Funds vs. Portfolios

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Which Investment Vehicle is Best?

Overview

There are a number of different investment models, tools, and techniques for individuals seeking to take a holistic approach to their financial well-being. Although these models are all ultimately aimed at fulfilling the same purpose (maximizing returns in an effort to meet an investor's financial goals), each method must be carefully examined in order to make informed investment decisions. Funds and portfolios are two key models for investors to examine and understand. What exactly are funds? What are portfolios? How do these tools differ?

What is a Fund?

In simple terms, a fund is a pooled investment with a portfolio of direct holdings in common stock (usually shares of a company), bonds, and other financial instruments. Essentially, individuals invested in funds do not have direct ownership in any of the instruments themselves, rather they purchase "“units” of a fund that owns the securities and bonds.

Pooled investments are investments collectively owned by a group investors. Examples of pooled investments include mutual funds, hedge funds, pension funds, etc.

All funds are managed by portfolio managers—often experienced professionals that hold a Masters in Business Administration (MBA) and/or are a Chartered Financial Analyst (CFA charter holder). A portfolio manager works collaboratively with a financial team in order to implement the investment strategy that they had determined in their Fund Prospectus.

This Prospectus highlights the type of investments the manager can utilize, the level of investment risk to which they must adhere, the geographic or segment allocations, and the fee structure. The fund is not required to disclose a full list of its holdings and, as a consequence, are also not required to disclose the rate at which they change their holdings.

Fund portfolio managers focus on the investing, while advisers focus on representing and advising on the fund to suitable clients looking to invest their savings. We can consider these advisers as the 'middle-man', similar to how insurance agents act as advisers and brokers on your behalf. Thus, when purchasing a fund, you are required to pay fund management fees as well as commission fees to your adviser. (Some funds are non-commission, however.)

Fees can be structured as...

Front-end: You pay the commission to the advisor at the beginning.

Back-end: You pay the commission fee when you sell the fund.

Deferred: You will need to pay a lump sum of fees to your adviser if you sell before the prescribed period has elapsed—a disincentive for you to sell out of the fund too quickly.

What is a Portfolio?

As opposed to indirect ownership where investors own "units" of a fund that owns the securities, portfolios allow individuals to own those securities directly.

Portfolios are also managed by portfolio managers with extensive expertise, degrees, and professional certifications. Boutique portfolio managers like Qube are registered with their provincial governing body and operate as fiduciaries.

Because portfolio managers are fiduciaries, there are often no commissioned salespeople. Typically when working with a firm that manages individual portfolios, investors are only charged an annual management fee without commissions. Simply put, portfolio managers provide a craftsman service; they don't sell a product.

A **fiduciary** is an organization that acts in their clients' best interests, bound by legal and ethical obligation. A fiduciary must act honestly and refrain from misleading their clients.

This difference is apparent in the tax treatment of mutual fund fees and portfolio manager fees; the latter's fees are tax deductible because they were paid in exchange for fiduciary advisement, similiar to accountant or lawyer fees.

Employees are paid on salary and advisory services are targeted for wealth maximization, not to make commission. These portfolio managers are bound by a fiduciary duty wherein they are entrusted with the assets of an individual and are legally required to act in the best interest of their client at all times. As a result, fiduciaries must justify each move they make on their client's behalf. Any investments made must be in line with their agreed upon investment policy statement.

Different Benefits of Funds and Portfolios

Although funds are typically associated with higher fees, tax inefficiencies, and random diversification (as opposed to strategic diversification in portfolio management), they can offer two main benefits: **lower minimums and convenience.**

Funds often have lower capital requirements when compared to their portfolio management counterparts. This is because risk diversification is easier to achieve when you are purchasing units of a pooled investment, instead of building your own portfolio independently and acquiring enough funds to both diversify and justify trading costs.

This could be compared to the trade-off between pitching in and sharing a pizza with your friends or buying all the ingredients to make one yourself. If you only have $5, you will be unable to build your own pizza. (You could try, but you will barely be able to buy the dough, and that does not sound very tasty.)

But if you and your friends pooled your money, you would be able to order a pizza together. The caveats are that you would have less control over what goes on top of the pizza, you would need to compromise on where to order from, and you can forget about any special requests like gluten-free crust.

Registered portfolio managers must always be fully compliant with the regulations of the of the security commission in their jurisdiction. For example, Qube is regulated by the Alberta Securities Commission, which results in our fiduciary responsibility.

Brokers, however, are not held to the same standards. Their level of standard is "suitability," meaning that a broker is not obliged to advise on the best possible option; a suitable option suffices. Since brokers possess fewer regulatory requirements, there are more available fund advisers than registered portfolio managers. The more abundant the amount of available brokers with lower investment minimums, the more convenience for potential investors.

The regulation requirements imposed on portfolio management firms prioritize investment clients and therefore exist to ensure that a high level of care is taken with each individual. Three key benefits are derived from these reforms: **holistic financial planning, frequent and recurring check-ins, and transparency.**

Whereas funds manage small fractions of an investor's money without needing to consider their financial position, portfolio managers aim to manage their clients' accounts holistically. For example, in addition to their fund investments, an individual may be investing in a TFSA, RRSP, or other registered account. How could this impact their tax deductions, withdrawal maximums, and the amounts they are able to contribute towards their portfolio in future years?

Analyzing the entirety of the client's financial environment allows portfolio managers to take advantage of different tax regulations, enable growth, and prioritize specific after-tax financial goals using strategic asset allocation and financial planning techniques.

In addition to providing portfolio performance updates on a frequent basis, portfolio managers are also required to conduct **Know Your Client (KYC) meetings** with each client on an annual basis. The purpose of the KYC meeting is to document and track any changes in the client's risk tolerance and capacity to invest. This check-in allows investors to gauge where they are with their portfolio and ask questions. They can discuss the potential need to change their risk allocation or if there are any upcoming material events or purchases in the clients' lives that may impact their financial well-being.

In Conclusion...

Individuals seeking transparency, coordination, and strategic allocation within their financial planning will benefit from the services of a portfolio manager. Unencumbered by alternative motivations, Qube will work with you to delve deep into your unique, personal circumstances and investment preferences to consider your specific financial goals, risk tolerance, and ongoing needs. Our team is committed to providing you with a holistic, diversified, and personalized investment experience. If you would like to learn more, please contact us using the details below.

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