GENTRUST

The GenTrust Investment Process

Introduction

One of the primary reasons we created GenTrust was to deliver to our clients the comprehensive investment approaches we saw being implemented by the most sophisticated institutions. We knew we would need to take an unbiased, academic approach to decision-making. This meant every part of our process, no matter how small, would be thoroughly researched before it was implemented. We also knew our incentives would need to be aligned with our clients and we couldn't be compensated by anyone but our clients. We would manage our own money in the same manner as our clients. In this GEMS, we will discuss our investment process in detail, beginning with a discussion of our core principles.

GenTrust's core investment principles include a focus on asset allocation, low costs, diversification, tax efficiency, stress testing, macro risk factor allocations and valuations.

Core principles

The investment world is very dynamic with new ideas and products continually being promoted. To navigate this dynamic world consistently and effectively, we created a series of core principles that guide our approach. These seven principles have guided us since we launched GenTrust in 2011.

Each core principle has its own GEMS where we explain the rationale and the consequences of each in more detail.

1. Focus on asset allocation – In our experience, a large majority of variation in investment portfolios is driven by the overall asset allocation decision, not by individual security selection. We focus on the big picture without neglecting the details.
2. Low costs – The available alpha in most markets can be zero and costs are certain while outperformance is not. We use lower-cost passive ETFs for exposure to most asset classes. For areas where we feel alpha is present, we bring them in-house to save our clients the layer of fees. We keep fees low with the goal that our clients get the largest possible share of returns.
3. Diversification – True diversification requires an understanding of what risk factors are driving each investment over time and extending beyond simply stocks and bonds to build portfolios that have higher rewards for a given amount of risk. We don't keep all the client's eggs in one basket.
4. Tax efficiency – Decisions made that range from municipal vs taxable bonds, ETFs vs mutual funds vs individual securities, asset location, and tax loss harvesting are done with tax efficiency in mind. The only two certainties in life are death and taxes - we cannot impact the former, but we will do our best to make sure our clients don't pay more taxes than necessary.

Benchmarking

Our intake process results in each client being assigned a personalized benchmark. The client chooses the amount of tracking error we will take which is the percentage of the portfolio in our various tilts, or intentional deviations from the client's benchmark.

Tilts

For each tilt we take, we ask several questions including: What is the rationale? What is priced into the market? Is there asymmetry to the tilt? What is our edge? How will this behave relative to other tilts? What is our exit plan?

Beyond Tilts

In addition to providing low-cost, tax-efficient, and risk-aware exposure to a client's benchmark and making allocations to tilts we believe will result in above benchmark performance for clients in the long run, we also systematically rebalance, tax loss harvest, review holdings, stress test portfolios and track real-time performance of client portfolios.

5. Stress testing – Looking back at how portfolios would have behaved in the past is important, but it is not sufficient. New information changes the investment landscape all the time and portfolios must continually be stressed to see how they will hold up to unprecedented events such as a large-scale global cyberattack or a nuclear confrontation. You wouldn't drive looking in the rearview mirror and your money shouldn't be managed that way either.

6. Macro risk factor allocation – A piecemeal built portfolio consisting of outsourced managers lacks coordination, and results in a portfolio often over-exposed to various macroeconomic risk factors. Our process strives to assess the true drivers of each investment's performance and then designs portfolios from the top down.

7. Valuation – Valuations in our experience are not good predictors of future returns, except at the extremes. We pay attention to valuations to monitor if they are reaching extreme levels and then adjust portfolios accordingly.

Benchmarking and tracking error

In a previous GEMS, we discussed our intake process and how it results in each client being assigned a personalized benchmark. Every client's benchmark is some combination of cash, municipal bonds, taxable bonds, equities, real assets, and alternatives and represents how much risk and illiquidity a client is willing to take, as well as their taxation profile.

Clients also choose the amount of benchmark tracking error they are comfortable with. A small amount of tracking error means the returns of the client portfolios will be close to their chosen benchmark. A large amount of tracking error gives us the freedom to deviate more from the benchmark and invest in what we call "tilts", where we attempt to add positive "alpha" (return above/below the benchmark) to client portfolios. Regardless of tracking errors, we try to follow our core principles and deliver these returns in a manner that is low-cost, tax-efficient, and risk-aware.

How "tilts" work

A "tilt" is any position we are taking which deviates from a client's benchmark. It is our attempt to overweight and underweight asset classes or securities that we believe will deliver higher returns or lower risk than the benchmark.

Some examples of tilts include:

- Super asset class tilts – such as overweight equities by holding more of the equity bucket than a client's benchmark
- Sub-asset class tilts – such as overweight inflation-linked bonds in place of holding the fixed income benchmark allocation
- Security tilts – such as holding gold producer equities in place of holding the gold commodity

We approach taking tilts from the perspective that markets are broadly efficient and the odds we will be right on any given tilt are close to 50% +/-. We have a rigorous process where tilt ideas are researched and presented at our Investment Committee meetings. The bar to add a tilt is high because adding a new position requires a sale of another position and generally creates a taxable event for a client.

For every tilt, we ask several questions:

- What is the theory and rationale behind the tilt?
- What is priced into the market? Is there asymmetry to this tilt – can we add more value than we might lose?
- Why do we know something the market doesn't know? What is our edge? Is it time horizon or that the market is less efficient?
- How will this tilt behave relative to the other tilts we currently have?
- What is our exit plan? When would we exit this tilt?

We take less tilts where we have less edge such as in the overall direction of markets. We take large positions when the potential benefit is much larger than the potential loss. One example was when 10-year US treasury rates were at 0.7%, we replaced a large portion of our fixed income risk because the risk/reward was very poor.

In some inefficient markets such as the municipal bond market, we will take a significant amount of security selection risk. We also have some systematic strategies that we run on client portfolios which represent a permanent tilt to a systematic process.

Beyond tilts

In addition to providing low-cost, tax-efficient, and risk-aware exposure to a client's benchmark and making an allocation to tilts we believe will result in above benchmark performance for clients in the long run, there are several other parts of our investment process which we are doing are simultaneously to client portfolios:

- Rebalancing – determining the appropriate time to rebalance portfolios back to benchmark levels
- Tax loss harvesting – harvesting positions that exhibit losses to provide clients with tax benefits
- Holdings review – we are continually reviewing new investments that come to market and existing investments in client portfolios to verify we are using the most efficient tools
- Stress testing – we are subjecting portfolios to stress testing to make sure they are compatible with client-defined parameters
- Performance tracking – we are tracking the daily performance of portfolios both on an absolute basis and relative to the benchmark

Conclusion

Our goal was to deliver institutional quality investment processes to high-net-worth individuals. We created a process that strives to have an unbiased decision-making paired with alignment of incentives with our clients. Our investment process is driven by seven core principles which are meant to be timeless and universal. We follow our core principles and seek to deliver returns in a manner that is low-cost, tax-efficient, and risk-aware.

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