What Outsourcing Has to Offer: Part II

California Municipal Treasurers Association

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What is an Investment Adviser?

- An investment firm with demonstrated expertise in the management of investment portfolios
- Acts as a fiduciary for client assets
- Registered with and regulated by the SEC under the Investment Advisers Act of 1940
- Compensated on the basis of assets under management, not transactions
Emphasis on the Whole Portfolio

Investment Policy
- Acceptable risks
- Objectives
- Governing law

Portfolio Decisions
- Implementation of policy

Evaluation of Program
- Risks undertaken
- Compliance
- Results achieved
- Suggestions for change
Are There Any Risks?

- Third party custodian is essential—an outside adviser should never have custody of assets

- The client can’t delegate fiduciary duty
  - Compliance with Government Code
  - Compliance with Policy
  - Performance relative to appropriate benchmarks
What To Look For in an Adviser

- **Capabilities**
  - Tenure/qualifications of the investment team
  - Investment process
  - Longevity of the firm
  - Consistent performance history for similar accounts reported in accordance with industry standards
What To Look For in an Adviser

Service

- Quality of reports
- Willingness to tailor services and reports to agency's needs and preferences
- Experience with like agencies
- Compatibility working with the adviser's staff
- References from current clients
What To Look For in an Adviser

- Professionalism
  - Designation as Chartered Financial Analyst
    - Graduate-level program specific to investment professionals
    - Comprehensive knowledge base in investment analysis and portfolio management
    - Code of Ethics and Standards of Professional Conduct
    - Performance presentation standards
AIMR Standard Performance Reporting

The Industry Standard

- Time-weighted total rate of return, including realized and unrealized gains and losses
- Compared to appropriate benchmark
- Including measures of risk
- Extensive footnotes regarding the calculations and the firm
## Discretionary vs. Non-Discretionary

### Discretionary
- Decisions based on Policy and Guidelines
- Better accountability of manager
- Less day-to-day staff involvement
- Greater benefit from manager's process

### Non-Discretionary
- Permission needed prior to trading
- More direct control over manager
- More day-to-day staff involvement
- May miss some benefit if timely permission not received
One Adviser or More?

**One Adviser**
- Consolidated Reporting
- Lower fee
- Less staff time for monitoring

**Multiple Advisers**
- Diversified styles
- Competition between advisers
- More interaction required
Investment Advisory Fees

- Should be no more than 0.15 of 1% (15 basis points), or $15,000 for every $10 million under management

- Enhanced earnings should more than offset the fees

- Third party custodian costs are in addition to adviser's fees
Why Have An Investment Adviser?

- Expertise
- Experience
- Information
- Analytic Tools
- Defined, Disciplined Process
- Collaboration with Staff to Maximize Internal Resources
Request for Proposals

- Firm organization
  - Ownership & history
  - Client and asset base
  - Assets under management
  - Types of clients
  - Retention of clients
  - Account losses

- Personnel
  - Team approach or individual PMs
  - Detailed biographies of key people
Request for Proposals

Investment philosophy and process
- Philosophy of achieving “safety, liquidity, yield”
- Investment decision-making process
- Methods of adding value
- Risk management
- Frequency of contact
Request for Proposals

- Documented AIMR-compliant returns
- Additional services provided
  - Reporting
  - Policy & procedures
  - Training, etc.
- Cost for services
- Registration with SEC—Request Form ADV, Part 2
- References
Getting Started

- Negotiate & finalize agreement
- Obtain governing body approval
- Bring advisor on board
- Develop investment strategy
- Implement program
- Monitor and report
- Re-evaluate over time
The Adviser Intermediates Between the Client and The Market

The Client
- Objectives
- Constraints
- Return Requirements
- Risk Tolerance

The Market
- Opportunities
- Acceptable Risks
- Risks to Avoid

Investment Adviser
- Experience
- Systems
- Knowledge
- Judgment

Optimal Portfolio