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Dave McClearn, CFA, Senior Portfolio Manager

Home-Field Advantage

BY DAVE MCCLEARN, CFA, SENIOR PORTFOLIO MANAGER

The location of a sporting event can significantly influence the outcome of a contest. Maybe no other game where this is more evident is college football. Every season seems to be shaped by at least one underdog team feeding off the energy of its home crowd to defeat a superior opponent. Most fans, football pundits, and odds-makers are well aware of the importance of stadium location come September. Like college football, the location of assets within a portfolio can influence financial planning and performance outcomes.

Prudent Asset Allocation

Prudent asset allocation design and integration of client priorities is essential to achieving optimal portfolio returns. At Hartland this begins with broad diversification across asset classes. Our research demonstrates that broad diversification reduces portfolio volatility and enhances the opportunity for superior risk-adjusted returns. Next, we believe the skillful utilization of passive and active strategies can strengthen portfolio allocations. Careful consideration is given to which financial market segments to employ passive and active strategies to ensure we maximize market efficiencies in a low-cost manner, diversify exposures, and control risk. Like asset allocation design and strategy selection, the asset location decision-making process can be a critical element to a well-constructed investment plan.

Hartland Continues to Bolster Team with New Talent

We are pleased to announce that we have added talent to the Institutional, Private Client, and Research teams with John Evans, Jeff Hertel, CFA, and Anna Rathbun, CFA respectively.

Prior to joining Hartland as a Director in the Institutional Consulting Group, John spent six years at Goldman Sachs in New York, where he was most recently a Vice President and Portfolio Manager for foundation and endowment clients across the U.S. He is a graduate from University School in Cleveland, Ohio, and earned a BA in Economics from the University of Pennsylvania.

Jeff Hertel is a CFA charterholder and earned his BS in Finance and Computer Information Systems from Kent State University and his MBA from Cleveland State University. Previously, Jeff was an investment analyst with Waypoint Intelligence, responsible for generating and presenting investment ideas for private client portfolios.

Prior to joining Hartland as a Director in the Research Group, Anna led the investment team in macroeconomic research, portfolio construction, and manager due diligence at CBIZ, Inc. After graduating from Harvard with a BA in Economics, Anna pursued a

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Asset Location

While we cannot control the direction of financial markets, nor predict the outcome of potential tax reform as political leaders take office, identifying favorable pairings between asset types and account types is central to our investment planning process. For instance, many clients own multiple accounts within a portfolio --Trusts, Roth Individual Retirement Accounts (IRAs) Personal Accounts, Traditional IRAs, etc. -- and, therefore, a decision needs to be made on locating assets between taxable and tax-advantaged accounts. All things being equal, this decision typically begins with distinguishing tax efficient from tax inefficient investment strategies; discerning the tax treatment of expected return profiles. Such treatment can certainly vary depending upon the specific circumstances of a client's tax planning situation. Nevertheless, the underlying goal is to reduce tax drag on a portfolio while adhering to the framework of the total portfolio's asset allocation design.

As illustrated in the hypothetical scenario below, tax drag can have considerable ramifications on financial wealth generation. Compound interest amplifies the effects of tax drag as time horizon increases, creating a large opportunity cost for a long-term investor. In fact, when presented in percentage terms, the tax drag as a result of compounding annual taxation produces a percentage greater than the scenario's original tax rate of 30%.

"Compound interest is the eighth wonder of the world. He who understands it, earns it…he who doesn't…pays it." -Albert Einstein

career in investments at Wellington Management and subsequently, Harvard University. She obtained a Master of Music and a Doctor of Musical Ats from the Cleveland Institute of Music. Anna is a CFA charterholder.

These changes underscore the firm's commitment to building its investment consulting practice, promoting the next generation of leadership and maintaining a rigorous investment process.

Investment	Conditions	Account Type: Taxable	Account Type: Tax-Advantaged	Tax Drag $	Tax Drag %
Taxable Bond Fund	Beg. Balance	$1,000,000	$1,000,000	-	-
	Annual Tax Rate	30%	0%	-	-
	Annual Rate of Return	4%	4%	-	-
	End. Balance – 10yrs	$1,318,047	$1,480,244	$162,197	34%
	End. Balance – 20yrs	$1,737,249	$2,191,123	$453,874	38%
	End. Balance – 30yrs	$2,289,778	$3,243,397	$953,619	42%

Assumption: Annual rate of return is interest income taxed each year at 30%
Tax Drag $ = Tax-Advantaged End. Balance – Taxable End. Balance
Tax Drag % = Tax Drag $ / Tax-Advantaged Gain (e.g. $162,197 / $480,244 at year 10)

Asset location decision-making is a dynamic process, and taxes are only one of the many factors taken into consideration for asset location selection. By no means is this an exhaustive list, but investment time horizon, account sizes, liquidity needs, withdrawal sequencing (if any), account purpose, as well as beneficiary designations are other key variables we examine, to name a few examples. A thorough understanding of each is imperative for a well-constructed investment plan.

Quantifying Asset Location

Research published by Morningstar and Vanguard attempts to quantify the value of concepts like asset location selection. The goal for each publication was to demonstrate how intelligent financial planning decisions, such as asset location selection, can enhance after-tax portfolio returns. According to Morningstar, optimizing asset location and withdrawal sequencing can add over 50 bps (1/2 of 1%) to annualized performance for an individual investor.[1] Based on asset location alone, Vanguard derived

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a similar return enhancement conclusion of up to 75 bps (3/4 of 1%) on an intermittent basis, as opposed to Morningstar's annualized figure.[2] Despite being an imperfect science due to the uniqueness of client scenarios, such research demonstrates that optimizing asset location can be a fundamental source of additional portfolio value.

Similar to the importance of stadium location in college football, asset location within a portfolio can influence financial planning and performance outcomes. Even though the college football season is months away, we remain devoted to capitalizing on potential home-field advantages for client portfolios throughout the year.

Sources:
1- Alpha, Beta, and Now...Gamma by David Blanchett and Paul D. Kaplan
2- Putting a value on your value: Quantifying Vanguard Advisor's Alpha

MARKET BENCHMARK RETURNS

February 28, 2017		1M	3M	12M	YTD
US Large Cap	S&P 500	4.0%	8.0%	25.0%	5.9%
US Small Cap	Russell 2000	1.9%	5.2%	36.1%	2.3%
Developed Intl	MSCI EAFE	1.4%	8.0%	16.3%	4.4%
Emerging Intl	MSCI Em Mkt	3.1%	9.0%	29.9%	8.7%
Real Estate	NAREIT	4.2%	8.8%	18.6%	4.4%
Core Fixed	BarCap Agg	0.7%	1.0%	1.4%	0.9%
Short Fixed	BarCap 1-3Yr	0.2%	0.4%	1.0%	0.4%
Long Fixed	BarCap 10+Yr	1.8%	2.9%	4.4%	2.1%
Corp Debt	BarCap Corp	1.1%	2.1%	5.7%	1.5%

Source: Bloomberg

The performance data shown represent past performance. Past performance is not indicative of future results. Current performance data may be lower or higher than the performance data presented.