

*Dean Witter Senior Consultants Program  
The Aresty Institute of Executive Education  
The Wharton School - University of Pennsylvania*

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# **Investment Planning & Policy Development**

presented by:

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Paragon Resources

# Introduction

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- Most important phase of the consulting process
- Often overlooked by investors and consultants
- Can be a significant advantage
  - ✓ increases the probability of investment success
  - ✓ provides an opportunity to add significant value to client relationships
- Other phases of the consulting process are becoming “commodities”

# Presentation Objectives

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- To provide a better understanding of the importance of investment planning & policy development
- To review the essential elements of an investment policy
- To provide some actionable ideas and practical information

# Agenda

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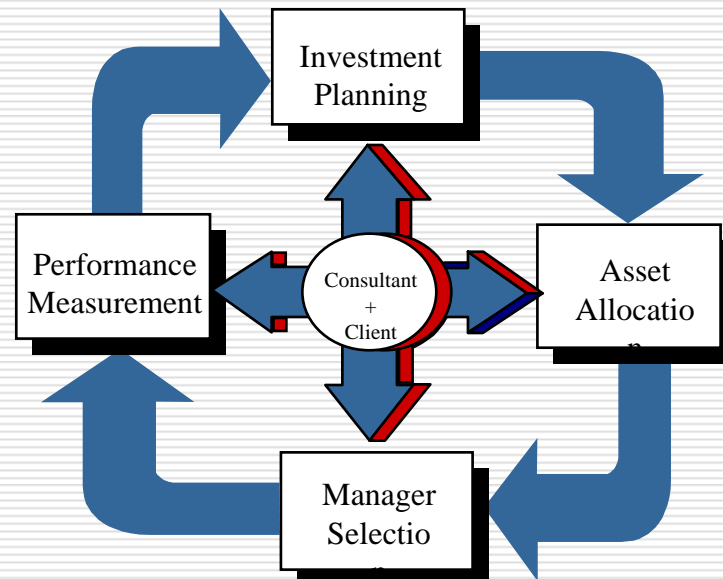
- Investment Planning and the Consulting Process
- Investment Planning: Critical Objectives
- Client Education
- Goals and Objectives
- Asset Allocation
- The Investment Policy Statement
- Practical Applications

# Investment Planning and The Consulting Process

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- ✓ First and most important phase
- ✓ Keystone for the entire process
- ✓ Least "sexy"
- ✓ Least emphasized
- ✓ Adds greatest value for client and consultant

## *The Consulting Process*



# Investment Planning: Critical Objectives

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- Educate the client
- Identify client's goals and objectives
- Determine strategic asset allocation
- Codify into a written investment policy






# Educating The Client




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- Key to earning and maintaining trust
- Best opportunity to add value to client relationships
- Establishes rational expectations up front
- Keeps consultant and client out of "trouble"

# Educating The Client: Suggested Topics

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-  Principles of financial planning
-  Power of compound interest
-  Asset classes
-  History of the capital markets
-  Risk/return trade-off

-  Asset allocation
-  Diversification (effect on risk)
-  Time horizon (effect on risk)
-  Manager styles
-  Economic cycles

# Identifying Goals and Objectives

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- Issues to consider
  - ✓ Investor type and characteristics
  - ✓ Required (target) rate of return
  - ✓ Risk tolerance
  - ✓ Liquidity requirements
  - ✓ Time horizon
  - ✓ Tax situation
  - ✓ Regulatory considerations

# Identifying Goals and Objectives

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## *Investor Types and Characteristics*

### **Institutional investors**

- ✓ Corporate
- ✓ Public
- ✓ Unions (Taft-Hartley)
- ✓ Endowments
- ✓ Foundations

### **Individual investors**

- ✓ Taxable
- ✓ Tax-deferred [IRA, 401(k)]
- ✓ Trusts

# Quantifying Goals and Objectives

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- Investment Goals
  - ✓ To achieve a specific target rate of return
  - ✓ To meet or exceed the actuarial rate of return
  - ✓ To meet or exceed a particular index
  - ✓ To rank in the upper half of similar funds
  - ✓ To achieve a specific real return (above inflation)
  - ✓ To exceed some measure of a risk-adjusted rate of return

# Quantifying Goals and Objectives

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- Investment Objectives
  - ✓ To minimize the risk of sharp declines in portfolio values
  - ✓ To maximize returns through capital appreciation
  - ✓ To generate a certain level of current income
  - ✓ To achieve full funding (assets > liabilities)
  - ✓ To acquire sufficient assets for a specific need (education, retirement)

# Determining Strategic Asset Allocation

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- Issues to consider (investor-related)
  - ✓ Acceptable asset classes
  - ✓ Weighting constraints
  - ✓ Investment horizon
  - ✓ Investment goals (target return)

# Determining Strategic Asset Allocation

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- Issue to consider (market-related)
  - ✓ Expected rates of return of acceptable asset classes
  - ✓ Risk (standard deviation) of asset classes
  - ✓ Correlation of asset classes

**PORTFOLIO  
OPTIMIZATION**

# The Investment Policy Statement

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- Definition

- ✓ Formal, written document that outlines the investment goals, objectives and guidelines of the investor

- Responsibilities

- ✓ Consultant assists by providing investor with necessary information
- ✓ Investor is ultimately responsible for drafting the investment policy
- ✓ Consultant reviews annually with investor

# The Investment Policy Statement

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## ■ Purpose

- ✓ Codify the information gathered during investment planning phase
- ✓ Establish a clear line of communication between the investor, consultant and manager(s)
- ✓ Define the role and responsibilities of the investment manager
- ✓ Establish asset allocation policy
- ✓ Establish investment guidelines
- ✓ Establish a basis for evaluating investment results

# The Investment Policy Statement

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- Importance
  - ✓ Regulatory requirements (e.g., ERISA)
  - ✓ Fiduciary responsibility
  
- Practical benefits
  - ✓ Logical and systematic approach
  - ✓ Incorporates key principles of investments
  - ✓ Promotes investment success
  - ✓ Keeps investor “on track”

# The Investment Policy Statement

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- Key elements
  - ✓ Statement of Purpose
  - ✓ Background
  - ✓ Statement of Responsibilities
  - ✓ Investment Goals and Objectives
  - ✓ Asset Allocation Policy
  - ✓ Investment Guidelines
  - ✓ Selection of Money Managers
  - ✓ Investment Performance Evaluation
  - ✓ Communication

# Practical Applications

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- Implementing the investment policy
  - ✓ Review with client
  - ✓ Obtain written approval from client
  - ✓ Review with investment manager(s)
  - ✓ Obtain written approval from manager(s)
  - ✓ Restructure portfolio(s) accordingly
  - ✓ Transfer funds to appropriate manager(s)

# Practical Applications

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- Existing situations
  - ✓ Reviewing existing investment policies
  - ✓ Restructuring existing portfolios
  - ✓ Replacing existing managers

# Practical Applications

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- Performance measurement and the investment policy
- Dealing with portfolio under-performance
- Using the investment policy to “stay on track”
- Asset allocation adjustments
- Replacing managers

# Summary

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- Most important phase of the consulting process
- Greatest opportunity to add value
- Critical objectives of investment planning
  - ✓ Educate the client
  - ✓ Identify investment goals and objectives
  - ✓ Determine strategic asset allocation
  - ✓ Codify into written investment policy
- The investment policy statement
- Practical applications

# Suggested Readings

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- Burroughs, Eugene B., Investment Success for Employee Benefit Plans, International Foundation of Employee Benefit Plans, 1988
- Ellis, Charles D., Investment Policy- How To Win The Loser's Game, Dow Jones Irwin, 1985
- Maginn, John L.; Tuttle, Donald L., Managing Investment Portfolios- A Dynamic Process, Warren, Gorham & Lambert, 1990
- Owen, James P., The Prudent Investor, Probus Publishing Co., 1990
- Lohr, John R., Using ERISA To Develop New Business, Isle Press, 1987
- Trone, Donald B.; Allbright, William R., Procedural Prudence, Veale & Associates, Inc., 1991
- Legal Corner Compendium - June 1992 - April 1994 Edition, Investment Management Consultants' Association, 1994

# Concept Checks

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- Briefly discuss why investment planning/policy development is the most important phase of the consulting process?
- What are the four critical objectives of the investment planning/policy development phase of the consulting process?
- List five “educational” topics a consultant should cover with a client?
- List three issues which must be considered in developing an investment policy? Briefly discuss why these issues are important?
- List three possible ways a client’s investment goal could be expressed in an investment policy?
- List three objectives an investment policy should accomplish (i.e., purpose)?
- Why is it important to have a written investment policy?
- List five key elements of a well-written investment policy?
- Briefly describe the steps involved in implementing an investment policy?
- Briefly describe how an investment policy should be used in dealing with a case of “under-performance?”

# About Your Instructor

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*Stephen A. Saenz* is the president of Paragon Resources, a training and consulting firm based in Atlanta. Paragon Resources specializes in helping investment professionals increase their fee-based consulting business. Prior to forming Paragon, Steve was a managing director for Harris Bretall Sullivan & Smith. During his 2 1/2 year tenure with Harris Bretall, he established himself as one of the industry's leading marketers of fee-based investment consulting services, raising over \$300 million in new assets. Before joining Harris Bretall, Steve was a regional manager for Merrill Lynch. There, he was responsible for training and marketing in the areas of investment consulting services and corporate retirement plans. He began his career in the investment industry as a financial consultant with Merrill Lynch, where he achieved President's Club status.

Steve graduated from Florida State University (yes, national champs) with a BS in Finance. He is a Certified Investment Management Analyst and has successfully completed Level I of the AIMR Certified Financial Analyst program. He is the Vice-President of the St. Regis Association and a member of the Investment Management Consultants' Association and The Atlanta Society of Financial Analysts.