ENVESTNET

Envestat Report

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Digging Into Portfolio Performance Outliers

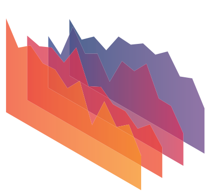
Volatility makes clients uneasy, often prompting impulsive investment decisions that can make for choppy returns. Advisors can seize this opportunity to demonstrate their value by structuring portfolios with professional managers who can both slash volatility and also smooth investment returns.

Looking back at our March 2017 Envestat report, we learned that performance in fund strategist portfolios (FSPs) had half the volatility of advisor-managed portfolios (APM). Now, a year later, we decided to take another look at the portfolio performance dynamics and extend the analysis to include unified managed account (UMA) portfolios in addition to APM and FSPs. We also wanted to examine the extreme outliers to determine what was driving outsized performance or underperformance.

In this edition of **Envestat**, we set out to address some key questions:

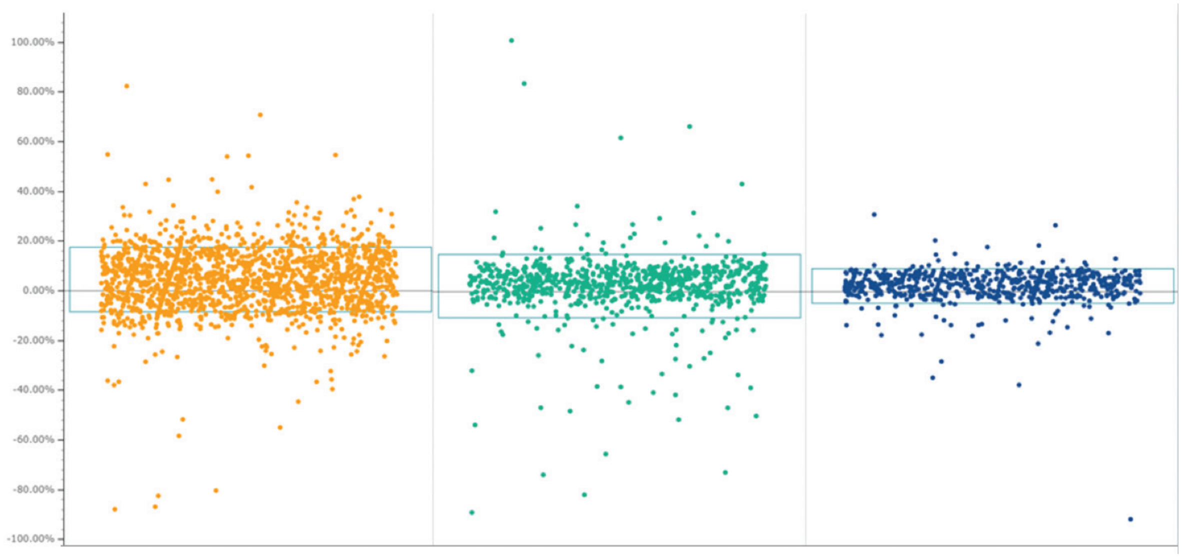
- **How concentrated are total returns across APM, FSP, and UMA portfolios?**
- **What accounts for the extreme outliers?**
- **How can advisors avoid excessive volatility in their clients' portfolios?**

We retrieved three-year performance data (Q2 2015 – Q1 2018) for each of the programs mentioned above that had portfolios in the moderate/moderate growth risk tiers. More than 100,000 accounts were included in each program type. The scattergrams illustrate the extreme performance outliers, which we proceeded to analyze further.



When we examined the extreme performance outliers in APM and UMA accounts (i.e., + /- 40%), we found that "managed positions" were the major contributor to the biggest performance swings.

Annualized 3-Year Performance by Program for Moderate/Moderate Growth Portfolios



Advisor as PM	Unified Managed Account	Fund Strategist Portfolio
Average Performance: 4.61%	Average Performance: 3.94%	Average Performance: 4.10%
Standard Deviation = 2.57%	Standard Deviation = 1.57%	Standard Deviation = 1.13%

Note: Fund strategist portfolios were selected as a good comparable because they are asset-allocated portfolios, akin to what advisor-managed portfolios would be.

Source: Envestnet Analytics. Performance data from more than 400,000 accounts in the Moderate/Moderate Growth risk tier, spanning April 1, 2015, to March 31, 2018.

Envestnet Observations

The markets over the last three years have not been very volatile, but this changed in Q1 2018 when we experienced massive market swings. With volatility spiking, investors grow more uneasy; and this only increases the potential for bad timing mistakes. Emotional decisions made during periods of market turbulence can be seen in greater dispersion of investment returns.

As is apparent from the scattergrams above, and in keeping with last year's results, FSPs had the tightest performance cluster whereas APM and UMA models tended to have greater performance dispersion: that is, accounts that generated 20%+ in gains or that lost more than 20% in value.

When we examined the extreme performance outliers in APM and UMA accounts (i.e., + /- 40%), we found that "managed positions" were the major contributor to the biggest performance swings. Managed positions consist of individual securities held in the client's account alongside other investments. These positions could be legacy holdings of the client, concentrated positions in the employer's equity, or the advisor's favorite stock picks for the portfolio.

Also consistent with last year's findings, standard deviations were much higher for APM and UMA, where advisors are managing the portfolio. In fact, in APM portfolios, volatility was double that of FSPs, where the asset management is outsourced to money management professionals. UMA volatility was in large part due to performance of the advisor managed portfolio sleeve.

Average annualized performance for the past three years was highest for the APM program, but there was greater variability in returns. FSPs generated both attractive returns and the smoothest ride for the investor.

Advisor Takeaways

Note to advisors: Be mindful of the impact that managed positions can have on your client portfolios. Turbulent market performance is often a byproduct of volatility. Structuring portfolios with FSPs can not only generate good returns but help your clients avoid erratic performance swings.

Contact us if you are interested in analyzing your own performance and volatility by product.

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.