Envestat Report

November 2017

Fund Strategist Portfolios vs. Advisor Managed Portfolios – A Story of the Tails

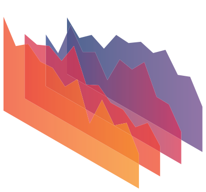
Earlier this year, we charted the dispersion of returns in fund strategist portfolios (FSP) and advisor-managed portfolios (APM). Our scattergram captured how much more volatile APM portfolios were and showed their standard deviation was twice that of FSP portfolios.

In this edition of **Envestat**, we expanded on our previous analysis to provide more granularity to that volatility with respect to advisors and accounts that had outperformed and underperformed in both products and sought to answer the following key questions:

- **How are advisors and accounts distributed on a performance basis in both programs, and how does that compare to the average performance?**
- **Is there a meaningful difference in the distribution when comparing APM against FSP programs?**
- **What is the implication for the end-investor?**

We set out to quantify and analyze the distribution of advisors and accounts against the overall average for each program using the Moderate risk tier as our guidepost, given that most portfolios reside in that risk tier.

Having examined three years of performance data from both programs and bucketing each data set into varying degrees of performance deviation from the average, we were able to see how the programs stacked up against each other and make some observations.

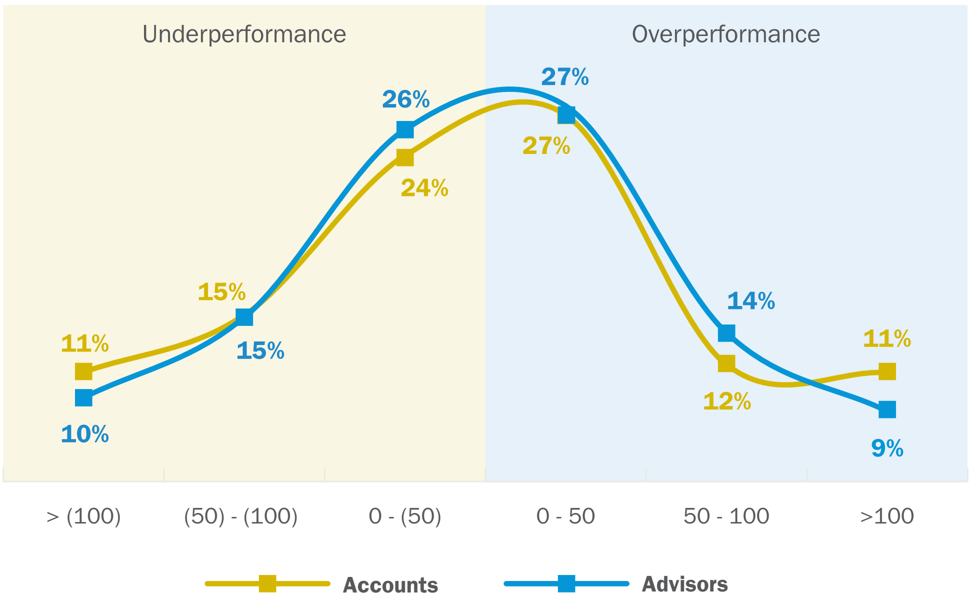


When comparing the two programs, both APM accounts and advisors were twice as likely to underperform significantly.

Account & Advisor Performance Distribution vs. 3-Year Average Annual Performance* (in basis points)

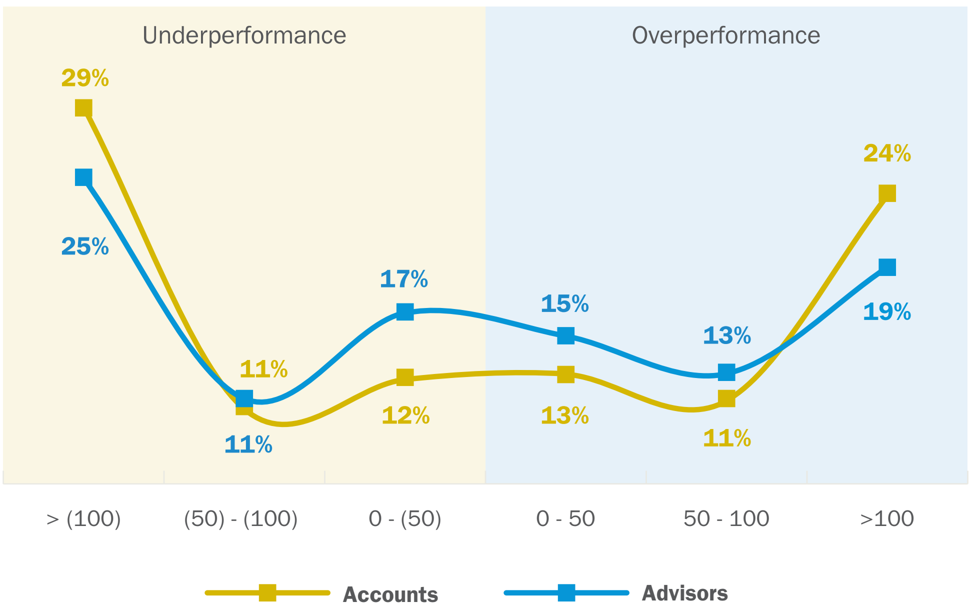
Fund Strategist Portfolios

Average FSP Account = 4.22%



Advisor Managed Portfolios

Average APM Account = 4.66%



Source: ENV Analytics. Data reflects 3-year performance as of 10/31/2017 for the moderate risk tier. Analysis includes over 142,000 accounts (71,161 fund strategist portfolio, 70,927 advisor as portfolio manager) and over 15,000 advisors (9,606 fund strategist, 5,632 advisor as portfolio manager)

Envestnet Observations

One would expect that most portfolios would post returns around the average; but in APM, there was greater variation across individual portfolios. The data showed a distinct difference in the distribution of both the number of advisors and accounts for APM and FSP programs.

FSPs resembled a standard bell curve distribution while APM resembled a barbell, with much fatter tails on either end; that is, a far greater percentage of advisors and accounts deviated from the average by more than 100 basis points. Thus, the end investor had a substantially different experience. In APM programs, more client accounts were subjected to below average returns. Investing in FSPs, on the other hand, would provide greater confidence that performance will be more like other FSP portfolios.

When comparing the two programs, both APM accounts and advisors were twice as likely to underperform significantly. Not only did APM accounts exhibit higher volatility, but those with extreme underperformance outweighed the overachievers in both number of advisors and accounts. In contrast, FSPs were much more tightly concentrated around the average return on a three-year basis, with 51% of accounts performing within 50 basis points of the average.

It is true that APM had a higher average performance over the past three years (4.66% vs. 4.22%), but the degree of dispersion is noteworthy. More APM accounts were materially below average (nearly 21,000 accounts) than above average (nearly 17,000 accounts). In contrast, 8,000 FSP accounts posted returns that were more than 100 basis points below the average.

Advisors need to be mindful of the potential risk and volatility associated with their models. Client accounts with significant negative deviations from the averages are potentially at risk because client expectations are not being met. APM programs have nearly three times as many possible clients at risk as FSP programs.

With this information, advisors would be wise to ask themselves some important key takeaway questions:

- **Is it worth taking the risk that nearly a third of your accounts could have performance that is well below the average?**
- **For those advisors concerned about an aging bull market, is it time to consider a tail risk strategy?**

About Envestat

Envestat, Envestnet's industry analytics engine, delivers regular digests of business intelligence designed to provide context to the decisions that financial advisors and enterprise business owners face every day.

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