Index Fund Advisors
FIDUCIARY WEALTH SERVICES

IFA Client Study

Maximizing Your Return Relative to a Benchmark

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Maximizing Your Return Relative to a Benchmark

What has been the value of following the advice of Index Fund Advisors (IFA)? Is there a way to measure one of the benefits of the fee paid to IFA for this advice? A similar question was addressed by Vanguard Research in their Advisor's Alpha article (http://bit.ly/1h0TxBV), where they estimated additional annual return values of about 3%, including 1.50% for behavioral coaching and 0.35% for disciplined rebalancing. IFA wanted to do its own internal study to determine the success of clients who followed our advice by measuring their returns compared to the IFA Index Portfolio originally recommended to them.

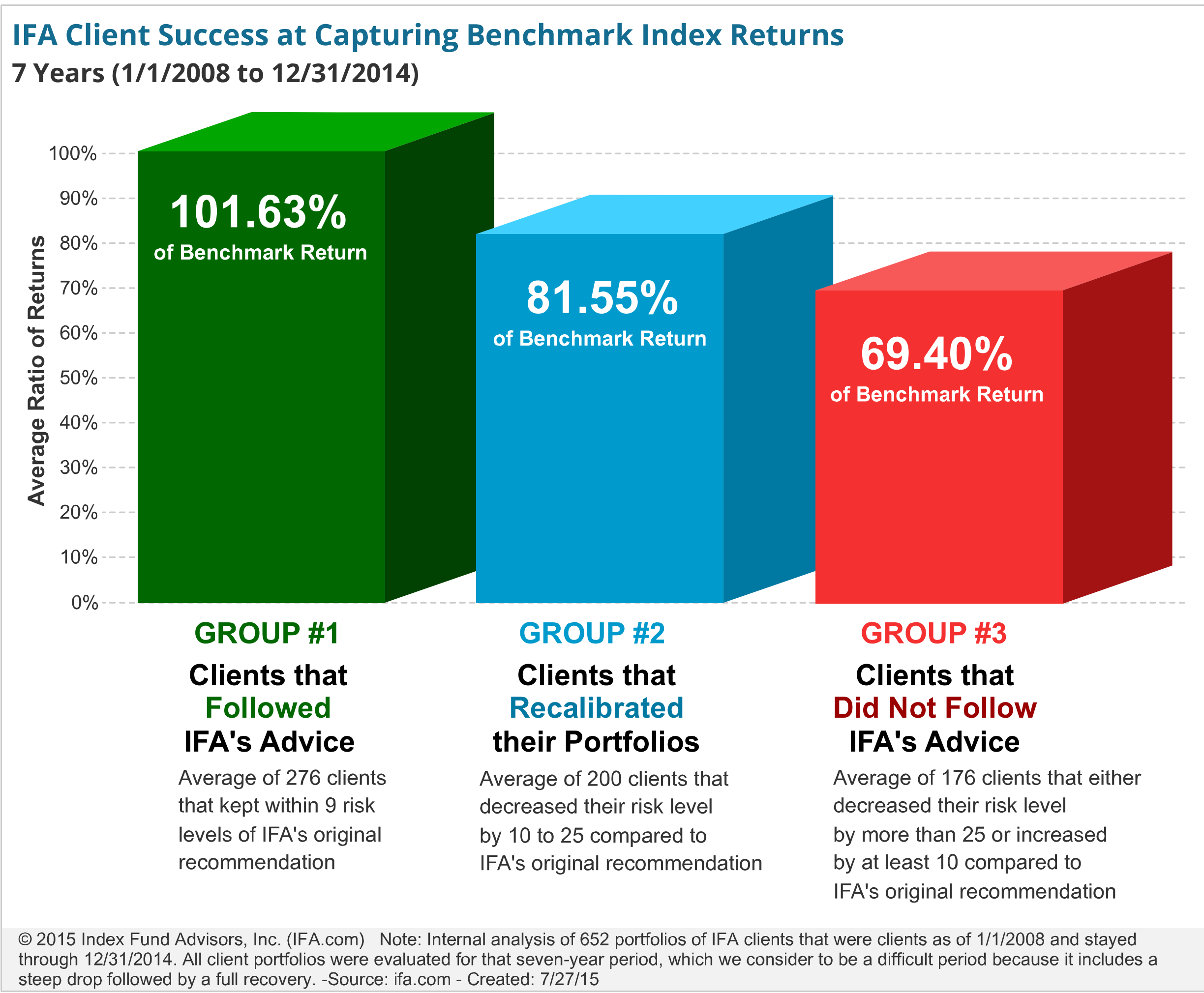
IFA analyzed the performance of 652 clients[1] who had been with IFA for at least seven years from 1/1/2008 to 12/31/2014. This period included the decline of equities during the global financial crisis of 2008 and early 2009, as well as the subsequent recovery period. For each of the 100 benchmark IFA Index Portfolios, IFA maintains monthly historical returns that can be used to benchmark our clients' time-weighted returns. For each client portfolio, we determined the annualized return of their portfolio and compared it to the annualized return of the originally recommended IFA Index Portfolio. Even though many of these clients had inception dates prior to 1/1/2008, we chose this time period so that each client would have experienced the same market conditions. The clients were divided into three groups based on how closely they followed IFA's advice:

Group #1 - This group consisted of 276 client portfolios that did not decrease their stock index allocation by more than 9% or increase it by more than 9% compared to IFA's original recommendation. We consider this group to be clients that followed IFA's advice. These clients captured 32.2% more of the available benchmark index portfolio return than clients in Group #3 who did not follow IFA's advice and substantially changed their risk level during the period.[2, 3]

Group #2 - This group consisted of 200 client portfolios that decreased their stock index allocation by 10% to 25% compared to IFA's original recommendation. We consider this group to be clients that mostly failed to rebalance their portfolios and instead elected to recalibrate, or reduce the risk level of their original portfolios in response to the global financial crisis. These clients still captured 17.1% more of the available benchmark portfolio return than clients who substantially changed their risk level in Group #3.

Group #3 – This group consisted of 176 client portfolios that either decreased their stock index allocation by more than 25% or increased it by at least 10% compared to IFA's original recommended portfolio. We consider this group to be clients that did not follow IFA's advice.[4]

The results of the study are illustrated in this chart:



There are millions of investors who did not have the benefit of IFA's advice and we would estimate that they had even lower returns than those in Group #3 of our study. Unfortunately, we have not seen any comparable studies of actual client accounts during this highly volatile time period. In addition, we are not aware of any other firm that could even do such a study because it is unlikely they would have kept accurate records of 100 benchmark index portfolios, all the clients who invested in those same portfolios, and the original recommendations for each client.

To summarize, IFA has provided a real and measurable value to our clients who followed our advice and stayed in their index portfolio that matched their risk capacity, which was initially determined with their IFA Wealth Advisor. The clients in Group #3 paid a substantial returns penalty during this period, with that group of clients giving up about 30% of the return of their original index portfolio. That can be compared to the 1.63% above the IFA benchmark Index Portfolio return by clients in Group #1 who followed IFA's advice.[5]

The results of this study are clear. If you want to capture the returns that the global stock and bond markets have to offer, stick to IFA's investment strategy that is based on over 87 years of risk and return index portfolio data (http://bit.ly/1fBqYtu), 60 years of peer-reviewed research (http://bit.ly/1VJYaAf) and 30 years of refined passive trading techniques (http://bit.ly/1h0TDcv).

Footnotes:

1. The 652 client portfolios consisted of those that were active for the entire period from 1/1/2008 to 12/31/2014, were not custom portfolios or special allocations such as sustainable or socially responsible, and had at least $100,000 by the end of the period. Portfolios using tax-managed funds were included.

2. Updated methodology from the previous client study ending in 2013 (https://www.ifa.com/articles/quantifying_value_portfolio_advice/): Reclassified 54 Clients from "Followed IFA's Advice" to "Did Not Follow IFA's Advice." Although these clients' starting and ending portfolios displayed the same characteristics as portfolios that followed IFA's advice, they did not follow IFA's advice because they changed portfolios (plus/minus 10 portfolios) within the time range of the study, adjusting risk down and up and vice versa. Thus reclassifying these portfolios provided a more accurate representation of which clients actually followed IFA's advice throughout the entire time period of the study and which clients did not follow IFA's advice.

3. Group #1 and Group #2 would still include exceptions to following IFA's advice such as failing to invest cash when available, transferring in non-IFA-advised securities and not immediately selling them, or not agreeing to rebalance when IFA recommended it. The impact of these deviations varied over time and clients.

4. Group #3 would still include clients that may have had legitimate reasons to drastically change their risk and thus actually were following IFA's advice.

5. It is important to understand that there are many reasons why a client's time-weighted return may be different than the return shown for the corresponding IFA Index Portfolio.
   - The Benchmark IFA Index Portfolio returns are calculated on a monthly basis and interpolated for mid-month returns, so a portfolio that starts in the middle of the month usually has a different return for that month.
   - The funds used to implement client portfolios vary with client situations and may be different than the funds included at the end of the time-series construction for the IFA Index Portfolios (https://www.ifa.com/disclosures/index-data/). For example, taxable accounts would have tax-managed funds, which may have different returns than the non-tax-managed funds used in the IFA Index Portfolios.
   - Actual client rebalancing will differ from the January 1st assumption incorporated into the IFA Index Portfolios. This could have made an especially large difference for portfolios that were not rebalanced near 1/1/2009.
   - Client returns are net of transaction costs while the IFA Index Portfolios do not include them.
   - Client returns are affected by allocations to cash for fees and withdrawals and client behaviors such as not authorizing the investment of cash immediately when it is deposited or asking IFA to raise cash and then not removing it from the account. They can also be affected by client preferences such as not reinvesting dividends.
   - The IFA Index Portfolio returns are based on a 0.9% advisory fee, and with a tiered fee schedule, clients with larger accounts have lower fees. The benchmark IFA Index Portfolio returns assume that the fee is taken on a monthly basis, but for clients, fees are paid on a quarterly basis. The returns shown throughout the IFA website and the benchmark portfolio returns shown on client performance reports (https://www.ifa.com/pdfs/joe_sample_ifa_sample_client_report.pdf) are net of a 0.9% advisory fee, which is the highest fee paid by any IFA client. The IFA fee schedule includes a declining percentage fee for larger assets under management, so those clients with larger assets benefited even more relative to the IFA benchmarks.
   - Other factors that may have affected clients' returns for portfolios that include taxable accounts are the use of asset location, tax-loss harvesting, and the use of tax-managed funds.