

There **IS** Such A Thing As A FREE LUNCH!

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“One of the central findings of Modern Portfolio Theory [is] that huge and essentially costless gains [can be obtained from] diversifying [a] portfolio thoroughly [by minimizing Uncompensated Risk].”

- John H. Langbein, Reporter for the Uniform Prudent Investor Act-Sterling Professor of Law and Legal History at Yale Law School

“Markowitz’s Notion of Diversification is the Only Known “Free Lunch” in All of Investing”

- W. Scott Simon, J.D., CFP®, AIFA®

“Un-Measured is Un-Managed” Peter Drucker

Evidence of ‘*there is such a thing*’ is outlined in the following real-life example. It involves a RIA with a practice of approximately ½ Billion AUM. One of their client’s asset allocation was analyzed in the AICPA sponsored webinar: [The Dangers of Ignoring a Portfolio’s Uncompensated Risk](#) see page 47.**** This was for the year ending September 30, 2018. For the ASFG presentation we updated this case for the year ending July 11, 2019. Since 90% of Uncompensated Risk comes from risk investments (e.g. equities, REITs, MLP, ETFs, Mutual Funds, etc.) and 10% from fixed income instruments we analyzed and optimized only the risk assets.

We performed our analysis on our *Institute’s Diversification Optimizer* with the following queries:

- 1) We compared the original portfolio with the FTSE benchmark on the attached Risk/Reward Scatter Chart & Statistical Table and 82% of Uncompensated Risk still existed (79% in the 2018 study). This is not a prudent or reasonable level for any size portfolio let alone a \$5 million portfolio. **** see page 53-72 of the webcast for an explanation on how this is calculated.
- 2) Using the Optimizer, we created an unconstrained maximum reduction Uncompensated Risk Portfolio from a universe of sectors and subsectors. *
- 3) We posed the question to the algorithm: *proportionally reduce the actual portfolio by 10%, let the program optimize the 10% cash and place it in sectors that reduce Uncompensated Risk.* *
- 4) Same as (3) but increase cash to optimize to 20%. * **
- 5) The 20% choice might be unacceptable to an adviser as it did allocate very high amounts to several new sectors. The adviser can add constraints, toggle in the dashboard to only accept a 6.5% ROR etc. In this case it produced a 9.1% semi-deviation. *** Mark it on the Chart!

*The algorithm makes optimizing decisions only from data at the beginning of the period studied and with no knowledge of what happened after that. **There are numerous other queries that can be tested e.g. For each asset one can constrain on both sides of the actual per cent allocation and let the computer optimize those constraints while also considering proportional allocations of cash!
*** An example of adviser-driven trial & error using the Institute’s optimizer to satisfy, for instance, IPS constraints or maybe *gut feelings*.

CONCLUSION: Adding uncorrelated sectors with high Sharpe Ratio momentums significantly improve returns and reduce volatility. Potential increased return with lower risk is significant to any owner or beneficiary and, for any size portfolio. “There is such a thing as A FREE LUNCH!”

P.S. Advisers can choose securities within sectors to produce additional Alpha (ask Institute’s platform: *enter all symbols in sector and optimize within the sector*). Furthermore, advisers can add more value and lower volatility when creating various equity/fixed income ratio portfolios (e.g.70/30, 60/40 etc.).

****Webcast PDF Slides & Comments: <https://precisionfiduciary.com/AICPA2019Webcast/>

Prudent Management of Investment Risk precisionfiduciary.com/PrudentRisk/

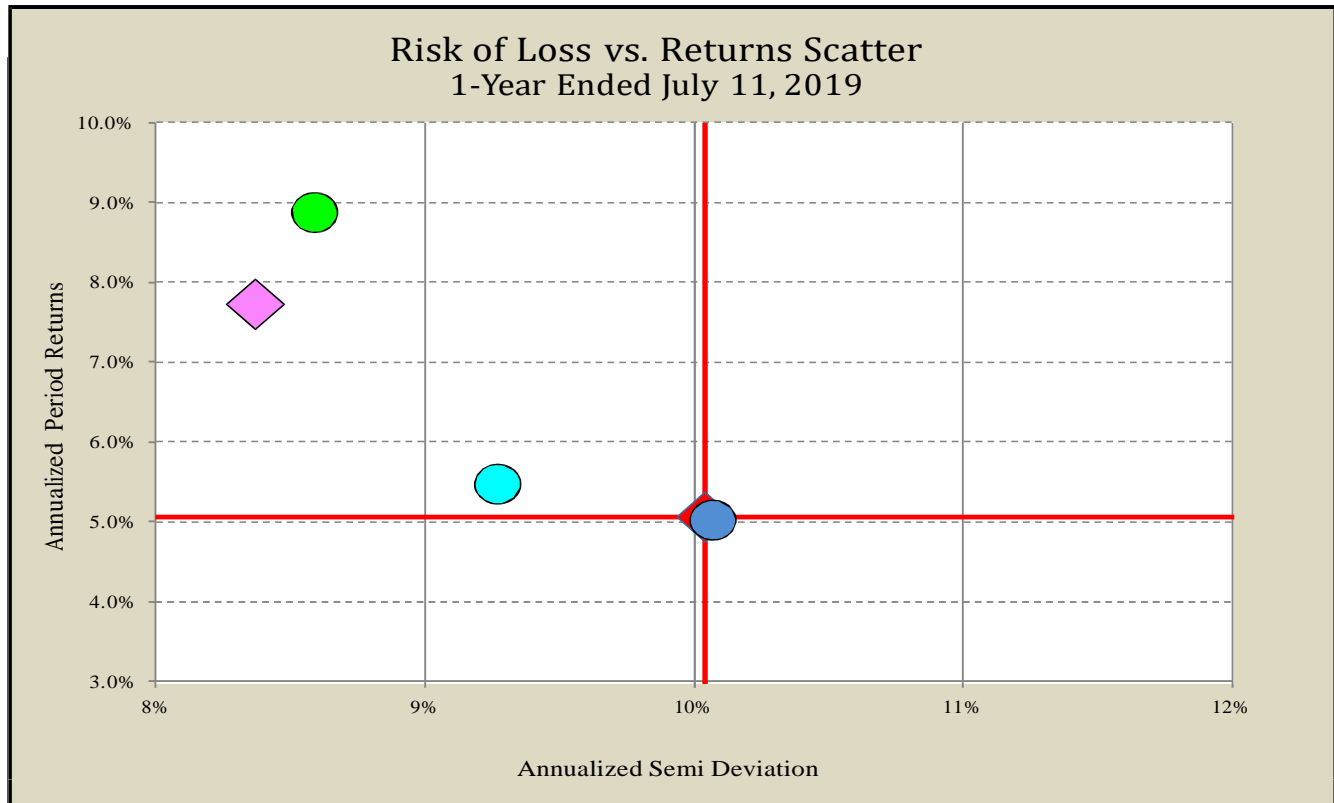
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ASFG 2019 Summer Conference

Comparative Risk / Return Analysis

For the Trailing 1-Year Period Ended on July 11, 2019



| Indices & Portfolios: | FTSE ALL Cap Global Index | Original Portfolio 100%/0% | MAX -UCR Portfolio | 90%/10% Portfolio | 80%/20% Portfolio |
|--|------------------------------|----------------------------------|-----------------------|----------------------|----------------------|
| Risk/Return Data | | | | | |
| ROR | 5.05% | 5.02% | 7.72% | 5.47% | 8.87% |
| Standard Deviation | 14.10% | 14.07% | 11.85% | 12.96% | 12.12% |
| Semi-Deviation | 10.04% | 10.07% | 8.37% | 9.27% | 8.59% |
| Sharpe Ratio | 0.3582 | 0.3567 | 0.6514 | 0.4217 | 0.7315 |
| Maximum Drawdown | 17.8% | 19.1% | 15.9% | 16.7% | 14.24% |
| Uncompensated Risk Measurements | | | | | |
| Quantity Factors | | | | | |
| Total Number of Risk Holdings | 1 | 21 | 50 | 30 | 31 |
| Concentrated Coefficient of Risk Holdings | 1 | 12 | 50 | 14 | 17 |
| No. of Asymmetrical Equally Weighted Risk Holdings | 1 | 8 | 31 | 11 | 13 |
| Quality Factors | | | | | |
| Sum of Weighted Variances | 1.99% | 2.71% | 4.28% | 3.03% | 3.07% |
| Portfolio Variance | 1.99% | 1.99% | 1.40% | 1.93% | 1.47% |
| Variance Gap Percent | 0.00% | 0.72% | 2.87% | 1.10% | 1.60% |
| Diversification Ratio | 0% | 36% | 205% | 57% | 109% |
| Diversification Scorecard | | | | | |
| Uncompensated Risk Remaining in Portfolio | N/A | 82% | 0% | 72% | 47% |