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# A Behavioral Approach to Outsourcing your CIO

## Scientifically Engineered Models



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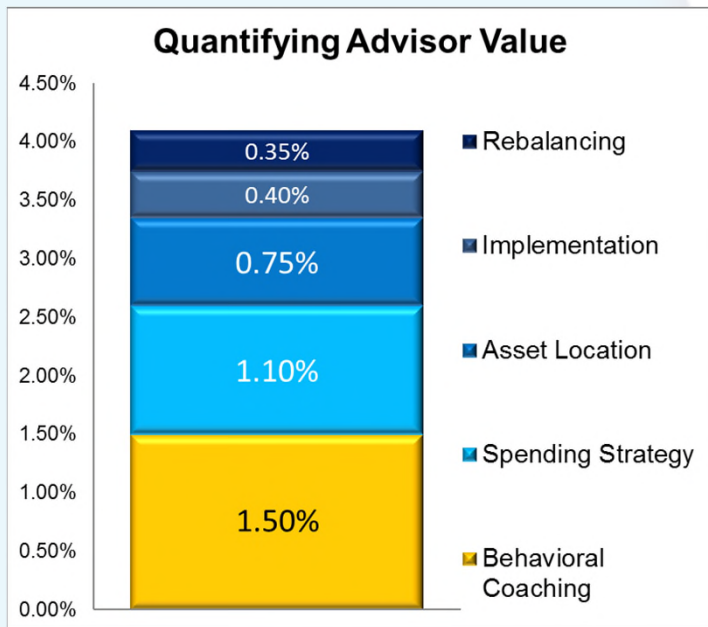
# 1.) Assess your strengths & weaknesses

What gives you joy?

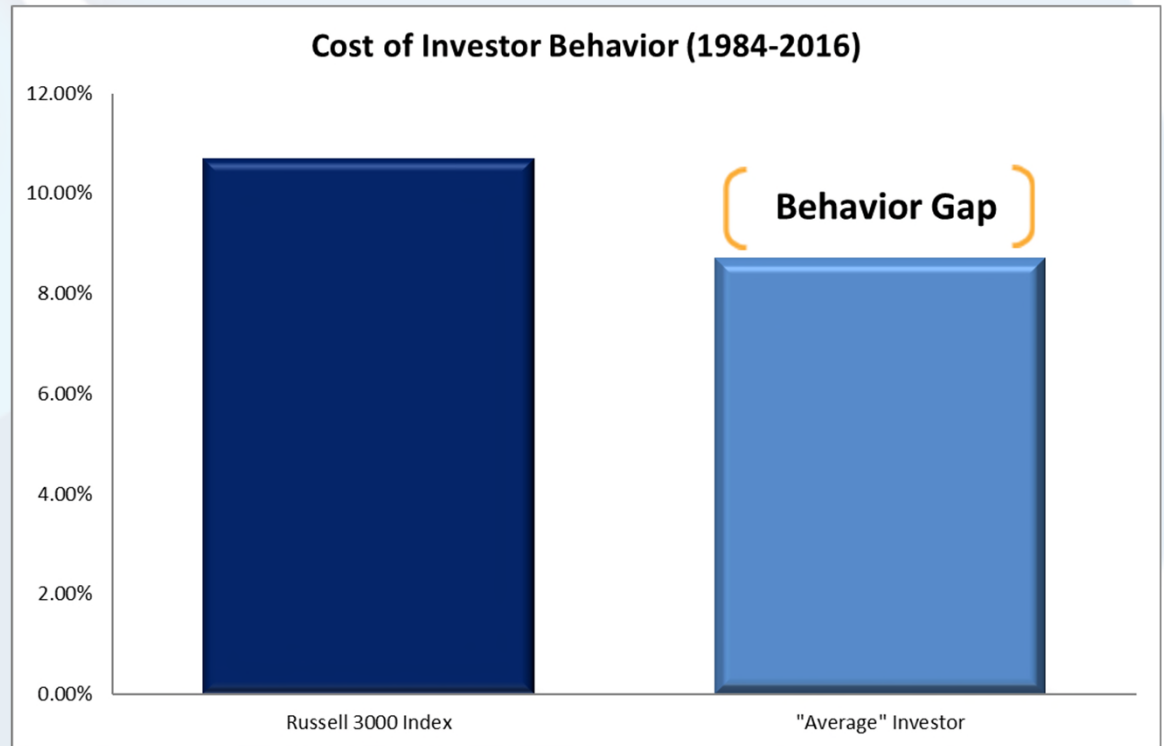
What do you not look forward to doing?

What distracts you from doing what you enjoy? →

# The Value of an Advisor = 2.25% to 4.1%/yr.



SOURCE: Vanguard Putting a value on your value, September 2016.



SOURCE: Russell Investments 2017 Value of a fiduciary advisor, March 2017.

# A Behavioral Portfolio Approach

STEP  
5

Use smaller portions of portfolio for concentrated or riskier investments.

STEP  
4

Select investments that align with specific objectives and risk levels for that layer.

STEP  
3

Divide assets into specific layers and set specific goals and objectives for each layer.

STEP  
2

Develop cash flow strategy taking into consideration cash and other low risk investments. This reduces short-term risk and the likelihood of making short-term, emotional decisions.

STEP  
1

Construct complete financial plan with specific goals and objectives.

## **2.) Document how you spend your time**

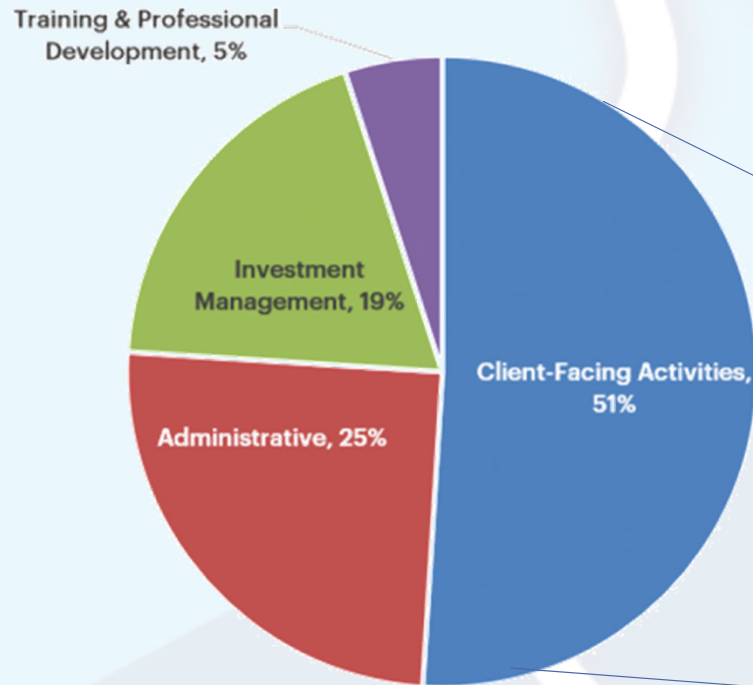
How many hours do you spend on client facing activities?

How much time do you spend on generating new business?

What is your highest & best use for your business? ↪

# Imagine if.....

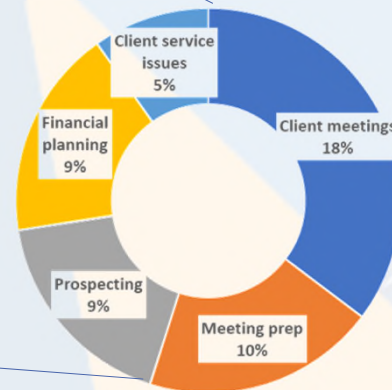
## How advisors spend their time



.....you could gain 55 extra days per year\*.

That's about how much time the average advisor spends on investment management under "normal" conditions.

\* Based on a 9 hour work day



.....what if those 55 extra days were spent on client facing activities?

Source: The Cerulli Report, RIA Marketplace 2018, E\*Trade Advisor Services

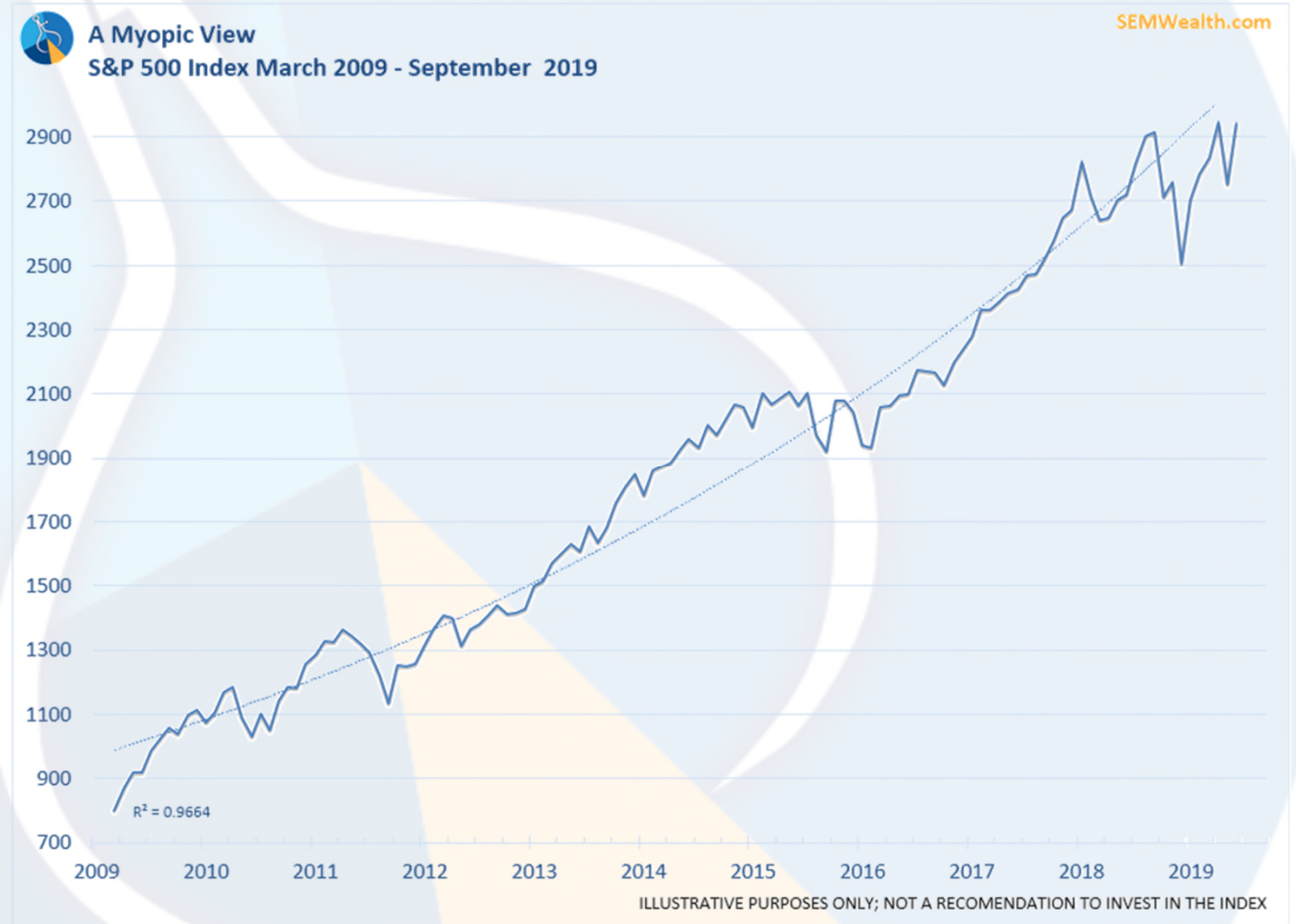
## 3.) Stress Test Your Practice

- How much revenue is exposed to a recession / bear market?
- Are my investments/models designed to protect my revenue?
- How has my client mix changed since the last bear market?
- Where will my focus be during a recession / bear market? ↪



# A Biased Point of View

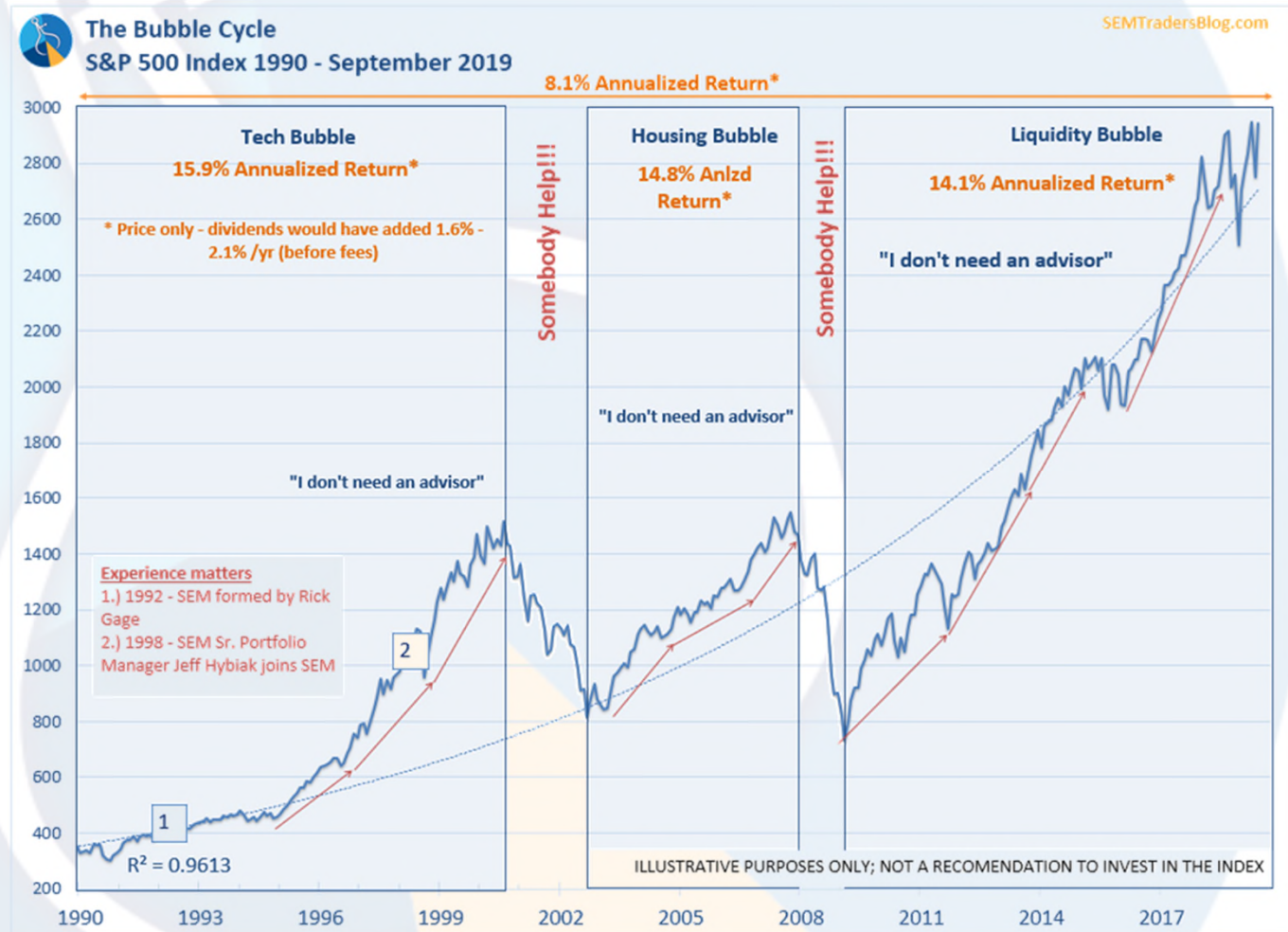
- Conservatism: not adapting to new information
- Confirmation: seeking only positive information
- Representativeness: evaluate based on past experience
- Illusion of Control: I can get out in time
- Availability: “Recency” bias



# Long-Term Biases

## How Bubbles Form:

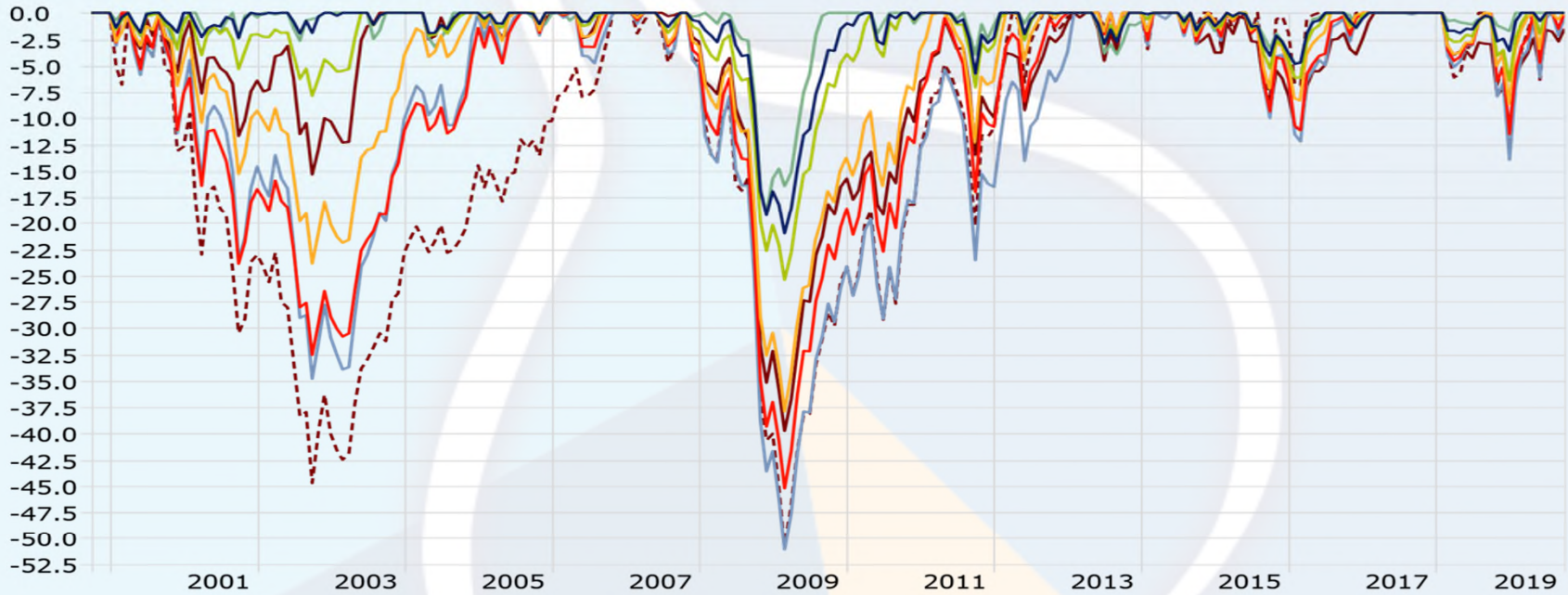
- **Hindsight:** past bear markets were predictable (cognitive)
- **Overconfidence:** unwarranted faith in abilities (emotional)
- **Self-control:** letting short-term influence long-term decisions (emotional)
- **Regret-Aversion:** avoiding decisions that differ from crowd (emotional)



# Diversification doesn't always help

## Historical Drawdowns (% Change from previous high level)

Time Period: 10/1/1999 to 9/30/2019



- MS Preservation Allocation
- MS Conservative Allocation
- MS Balanced Allocation
- MS Growth Allocation
- MS Aggressive Allocation
- US Multisector Bond
- US World Allocation
- S&P 500 TR USD

Returns are for the Morningstar US Fund Categories. Past performance is not a guarantee of future results. The S&P 500 Index is an unmanaged index of the 500 largest US based stocks. Investors cannot invest directly in the Morningstar Categories or the S&P 500 index. Trying to replicate may incur additional fees and likely will not track above performance.

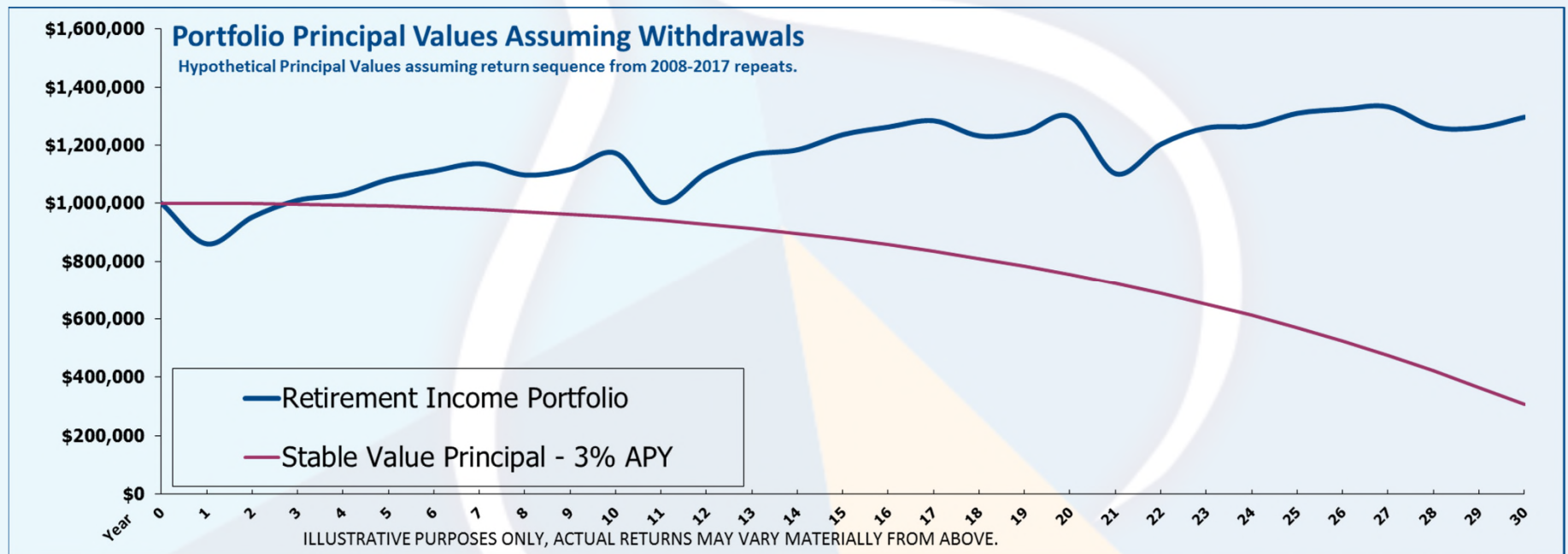
Source: Morningstar Direct

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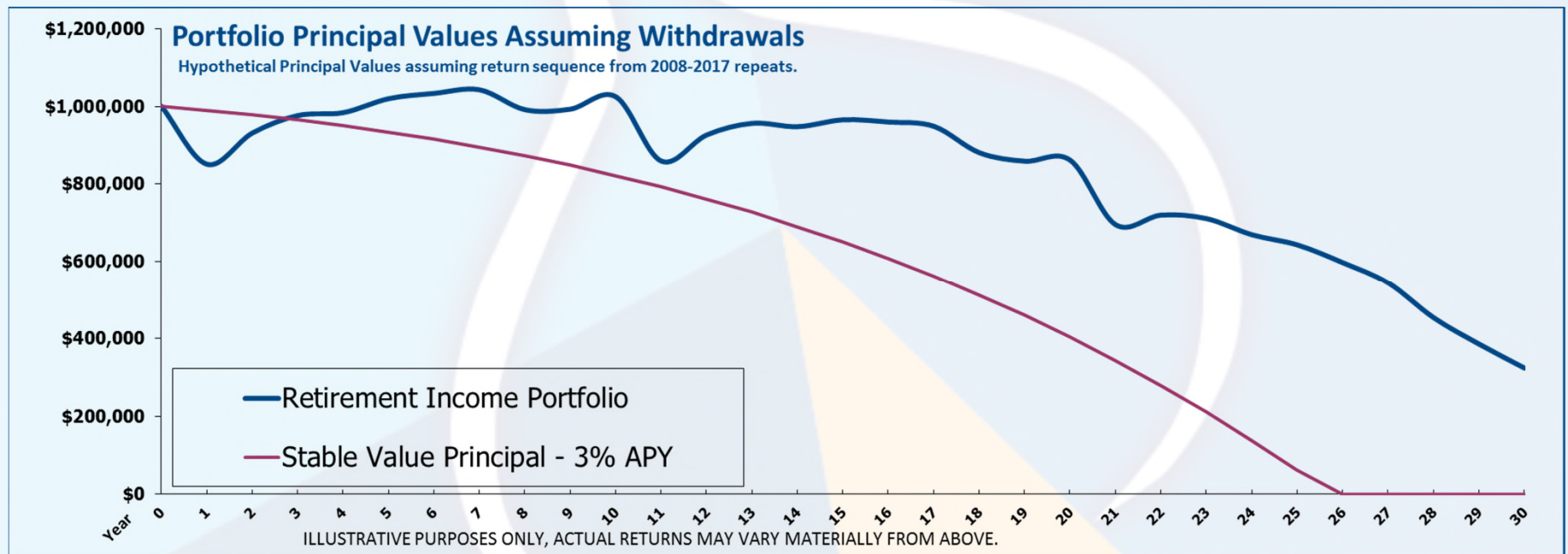
# Volatility Matters in Retirement

\$1M starting value | 3% Annual Withdrawals | 3% Annual Inflation Adjustment



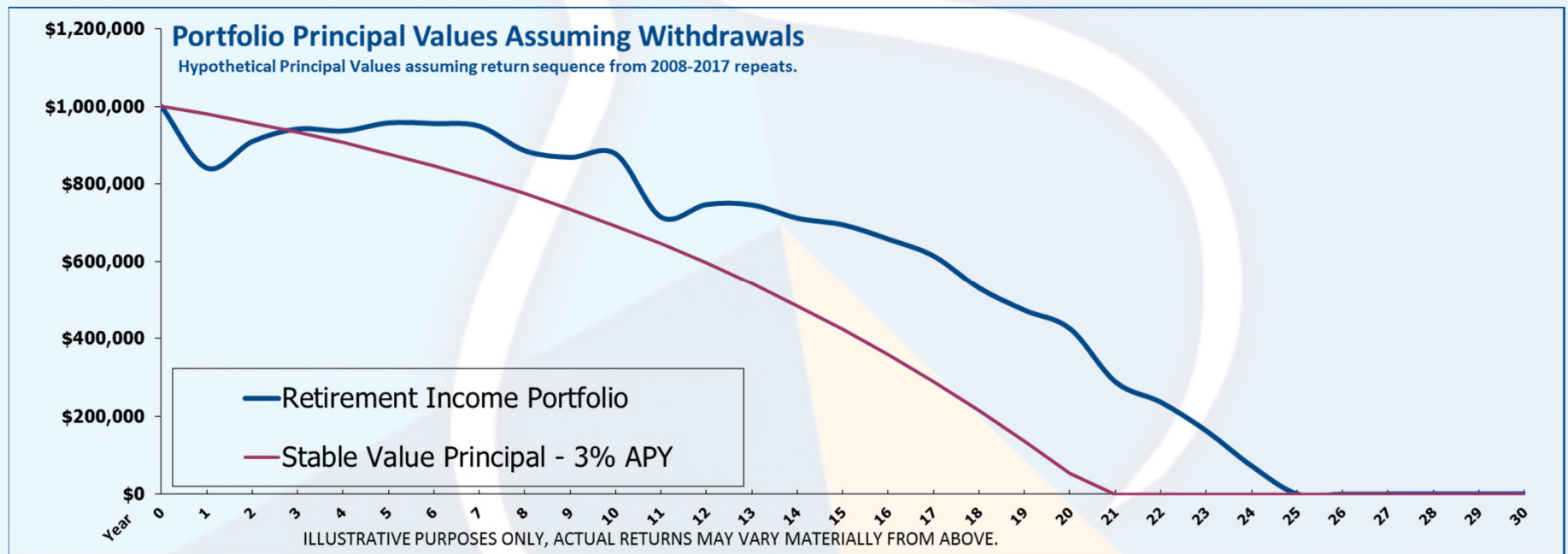
# Volatility Matters in Retirement

\$1M starting value | 4% Annual Withdrawals | 3% Annual Inflation Adjustment



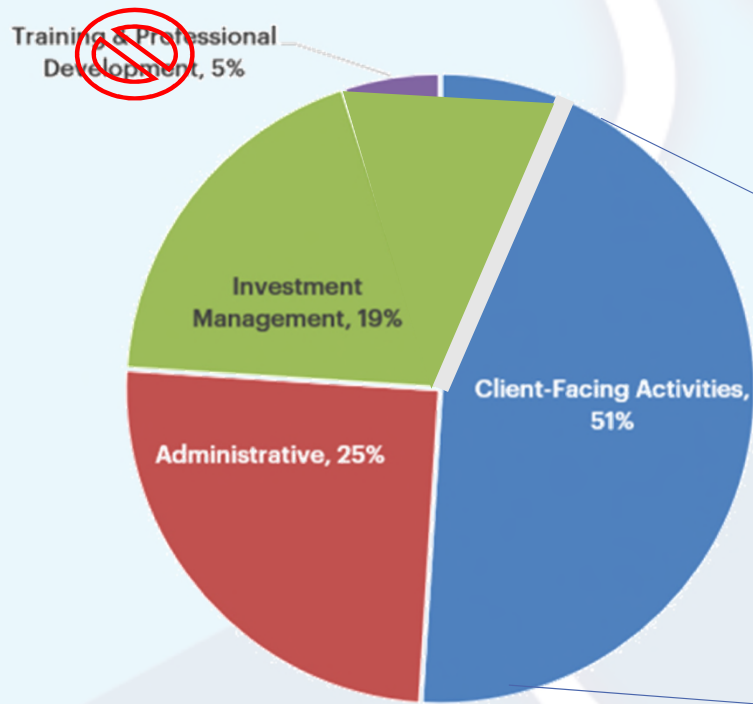
# Volatility Matters in Retirement

\$1M starting value | 5% Annual Withdrawals | 3% Annual Inflation Adjustment



# How will you spend your time?

## How advisors spend their time



During a large market decline, you may spend significantly more time monitoring your investment models & dealing with client phone calls & “emergency” meetings.



Source: The Cerulli Report, RIA Marketplace 2018, E\*Trade Advisor Services

# A Behavioral Portfolio Approach

STEP  
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Use smaller portions of portfolio for concentrated or riskier investments.

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STEP  
1

Construct complete financial plan with specific goals and objectives.



## **4.) Identify & Create Your Baseline Portfolios**

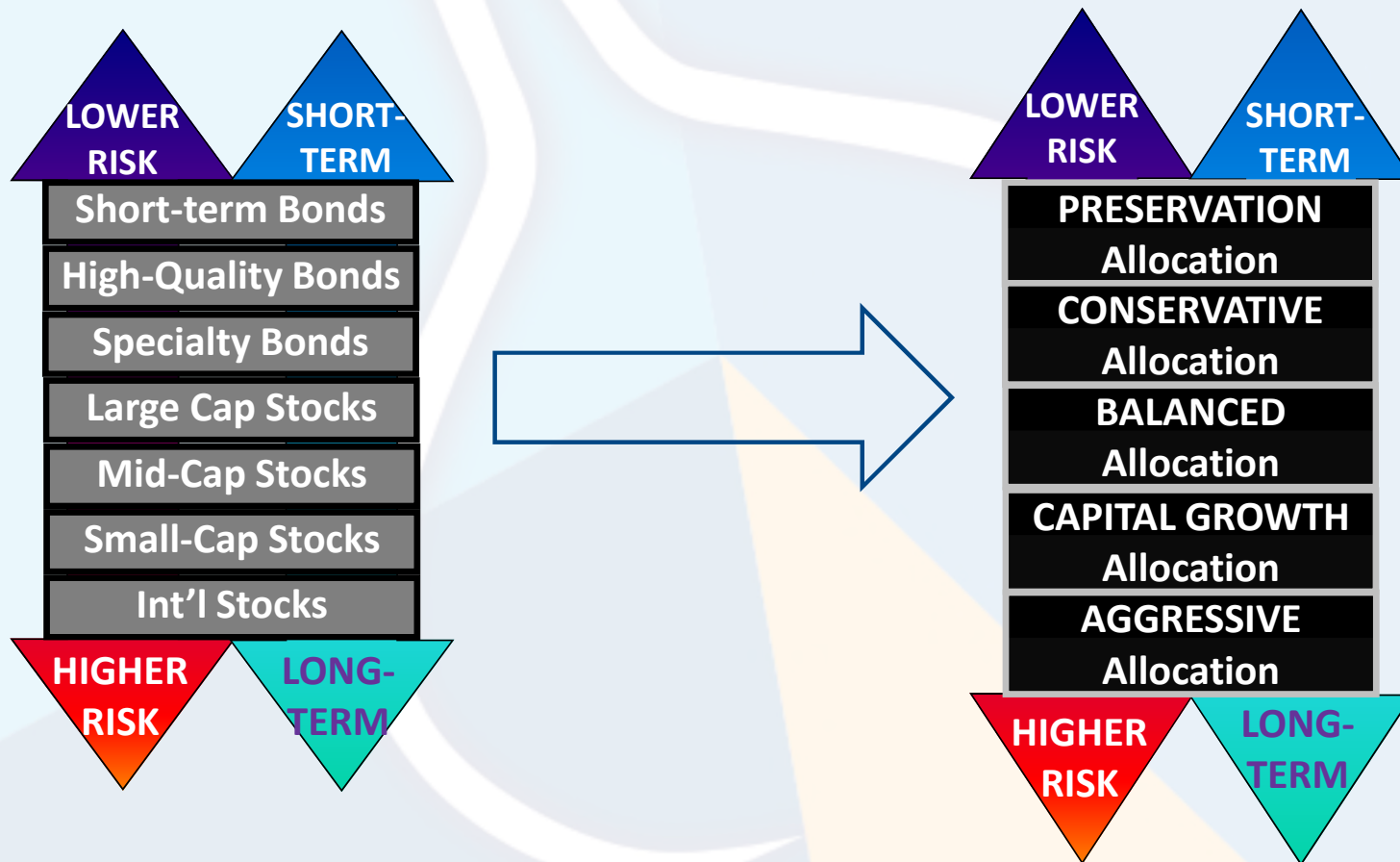
What investments or models will I use?

How do those investments inter-relate?

How will I monitor the investments/models?

How will I decide how to allocate the investments? ↪

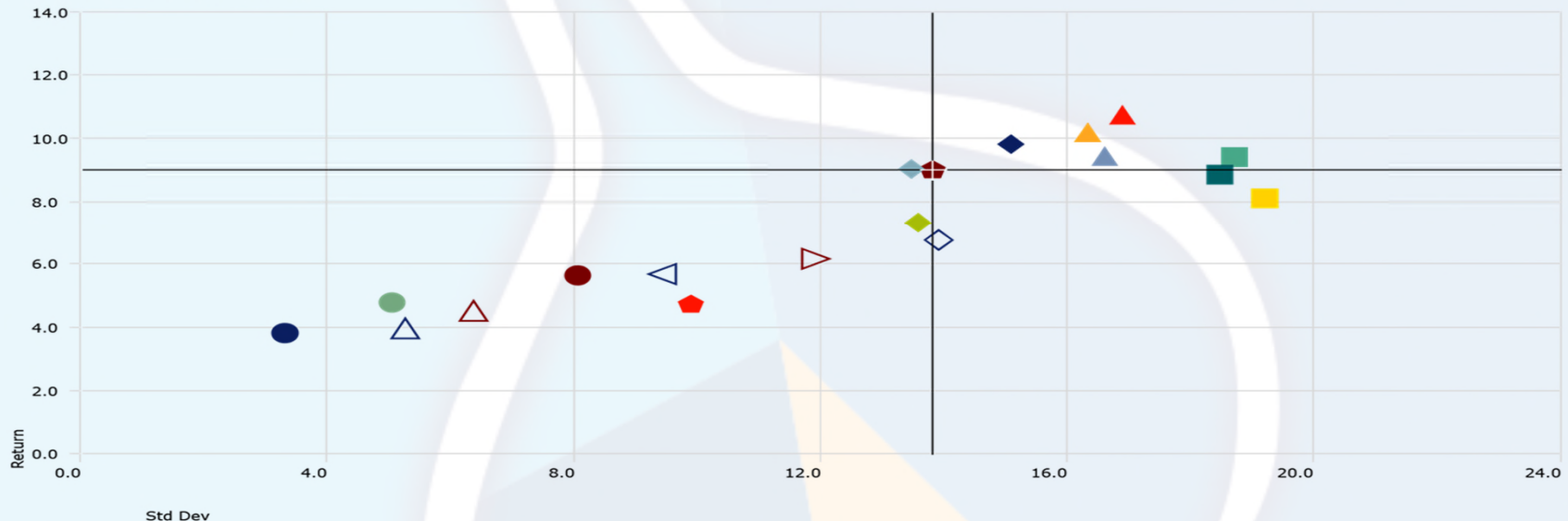
# What investments will I use?



# What investments will I use?

## Risk-Reward: Asset Allocation Portfolios (open shapes) vs. Asset Classes

Time Period: 10/1/2004 to 9/30/2019



- △ MS Preservation Allocation
- ▷ MS Growth Allocation
- US Fund Intermediate Core Bond
- ◇ Morningstar US Large Cap TR USD
- ▲ Morningstar US Mid Cap TR USD
- Morningstar US Small Cap TR USD
- S&P 500
- △ MS Conservative Allocation
- ◇ MS Aggressive Allocation
- US Fund Multisector Bond
- ◆ Morningstar US Large Growth TR USD
- ▲ Morningstar US Mid Growth TR USD
- Morningstar US Small Growth TR USD
- ◁ MS Balanced Allocation
- US Fund High Yield Bond
- ◆ Morningstar US Large Val TR USD
- ▲ Morningstar US Mid Val TR USD
- Morningstar US Small Val TR USD

Returns are for the Morningstar US Fund Categories. Past performance is not a guarantee of future results. The S&P 500 Index is an unmanaged index of the 500 largest US based stocks. Investors cannot invest directly in the Morningstar Categories or the S&P 500 index. Trying to replicate may incur additional fees and likely will not track above performance.

Source: Morningstar Direct

# A Behavioral Approach

## Most difficult aspect

Advisors are expected to:

1. Calculate probabilities of all future events & know impact of said events on investments / strategies
2. Understand cross correlations & event / environment specific correlations for each strategy



Use smaller portions of portfolio for concentrated or riskier investments.

Select investments that align with specific objectives & risk levels for that layer.

Divide assets into specific layers and set specific goals & objectives for each layer.

## Common Advisor Cognitive Errors :

- Conservatism
- Confirmation
- Representativeness
- Illusion of Control
- Availability
- Hindsight

## Common Advisor Emotional Biases:

- Overconfidence
- Self-control
- Status Quo
- Regret / Loss Aversion



# Understanding Your Clients' Personality

## Personality Score

Conservative

Moderate

Growth

Aggressive

## Bias Types

Emotional

Cognitive

Emotional

## Common Biases

Loss  
Aversion

Regret  
Aversion

Hindsight

Availability

Conserv.

Confirm.

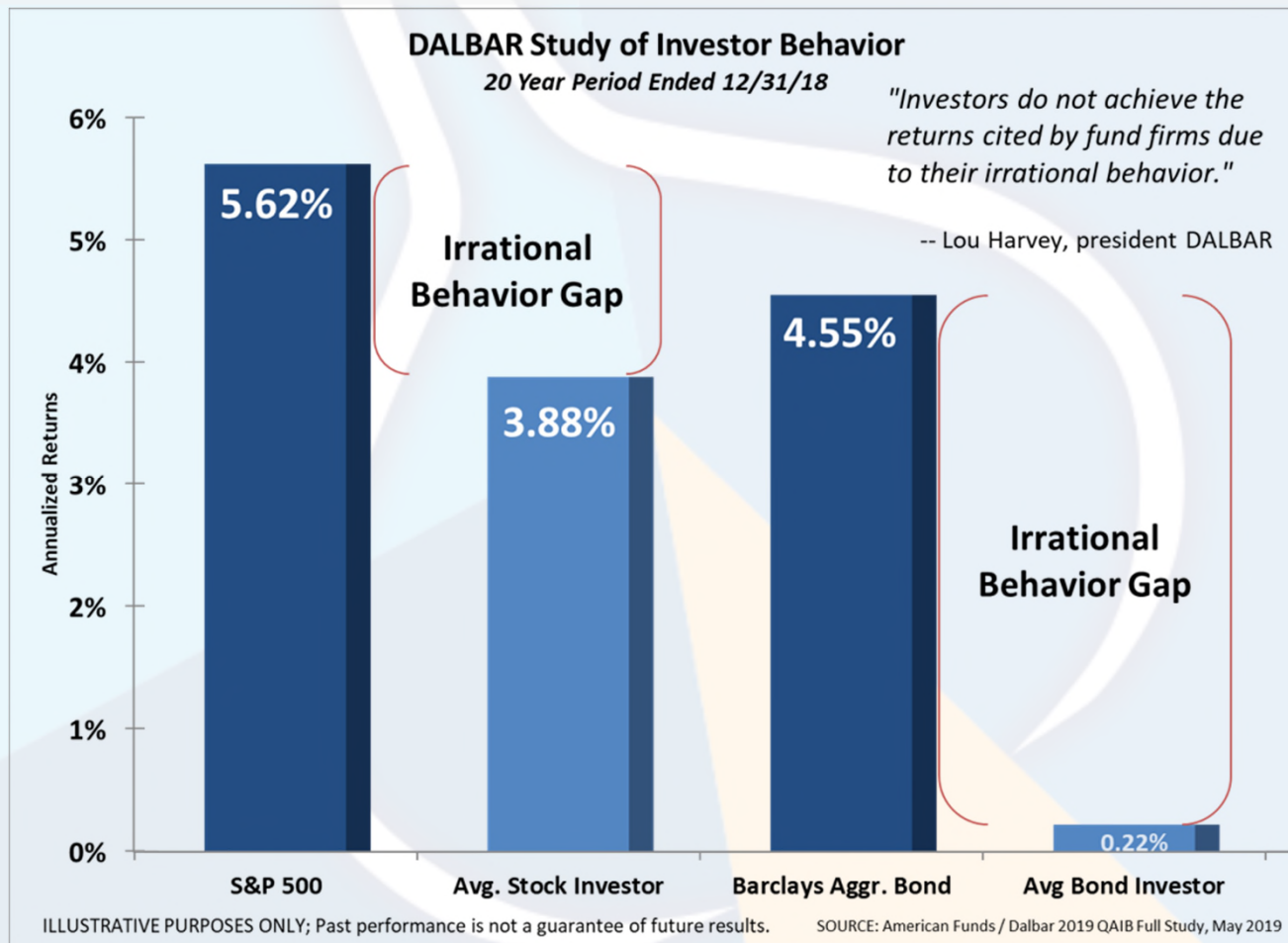
Represent.

Overconfidence

Illusion of  
Control

Self-  
control

# The Cost of Behavioral Biases



# The Art & Science of Risk Tolerance

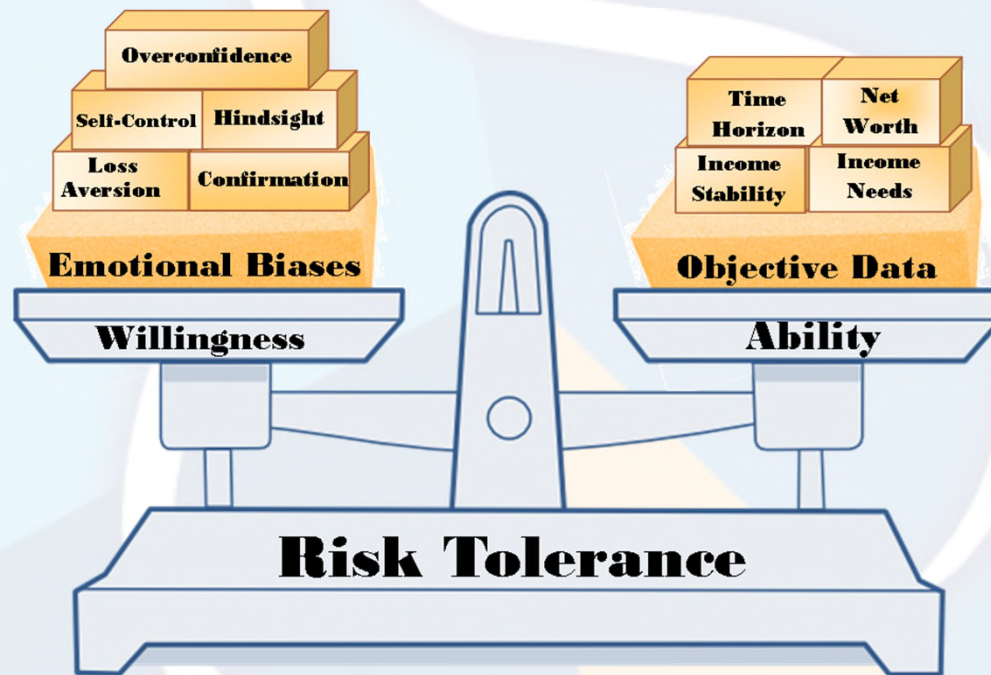
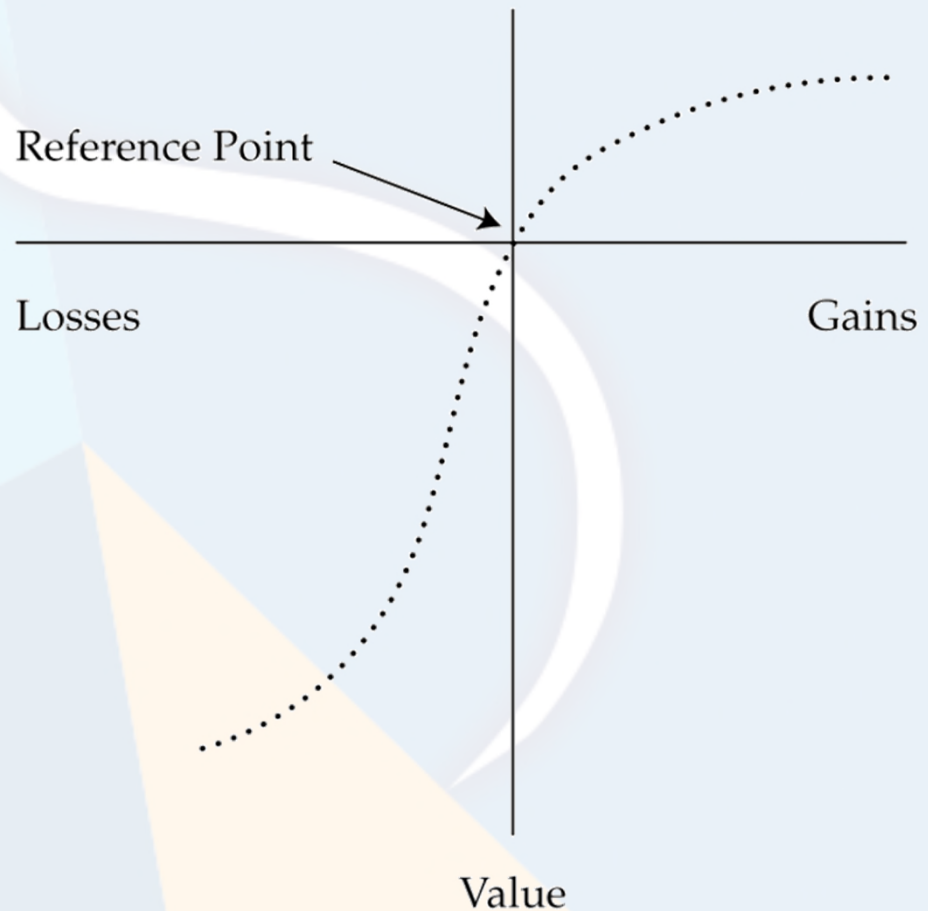


Exhibit 3. Value Function of Loss Aversion

## Loss Aversion

Studies have shown investors feel losses about 2 times more than they feel gains. This is the primary reason SEM focuses so heavily on risk management and diversification.

Advisors can be susceptible to this when evaluating investments, often creating an inferior client experience.

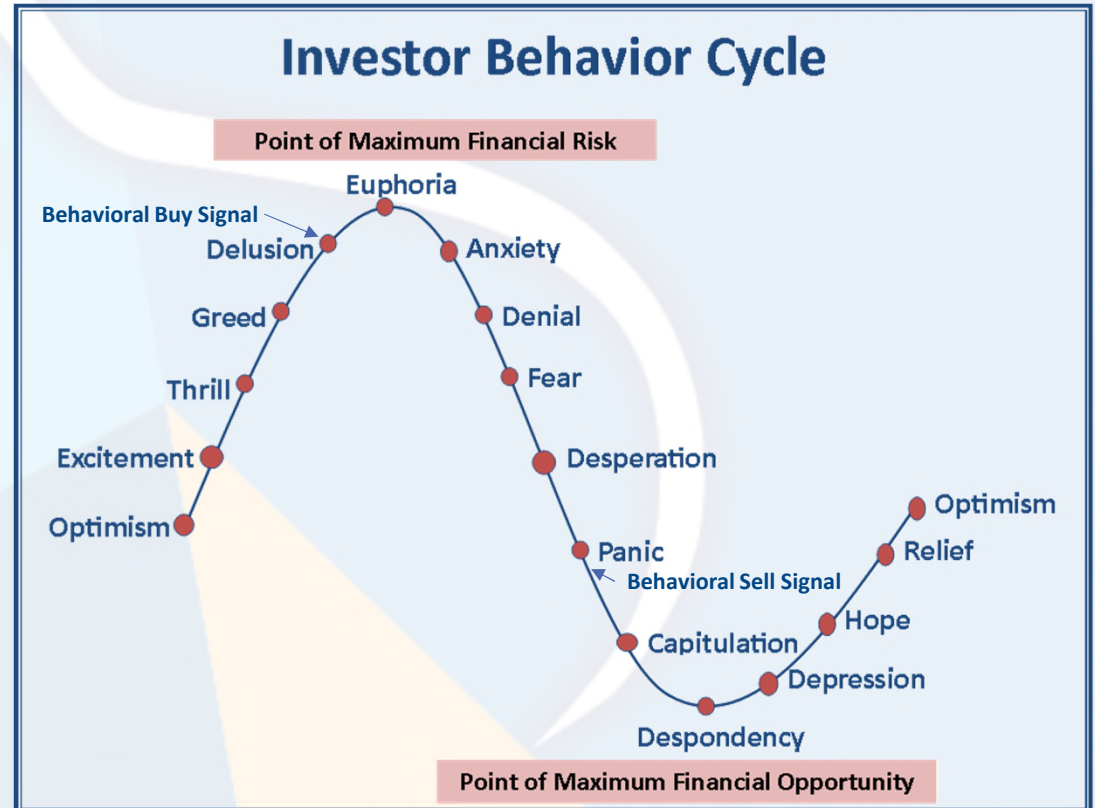




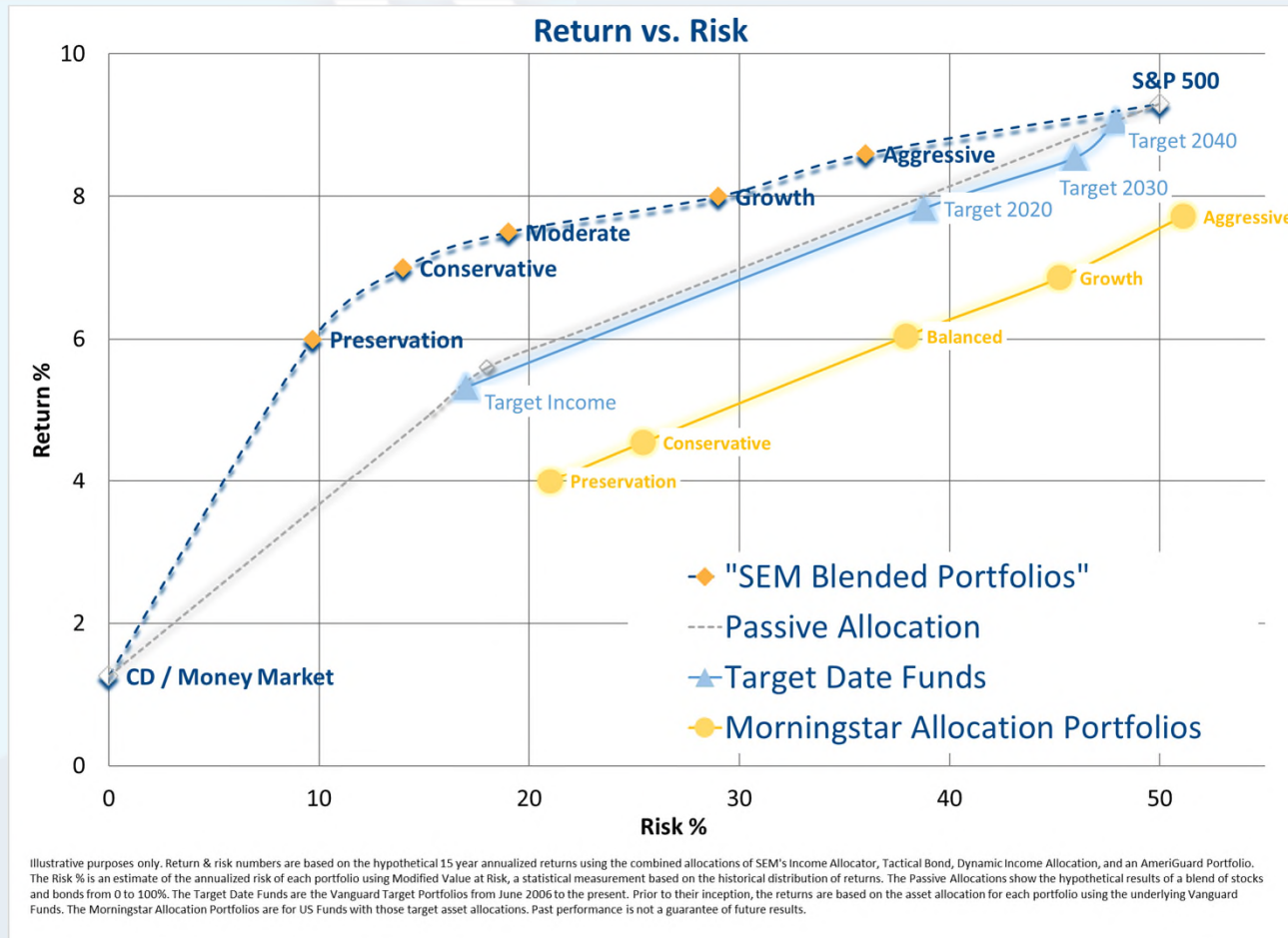
## Understanding Investor Behavior

The stock market is a story of cycles & of the human behavior that is responsible for overreactions in both directions.

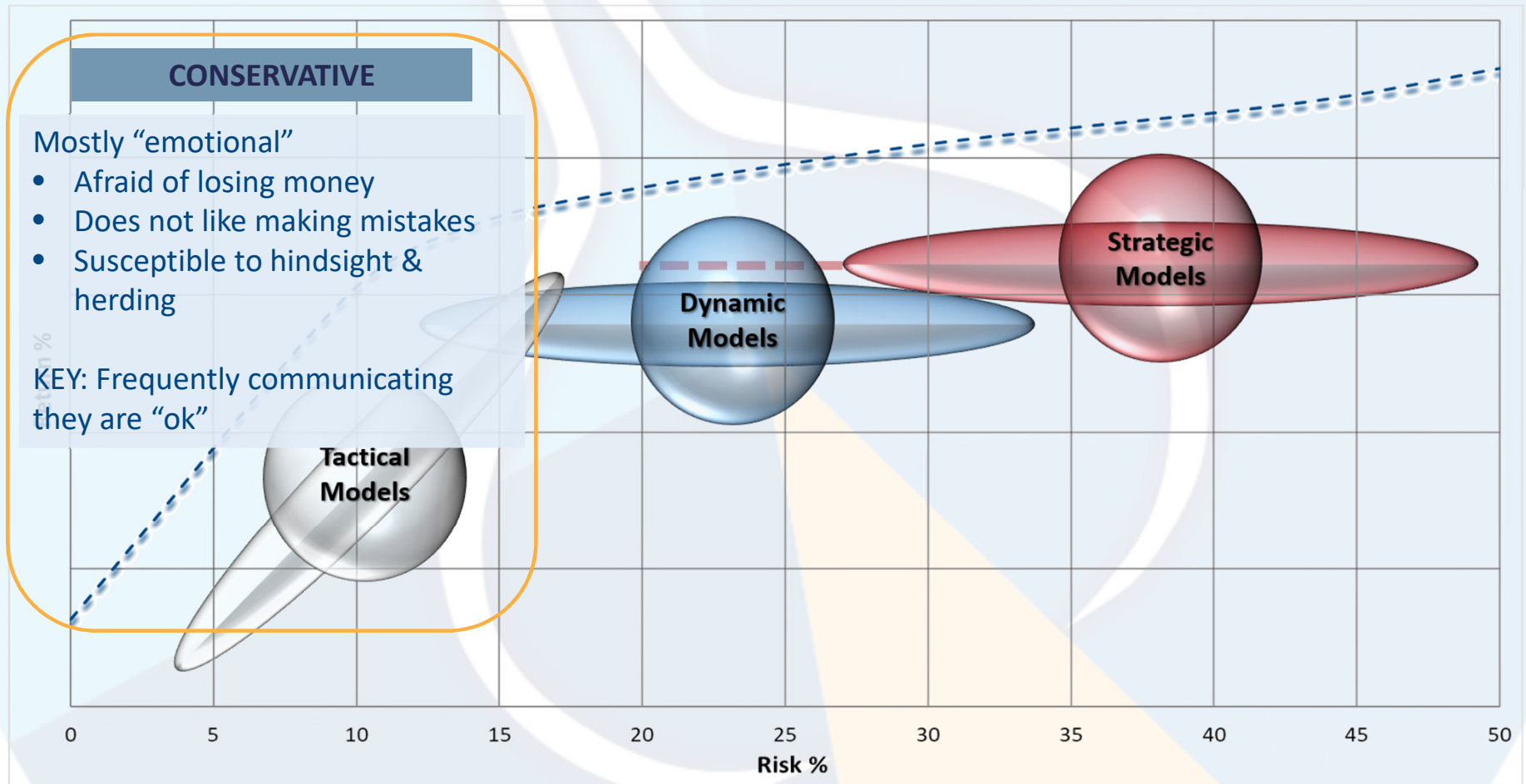
– Seth Klarman



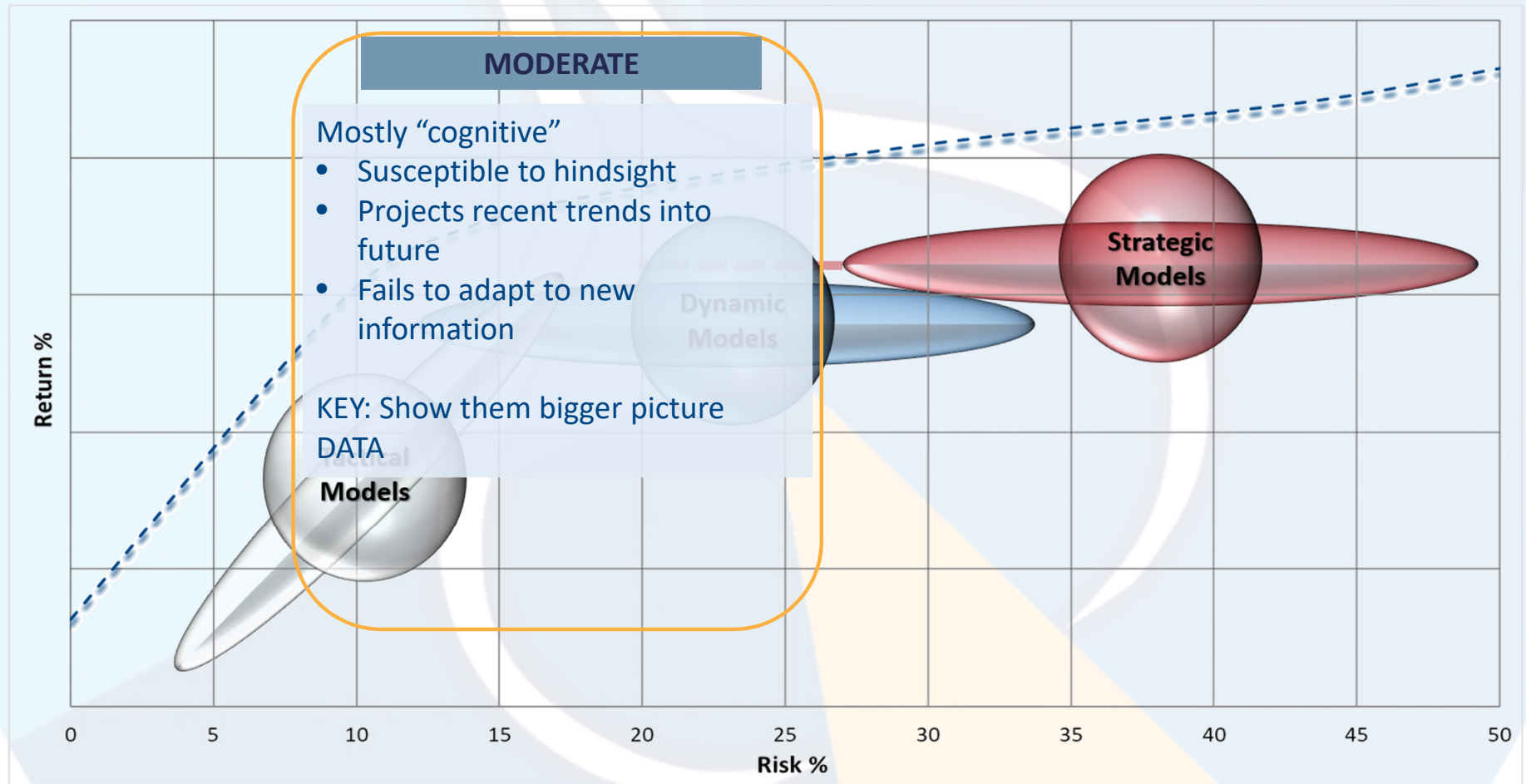
# The Value of Blending Strategies



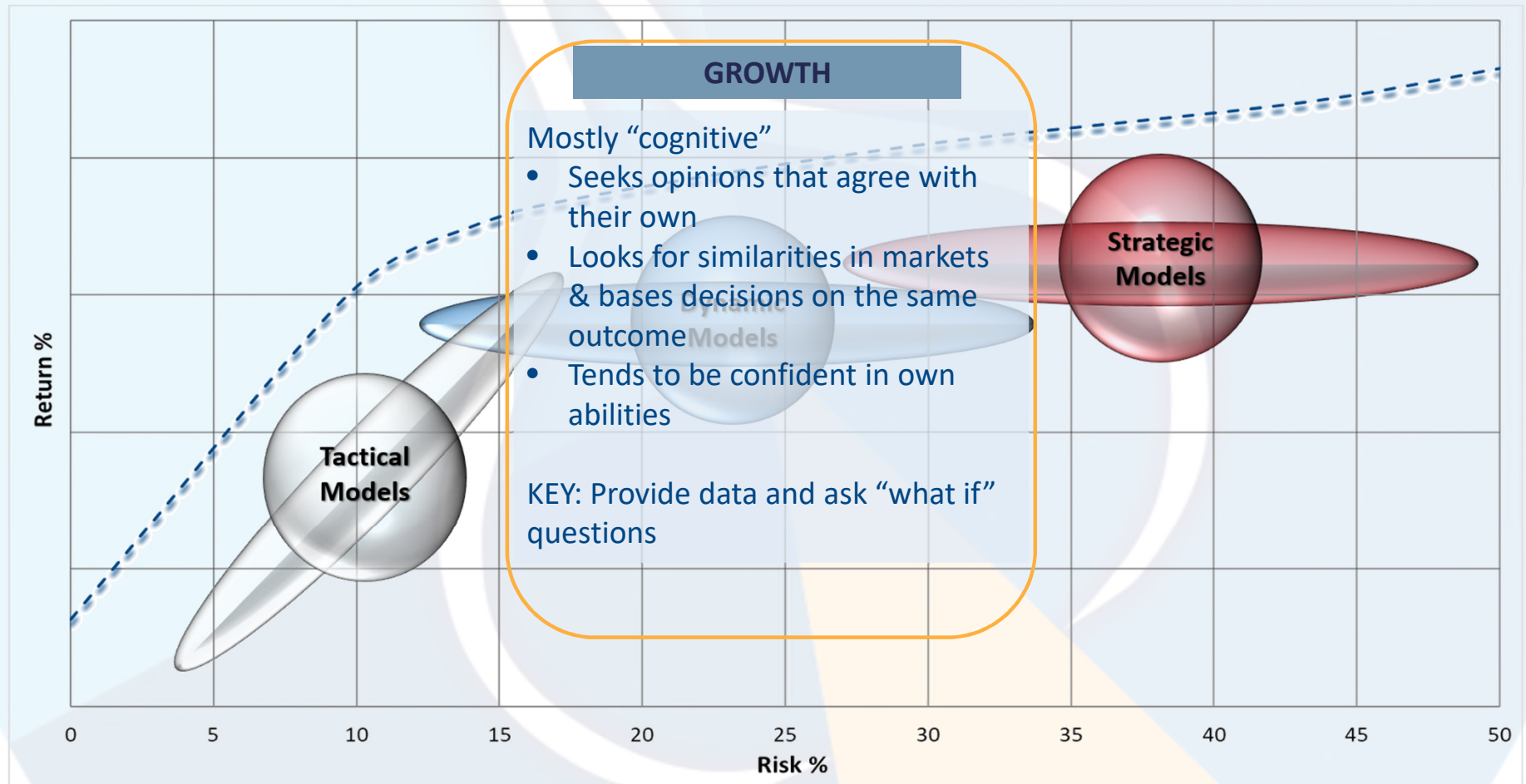
# Building Personality Based Portfolios



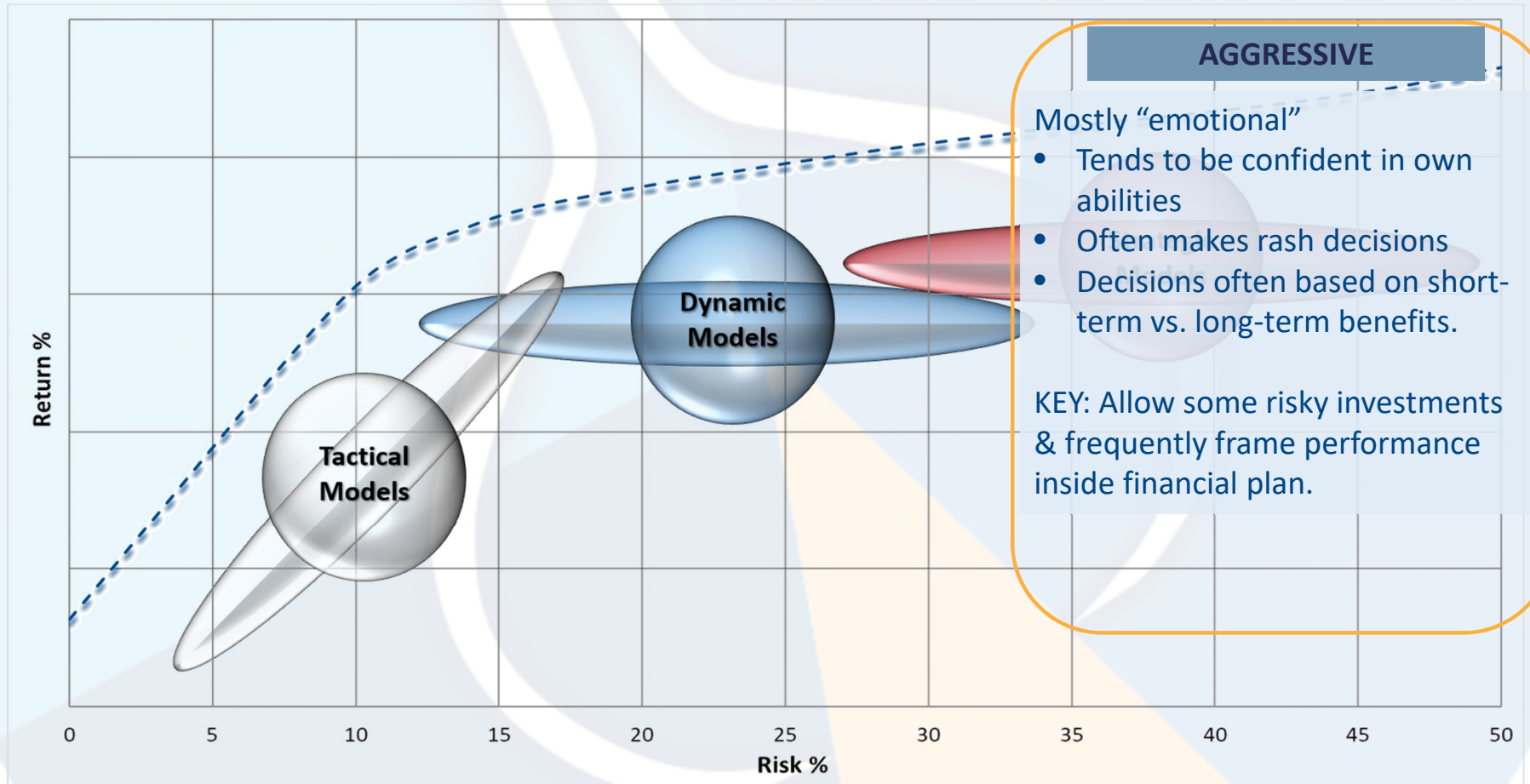
# Building Personality Based Portfolios



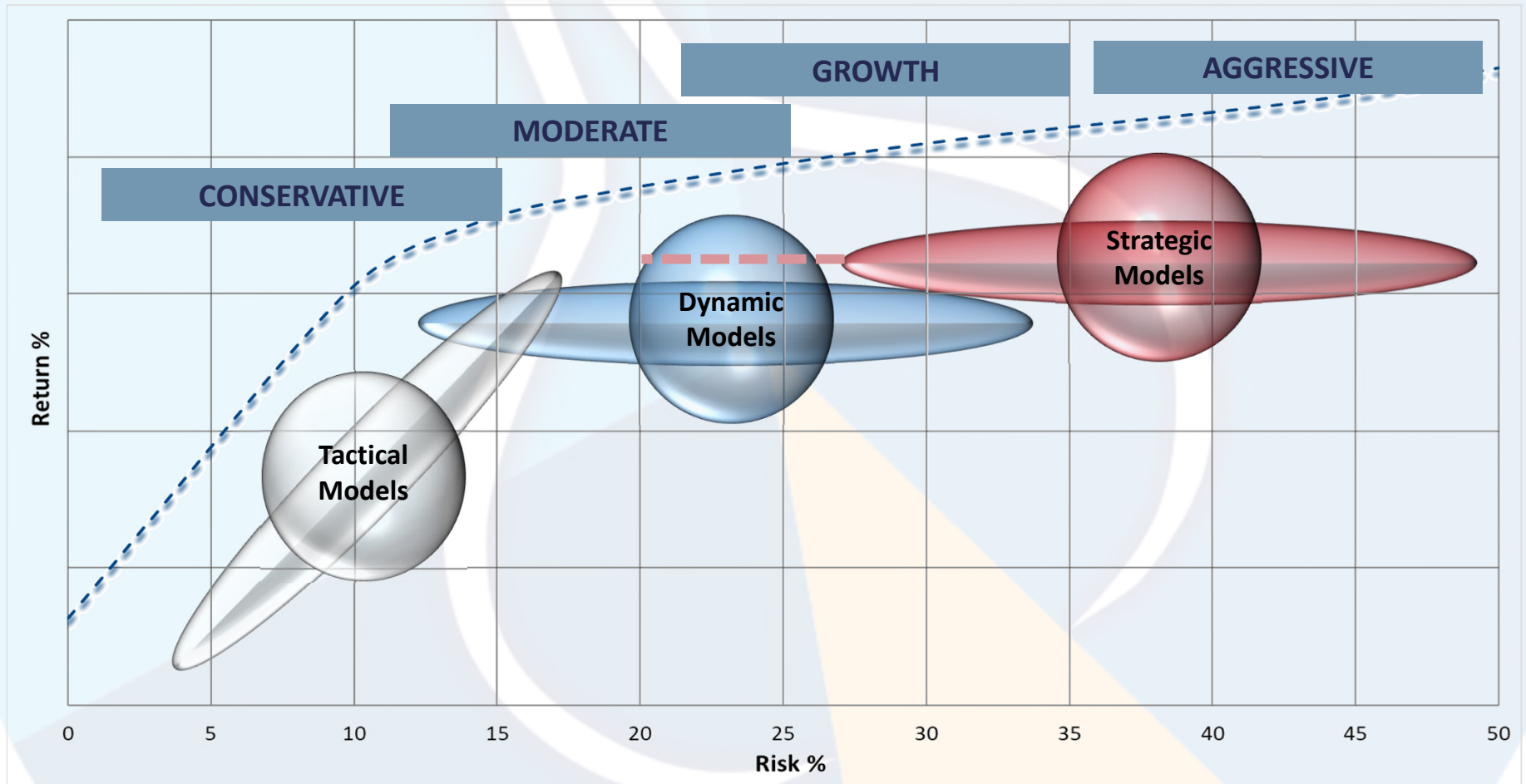
# Building Personality Based Portfolios



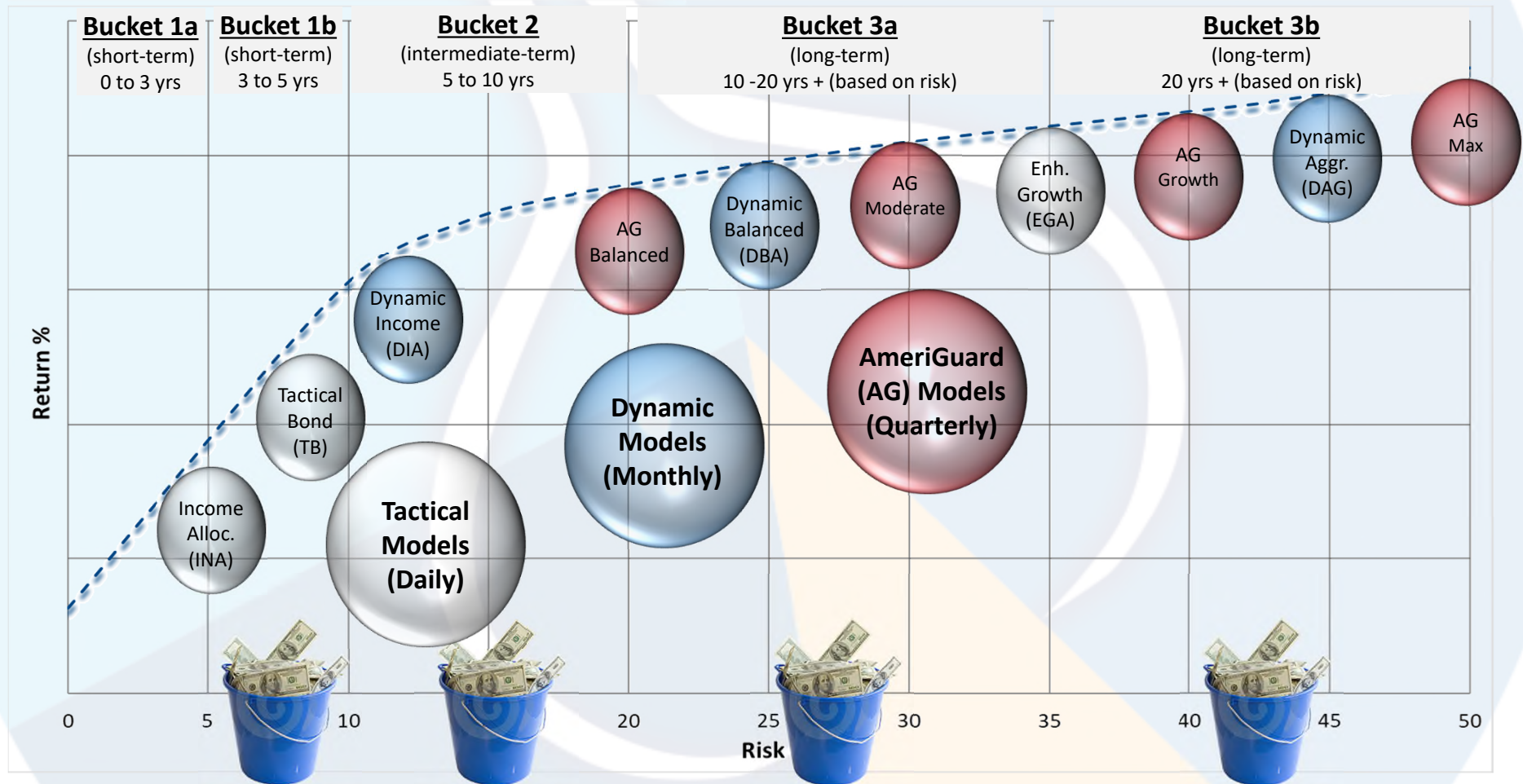
# Building Personality Based Portfolios



# Building Personality Based Portfolios



# SEM's Models & Asset Buckets



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# **5.) Implement your behavioral approach**

- 1 - Systematize your prospecting, meeting, and review process
- 2 – Develop model line-up of 4 client types
- 3 – Weed out clients & products that do not fit your culture

# A Case for a Behavioral Approach

**+193%**

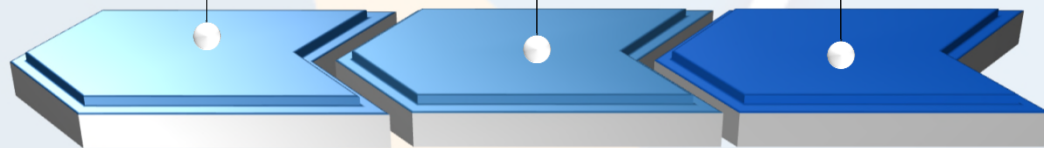
**\$56M**

*In 3 years*

Weed out clients & products that do not fit culture

Develop line-up for 4 client types

Structure Meetings  
& Reviews



# A Case for a Behavioral Approach

**+164%**



*In 1 year*

Weed out clients & products that do not fit culture

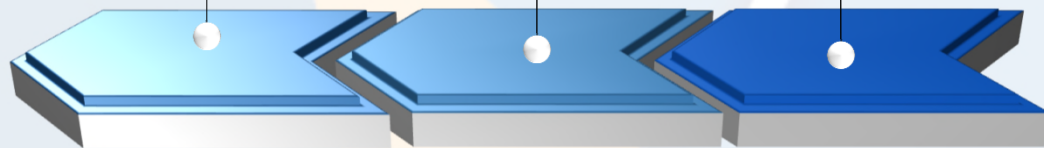
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Develop line-up for 4 client types

---

Structure Meetings  
& Reviews

---



# 3 Keys to Success

Focus on planning & cash  
flow strategies

Remove distractions of picking  
investments & other products

Systematize process:

Prospect → Planning → Cash  
Flow → Invest → Review



Focused Practice  
=  
Solid Growth

**For more information on how SEM can help, contact SEM or go to  
[SEMWealth.com/Advisors](https://SEMWealth.com/Advisors)**