February 2015

Steadyhand

Steadyhand vs. ETFs

Comparing the Investor Experience

Steadyhand and exchange-traded funds (ETFs) have a lot in common – they're low cost, simple and transparent. Where they differ is what type of investor fits their model. In this paper, we compare the experience of an ETF investor to that of a Steadyhand client.

Table of Contents

02 Introduction & Takeaways
03 The Investors
04 Comparing the Investor Experience
09 Appendix

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Steadyhand Investment Funds is an independent no-load mutual fund company that offers a straightforward lineup of low-fee funds directly to investors. The firm has an experienced management team and clear investment philosophy rooted in the belief that concentrated, non-benchmark oriented portfolios are the key to index-beating returns. Steadyhand's only business is managing money for individual investors and offering practical advice on building and monitoring portfolios.

Introduction & Takeaways

This paper is a comparison between an ETF investor (exchange-traded funds) and a Steadyhand client. We've written it for a number of reasons.

First of all, ETFs have received a lot of interest and for good reason. In an industry characterized by complexity, high costs and disappointing returns, they're a refreshing alternative. ETFs offer simplicity, low fees and market-like returns. And while some ETFs follow trendy, flavour of the month strategies, these investment vehicles are here to stay.

Second, there are a growing number of investors who are frustrated with the returns and business practices of the traditional wealth management providers. Increasingly they're saying, *"I've had enough. I'm just going to buy ETFs."* For many of these disgruntled investors, we think Steadyhand is a better fit.

Third, there are many prospective ETF investors who don't know what's involved in indexing and what the trade-offs are.

And finally, ETF investors have a lot in common with our clients. They're cost conscious, want to keep things simple, appreciate transparency and want to get off of the industry's gravy train. And most importantly, they want to generate better returns in the future.

Key Takeaways

When making a decision on which investment approach is best suited for you, it's important to consider the strengths and weaknesses of both strategies. When you're done reading this report, we hope you'll come away with the following:

Simplicity: Using either ETFs or Steadyhand strategies are simple and easy to execute.

Building a Plan: Deciding on how to invest your hard earned money is the most important thing any investor does. Steadyhand investors get some help to both build a plan and stay on track.

Costs: Costs are the only predictable part of an investment and should be paid particular attention to. Both ETF and Steadyhand investors experience low costs, but ETFS are cheaper. An ETF portfolio held in a discount brokerage account is the lowest cost approach.

Support: Being a long-term investor is challenging. It requires a plan, cost effective execution, diligent monitoring, and plenty of patience and discipline. Buying ETFS is truly a do-it-yourself approach. Steadyhand investors can be as DIY as they want to be, but can also lean on the expertise and resources at the company when they need them (Steadyhand investors don't pay any additional fees for this service).

Transparency: Both ETFS and Steadyhand are more transparent than other options, but Steadyhand investors have more information about their overall portfolio at their disposal.

Performance: ETFS track their indices and so investors will always underperform their benchmarks after paying fees. Steadyhand funds are built using our *undexing* approach. We believe this will help investors beat the market over the long term.

Tax Efficiency: ETFS are likely to be more efficient than Steadyhand funds, although the Steadyhand funds are also designed to be tax efficient.

The Investors

To help with the ETF/Steadyhand comparison, we're going to follow two investors, Jake and Julie. While they have different approaches to investing, they're otherwise very similar:

- They both invested $250,000 on Dec. 31, 2007, in three accounts — two registered and one taxable.
- They're interested in investing, but not passionate about it. Neither has the time to make it a hobby or leisure pursuit.
- Both have thought out their strategy and are being guided by a Strategic Asset Mix (SAM), which is an investor's long-term mix of stocks, bonds, cash and other investments that will provide them with the best opportunity to achieve their objectives.
- Jake and Julie both feel strongly about keeping their costs down.

Jake is an ETF investor. He:

- Deals with a discount broker to take full advantage of ETFs' low costs.
- Has a balanced portfolio comprised of three ETFs.
- Is seeking returns that are in line with the market indices.

Julie is a Steadyhand client. She:

- Deals directly with Steadyhand — no middleman involved.
- Has a balanced portfolio comprised of four Steadyhand funds (the hypothetical Steadyhand Balanced Income Portfolio).
- Is seeking returns in excess of the market indices and is hoping to experience a smoother ride along the way.

STRATEGIC ASSET MIX	% of Total
Cash and cash equivalents	0%
Bonds	50%
Canadian Equities	30%
Foreign Equities	20%
	100%

Jake's Initial Investment	Market Value	% of Total
iShares DEX Universe Bond Fund (XBB)	$125,000	50%
iShares S&P/TSX Capped Composite Index Fund (XIC)	$75,000	30%
iShares MSCI World Index Fund (XWD)	$50,000	20%
	$250,000	100%

Julie's Initial Investment	Market Value	% of Total
Income Fund	$165,000	66%
Equity Fund	$35,000	14%
Global Equity Fund	$32,500	13%
Small-Cap Equity Fund	$17,500	7%
	$250,000	100

Comparing the Investor Experience

Knowledge, Interest, Time, and Temperament

When deciding how to invest, Jake and Julie asked themselves four important questions:

- How *knowledgeable* am I?
- How *interested* am I in investing?
- How much *time* can I devote to managing my portfolio?
- How does my *emotional makeup* fit with being an investor?

The ETF route requires a little more knowledge and interest. Jake needs the confidence to fly on his own. He may lean on a friend or family member for some advice, or use information that's available online, but at the end of the day, he's on his own. Julie, on the other hand, has the Steadyhand team interested in how she is doing, and importantly, invested alongside her. Neither the ETF nor the Steadyhand approach requires much time.

Whether Jake and Julie have the right temperament to be successful investors is a tough question. Are they able to keep focusing ahead (i.e. long term), no matter what's happening at the time? Will they always be cognizant of price when they're considering investments (valuation driven)? Are they comfortable going ahead, behind or against the pack? And will they be able to buy when things look gloomy and sell when all is going well?

It helps that both of them have a plan in place (including a SAM). It also helps that they're keeping it simple. In Julie's case, she'll have support available if she needs it. As the name implies, Steadyhand was created to help clients deal with the tough stuff, particularly at market extremes.

Cost

The ETF and Steadyhand portfolios are both low cost, although Jake has an advantage over Julie in this regard.

The Management Expense Ratios (MER) of the funds account for a majority of the cost. Jake will incur some additional brokerage charges, but they should be modest given the size of his portfolio ($250,000+). There will be trading commissions on contributions, withdrawals and rebalancing transactions, but he's unlikely to be charged any administrative or account fees.

For Julie, the only cost is the 'One Simple Fee' on the Steadyhand funds. There are no transaction or account fees. Because of the size of her portfolio, she is paying a lower fee than the published MERs. For assets above $100,000, the fee is reduced by 20% (30% above $250,000 and 40% above $500,000), which means the fee per dollar of assets declines as her portfolio grows. In addition, her fees are reduced a further 7% because she has been a client for 5 years (they will be reduced by 14% after 10 years).

If Jake and Julie were investing the $250,000 today, their annual fees would be as follows:

Jake's Cost of Investing	Fee (%)	($)
iShares DEX Universe Bond Fund	0.33%	$413
iShares S&P/TSX Capped Composite Index Fund	0.05%	$38
iShares MSCI World Index Fund	0.46%	$230
Blended MER	0.27%	$681
Trading commissions Admin charges Tracking error	0.15%	$375
	0.42%	$1,056

Julie's Cost of Investing*	Fee (%)	($)
Steadyhand Income Fund	0.85%	$1,402
Steadyhand Equity Fund	1.16%	$406
Steadyhand Global Fund	1.46%	$475
Steadyhand Small-Cap Equity Fund	1.46%	$256
Blended MER	1.02%	$2,539

*After fee rebates based on account size and tenure, assuming portfolio value of $250,000.

Transactions

One of the features of an ETF is that it trades throughout the day (intra-day) on the stock exchange. If Jake wants to fine tune his purchases, he can buy or sell during the day without waiting for the market to close. This flexibility comes with trade-offs, the main one being that Jake has to be a knowledgeable trader. He needs to make sure he's buying his ETFs at, or close to, their Net Asset Value (NAV). Generally, this isn't difficult for large, established ETFs, but to avoid getting bad fills on his trades, there is some learning required.

Mutual funds are priced once a day at the closing prices. Any orders placed prior to the market closing (4:00 p.m. EST or 1:00 P.M. PST) are executed that day at Net Asset Value (to four decimal points).

Advice

Jake and Julie have taken care of two key elements necessary to be successful investors, namely security selection and cost control, but there is more to do. They need to determine a long-term asset mix, rebalance their portfolio from time to time, defer taxes where possible and eventually generate income in an effective way. They also need to be diligent about monitoring how they're doing and make sure their SAM is still appropriate.

Jake is doing it on his own with a discount broker, so he's responsible for covering off these requirements. As noted above, he may lean on someone for informal advice, or follow a few commentators, bloggers or money managers who provide guidance on these topics. He may also get help from the tools or educational material on his dealer's website.

Note: We recognize that there are many types of ETF investors, including ones that use a full-service advisor. We've chosen Jake's approach because it takes full advantage of the low cost, which is the benefit most often cited when ETFs are recommended. Also, the potential ETF investors that we see are usually doing it to get away from the advisor channel.

Julie is also responsible for determining her SAM and managing her portfolio, but she relies on the Steadyhand team for their expertise. She's gotten to know Chris Stephenson, Lori Norman, Sher Gray and Scott Ronalds, who do most of client servicing, and knows she can reach them instantly by phoning 1.888.888.3147. If she has an enquiry, wants to make a contribution, or just needs to make an adjustment, she'll get a live person right away and only be on the phone a few minutes.

It's worth noting that Steadyhand's advice always gravitates around Julie's long-term strategy. Most of the time, the team will encourage her to stick to her SAM, although there will be points in the market cycle when extremes in valuation and/or investor sentiment (mood) will lead them to suggest some adjustments.

Investment Returns

Jake's ETF portfolio is designed to replicate indices that represent certain markets. It will do that faithfully, although final returns will be slightly lower than the indices due to fees, account costs and from time to time, tracking error (the gap between the ETF and actual index returns).

The Steadyhand portfolio is attempting to do better than the market by using an investment approach called 'undexing', which means holding undervalued securities with little regard for the market indices, while keeping fees and portfolio turnover to a minimum. At Steadyhand, everything has been done to eliminate, or at least minimize, the impediments that prevent funds from beating the indices, specifically frequent trading, index-like strategies and high fees.

Jake and Julie have been investing since the end of 2007, so the return comparisons on the following page extend out seven years (all performance figures are after fees).[1]

	Annual Returns as of Dec. 31, 2014 (%)						
	2008	2009	2010	2011	2012	2013	2014
Jake	-12.9	14.8	9.7	1.4	6.5	9.3	11.2
Julie	-15.1	20.4	10.2	4.7	10.3	12.0	8.6

	Annualized Returns as of Dec. 31, 2014 (%)						
	1 Y	2 Y	3 Y	4 Y	5 Y	6 Y	7 Y
Jake	11.2	10.2	9.0	7.0	7.6	8.7	5.4
Julie	8.6	10.3	10.3	8.9	9.1	10.9	6.8

[1]The performance of both Jake and Julie's portfolios assume they are rebalanced quarterly to the target fund allocations. In Jake's portfolio, the inception date of the iShares MSCI World Index Fund is June 2009. Returns prior to this date are the MSCI World Index minus 0.12% per quarter. In Julie's portfolio, the returns reflect an annual fee rebate of 0.15% (calculated quarterly). In addition, they reflect a tenure rebate of 7% applied in 2013. In reality, her fee rebates would be higher as her portfolio grows.

Over the last seven years, Jake and Julie have seen all kinds of markets. There are few precedents for the drama and market declines of 2008, while the recovery since the crisis has been very strong. *Julie's portfolio has grown to roughly $395,000 (over the seven year period) while Jake's has grown to $360,000.*

Both investors' returns have had lots of good and bad imbedded in them. Jake's ETF portfolio, which is capitalization weighted (i.e. the larger the stock, the more he owns), benefited from the growing prominence of gold, base metals and other cyclical stocks in 2009 and 2010, as the resource-heavy iShares XIC (S&P/TSX Composite Index) did well relative to active managers like Steadyhand. These same exposures weighed on Jake's returns over the last three years.

Julie's Steadyhand portfolio was particularly strong in the areas of corporate bonds, income securities and small-cap stocks. In general, the Steadyhand equity funds lagged the overall market in 2009 and 2010, as they were positioned more cautiously following the credit crisis. This paid off in 2011, 2012 and 2013, however, as high-quality stocks (strong balance sheets, steady cash flows) performed well and resource stocks were in decline.

Julie's portfolio had a positive return in 2014, but didn't fully benefit from the strong markets and weak Canadian dollar.

In 2014, the Income Fund (+9.7%) and Equity Fund (+13.2%) had good returns, building on their strong long-term track records. The Small-Cap Equity Fund (-6.3%) struggled after a number of good years, and the Global Equity Fund (4.0%) had a disappointing year.

If Julie wants more detail on how her portfolio is doing, she can go to the Steadyhand website and download a report entitled, *'How is Steadyhand Doing'*. The report is updated annually and provides an in-depth analysis of the Balanced Income portfolio, which is identical to Julie's mix.

While Steadyhand's goal is to beat index portfolios over the long term, Julie won't always be ahead of Jake in the short and medium term (as was the case in 2014). The ETF portfolio will tend to do better in hot markets that are led by a limited number of industry sectors. Over the long term, however, the markets will even out. Who wins will depend on how well the Steadyhand funds are managed.

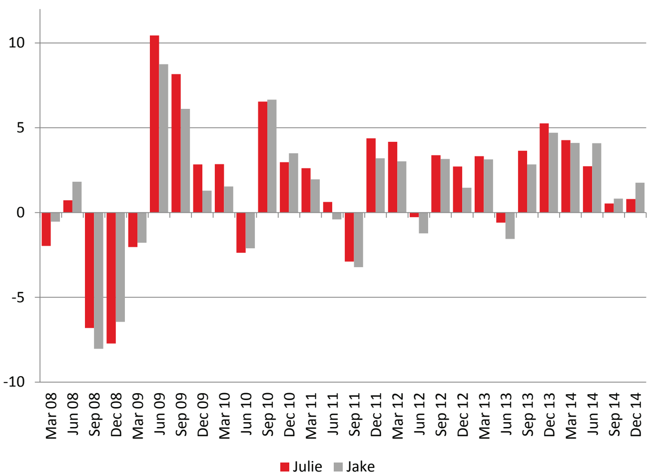
Volatility

In general, ETFs will be more volatile than actively managed funds, mainly because they hold no cash and are 'momentum-style' funds. That is, index funds have the largest weighting in a stock when it's at its peak price and smallest weighting at its low. In markets driven by a small number of industry sectors, index returns are hard to beat. When those leading sectors turn down, however, index funds tend to get hit harder than managed portfolios that are more broadly diversified.

For client portfolios overall, indexing vs. active management is only one factor impacting how bumpy the investing road will be. The asset classes held and the degree to which they're correlated (i.e. move together) are also important factors.

As you can see from the chart on the following page, Jake and Julie's quarterly returns have been similar. Jake's

Quarterly Return Comparison: Julie vs. Jake



	Jake	Julie
Average Quarterly Return	1.4%	1.7%
Standard Deviation	3.7%	4.0%

portfolio has been slightly less volatile than Julie's over the past seven years.

In general, Julie's portfolio pursues a more aggressive approach to fixed income (due to the Steadyhand Income Fund's emphasis on corporate and high yield bonds). This can lead to greater short-term volatility. Countering this, however, is Steadyhand's more cautious approach to stocks. The investment philosophy of the equity fund managers, undexing, tends to hold up better in weak markets.

Tax Efficiency

Both Jake's ETFs and Julie's Steadyhand funds distribute taxable income as it's realized. The funds vary as to how often distributions are paid – quarterly or annually – but over the course of the year all interest income, dividends and realized capital gains flow through to investors.

One of the advantages of Jake's capitalization-weighted portfolio (i.e. indices) is that his funds don't trigger capital gains taxes through active trading. Steadyhand's undexing approach is also low turnover (i.e. minimal trading) and is expected to be relatively tax efficient. It will trigger some capital gains along the way, but will also pursue tax management strategies whereby losses are realized to offset the gains.

Living Together

Both Jake and Julie are hoping to make their investing relationship a lasting one, maybe even their last one. For that to happen, they'll need to trust who they're dealing with and be charged reasonable fees. They'll also need to be comfortable with how they're being serviced and communicated to.

When we look at strategy implementation and account management for Jake, we can't be too precise, because his experience largely depends on the dealer he's using. Suffice to say that the competition amongst discount brokers is intense and they all have some excellent features, especially for web-savvy investors. We can and will be more definitive about Julie's experience.

We compare and contrast the ETF and Steadyhand experience on the following page.

		
Account setup	Jake filled in his application forms online, although his dealer required that he mail in the originals along with a cheque and proof of ID. When he had questions, he called the call centre.	Julie filled in the Steadyhand account opening and transfer forms online. As Jake did, Julie sent in hard copies along with a cheque. When she had questions, she called 1-888-888-3147 and got a live voice immediately.
Asset allocation	Jake determines his asset mix and what funds he'll use.	Steadyhand works with Julie (at her request) to make sure her strategic asset mix is appropriate and determine the funds that will best implement it. The advice takes into account all her assets and any future sources of income (i.e. pension payments).
Portfolio construction	Jake sets up his portfolio to minimize taxes and rebalancing costs across his accounts.	Steadyhand advisors aren't tax experts, but they can help Julie set up her accounts so they are tax efficient.
Transactions	Jake trades online. There are commissions on each transaction, but they're low. Given that he owns 3 well-traded ETFs, he doesn't find it difficult ensuring that his trades are done close to NAV.	After the initial account setup, purchases, redemptions and switches are done by phone or fax. There are no fees or commissions charged. At Steadyhand, trades are done after the markets close exactly at NAV.
Ongoing advice	The call centre at Jake's dealer is able to deal with account enquiries and answer administrative questions, but their personnel are not licensed to provide advice.	Steadyhand's simple, clear-cut advice comes in many forms: • Phone conversations • In-person meetings or portfolio reviews (Vancouver or Toronto) • Quarterly Report • Monthly Newsletter • Blog • Annual client presentation
Automatic purchases / withdrawals	Certain iShares ETFs are eligible for Pre-Authorized Cash Contribution (PACC) and Systematic Withdrawal Plans (SWP). The ability of investors to enroll in the programs depends on the participation of their brokerage firm.	Julie can establish a pre-authorized chequing plan (PAC) or an automatic withdrawal plan (AWD) with Steadyhand. Under the plans, she can purchase/withdraw funds on the 15th of each month with no charges or commissions.
Statements and reports	Generally, brokerage statements are mailed out monthly. Depending on the dealer, Jake may be able to receive them online. Generally, the statements will show his ETF holdings and any trades he's done in the previous period. They're unlikely to show his overall asset mix or the total fees he's paying.	Julie receives an account statement and Quarterly Report every three months. She is notified by email that her documents are available in the secure client section of the website. In addition to her fund holdings, the statement shows the fees she's paid (in percentage and dollar terms), the overall asset mix and her investment returns.

Appendix

The following tables illustrate the returns that Jake and Julie would have received under different asset mix scenarios.

Scenario 2: 65% Equities / 35% Fixed Income

Jake's Initial Investment	Market Value	% of Total
iShares DEX Universe Bond Fund (XBB)	$87,500	35%
iShares S&P/TSX Capped Composite Index Fund (XIC)	$87,500	35%
iShares MSCI World Index Fund (XWD)	$75,000	30%
	$250,000	100%

Julie's Initial Investment	Market Value	% of Total
Income Fund	$117,500	47%
Equity Fund	$62,500	25%
Global Equity Fund	$45,000	18%
Small-Cap Equity Fund	$25,000	10%
	$250,000	100

	Annual Returns as of Dec. 31, 2014 (%)						
	2008	2009	2010	2011	2012	2013	2014
Jake	-18.0	16.9	10.2	-0.8	7.7	13.5	12.3
Julie	-18.5	19.1	9.9	3.1	11.6	16.3	8.0

	Annualized Returns as of Dec. 31, 2014 (%)						
	1 Y	2 Y	3 Y	4 Y	5 Y	6 Y	7 Y
Jake	12.3	12.9	11.2	8.0	8.5	9.8	5.3
Julie	8.0	12.1	11.9	9.7	9.7	11.2	6.4

Scenario 3: 35% Equities / 65% Fixed Income

Jake's Initial Investment	Market Value	% of Total
iShares DEX Universe Bond Fund (XBB)	$162,500	65%
iShares S&P/TSX Capped Composite Index Fund (XIC)	$62,500	25%
iShares MSCI World Index Fund (XWD)	$25,000	10%
	$250,000	100%

Julie's Initial Investment	Market Value	% of Total
Income Fund	$212,500	85%
Equity Fund	$18,750	7.5%
Global Equity Fund	$18,750	7.5%
Small-Cap Equity Fund	$0	0%
	$250,000	100

	Annual Returns as of Dec. 31, 2014 (%)						
	2008	2009	2010	2011	2012	2013	2014
Jake	-7.6	12.7	9.2	3.6	5.3	5.3	10.0
Julie	-11.5	21.6	10.3	5.6	9.0	7.6	9.7

	Annualized Returns as of Dec. 31, 2014 (%)						
	1 Y	2 Y	3 Y	4 Y	5 Y	6 Y	7 Y
Jake	10.0	7.6	6.8	6.0	6.6	7.6	5.3
Julie	9.7	8.6	8.7	8.0	8.4	10.5	7.1

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