THE EVOLUTION OF PORTFOLIO MANAGEMENT

Modern Portfolio Theory produced the 60/40 portfolio

An investment framework that can be used to create the best risk-adjusted returns for investors has long been the pursuit of portfolio managers.

Portfolio managers and academics have worked over the years to build an investment framework that can be used to create the best risk-adjusted portfolio for investors. The starting point for this approach has long been *Modern Portfolio Theory,* which was established in 1952 by Nobel Laureate Harry Markowitz. Modern Portfolio Theory (MPT) assumes that investors are risk averse – meaning they do not want to take risk without being compensated – and, as a result, the best possible portfolio is one that achieves the required amount of return while taking the least amount of risk: the optimal portfolio.

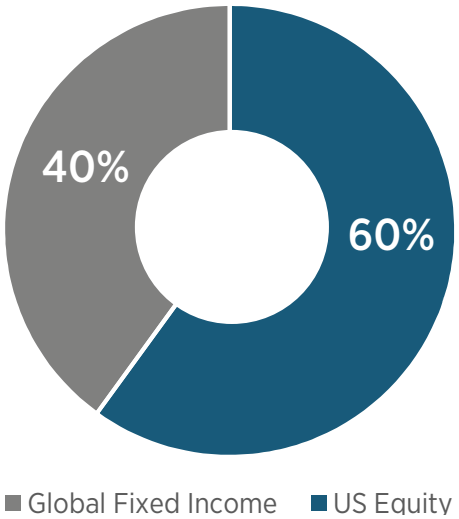
One of the great outputs of MPT was the 60/40 portfolio which, composed of 60% equities and 40% fixed income, has long helped investors achieve these goals. The 60/40 portfolio was intended to give investors a balanced mix of assets that are relatively uncorrelated and can be assembled with relative ease. This approach brought about the significant rise of balanced mutual funds and ETFs focusing on broad market indices.

	Modern Portfolio Theory *Est. 1952 – Adopted in 70's*	**Portfolio Factoring** *Est. 1960 – Adopted in 80's*	**Endowment Model** *Today*
Investment Thesis	Risk-averse investors can construct portfolios to optimize returns based on a given level of market risk ie. 60/40	Differentiating assets within broad classes (see next page for examples), based on their characteristics, can highlight opportunities to increase risk-adjusted return	Allocating to Alternative Assets can increase portfolio efficiency because of their unique risk-return profiles
Current Investor Base	Retirement Savings	Mass Affluent High Net Worth	Ultra-High Net Worth Family Office Institutional Investors
Current Providers	MFDA Low cost ETF Managers Robo-Advisors	Traditional Asset Managers Banks	Sophisticated Alternative Asset Managers

Traditional Allocation: 60% Equity and 40% Fixed Income

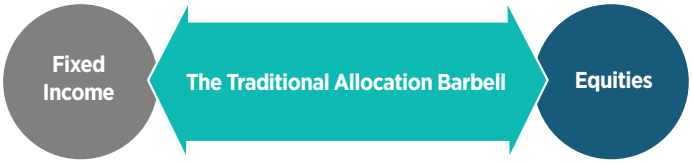
Modern Portfolio Theory states that a risk-averse investor can construct portfolios to optimize expected return, given a level of market risk.

- The 60-40 Portfolio was designed to be a balance of capital growth and income for the average investor.
- Modern Portfolio Theory developed a series of optimized portfolios given a universe of assets.
- The 60-40 Portfolio, is a simplified approximation of a balanced efficient portfolio.



The Traditional Allocation Barbell

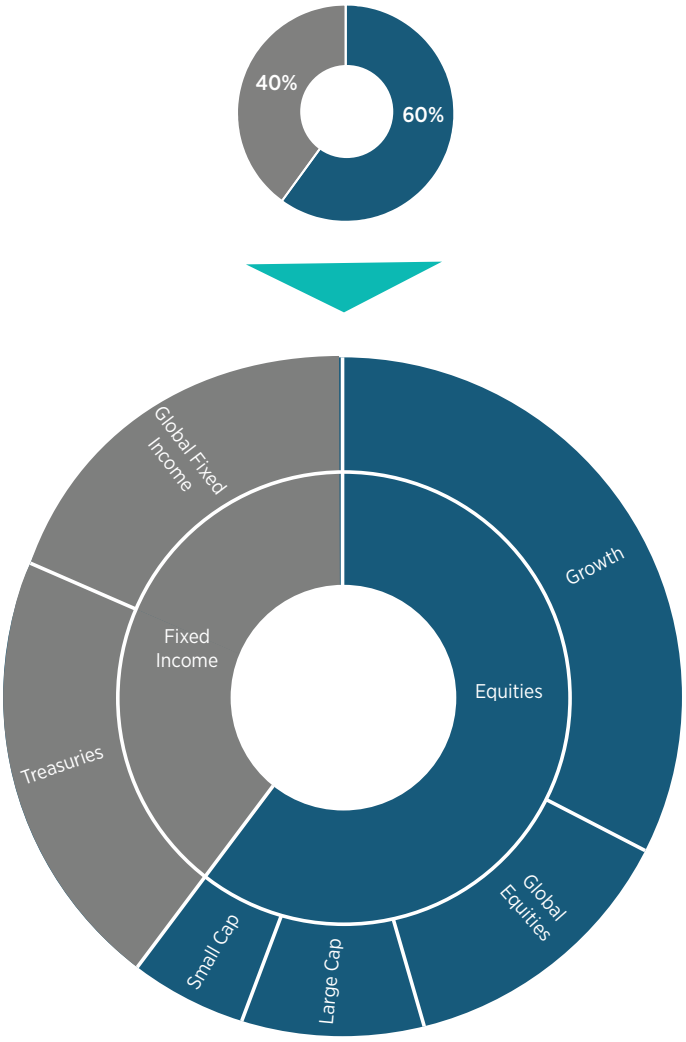
Investors must balance passive income versus capital growth from publicly traded assets:



Portfolio Factoring: Fama-French Model Investing

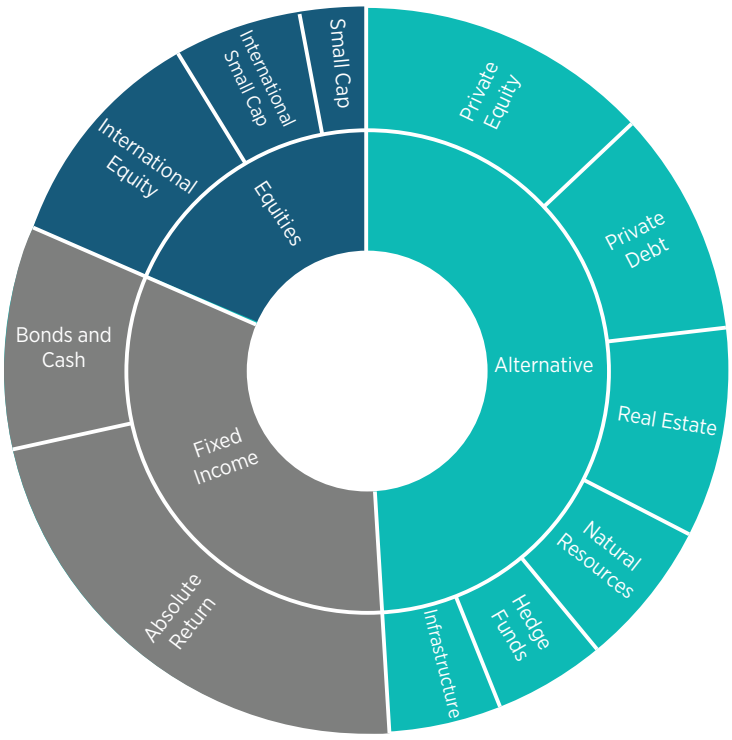
This investment framework introduces the idea of factoring the allocation beyond the 60-40 split in order to optimize the investor's return, based on the level of risk they are comfortable with.

Portfolio factoring is intended to enhance diversification, generate above-market returns, and manage risk. While portfolio diversification was the goal of traditional portfolio allocation, the gains of diversification are lost if the selected securities move in lockstep with the broader market. Portfolio Factoring can offset potential risks by targeting broad, persistent, and long recognized drivers of returns that provide less correlation between asset classes.



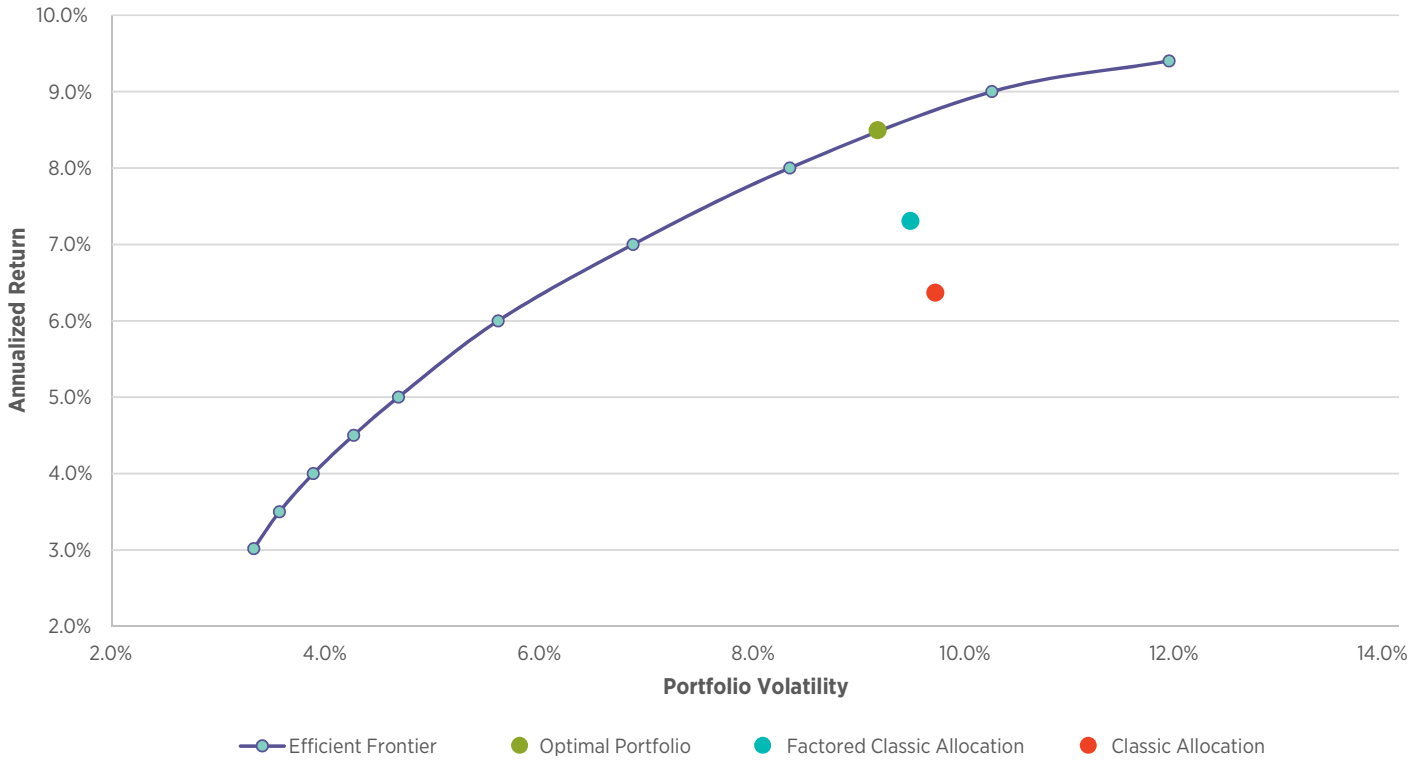
Alternative Market Opportunities: Endowment Model

Institutional investors use Alternative Asset allocations to enhance yield and diversify their portfolios.



Private Market Opportunities within the Endowment Model

Alternative Assets provide vehicles for exposure to private markets where active management thrives.



Source: Thomson Reuters; theoretical 60/40 portfolio based on portfolios of index returns from 2013–2018.

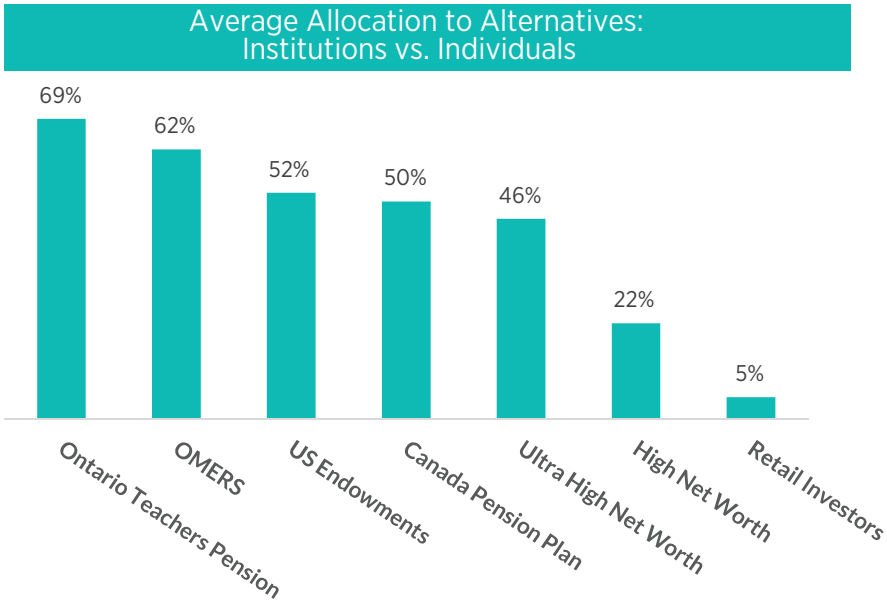
Alternative Asset Allocations for Individuals

Institutional investors have been quick to adopt alternative asset investments, while retail investors have lagged.

Alternatives operate under different market conditions:

- Managers less constrained
- Less efficient markets
- Low correlation to public markets

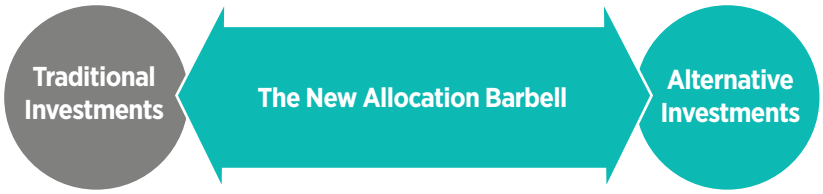
Most individual investors have not taken advantage of the full investment universe to optimize their portfolios.



Source: Blackstone, Global Pension Study 2018, Willis Towers Watson, OTTP, CPP, OMERS

The New Investor Barbell

Balancing liquidity from public markets with private investments that generate additional yield and diversification:



Alternative Investments	Private Investments	Mutual Funds	Exchange Traded
Real Estate	• Direct Investment • Private REITs	• REIT Funds • Real Estate Sector Funds	• Public REITs • Closed-End Funds
Infrastructure	• Direct Investment • Direct Investment Funds	• Infrastructure Sector Funds	• Infrastructure ETFs • Closed-End Funds
Commodities	• CTAs • Managed Futures • Direct Investment Funds	• Resource-Focused Sector Funds • Precious Metals Funds	• Resource ETFs • Precious Metals ETFs
Private Debt	• Direct Investment • Private Debt Funds	• N/A	• BDCs
Private Equity	• Direct Investment • Private Equity Funds	• N/A	• Listed Holding Companies
Marketable Securities	• Traditional Hedge Fund Strategies	• Liquid Alt Funds	• Hedge Fund Indexed ETFs • Closed-End Funds

Retail Access to Alternative Investments

As Institutional allocations to Alternative Investments have grown, retail Investment Managers have taken note.

Today there are several ways for a retail investor to access Alternative strategies and asset classes, many which feature liquidity more suitable to the retail environment.