MO•Ē•NĬO

~TO FORTIFY, PROTECT

Investors look at fees the wrong way:
It's the ratio, not the percentage that counts.

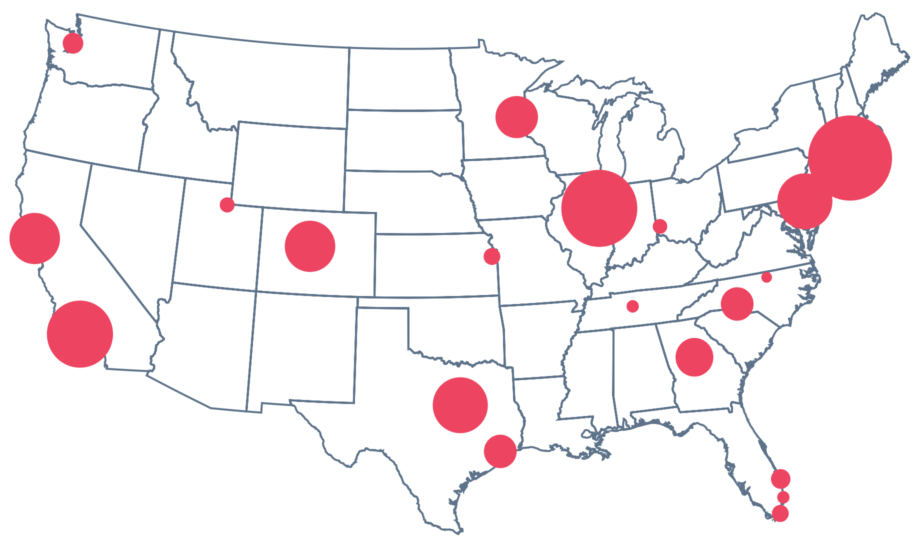
How's Your Investment Advisor Doing? To Find Out, Tie Fees to Performance and Look at Costs versus Returns.

A Moenio Commentary.

How is your financial advisor doing? That can be a surprisingly difficult question to answer. And financial advisors themselves don't make getting at the answer any easier. The end result is a serious challenge for anyone who has to choose a financial advisor – either to manage his or her own wealth, or, for attorneys and CPAs, to provide referrals to high net-worth clients.

There are currently more than 625,000 registered advisors in the USA.

According to FINRA, there are more than 50,000 registered advisors in the New York area alone. Chicago boasts over 21,000, Los Angeles 15,000-plus, more than 14,000 in Dallas/Ft. Worth, and over 10,000 in South Florida.



With numbers like these, how do you know you've chosen one of the best? One of the elite in terms of outstanding performance and client service?

Let's say, as a rule of thumb, that while many of them are good, there's a top one percent who are truly outstanding. But those 6,000-plus advisors don't advertise. Like top performers in any profession, they're quiet and unassuming. You need to find them. Even if we broaden the ranks to the top five or 10 percent, the challenge remains – how do you find these top advisors or know your advisor is one of them?

The short and obvious-seeming answer is to look at the advisor's performance. But it's difficult to arrive at an objective assessment of an advisor's performance and value.

Advisors are good storytellers.
In their stories, they share compelling information about global events, the changing business environment, and how all of this might affect you and your portfolio.

But how do these stories translate into actual success?

Stories aside, when it comes to you and your wealth...
How well do they perform and what value do they deliver?

At **Moenio**, our business is evaluating advisors – finding them, comparing them, and making the right selection on behalf of our clients. For us to get beyond the stories, we start by asking some simple, straightforward questions keeping in mind the risks and goals of our clients:

"Is the advisor I'm using, or considering, one of the best in delivering performance to their clients?"

Nearly every advisor will say he or she can do this – but how do you know? How do you verify the advisor's claims while keeping *risk and goals* in mind?

That is, how much will he or she generate in gains and how does that compare to the cost (fees and other expenses) I'll incur?

To see whether advisors can achieve what really matters - a competitive risk-adjusted return on the investment - it's necessary to look for facts, not just stories. And it's necessary to look at data from a different angle.

We take an objective and systematic approach:

OVERVIEW — Does the advisor have the attributes as one of the best? This is a qualitative screen to start the process or, in some cases, end it, if the advisor doesn't pass. If the overview is completed successfully, we perform a two-phase quantitative analysis:

PHASE I — Is the advisor delivering results in-line with client expectations and goals?

PHASE II — If the advisor has passed the Phase I screen, we look more closely to determine if he or she is delivering fair value.

Overview

Know the qualities of outstanding advisors and see if your current or prospective advisor matches up.

The purpose of the overview is to make certain a current or prospective advisor demonstrates the attributes of a top advisor. Every day, in the course of our work, we have to ask ourselves:

"What are the qualities that define the best advisors?"
Our experience tells us they share three attributes.

Consistency.

The best advisors deliver consistent advice focused on meeting clients' needs and goals. Clients believe their needs are being met if not exceeded.

Communication.

The best advisors have open and patient interactions with their clients. As a result, both the client and advisor gain a clearer understanding of the issues and challenges they face. Clients leave advisor meetings with increased clarity and confidence.

Proactivity.

The best advisors are proactive, not reactive. They anticipate and address clients' needs and concerns, saving clients time and money, and reduce their stress.

As a client, you should be confident the interaction with your advisor will be positive in these three areas. We conduct our qualitative review to determine this and, once complete, we move on to the numbers.

Phase I

To evaluate advisors around facts, start by asking systematically about goals, benchmarks, and investment vehicles.

We concentrate on three aspects of an advisor's process and how they deliver performance:

1. Performance against goals.
2. Performance against benchmarks.
3. Decisions about investment classes and about individual investment vehicles.

Here are the details of what we want to know about these three aspects, and why:

1. Performance against goals.

At the most basic level, has the advisor been delivering performance in-line with the client's goals and expectations?

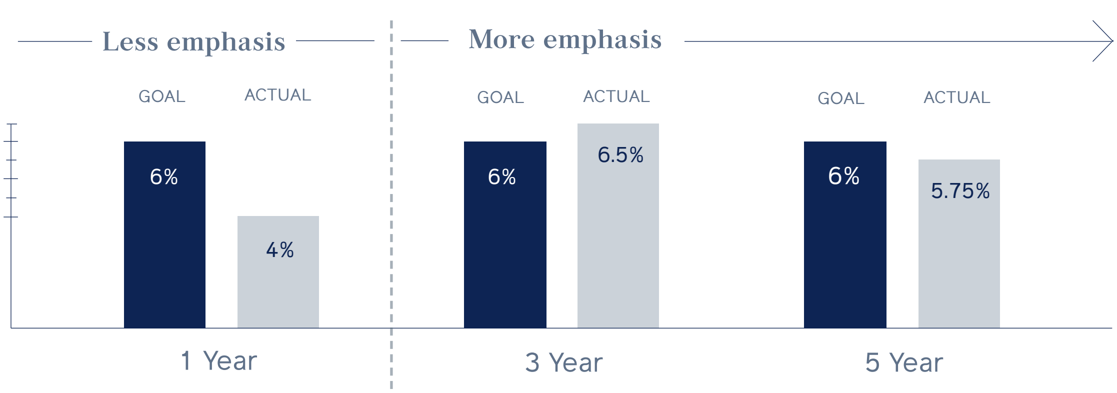
We look at one-year, three-year, and five-year periods with greater emphasis on the three-year and five-year period.

The individual goals need to be the focus of performance metrics and the longer time horizons are essential - you need to make sure that results were delivered consistently, not just under limited market conditions. Market risks can often skew and distort results in shorter time horizons. Viewing only the short term can cause clients needless anxiety or, conversely, it can create unrealistic expectations.

But this only takes you so far and this is where benchmarks come into play. You need benchmarks to verify how well an advisor has actually performed.

TAKEAWAY	Ask your advisor, or one you are considering, for a track record on performance – one-year, three-year, and five-year periods.

Measuring Goals and Expectations.



2. Performance against benchmarks, and what benchmarks to apply.

The benchmarks for each investment need to be understood, agreed upon, and used at each meeting as a measuring tool. Benchmarks apply at several levels. There needs to be:

- A benchmark for the portfolio.
- A benchmark for each individual investment.

The critical question concerning benchmarks is,
"What am I comparing you to?"

Without a tool for comparison how do you evaluate your advisor on a regular, consistent basis? For the answer to be meaningful, ***the selected benchmark has to be relevant to the assets in the portfolio and to the individual investor's goals, and reflect the investor's comfort with risk.***

To their credit, advisors who use benchmarks generally select the right ones. But investors often don't. Investors are too inclined to judge against a broad benchmark like the DJIA when the advisor is trying to build a risk-adjusted portfolio. As a client, you need to be very specific when discussing benchmarks with advisors so that expectations are managed correctly.

An example of a broad benchmark versus specific:

LARGE CAP GROWTH FUND

- Typical Benchmark
  - S+P or Dow Jones
- VS
- Better Benchmarks
  - Russell 1000
  - Morningstar Large Cap Growth Index
  - CRSP US Large Cap Index

US CORPORATE BOND FUND

- Typical Benchmark
  - Barclays Capital Aggregate Bond Index
- VS
- Better Benchmarks
  - Barclays US Corporate Investment Grade
  - BofAML US Corporate Master Index
  - FINRA - Bloomberg US Corporate Bond Indice

TAKEAWAY

Your advisor should be providing you a benchmark analysis when they deliver performance results (or meet with you to show their past performance with clients). There should be benchmarks against the portfolio and each investment.

3. Decisions about investment classes and individual investment vehicles.

When choosing individual investments, what's the advisor's basis for the decision?

We evaluate at two levels:

What type of investment vehicles do they choose, and why do they choose them?

In a particular situation, is the choice a mutual fund, a money manager, an individual stock or bond, an ETF, a structured note? Why did they choose one - mutual funds, for example - over another, such as an ETF?

Why did they choose one manager or product over another?

Why ABC Mutual Fund instead of XYZ Mutual Fund? Why one US Large cap equity ETF instead of a different US Large cap equity ETF?

In asking these questions, ***we are not trying to second-guess the advisor*** or compare one advisor's decisions to another's. We want to understand why they make the decisions they do, and how those decisions translate into an outcome for the client. If over a period of time, the advisor's decisions are predominantly correct, then the advisor is good – perhaps one of the best.

TAKEAWAY

Ask the advisor why they chose one investment option (a recommended mutual fund, for example) over alternatives? Typically they have data backing up the analysis.

How should you use the information about goals, benchmarks, and decisions?

Each of these areas of focus - performance, benchmarks, and investment choices - represents a sort of "safety stop." If an advisor's performance against goals is substandard in the first category – performance – there is no need to evaluate the benchmarks. We break off the inquiry and move on to the next candidate. Only if the advisor passes the first test do we go on to apply the second. Only after the advisor passes the second do we apply the third.

Phase II

What are the fees?
The critical factor is the *fee ratio*:
It directly relates fees to whether
you’re getting fair value.

Once we've come to understand the advisor's performance against the goals, applied the benchmarks, and reviewed their choices with individual investments, we then move to:

The heart of the matter — ***How the advisor gets paid, and the impact this has on results.***

a. We look at how much a client is being charged and what this fee represents.

Advisors aren't always eager to discuss fees – unless they feel it's a matter of competitive advantage. But information about fees is readily available to clients – it has to be, because it is *tax-relevant.*

The fact that fees are potentially tax-deductible means that advisors have to disclose them on request. The fee can then be compared to industry-wide fee averages - we use this comparison as a starting point and then go beyond.

A host of factors determine advisors' fees, not all of them rational. The traditional way of establishing a fee is to start with the average for accounts of similar size, then adjust for competitive factors. The consideration might be along the lines of, "This is the industry average… but can I get away with charging it?" Fees go up or down for competitive reasons. The client's willingness to pay is also a factor. Sometimes the result is that in the same office, 10 advisors are charging 10 different fees on accounts of the same size.

These complexities make evaluation difficult, but the complexities are, in fact, something of a distraction. So, too, is the standard way of looking at fees – as a percentage of assets under management. The real issue is – what does the fee buy you, as an investor, in terms of net return with risk and goals in mind?

To be clear – we believe financial advisors, brokers, and bankers should be paid fair compensation for what they provide to their clients. We believe additional services provided outside the scope of performance (financial planning, coordinating professionals around tax, estate, sale of business, for example) can be a factor in the fees – but these should also be evaluated in terms of fair compensation.

b. We look at the “fee ratio” over a three-year and five-year period.

We want to understand how much a client pays in total out-of-pocket fees over a defined time horizon. We then evaluate this against the total dollars generated for the client.

For the fees you paid, how much did you receive from your investment returns?

We call this the fee ratio. It’s the final element in our evaluation process.

Why the fee ratio?

Keep in mind that the fee ratio is not a performance metric. Performance was addressed when you looked at performance against goals, benchmarks, and individual investment choices. That’s the information that tells you whether you’re working with one of the best. If you’re not, fees don’t matter, because the overriding issue is that you’re with the wrong advisor, and should change. Fees become relevant as you start to dig deeper into an advisor who is already delivering the ***right risk-adjusted returns***.

At **Moenio,** we utilize the fee ratio to answer an important question:

- *"Am I paying fair compensation to my advisor?"*

A simple example illustrates the power of the fee ratio.

The fee ratio can be difficult to compute.
The extended time horizon for a typical investment requires that compounding and fees be taken into account on a yearly basis as well as recognizing that there could be potential yearly withdrawals affecting any calculation.

But the concept is straightforward.
A client asks for the total fees paid over a three-year and five-year period. With that information in hand, the client then looks at the statement to determine the gains (net of fees) during the same time period.

Divide the fees paid against the total net return and you have the fee ratio.

Here's a simplified example .

Leaving out compounding, and the impact of fees – this nevertheless illustrates the power of the ratio to cut through the clutter and answer the central question:

- *"Am I paying too much?"*

Let's say that on assets of $10 million, you paid 1% in fees a year. That's $100,000 per year in fees, or $300,000 over a three-year period (leaving out compounding of returns and deduction for fees). Let's also say you earned 5% a year for the three-years (again leaving out compounding). Your total net return would be $500,000 or $1,500,000 over three years. That means you paid $300,000 to the financial advisor in order to net $1.5 million. That's a fee ratio of 33%. And that's the figure you need to work with. It takes us to the core question:

- *"Was the net gain of $1,500,000 worth the amount paid in fees?"*

There are two dimensions to the answer:

First, could you have produced equivalent results on your own, and realized a gain of $1,500,000?
Perhaps, perhaps not. The fee, if fair, compensates the advisor for producing those results and for taking your risk tolerance and your goals into account.

Second, how does the advisor measure against competitors?
While this is not an exact measuring tool, it does help you understand how much one advisor is getting paid relative to another with the fee ratio. In our work, we've seen advisors getting paid a higher fee ratio who are performing better thus giving us the ability to negotiate a more realistic fee with our clients.

This raises the question:

> *Why not simplify the process, "cut through the clutter," and use the ratio as the single performance metric?*

(The answer on next page)

If you use only the fee ratio you take the returns for a given, and don't examine what the advisor did to produce them.

Is the advisor taking acceptable risks, or are the returns the results of dangerous strategies that are unlikely to keep paying off? So it's essential to put the advisor's approach under scrutiny – that's what the first phase is about.

The fee ratio – in addition to telling you about fair value – gives a final, confirmatory look. This is most useful in a situation when you're already comfortable with the advisor's results and approach.

Remember also that applying the fee ratio in practice can be complicated.

The numbers must be used correctly, and there could be multiple accounts with differing fees and withdrawals to consider. In addition, there are situations where a high fee ratio is unavoidable, such as lower return requirements, minimum fees charged, specific client requests, and more.

These complexities help illustrate why. While it's extremely helpful to master the concept of the fee ratio, the actual calculations could require the use of a consultant.

How to evaluate advisors on your own.

Start with these takeaways.

If selecting an advisor is a task that demands expert help, is there any way you can apply these lessons on your own? Of course there is. The framework we've described gives you a different and more effective way to think about advisors.

To help make good advisor choices, remember these takeaways:

1. The right way to evaluate performance is to measure it against your own goals and against relevant benchmarks.

2. You know the results – they're in your account statements.

3. You know the fees, or if you don't, ask your advisor. The advisor is required to disclose them.

4. Comparing the two – results and fees – will give you a rough, "back of the envelope" fee ratio. It's not 100 percent accurate, but it's a start.

5. Short-term data can be distorted. Look at results over one-year, three-year, and five-year time frame with emphasis on three-year and five-year.

Using this framework will get you started on the evaluation process. It will help you assess your needs and set up a more effective conversations during your long-term relationship with your current advisor or the one you will ultimately choose.

An advisor evaluation checklist.

For investors looking for advisors, and for professionals who need to provide referrals, these five questions can help you narrow the search:

1. What are the advisors returns? Understand the returns and verify them, looking at results for more than one client. ☐
2. What benchmarks does the advisor use? Do they accurately reflect the advisor's approach and the investor's goals? ☐
3. What are the investment vehicles he or she is using? How does he or she decide which vehicles to use? ☐
4. What fees does he or she charge? ☐
5. What fee ratio should I expect from the advisor? ☐

The Fee Ratio In Action.

Here is a still simplified, but more detailed, example of the fee ratio system in action, and the kind of information it provides.

A client with a $10,000,000 account is being charged 1.00% a year and generated returns of 7% (year 1), 1% (year 2), and 9% (year 3).

Year 1		Return 7%		Gross Balance	Year 1 Ending	Net Gain / Loss
$10,000,000	+	$700,000	=	$10,700,000	$10,593,000	$593,000
				(MINUS FEE) ($107,000)	MINUS 1% FEE	

Year 2		Return 1%		Gross Balance	Year 2 Ending	Net Gain / Loss
$10,593,000	+	$105,930	=	$10,698,930	$10,591,941	($1,059)
				(MINUS FEE) ($106,939)	MINUS 1% FEE	

Year 3		Return 9%		Gross Balance	Year 3 Ending	Net Gain / Loss
$10,591,941	+	$953,275	=	$11,545,215	$11,429,763	$837,823
				(MINUS FEE) ($115,452)	MINUS 1% FEE	

Fee Ratio $1,429,736 ÷ $329,441 = 23%

Beginning Balance	$10,000,000	Total Fees paid:	$329,441
Ending Balance:	$11,429,763	Total Gross Return - rate:	5.61%
Total Net Return:	$1,429,763	Total Net Return - rate:	4.56%

- Fees are withdrawn at the end of each period
- The calculation does not show addition and withdrawals
- Each periods return is calculated at the end of the period

About Moenio.

Moenio was founded with one goal in mind:

Helping individuals, families, and organizations work with their advisors and advisory firms to better navigate the complexities of wealth.

We recognize the difficulty of finding the right financial advisor or evaluating an existing advisor. How do you know an advisor is among the best, delivering the great service and performance you deserve?

Capitalizing on decades of wealth management experience and expertise, Moenio created a proprietary evaluation process that provides clients unsurpassed guidance in finding, evaluating, and monitoring their financial advisor.

- We are unaffiliated with any financial firm
- We do not manage assets or investments
- We do not accept fees or commissions from the advisors we recommend or evaluate

Your interest is our sole interest.