Provisus Wealth Management Limited

FALL 2017

ADVISOR'S PERSPECTIVE

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WEALTH MANAGEMENT

Diversity, Not Just For Your Portfolio

There is an old joke in investment management that if everything in your portfolio went up, then it isn't diversified enough. The same line of thinking also applies to those who work in the industry as well; if everyone thinks the same way then we could get systemic errors occurring all the time. Thankfully diversity has become a key trait to being a successful asset manager and advisor, along with curiosity, tenacity and integrity.

Time has the magical ability to change all things and allow access to fundamental financial advice for all; every age group, gender, family type, religion, sexuality, language or cultural group. The reality is that money is personal. Generally, clients want to talk about their financial issues with someone who is on the same wavelength and appreciates their values, culture and lifestyle.

Today's clients are expecting the advisor sitting across from them to understand their specific values and culture, and safeguard their financial future. After all, strength lies in differences, not in similarities. However, it is up to each individual advisor to overcome the "stale" part.

Most good advisors are passionate about what they do and actively seek to improve the lives of the clients they work with. But in an increasingly fast paced world with highly volatile and complex markets, going it alone is becoming more difficult. Knowledge is crucial to succeeding in the new world; as is knowing what you do not know. So, advisors will need to adjust their perspective and practices accordingly to successfully navigate the sea of change that is coming.

The industry is changing and the demand for financial services that require empathy and top-notch communication skills is rising. Financial advisors are a key conduit of financial knowledge. But the next 10 years will change the landscape beyond recognition. Sure, robo advice grabbed the media's attention and version 1.0 proved to be a damp squid. But robo 2.0 will be better and robo 5.0 whenever it occurs will be better still. It is the incremental creep that eventual changes the world, not the moonshots.

By being enlightened and progressive you will help clients prosper. There is nothing wrong with being who you are; after all it has gotten you to where you are today. But what you cannot do is remain mired in the past, resistant to new thinking and strategies. The reality is that the industry as it is currently configured has helped countless clients achieve their goals and embracing diversity will get us to where we need to be. Sometimes though, clients just want a hamburger and serving them foie gras does not work.

Here Are The 5 Things That Advisors Need To Do

- **Win the War for Talent -** Advisors need to prioritize talent management by hiring (and if need be firing) people who have the right qualities and skills and who can strategically move your practice forward. Systematic recruitment, retention and training will be a key to success.
- **Leverage Technology and Innovation -** Make your practice future-ready by embracing innovation and new technologies.
- **Collaborate -** Focus on what you can do yourself and what can be done with third party organizations. There is no need to recreate the wheel, just reach out and get the help you need.
- **Rejuvenate Your Practice Culture** - Set out a bold vision that is undaunted by tradition. Having a conservative, "fear of failure" culture will only hamper your practice and drag you down by inertia.
- **Invest in Diversity -** The industry is increasingly undergoing a digital transformation. The next wave of clients think, act and behave differently so by positioning yourself now you will be well situated for the future.

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Will New Disclosure Rules Lead Advisors To Abandon Segregated Funds?

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It is easy to understand why Segregated Funds are a favourite investment vehicle for many financial planners. They have a great marketing gimmick, a rosy benefits story making them an easy sell, the payout to advisors is great, and currently they do not fall under transparency rules like mutual funds with the Customer Relationship Model (CRM). Strategic Insight data shows that Seg Fund assets increased from $110.7 billion to $116.8 billion between June 2016 and June 2017. If we look at these products objectively they do have some theoretically appealing features for certain clients, but many clients would be better served in other investment vehicles. Now that the Canadian Council of Insurance Regulators (CCIR) is recommending greater transparency will Seg fund growth continue to be as robust as it has in the past?

This new disclosure framework seeks to ensure consumers are informed of not only the performance of their segregated funds, but also all of the details of what they cost. As well that disclosure provides a better understanding of this product. Are you ready for this discussion?

Segregated funds are considered to be like mutual funds with an insurance policy wrapper that give investors the following benefits:

- Downside risk protection. Guarantee of capital after ten years and resetting privileges to lock in growth
- Protection of assets from creditors
- Guarantee of capital at death
- Probate protection

All these benefits are priced into Seg funds and with a greater focus on costs through the proposed disclosure rules clients are going to want answers. The Management Expense Ratios (MERs) of Seg Funds tend to be higher than mutual funds to cover the cost of the insurance features. The fund filter on Globeinvestor.com shows that the management expense ratio for the 20 most widely available Canadian Equity Seg Funds range from 2.57 per cent to 3.25 per cent. MERs for the 20 largest Canadian equity mutual funds run from 2.05 per cent to 2.39 per cent. In order to determine if the benefits are worth the extra cost let's examine these features.

Downside Risk Protection

Salespeople tell clients that Seg Funds are safer than mutual funds because they guarantee a certain amount of its principal to its investors, typically ranging between 75 and 100%, as long as they hold it for a determined period, usually ten years. If the fund value rises, some segregated funds also let you "reset" the guaranteed amount to this higher value (which also resets the length of time that you must hold the fund). This is an investment that has all the upside of mutual funds and no downside because your capital is guaranteed so why wouldn't everyone buy these funds?

While they are appealing to an investor's peace of mind, the first problem is that you have to lock your money in because if you cash out before the maturity date, the guarantee won't apply.

The second issue is that since stock markets have historically risen over the long term, the likelihood of actually needing the guarantee to get your original capital back after 10 years is small. In fact, since 1900, the only two short-lived periods when the S&P 500 was negative over 10 years were the periods ending in the late 1930s following the Great Depression and those ending in 2009 at the lows of the subprime mortgage crisis. So 98% of the time, 10 year returns were positive for U.S. stocks. For Canadian stock markets, since 1960, more than 90% of the time the TSX has returned over 6% over 10 years. And in no 10-year period have TSX returns been negative. Consultants William M. Mercer found there's a 2% likelihood of losing money in the stock market over ten years.

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The Canadian Council of Insurance Regulators recommends changes to Seg Fund disclosure rules to bring that information more closely in line with the information clients receive about their mutual fund investments. **Specifically, the CCIR outlines a list of information that must be part of the Seg Fund investors' annual statements, including:**

- all charges for the year, in dollar amounts, with the management expense ratio (MER) broken out to show management fees, distribution costs and insurance costs explicitly;
- all remuneration paid during the year for the provision of services in connection with the contract;
- changes in the net asset value of the contract in dollar amount;
- redemption value; and
- total personal rate of return, net of charges, calculated using the money weighted method for the last year, three years, five years, ten years and since issue; among various other items.

Will New Disclosure Rules Lead Advisors To Abandon Segregated Funds?

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Protection of Assets From Creditors

Creditor protection is a key benefit for business owners in particular but has also served as a selling feature for individuals as well. The first issue with this is that there is a way to achieve creditor protection without paying a higher fee for your investments. Instead of structuring a business as a sole proprietor or a partnership, small business owners can incorporate or may already be incorporated. Seg funds are based on the market value of a portfolio and as it gets larger, the costs of managing a portfolio for a small corporation (which are mostly fixed), may be more cost effective than the additional cost within the Seg fund for this protection. If a business is big enough that it faces the chance of large losses, or if it is risky enough that there is concern with solvency, then incorporation may be more suitable.

Here is where the proposed disclosure requirements come into play. The more knowledgeable the consumer of Seg Funds is on this point, the more likely creditor protection will not be available. Seg Funds may not be able to provide creditor protection where it can be proved that the purchaser was in financial difficulty ahead of the purchase. Fraudulent conveyance, dependant relief claims, property claims in marriage breakdown as well as CRA claims are instances where creditor protection may be impacted so the feature is not as enticing as it is laid out to be.

Guarantee of Capital at Death

This is a benefit that makes a lot of sense for using Seg Funds...if you think you are about to die and you also think the markets are about to crash.

Probate Fees

Seg Funds have an additional cost to the client of roughly 1% per year which they pay each year they are locked into the product. Probate fees charge a one-time fee of about 1-2%. As such, there is limited value in this feature.

Conclusion

What an investor ends up with in segregated funds is a portfolio with higher than normal fees, marginal performance and features they may not really need. There's a cost for peace of mind but has that cost become too high for Seg Funds? As exchange-traded funds and Pay-for-Performance pooled funds gain ground, Segregated Funds must hold their own if they want to carve out a place among the solutions offered to increasingly cost-sensitive investors. Market trends in the coming years indicate money management costs will be a greater focus. If you currently sell Segregated Funds, it is time to prepare for the inevitable disclosure requirements. It may also be time to re-evaluate your options and entertain alternative solutions.

The new disclosure initiative has the potential to create a scenario where creditor protection may be lost and a court can rule that you had set up the Seg Fund to avoid your debts**. There are circumstances where the creditor protection may not apply:**

- The Seg Fund must be purchased in good faith. The creditor protection feature could be challenged if the investor purchases the fund knowing that they may eventually face financial difficulties. This falls under fraudulent conveyances provincial legislation.
- Seg Funds may not provide creditor protection from the Canada Revenue Agency if income tax liabilities are outstanding in a non-bankruptcy situation.
- Claims under Family Law may take precedence over creditor protection in a court of law to provide for a dependent.

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2016 PROFIT 500 CANADA'S FASTEST-GROWING COMPANIES

Manager Profile: Jarislowski, Fraser Limited

Provisus is pleased to announce that we have recently added Jarislowsky, Fraser Limited as the investment manager of 11 new investment mandates within our Separately Managed Account (SMA) program. Jarislowsky, Fraser was founded in 1955 and is privately owned by more than 30 partners. It has offices in Montreal, Toronto, Calgary and Vancouver and has $39.2 billion under management for pension funds, pooled funds, endowment funds, corporate and private portfolios for clients in North America and Europe.

The firm employs a high-quality/low-risk strategy that relies extensively on in-house research and bottom-up fundamental analysis which integrates Environmental, Social, and Governance (ESG) factors into their investment decisions. They believe superior long-term performance is achieved by investing in high-quality businesses with attractive earnings prospects and reasonable valuations. As long-term investors they believe that strong, ethical management teams and good governance practices will drive sustainable value creation.

Jarislowsky, Fraser's investment philosophy has an emphasis on downside protection by focusing on leading non-cyclical global growth stocks to reduce portfolio volatility in down markets. Their primary goal is to grow capital for clients in a low-risk manner and invest in concentrated portfolios with a long-term perspective that exploits the market's excessive focus on short-term results.

They also emphasize industries with strong secular and unique growth trends; management teams with successful track records that align with long-term stakeholders; and are able to successfully generate, sustain and grow free cash flow. In-depth security analysis is based on four key criteria: competitive advantages, quality management, financial strength and valuations. They focus on corporate bonds for yield enhancement; safety of principal and strict quality guidelines. As well, they employ a conservative approach with gradual duration shifts and minimal trading risk.

These 11 new Jarislowsky, Fraser investment mandates are subject to an account minimum size of $150,000:

- Canadian Equity
- Canadian Balanced
- North American Balanced
- Global Balanced
- U.S. Equity
- International Equity
- Global Equity
- North American Equity (2 versions)
- Total Equity (2 versions)

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Provisus offers high net worth individuals integrated wealth management across their entire household and leading edge investment strategies that until now were only available to multi-million dollar institutional investors. Our portfolios are structured as fee based Unified Managed Households (UMH) that can combine multiple unaffiliated products into one householded investment portfolio. A UMH can combine the benefits of Separately Managed Accounts (SMA), ETF accounts, and funds with the ability to hold almost any other investment that the client chooses to maintain. The ability to monitor all client assets facilitates higher risk adjusted returns and better tax management.

Separately Managed Accounts (SMA) are the key component of the UMH structure. These tax efficient investment portfolios are managed by institutional investment managers and enable clients to have their own "segregated" equities and bonds which are kept separate from those of other clients. Provisus works with 11 institutional third party managers allowing us to offer over 85 mandate model equity and fixed income portfolios. The result are customized portfolios designed specifically for each client where the client owns the securities outright**.**

Provisus Managed Exchanged Traded Fund (ETF) accounts allow for index, style and broad market diversification holdings in mid-sized accounts. These are ETF portfolios where the clients own the ETF's directly in their own names and where the decision to purchase / sell is left to the money manager.

Provisus Corporate Class Pooled Funds offer portfolio diversification, competitive fees and are available for smaller accounts.

Provisus oversees all of these account types and manages the asset allocation, the Investment Policy Statement preparation, manager selection, account setup, trade execution, performance measurement, tax reporting and client servicing.

Provisus is registered with the Ontario Securities Commission (OSC), the British Columbia Securities Commission, the Alberta Securities Commission, the Saskatchewan Financial and Consumer Affairs Division, the Manitoba Securities Commission, the Autorité des Marchés Financiers (Province of Quebec), New Brunswick Financial and Consumer Services Commission and the Nova Scotia Securities Commission as a portfolio manager and investment fund manager. The OSC is the principal regulator for Provisus. CIPF coverage is provided by the program's custodian, Laurentian Bank Securities.

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