ANODOS
ADVISORS

# INVESTMENT GOVERNANCE OVERVIEW

*"Is my investment advisor doing a good job?"*

## The Problem

It's difficult to answer the question, "Is my investment advisor doing a good job?" Predictably, all investment advisors report that they are "doing great" and are "above average." They all provide compelling charts, graphs and benchmarks to confirm their conclusions. The reason this question is so hard to answer is that the capital owner (the "employer") has failed to clearly define and measure the job for which the advisor (the "employee") has been hired. Too often, defining the investment objectives and key performance indicators is left to the advisor with predictable results. It is for the capital owner to define the job that the advisor has been hired to accomplish. Absent clear instructions from the employer, it is impossible to evaluate the employee's effectiveness.

## The Solution

A prudent capital owner will: (1) identify the financial objectives they are seeking to accomplish; (2) define investment policies that inform the advisor's activities; and (3) establish procedures to test that the policies are being complied with. This three-step process is the framework for effective investment governance for both large and small portfolios. The capital owner's question, "Is my investment adviser doing a good job?" cannot be answered unless these investment policies and procedures have been established in writing.

## The Job Description

Following are examples of the types of objectives and expectations that define the terms of employment. (The capital owner's particular investment objectives, expectations, policies and procedures will likely differ from this illustration.)

- Long-Term Targeted Return: *Inflation+3.0%*, which can be alternatively stated as a nominal 6.0% return, in a normalized 3% inflation environment.
- Investment Time Horizon: The remaining life expectancy for the capital owner is projected to be 32 years per the IRS actuarial tables.
- Projected Distribution: $200,000 per year (4% of the $5,000,000 portfolio value).
- Risk Expectations: 10% standard deviation with a normal range of annual returns between 16% on the high side and <4%> on the low side.
- Bear Market Expectations: Expected drop of <20%>, or $1,000,000 of the current $5,000,000 portfolio value, during a typical bear market.

## Investment Policies & Procedures

Not only will the capital owner define the financial objectives, but also the parameters that the advisor must abide by. Following are examples of several key investment policies and procedures that a capital owner should identify. (Again, the capital owner's particular policies and procedures will likely differ from the examples provided in this illustration.)

- Performance Reporting: Performance reporting shall be provided at least quarterly and will be calculated according to the CFA Institute's performance standards (time weighted, net of fees).
- Benchmarking: The portfolio will be compared against a series of blended benchmarks that reasonably approximate the risk and return characteristics of the portfolio.
- Liquidity Requirements: At least 90% of the portfolio must be invested in securities that can be liquidated within 2 business days of the capital owner's instructions (SEC T+2 settlement).
- Alternative Investments: In those instances when the advisor recommends that an "Alternative" investment be included in the portfolio, the advisor shall provide a series of disclosures in writing.

- Diversification: On an annual basis the advisor will provide a report that identifies the largest three (1) non-pooled holdings; (2) industry sectors; and (3) asset classes held in the portfolio (both by $ and %).
- Management Cost: On an annual basis the fee charged by the advisor shall be compared to the results of an independent fee study comparing portfolios of comparable size, complexity and product mix.

## The Employee Review

After the capital owner's financial objectives and investment principles are defined, the advisor will: (1) design a portfolio that is expected to accomplish the client's financial objectives with low relative risk; (2) select the products, securities, or sub-managers that they believe will optimize their portfolio design; and (3) make tactical shifts in the portfolio based on their assessment of prevailing risks or opportunities.

The advisor's activities are compared against the investment objectives, policies, and key performance indicators that are the foundation of the employment relationship. It is through this governance process that the client will be able to know if the advisor they have selected is doing the job they were hired to do.

## Concluding Remarks

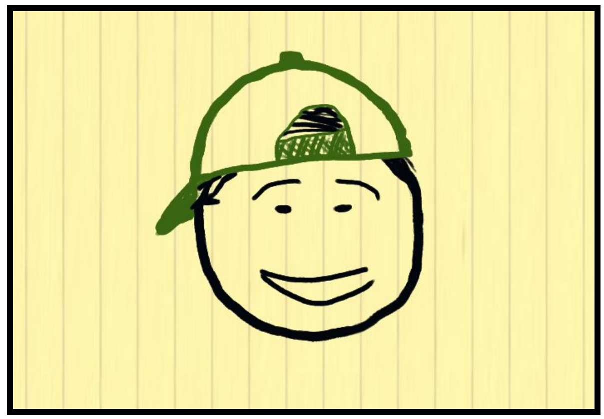
Without a job description, an employee's performance cannot be assessed. Without written investment governance policies and procedures, an investment advisor's efficacy cannot be evaluated.

For the most part, the investment industrial complex is at best unable, or at worst unwilling, to provide this level of documentation or accountability to their investment process. Their internal compliance departments simply will not allow them to provide this level of detail. Further, they, like all employees, are not in the position to independently evaluate their own activities.

## About Anodos

Anodos helps capital owners develop and manage an investment governance process. For many of our clients this oversight responsibility is not merely a subject of curiosity, but a duty they are obligated by statute to fulfill on behalf of the beneficiaries and organizations they serve. What makes Anodos unique is this is all we do. We don't manage money, sell insurance, or accept referral fees. We don't have a horse in the race.





**Josh Yager, Esq., CFP®, ChFC®, CLU®**

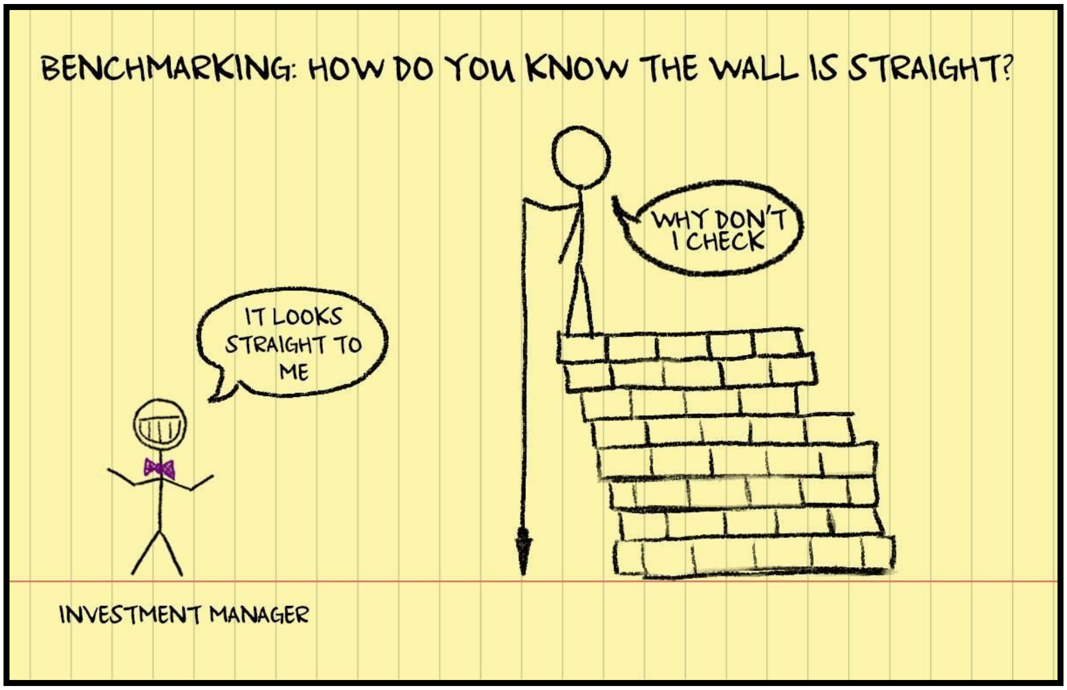
Josh is a recognized content expert on the issues of fiduciary duties relating to the management and oversight of trust assets. He lectures extensively on the policies and procedures for conducting investment manager audits to CPAs, attorneys, and professional fiduciaries throughout the country. Josh is Managing Partner at Anodos Advisors and a licensed attorney. Prior to founding Anodos in 2005, Josh worked for fifteen years as an investment advisor with Mercer Advisors.

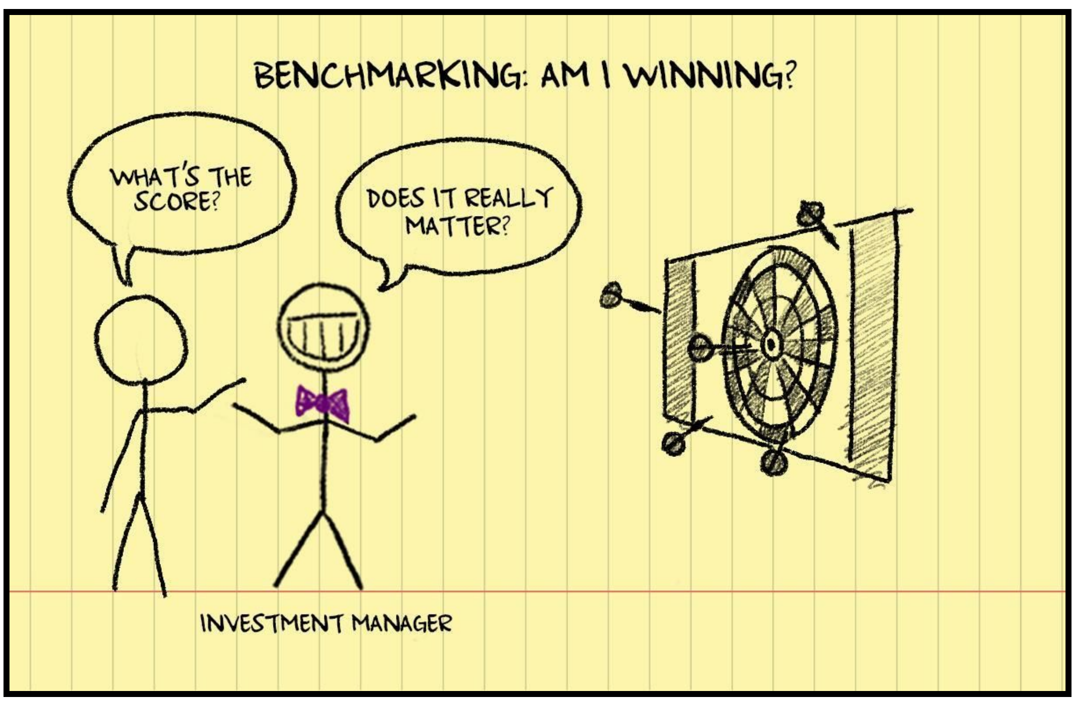
**Ryan Wolfshorndl, CFA, CIPM, CFP®**

Ryan has been with the firm since its inception in 2005 and holds the Chartered Financial Analyst and Certified Financial Planner designations. Ryan is a Partner and has 12 years of experience conducting performance attribution and other statistical analysis relevant to the investment experience. This work ensures accountability, adherence to investment parameters, and clarity of expectations between clients and their managers.

Anodos Advisors
115 E. Micheltorena Street, Ste 100
Santa Barbara, CA 93101

805-899-1245


BENCHMARKING: HOW DO YOU KNOW THE WALL IS STRAIGHT?
WHY DON'T I CHECK
IT LOOKS STRAIGHT TO ME
INVESTMENT MANAGER


BENCHMARKING: AM I WINNING?
WHAT'S THE SCORE?
DOES IT REALLY MATTER?
INVESTMENT MANAGER