed as the MER or management expense ratio. This is an annual percentage you pay from your capital in the fund for management and administrative costs.

"They are a big factor, but they're not the only factor," Fisch says. "In different asset classes, they may be more or less impactful, but they are always important, especially in Canada where they are particularly high."

In some instances, a higher fee is warranted if the manager adds value. That is, he or she consistently beats the benchmark. To get an indication of whether the fee is worth the cost, it's helpful to look at the four other criteria -- like the manager.

"Admittedly, investors don't have the access to arrange a sit-down meeting with a manager, but there are things they can do," Fisch says. Most managers publish quarterly reports on the web and, with a little digging, you can often find managers' reviews and biographies, detailing experience, performance and investment style.

But beware; 'Star managers' that once drew you to a fund do jump ship.

"The big one the industry underreacts to is when there's a significant change in personnel," Bradley says. "Sure money leaves a fund after the manager is gone, but it's remarkable how much stays with the fund."

Of course, if you have a financial adviser or planner with whom you meet regularly, he or she should help keep track of important indicators like a switch in management, Mizgala says.

"If they can't get information for you easily, that is a strike against them," she says.

You might consider looking elsewhere for help.

Still, picking and evaluating funds shouldn't be left only to your adviser, Atkins says.

The mutual fund world has plenty of underperforming funds and only a handful of good ones.

An adviser should help you find the good ones. But given the amount of bad funds floating about, you might conclude there's some bad advice going around.

Atkins says part of the problem is picking good mutual funds is tough. To do it well, it can be as hard, if not more so, than picking individual stocks.

"I'd rather spend the time learning to pick a good stock than a good fund."

Still, before you get ready to blow up your portfolio, Bradley says only make a decision after asking questions and deciding whether you get the right answers. Rash decisions rarely pay off -- at least for 'the 99 per cent.'

"There's that old saying Wall Street does well through activity and you make money off of inactivity," he says.

"Our bias as investors should be to do very little. You should stick with what you got, but there will be things that jump and say, 'I've got to make a change.' "

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