Steadyhand

10 Years Wiser

May 2017

Reflecting back on the origins of Steadyhand and the challenges, opportunities, and lessons we've embraced over our first decade.

Steadyhand celebrated its 10th anniversary this spring. To mark the occasion, we held a series of receptions, coined *10 Years Wiser*, in Toronto, Vancouver, Victoria, Calgary, Winnipeg and Ottawa.

As part of the events, Tom Bradley told 'the Steadyhand story.' What follows is a somewhat condensed, although hopefully just as captivating, recount of the presentation! ... as told by Tom.

Sandy beginnings

Steadyhand was conceived here, near my home on Kits Beach in Vancouver. It's where Neil Jensen, our co-founder, and I started talking about building a new firm.

Neil (left) and me on Kits Beach circa July 2006

I'd wanted to work with Neil since he'd consulted with us at my previous shop, Phillips, Hager & North. He'd always impressed me with his understanding of our business. Fortunately, I got the chance in the spring of 2006. We agreed to spend three months to see if there was an opportunity to do something in wealth management.

We were intrigued because we saw an industry that had high fees and mediocre performance. Reporting to clients was non-existent and one of my favourite investment concepts, diversification, had morphed into 'di-worsification'. Portfolios had become bloated with hundreds, sometimes thousands of stocks.

The wealth management industry was also becoming less of a profession and more of a business. By 2006, it was starting to be dominated by big institutions that were ruthlessly pursing scale and profitability. Neil and I thought that maybe, just maybe, a growing contingent of Canadians would be looking for an alternative.

Fast and nimble

I learned pretty quickly that when you work with Neil, things move fast. While we'd planned to make a 'Go/No Go' decision after Labour Day, we were going full bore by the end of July. And when an article came out in the National Post on August 4th about us starting up, I had to phone my wife, Lori, at the cottage and tell her that she'd better pick up a copy. We were starting a company.

Despite my faux pas, Lori was all in. She thought the combination of Neil and I was an interesting one – a geeky investment guy and even geekier tech guy. It fit well with the opportunity.

We were starting fresh with no legacy systems that so burden the big players. We felt a rapidly maturing internet would be a great field leveler between the big guys and us. Neil knew his way around the web and we could do things that others couldn't. Specifically, we could lever off of my writing, as well as Scott Ronalds' writing and creativity.

In an industry that is driven by short-term, short-term, short-term, we also saw a chance to run our business differently. We would manage like we invest – long term, patient, transparent and contrarian.

The other partner

When we decided to go ahead that summer, Lori, Neil and I were not only partnering with the other founding shareholders, Scott, Elaine Davison and Chris Stephenson, we were also getting into business with a friend we all knew well. He's one of those friends you can't live with and you can't live without.

Mr. Market is quite the character. He's unpredictable, unreliable and prone to exaggeration. He can fly off the handle at a moment's notice and never seems to be sensitive to our needs. But he has some endearing qualities too. If you pull back and look from a distance, you can see that his ups and downs are quite predictable. They come and go, and are never permanent. And more importantly, Mr. Market is a very good provider over the long term.

Mr. Market: a man of many emotions

So, when we designed Steadyhand, we had our eyes wide open. We knew Mr. Market's traits. We couldn't count on calling the market, so economics and macro research

wouldn't play a large part in what we did or how we talked to clients.

And we wouldn't tell our clients where the market was going, even if everyone else was trying to do it.

Instead, we would focus on building portfolios from the bottom-up, one company at a time. Our fund managers would pound the pavement to find new ideas and grind through the numbers to confirm their view.

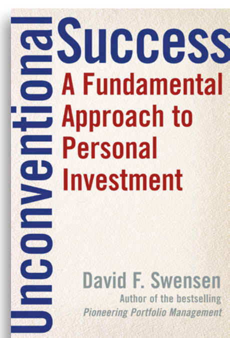
My research and experience told me that the most reliable way to enhance our clients' returns and beat the competition was to ignore the market indexes in the short term, not put undue constraints on our fund managers and concentrate on only the holdings (bonds and stocks) that we felt strongly about. We didn't want to hold any filler stocks that were there because they were in the index or being held by our competitors.

We would eventually call our approach 'Undexing'.

Sweating the details

In the fall of 2006, we were starting with a clean sheet of paper. There was nothing preordained, so we agonized over every detail.

Our bible was a book called *Unconventional Success* by David Swensen, the Chief Investment Officer of Yale University. It was required reading for everyone who joined the firm because it was a good, basic investment book. But it took on more significance because in the book Mr. Swensen was highly critical of the wealth management industry in the U.S., and specifically mutual funds. He was talking about the same flaws Neil and I had identified in the Canadian industry.



So as perverse as it sounds, we used Unconventional Success as a motivator. Mr. Swensen gave us our To Do list - things we either wanted to eliminate (bloated portfolios, excessive trading) or at least reduce (fees).

The funds

When Scott, Neil and I started working on the fund lineup, I thought we would offer at least 10 to 12 funds. I'd come from a firm that had a fund for every purpose and I wanted our clients to have access to all the tools they needed to generate returns.

But Neil encouraged me to look at it another way. To get me out of my big-company mindset, he introduced me to another book, *The Paradox of Choice* by Barry Schwartz. What came out of this fresh thinking was not an endless list of options, but rather a small lineup that reflected how we wanted our money managed.

Our clients would have all the necessary tools available to them, but it would be up to the fund managers to determine how they were used. The income area of our lineup was the best example of this approach. Instead of offering separate funds for government bonds, corporate bonds, high yield bonds and dividend stocks, we would offer one fund, the Income Fund. The manager, Connor, Clark & Lunn Investment Management, would determine where the best income was being offered. In other words, the expert in the area would pick the tools to use, not you or I.

The managers

The 'Undexing' approach didn't make it easy for us to find managers for the funds. As I met investment firms in Canada, the U.S. and the U.K. over the course of 18 months, it became obvious that most portfolio managers, while purporting to be 'active', were highly focused on the indexes. They thought of their portfolios' positioning as being relative to the index (i.e. overweighted energy, underweighted technology) as opposed to taking an absolute return approach.

We didn't want managers being ruled by the relative. Rather, we wanted managers who didn't worry about the index in the short term and were willing to concentrate their portfolios on only the stocks and bonds they felt strongly about.

After meeting and researching a wide array of managers, we found four who were passionate about investing (more geeks) and weren't afraid to go against the grain.

The really important thing

None of this careful planning around our investment approach, fund lineup and managers would have mattered if we didn't design the firm to do one important thing. We needed to provide our clients with a steady hand (yes, that's where the name came from), which means: **being accessible**, **providing sound counsel** and **making our communications understandable**.

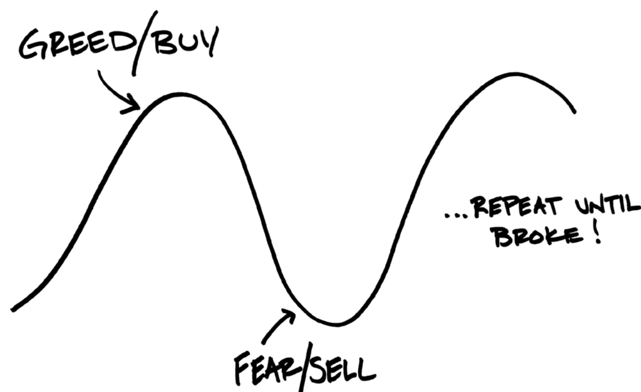
Why is a steady hand so important? Well, I hinted at it at the beginning when I talked about Mr. Market. Investing is like buying no other product or service. It's not intuitive. It runs counter to human nature. And it's one of the longest things you'll do. Investing for retirement spans many decades and doesn't end until you do.

In a nutshell, investing is more about EQ (emotional quotient), or temperament, than it is about IQ.

Pretty early on we started following a fellow by the name of Carl Richards. Carl is known as *The Sketch Guy* in the New York Times and is a financial educator. What caught our attention was a book Carl wrote called *The Behavior Gap*. In it, he pointed out that on average, investors don't do as well as the products they invest in. There is a gap between the returns.

Investors have a tendency to buy high when things are popular and sell low when the tables have turned. And in general, they trade too much. Study after study in the U.S. had confirmed Mr. Richards' thesis.

As we were setting up Steadyhand, we were determined to eliminate the gap.



We're big fans of Carl Richards' sketches.

Running the business

Keeping our clients on track wasn't the only thing we felt strongly about. We also saw an opportunity to run our business differently – differently enough that clients could feel it.

If David Swensen was our muse on the investment side, Tony Hamblin was my entrepreneurial muse. When Tony was at Confederation Life, he trained many of Canada's great investors, including his eventual partner, Prem Watsa. But Tony is also a serial entrepreneur and his advice and inspiration to me was invaluable when we were getting going.

At one point, Tony said, "*If you focus on the people, philosophy and business practices, the performance and clients will take care of themselves.*" And so we did.

As I've described, we already had a defined **investment philosophy** – Undexing.

On the **people** front, we hired professionals who come from a diverse set of backgrounds and experiences. They all wanted to be owners and have a stake in our clients' success. And they were willing to each eat their own cooking.

Eating our own cooking. And lots of it.

We call the cooking part 'co-investment' – the percentage of the team's financial assets that is invested alongside our clients in the Steadyhand funds. We publish the number every year. In 2016, it was 83%.

As for our **business practices**, our most important criteria for making decisions was keeping it 'simple'. We looked at everything we did through this lens. It's how we wanted the firm to be, and it would help us differentiate ourselves in an industry that was getting increasingly complex.

Simple played out in a number of ways. I've already talked about our tight fund lineup. As well, we would use our website as the hub for everything (this worked particularly well because Scott and Neil did a wonderful job of designing the site). And we would report back to clients in terms they could understand – dollars and cents. Every client, no matter how big or small, would get the same statement. We would have one phone number, one philosophy and really, one business.

Simple!

Fees

Where we bent the 'simple' rule slightly was with fees, but we felt it was justified. We wanted our fee schedule to reflect the relationship we had with each client. Your fee per dollar invested would go down as your portfolio grew and the longer you worked with us.

When we finalized the schedule, there was definitely a marketing element to it. We were hoping it would help attract clients. But more importantly, we wanted our fees to reinforce our long-term approach.

The most innovative part of our fees was the reward for longevity. This didn't come from any deep insights or analysis. It was simply a negative reaction to how other businesses operated.

One night Lori yelled out from our home office to tell me that she was renewing my Sports Illustrated subscription (which went back almost 40 years). She said, *"Honey, did you know that if I go online and sign you up as a new subscriber, I can get a way better rate?"* Wow, 40 years.

Needless to say, we didn't want to take advantage of our loyal clients. We wanted to share in the cost savings and celebrate it. Our 5-Year Club (5YC) was designed to do just that.

Intergenerational members of the 5-Year Club

Hurdles? What hurdles?

As we cut the ribbon to open the firm on a glorious Vancouver day in April of 2007, we were bubbling with enthusiasm and optimism, but even then we knew we would have lots of hurdles ahead. Some would be external, many self-inflicted and most would be unanticipated.

The many hurdles we encountered, however, paled in comparison to one enormous one that came in year two - the financial crisis of 2008.

The global financial crisis of 2008/09 was by far our biggest hurdle

I saw Black Monday in October, 1987 first hand. I put my analyst duties aside for the day and watched the markets unravel from the edge of the trading desk. When the tech wreck came along at the beginning of the millennium, I was CEO of one of the largest asset managers in the country.

But neither event came close to what we went through in 2008 and early 2009. Like the previous two, stock prices melted down in front of our eyes, but we could also feel the whole financial system collapsing under our feet. Global banks were being bailed out, iconic names like Lehman Brothers were disappearing and for weeks the corporate bond markets were essentially closed for business. Even some AAA-rated securities, supposedly the safest investments you can hold, proved to be worthless.

Our team did a great job throughout these horrendous five months. We wrote more than usual in an attempt to explain what was going on and how were managing the funds. It was all hands on deck when it came to manning the phones and providing advice to clients. Chris led the way in this regard.

We didn't get it perfect – we recommended rebalancing after the market was down 30%, which proved to be

about a month and 20% too early – but we kept at it and proved to be very right in the end. It helped that our fund managers were rock solid through it all. They stuck to their disciplines and took advantage of the low prices.

I'll always remember at one of our quarterly review sessions, Connor, Clark & Lunn saying to us, "*This is a once-in-a-career opportunity in credit* [corporate bonds]."

It's important to understand why we were able to negotiate 2008 as well as we did.

First of all, our managers and I kept our focus on the long view. It sounds corny, but we really did look at what our companies would look like in 3-5 years when things had returned to normal.

Second, we held quality assets. By this, I mean well financed businesses with clear competitive advantages, strong track records of growing profits and proven leaders at the helm.

"This is a once-in-a-career opportunity in credit"

Third, we focused on valuation (as we always do). We know that the price paid for an asset is not a market timing tool, but it's the closest thing to gravity that we investors have. In other words, the price of a stock will eventually reflect the true value of the company. In late 2008 and early 2009, stock prices were screamingly cheap compared to future earnings, cash flows and dividends. Our managers acted accordingly.

The other thing we relied on is something I learned early in my career from Art Phillips and Bob Hager. They were both students of investor sentiment, or the mood of the market. 2008/09 was a great example of how this contrarian indicator works. People were running for cover and giving up on stocks, which meant it was a good time to buy.

This approach also served our clients well in 2011 and early last year, when the stock market was in serious decline and the news was gloomy. But there was one thing we did in early 2009 that we couldn't do the other times – we took our 'Don't Fear the Bear' videos off our home page (these were short vignettes where I discussed some key aspects of investing and our firm, with a 1,600 pound grizzly bear doing his thing beside me). Call us superstitious, but it seemed to work. Within days of doing it, the market bottomed and as it turned out, an 8-year bull market (so far) had begun.

Our furry friend Koda left our website in 2009

The hangover

Our funds bounced back relatively quickly, but the financial crisis would have a lasting impact on our clients. Economies started to recover, but politicians and central bankers worried incessantly about deflation and the possibility of another 2008. As a result, interest rates and monetary policy weren't allowed to normalize. Instead, central banks continued to micro-manage the economy and interest rates were pushed down near zero.

The biggest impact of this tampering was felt by our retired clients. During our time in business, their situation changed dramatically. Think about it. Ten to fifteen years ago, if you'd saved a reasonable amount and didn't have an extravagant lifestyle, you could buy some GICs and bonds, and enjoy retirement without being subject to the ups and downs of the stock market. Today, if you did that, you would have a severely reduced income and be losing ground to inflation. Unless you're wealthy, you must own stocks in your portfolio and live with a higher degree of volatility.

At the other end of the spectrum, investors with a long time frame (often referred to as accumulators) were impacted in a different way. 2008 came just five years after the tech wreck, which meant that stock investors were feeling severely beaten up. With significant negative returns in 2001 and 2002, followed by 2008, many

Canadians threw in the towel.

It was one of the most meaningful trends we observed during our first decade - many Canadians lost the ability to take risk, which means they stopped investing (not Steadyhand clients fortunately). BlackRock, one of the world's largest asset managers, did an investor survey in 2015 which revealed that 62% of Canadians' financial assets were held in cash-like instruments. 62% in savings accounts, GICs and index-linked notes. By holding large amounts of cash, many Canadians made a huge bet against their long-term plan and missed out on one of the great bull markets.

For a long-term investor who was properly diversified, however, the decade proved time and again that losses on paper are not a risk. And volatility, while disconcerting, is not a risk either, it's a blessing.

So, if you're feeling uneasy about Trump, Brexit or our speculative housing markets, your hiding place is not putting money under the mattress. It's going straight to your strategic asset mix or SAM. SAM is your friend.

A new fund ... finally

Speaking of diversification and friendly places, we should talk about the Founders Fund, which many of you are invested in.

As I outlined earlier, we didn't have a balanced fund initially. It was a conscious decision. We wanted to build every client portfolio custom. That hasn't changed, of course, but it became clear that our clients wanted us to do more. They, along with financial planners and industry consultants, were asking for a fund that would capture everything that we did and take care of the rebalancing. Some clients also wanted a fund that reflected my views of the investment landscape. Internally, David Toyne, our Toronto partner, was also pushing because he saw that many clients were busy with careers, children and travel, or just weren't interested in investing.

We were slow to get around to it, but we launched the Founders Fund in February of 2012. It would be managed by me and hold our other five funds.

The name of the fund certainly wasn't unanimous around the shop. 'Balanced Fund' would have fit with our simply-named lineup, but it sounded so boring. I couldn't stomach it, so we brainstormed for a few weeks, after which I pulled rank. We called it the Founders Fund. It had a nice ring to it and our clients would know who was losing sleep during the rocky times.

We're listening

Because we've been truly transparent in running the firm and don't pull any punches, our clients and followers have done the same. We've been blessed with a steady flow of feedback, which has helped shape the firm. We've improved our forms, changed wording on our website and even upgraded our coffee! And of course, the Founders Fund is the best example of feedback improving our business. The fund now accounts for half of our assets under management.

Of course, some of the feedback is quite colourful. When I asked the team for their favourite, there was no hesitation. It was a response to one of my articles – *"You're an idiot!"*

Colourful or not, please keep the feedback coming.

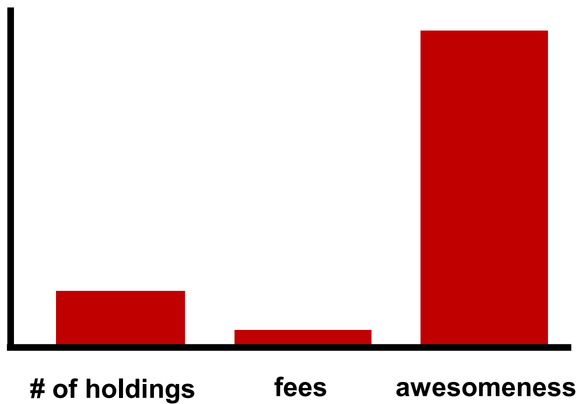
One of Neil's management disciplines that we use regularly is to assess people and projects by looking at three things we did well and three things that need improvement. I'm going to use his framework to assess our 10 years.

Neil's management discipline, "Three Things"

What we got wrong

The first thing that comes to mind is advertising. As you can probably tell, big advertising campaigns are not in our DNA or budget, but we did give it a try in 2009. We ran ads online, in magazines and on BNN, the Business News Network.

If you don't remember them, you're not alone. It wasn't one of our finest moments.



A Steadyhand ad we ran circa 2009

I would say the second big mistake we made was underestimating the dominance of the banks. In Canada, all roads lead to the banks and in wealth management, we hear a constant sucking sound as the Big 5 vacuum up assets. Needless to say, it took us longer to build momentum. Our early clients had to weave their way through the office towers and advertising barrage. We commend those of you who found us early on.

If I'm being hard on us, I'd say the thing that most impacted our clients was the fact that we didn't take full advantage of the good markets. Our clients participated in the up markets for sure, but our expectation of a normal economic cycle was out of sync with near-zero interest rates and an extended business cycle.

The impact was concentrated in two areas. In the Global Equity Fund, our manager (Edinburgh Partners) was too early in rotating away from interest-sensitive stocks and towards other stocks, including non-U.S. cyclicals. And in the Founders Fund, I was guilty of being too cautious with the asset mix. On a few occasions, I trimmed back on bonds and stocks too soon and substituted cash.

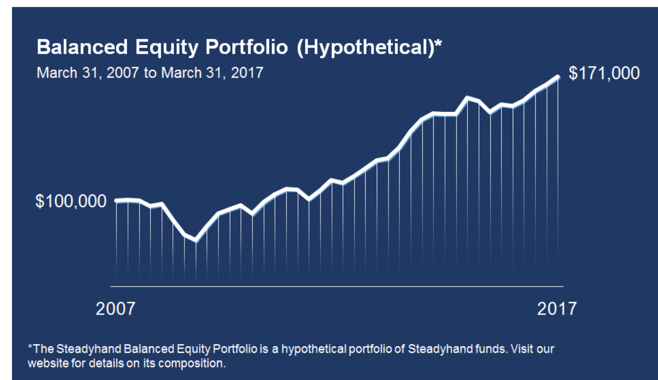
What we got right

The first thing I would highlight on the positive side of the ledger is stewardship, which measures how well our interests are aligned with yours. Morningstar, a global research firm, brought their research on stewardship to Canada about seven years ago and Steadyhand has consistently been at the top of the rankings. Indeed, recently Morningstar referred to us as the *"poster child of a good steward."*

We take these ratings as an endorsement of our business model and the culture we've created.

Second, I'd go to performance. Despite my comments about our handling of good markets, our long-term returns have been very good. Over the 10 years, which includes all types of markets, balanced portfolios at Steadyhand have beat indexed portfolios and rank highly against the competition.

Overall, our fund managers did a good job. They gave our clients exposure to foreign stocks and corporate bonds before these asset classes game came into vogue, and as I referenced earlier, they handled the bad markets exceptionally well.



The long-term performance of our Balanced Equity (Model) Portfolio

The final thing I would highlight is something we're most proud of - we lived up to our name. We provided a steady hand and as a result, there was no slippage between how our funds did and the results our clients experienced. No behavior gap.

Looking forward

As we lean in for the next 10 years, we're excited. We don't see any reason why you and us can't accomplish even more than we did over the last decade.

We believe we have the strongest, most versatile team we've ever had, and it's an exciting time to be an independent firm. The industry is consolidating into fewer and fewer hands, which makes us more unique by the day.

No matter how successful we are, we're always going to be a 'David' amongst 'Goliaths'. We're OK with that. It's wonderful most of the time and as Tony Hamblin said to me when we started, *"Tom, if you do this, it will be all about the independence."* He was so right. The ability to make unfettered decisions on behalf of our clients has made it worthwhile.

From an investment point of view, we'll take the 'David' position every time. We prefer to not be burdened by size and corporate agendas. We cherish the ability to trade more easily and own a wider range of securities. There is no disputing the fact that investing in stocks is an anti-scale business - the larger you get, the more difficult it is to beat the indexes and competition.

We relish being a David amongst the Goliaths

Success

Mr. Market will throw a lot at us in the coming years, but as our short history reminds us, the biggest factors as to how we all do have a lot to do with our own behaviour. And on that note, I'd like to leave you with five lessons that we learned, or had reinforced, over the 10 years we've been serving you.

First, **don't despair Mr. Market.** He has his ups and downs, but he's a reliable provider. Long-term investors have to be there.

Diversify. Always. The best way to deal with the challenges we face when we're investing is to be properly and completely diversified. Canadians have had a tendency to get carried away on narrower strategies like oil, gold and dividend-paying stocks.

Risk is a personal thing. It's imperative you understand what risk means to you. When you read the newspapers or watch the news, you'd think we all had the same risk. We don't. A 40-year-old should have a very different reaction to a bear market than a 70-year-old for instance.

Be needy. I'm referring to the fact that investing is super important. It's all about the last third of your life. We shouldn't leave any question unanswered or task unfinished. Whether it's Steadyhand or your other providers, be demanding.

And finally, to our clients I say, **keep doing what you've been doing!** You've been awesome. You've stuck to your plan and the results have showed.

“Why is a steady hand so important? Investing is like buying no other product or service. It’s not intuitive. It runs counter to human nature. And it’s one of the longest things you’ll do. Investing for retirement spans many decades and doesn’t end until you do.”

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