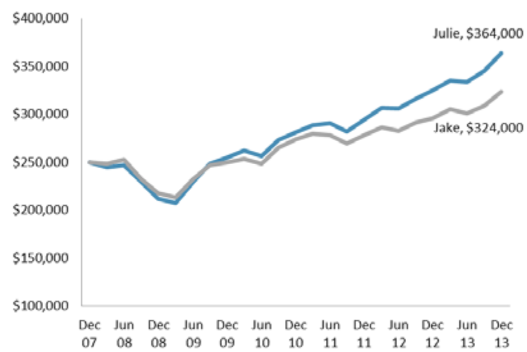
Steadyhand vs. ETFs

Comparing the Investor Experience

ETFs are growing in popularity and for good reason. They offer simplicity, low fees and market-like returns. Yet, there are important tradeoffs with these products that investors should be aware of. In this paper, we compare the experience of an ETF investor (Jake) to that of a Steadyhand client (Julie).



STEADYHAND

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Introduction

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 are a hot topic and for good reason. In an industry characterized by complexity, high costs and disappointing returns, they're a refreshing investment option. ETFs offer simplicity, low fees and market-like returns. Further, they're not a flavor-of-the-month; they're 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 some 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 tradeoffs 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.*

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 (RRSP and TSFA) 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).
- Jake and Julie both feel strongly about keeping their costs down.

Jake and Julie's Strategic Asset Mix (SAM)	% of Total
Cash & Cash Equivalents	0
Bonds	50
Canadian Equities	30
Foreign Equities	20
	100%

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 3 ETFs.
- Is seeking returns that are in line with the market indices.

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 is a Steadyhand client. She:

- Deals directly with Steadyhand - no middleman involved.
- Has a balanced portfolio comprised of 4 Steadyhand funds.
- Is seeking returns in excess of the market indices and is hoping to experience a smoother ride along the way.

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%**

Knowledge, Interest, Time & Temperament

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

- How *knowledgeable* and confident 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 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 being ahead, behind or going 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 by a further 7% because she has been a client for 5 years (they will be reduced by 14% after 10 years).

Jake's Cost of Investing	Fee (%)	($)
iShares DEX Universe Bond Fund (XBB)	0.33	413
iShares S&P/TSX Capped Composite Index Fund (XIC)	0.27	202
iShares MSCI World Index Fund (XWD)	0.47	235
Blended MER	0.34%	850
Trading Commissions Admin Charges Tracking Error	0.16%	400
	0.50%	**$1,250**

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 account values 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 tradeoffs, however, 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 4 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 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, Chris, Scott, David and Tom 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 the overall market. 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 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 shown below extend out 6 years.[1]

Annual Returns as of Dec. 31 (%)

	2008	2009	2010	2011	2012	2013
Jake	-12.9	14.8	9.7	1.4	6.5	9.3
Julie	-15.1	20.4	10.2	4.7	10.3	12.0

Annualized Returns as of Dec. 31, 2013 (%)

	1 Y	2 Y	3 Y	4 Y	5 Y	6 Y
Jake	9.3	7.9	5.7	6.7	8.3	4.4
Julie	12.0	11.2	9.0	9.3	11.4	6.5

Over the last six 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 $364,000 (over the six year period) while Jake's has grown to $324,000*.

Both investors' returns 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.

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. 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

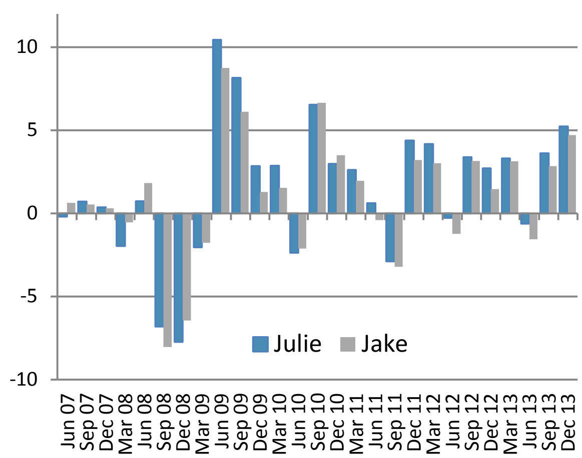
In general, ETFs will be more volatile than actively managed funds, mainly because they hold no cash and are 'momentum-style' funds. That is, index funds have the largest weighting in a stock

[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.

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, however, 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 below, Jake and Julie's quarterly returns were similar. From a statistical point of view, Jake's monthly standard deviation was 3.7% and Julie's was 4.0%. In the most extreme quarters, the Steadyhand equity funds were more stable than the equity ETFs, but Julie's heavier weighting in corporate bonds (through the Income Fund) substantially offset it.

Quarterly Return Comparison: Julie vs. Jake



	Jake	Julie
Average Quarterly Return	1.1%	1.5%
Standard Deviation	3.7%	4.0%

It should be noted that we didn't mention the number of stocks as a factor impacting the volatility of Jake and Julie's portfolios. Jake is diversified across approximately 1,650 stocks. Steadyhand's 'undexing' approach means Julie is more concentrated in just 110-120 stocks. At that number, she is far beyond the level where the diversification effect is maxed out. In other words, introducing an additional stock to her portfolio does virtually nothing to stabilize her short-term returns, let alone adding 1,500 more.

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 needlessly 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 two pages.

	The ETF experience	**The Steadyhand Experience**
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, but they weren't interactive. 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 and security selection	Jake determines his asset mix and what funds he'll use.	The Steadyhand team 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 (including GICs and investment accounts with other firms) as well as any future sources of income (i.e. pension payments).
Portfolio construction	Jake sets up his portfolio to minimize taxes and re-balancing costs across the three accounts.	Steadyhand advisors aren't tax experts, but they can help Julie set up her three 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. He can place advisor-assisted trades if he wants, but he'll be charged extra.	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.
On-going 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. It will most often happen on the phone, although Julie can take advantage of an in-person portfolio review up to once a year. The report sent with her quarterly statement tells her how the funds are doing and what strategies are being pursued. Between reports, if she's wondering what Tom Bradley and the team are thinking, she can go to the blog to read Steadyhand's latest views. At the beginning of each year, she's invited to attend Steadyhand's annual client presentation (five cities and growing). If she can't attend, a transcript is made available on the website.

… continued on following page

	The ETF experience	The Steadyhand Experience
Re-balancing	Occasionally, Jake will need to shift his portfolio to keep it in line with his SAM. If possible, he makes these adjustments when he's making contributions (or withdrawals) so as not to incur additional trading commissions.	The fund managers do most of the heavy lifting for Julie. If valuations are getting extreme, on the upside or downside, they're likely to take action. The (re)allocation of capital is a dynamic process. The equity managers will sell or trim stocks that are getting expensive and vice versa. If the Income Fund manager is worried about rising interest rates, he'll reduce interest rate exposure. The managers won't always get it right, but they will act when they see opportunities and risks. Having said that, changes to the overall asset mix and fund allocations are driven by Julie. She can get help from the Steadyhand team or do it herself by using the asset allocation tool on the website.
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 (not all firms offer the plans).	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	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 every three months, generally 5-6 business days after quarter-end. She is notified by email that her statement is 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. The asset mix and returns are shown for the consolidated portfolio and separately for each of the three accounts.
Website	Every dealer is different, but generally there is plenty of investment and product information on their websites. With regard to Jake's simple ETF portfolio, however, the iShares.ca website is perhaps a more valuable source of information.	There is a wealth of information on steadyhand.com. Given the firm's commitment to transparency, Julie is able to find everything she needs to know about the funds (holdings, sector and country weightings, fees, distributions, strategy) as well as a blog full of articles on long-term investing. Julie can also access her portfolio information at any time simply by logging into the secure client section of the website.
Marketing pitches	Depending on the dealer, Jake may be subject to any number and variety of sales pitches – new products, enticements to trade more, etc.	Steadyhand worked hard to gain Julie's trust and get her signed up, but once she became a client, the only pitches she gets are ones related to good investing behavior – regular re-balancing; TFSA and RRSP contributions; and PACs (pre-authorized contributions).

Takeaways

1. Both the ETF and Steadyhand strategies are simple and easy to execute.
2. Cost, the most predictable factor in investing, is low for both investors. Jake, however, will have a 0.52% head start over Julie at the beginning of every year. An ETF portfolio held in a discount brokerage account is the lowest cost approach.
3. Being a long-term investor is challenging. It requires a plan, cost effective execution, diligent monitoring, and plenty of patience and discipline. Jake's ETF strategy is truly a do-it-yourself approach. Julie can be as much of a DIYer as she wants to be, but can also lean on the resources and expertise at Steadyhand when she needs them.
4. Asset allocation is the most important thing any investor does. Jake and Julie have a strategic asset mix (SAM) and need to stick to it. Julie has some steady hands to help keep her on track.
5. For Jake and Julie, security selection is taken care of. Both portfolios are diversified across geographies, industries and company size. Jake owns all the stocks in the major indices (approximately 1,650). Julie owns 110-120 stocks that the Steadyhand managers feel are undervalued. Her portfolio will be more evenly spread across industries. Also, corporate bonds and small/mid-sized stocks will play a larger role in her portfolio.
6. On the tax front, Jake's investment account (non-registered) is likely to be more efficient than Julie's, although the Steadyhand funds are also designed to be tax efficient.
7. If Jake sticks to his SAM and rebalances periodically, he will achieve returns that are in line with the markets overall, less a small amount to cover fees and commissions (0.5% estimated). At Steadyhand, Julie will track market returns less closely. There will be periods when she does considerably better and others when she lags behind. Over the long haul, there are two factors that give her a chance to achieve higher returns than Jake – added value by the fund managers and enhanced returns due to Steadyhand's guidance on asset allocation.
8. Over the past six years, Julie's portfolio has achieved an annualized return of 6.5%, while Jake's has achieved a return of 4.4%. In dollar terms, Julie's portfolio has grown to roughly $364,000, while Jake's has grown to $324,000.

Appendix

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

Scenario 2 – 65% Equities / 35% Fixed Income

Jake and Julie's Strategic Asset Mix (SAM)	% of Total
Cash & Cash Equivalents	0
Bonds	35
Canadian Equities	35
Foreign Equities	30
	100%

Jake's Initial ETF Holdings	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 Fund Holdings	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 (%)

	2008	2009	2010	2011	2012	2013
Jake	-18.0	16.9	10.2	-0.8	7.7	13.5
Julie	-18.5	19.1	9.9	3.1	11.6	16.4

Annualized Returns as of Dec. 31, 2013 (%)

	1 Y	2 Y	3 Y	4 Y	5 Y	6 Y
Jake	13.5	10.6	6.6	7.5	9.3	4.2
Julie	16.4	14.0	10.3	10.2	11.9	6.1

Scenario 3 – 35% Equities / 65% Fixed Income

Jake and Julie's Strategic Asset Mix (SAM)	% of Total
Cash & Cash Equivalents	0
Bonds	65
Canadian Equities	25
Foreign Equities	10
	100%

Jake's Initial ETF Holdings	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 Fund Holdings	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 (%)

	2008	2009	2010	2011	2012	2013
Jake	-7.6	12.7	9.2	3.6	5.3	5.2
Julie	-11.5	21.6	10.3	5.6	9.0	7.6

Annualized Returns as of Dec. 31, 2013 (%)

	1 Y	2 Y	3 Y	4 Y	5 Y	6 Y
Jake	5.2	5.3	4.7	5.8	7.2	4.6
Julie	7.6	8.3	7.4	8.1	10.7	6.6

Disclaimers

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The indicated rates of return for the Steadyhand funds are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Mutual fund securities are not covered by the Canada Deposit Insurance Corporation or by any other government deposit insurer. There can be no assurances that the funds will be able to maintain their net asset value per security at a constant amount or that the full amount of your investment in the funds will be returned to you. Past performance may not be repeated.

About Steadyhand

Steadyhand Investment Management Ltd. is a low-fee mutual fund company that offers a straightforward line-up of funds directly to investors. Steadyhand's funds are concentrated and non-benchmark oriented. The firm offers clear-cut advice and simple tools to assist investors with their asset mix and portfolio strategy. It has approximately $350 million of assets under management with offices in Vancouver and Toronto.

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