vista™

THE INFORMED INVESTOR

Many people today are facing difficult choices in achieving their financial goals and are rightfully asking serious questions.

Our goal with *The Informed Investor* is to help you rise above the noise of the marketplace in order to systematically make smart decisions about your money.

Because educated investors are the most successful investors, we have created *The Informed Investor* to show you a Nobel Prize-winning approach crafted to optimize your investment portfolio. We have designed it specifically to both support you in your efforts to preserve what you already have, and to efficiently capture the market's returns for your investments.

In addition, because we recognize that reaching your financial goals requires more than just good investment management, we have also described an approach, comprehensive wealth management, that systematically addresses your entire range of financial issues.

We believe in empowering people to make the best decisions for themselves or, if they wish, to astutely choose a financial advisor who can implement sound wealth management principles. And we believe in sharing our own financial knowledge with everyone who wants to make wise decisions about his or her money.

Vista Wealth Management, LLC is pleased to present *The Informed Investor* to our clients and prospective clients. We hope it will provide you with an intelligent framework for making financial decisions that will help you achieve all of your most important goals.

Best Regards,
Vista Wealth Management, LLC

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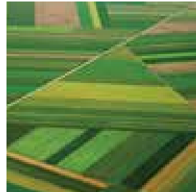

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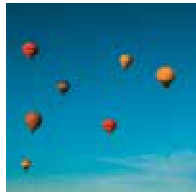

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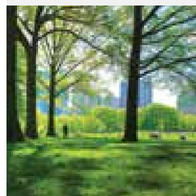

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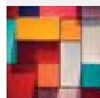

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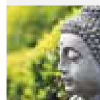

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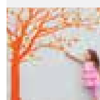

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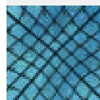

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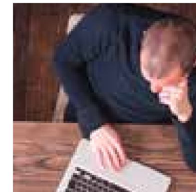

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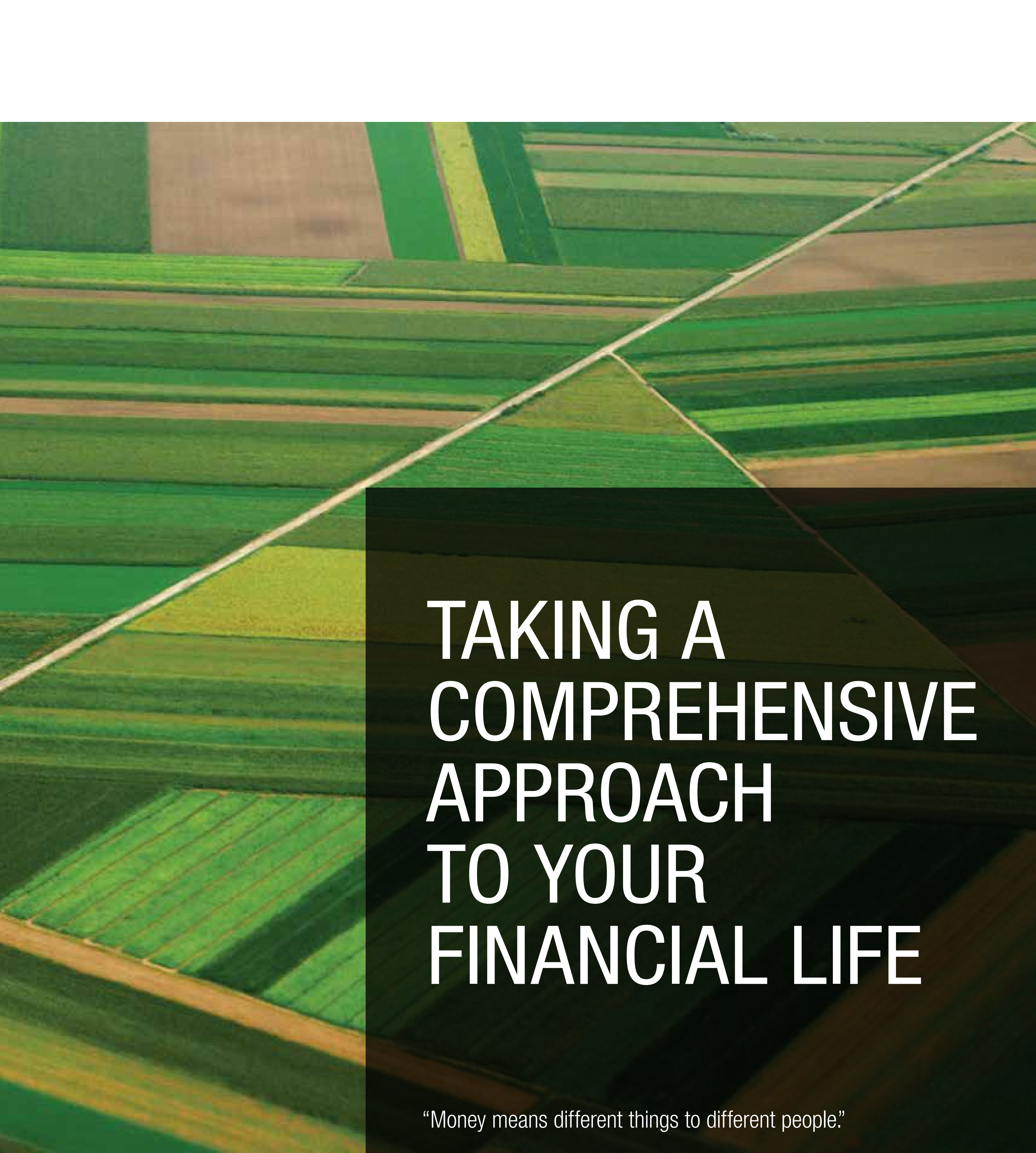


TAKING A COMPREHENSIVE APPROACH TO YOUR FINANCIAL LIFE

"Money means different things to different people."

Each of us has unique personal dreams.

You may want to achieve financial freedom so that you never have to work again—even if your plan is to keep working for the rest of your life.

You may want to make a top-flight college education possible for your children or grandchildren, or provide them with seed money for a home or a business.

You may dream of a vacation home on the beach or in the mountains. Or you may have achieved tremendous success throughout your career and want to leave behind an enduring legacy that will enable your favorite charity to continue its work.

Whatever your dreams are, you need a framework for making wise decisions about your money that will enable you to achieve all that is important to you. Chances are good that you have a wide range of financial goals, as well as diverse financial challenges.

Common sense tells us that such a broad range of issues requires a broad comprehensive outlook. It's for this reason that most affluent clients want their financial advisors to help them with more than just investments. They want real wealth management: a complete approach to addressing their entire financial lives.

As you've probably noticed, many financial firms claim to offer wealth management. The trouble is that many of these firms just provide investment management and a couple of extra services, such as college education planning and estate planning, and call that wealth management. So the challenge for anyone who wants help addressing all of his or her financial needs is finding a firm that provides comprehensive wealth management.

We define Wealth Management (WM) as a formula:

WM = IC + AP + RM

Investment Consulting (IC) is the astute management of investments over time to help achieve financial goals. It requires advisors to deeply understand each client's most important challenges and design an investment plan that:

- Takes into account the client's time horizons and tolerance for risk, and
- Maximizes the likelihood that the client will achieve his or her goals.

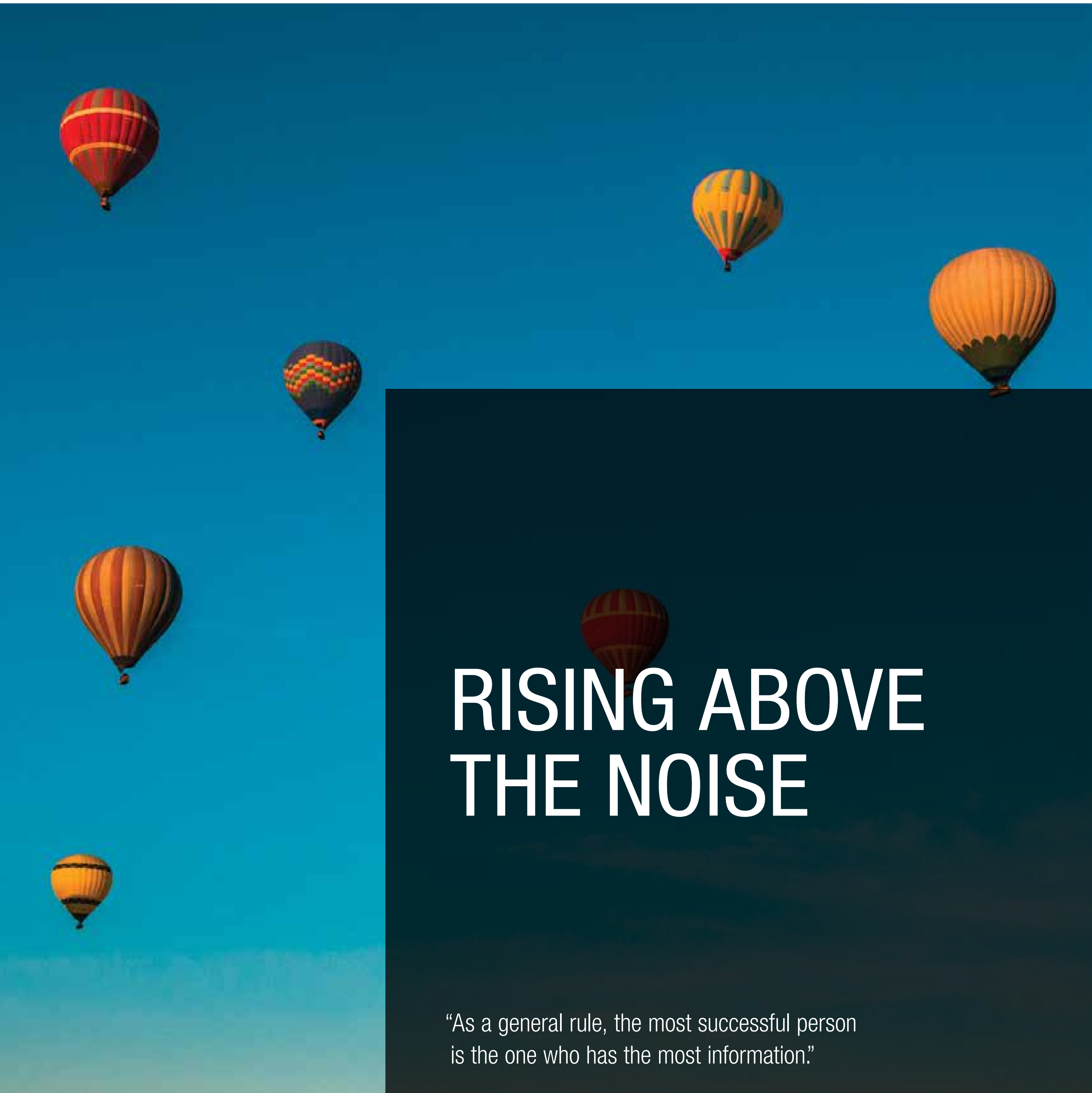
It also requires advisors to monitor the client's portfolio and financial life over time so that they can make adjustments to the investment plan as needed.

Advanced Planning (AP) goes beyond investments to look at all the other aspects of your financial life. We break it down into four parts: helping family, protecting lifestyle, managing net worth, and building a legacy. In our experience, very few financial advisors offer all these services.

Relationship Management (RM) is the final element. True wealth managers are focused on building relationships within three groups. The first and most obvious group is their clients, with whom they must foster solid relationships based on trust. Second, they must manage a network of financial professionals whom they can call in to address specific client needs. Finally, wealth managers must be able to work effectively with their clients' other professional advisors, such as their attorney and accountant.

Our focus in this resource guide will be on investment consulting, the first element of wealth management. But bear in mind that managing your investments is just one part of a comprehensive approach to your financial life. At the end of this guide, we'll describe what you should expect from a wealth manager so that you can make an informed decision when choosing a financial professional.

Let's turn now to our discussion of the concepts that can make you a more successful investor.



RISING ABOVE THE NOISE

"As a general rule, the most successful person is the one who has the most information."

Some investment professionals go out of their way to make their work confusing.

They use jargon that can intimidate and make it difficult for you to understand relatively straightforward concepts.

But investing is actually not that complicated. It can be broken down into two major beliefs:

- You believe in the ability to make superior security selections, or you don't.
- You believe in the ability to time markets, or you don't.

Let's explore which kinds of investors have each of these belief systems and how you should approach your own investments.

Exhibit 1 classifies people according to how they make investing decisions. Quadrant one is the noise quadrant. It's composed of investors who believe in both market timing and superior investment selection. They think that they or their favorite financial guru can consistently uncover mispriced investments that will deliver market-beating returns. In addition, they believe it's possible to identify entire market segments that are mispriced, and predict when they will turn up or down. But the reality is that the vast majority of these methods fail to even match the market, let alone beat it.

EXHIBIT 1

THE INVESTMENT DECISION MATRIX

Source: CEG Worldwide

Security Selection	Market Timing: YES	Market Timing: NO
YES	**1. NOISE QUADRANT** ▪ Most individual investors ▪ Financial journalists	**2. CONVENTIONAL WISDOM QUADRANT** ▪ Financial planners ▪ Stock brokers ▪ Most mutual funds
NO	**3. TACTICAL ASSET ALLOCATION QUADRANT** ▪ Pure market timers ▪ Asset allocation funds	**4. INFORMATION QUADRANT** ▪ Academics ▪ Many institutional investors

Unfortunately, most of the public occupies the noise quadrant because the media play into this thinking in an effort to sell newspapers, magazines, or stock-tip web sites. The media want you to return to them time and time again—so they constantly dangle the lure of the next great market tip.

Quadrant two is the conventional wisdom quadrant. It includes most of the financial services industry. Most investment professionals have the experience to know they can't predict broad market swings with any degree of accuracy. They know that making incorrect predictions usually means losing clients. However, they believe in the ability of individual market analysts—today armed with MBAs and high-tech information systems—to find undervalued securities that will make money for their clients.

This belief dovetails with the American dream that intelligence and hard work lead to success. But in fact, the strategy of picking individual stocks adds no value, on average, in an efficient capital market. And while there are academic debates about the efficiency of markets, most economists agree that, fundamentally, capital markets do work.

Quadrant three is the tactical asset allocation quadrant. Investors in this quadrant believe that, even though individual securities are priced efficiently, they (and only they) can see broad mispricing in entire market sectors. They claim to add value by buying when a market is undervalued, waiting until other investors finally recognize their mistake, and then selling when the market is fairly valued once again.

We feel it's inconsistent to think that individual securities are priced fairly but that the overall market, an aggregate of those fairly-priced individual securities, is not. No prudent investors are found in this quadrant.

Quadrant four is the information quadrant. This is where most of the academic community resides, along with many institutional investors. Investors in this quadrant research what works and then follow a rational course of action based on empirical evidence. Academic studies indicate that investments in the other three quadrants do no better on average than the market after fees, transactions costs, and taxes. But because of their lower costs, investments that are passive with regard to market timing and security selection have higher average returns than the other types of investments.[1]

Our goal is to help investors make smart decisions about their money. To accomplish this, we help investors move from the noise quadrant to the information quadrant. We believe this is where you should be to maximize the probability of achieving all your financial goals.

1. Michael C. Jensen, "The Performance of Mutual Funds in the Period 1945–1964," Journal of Finance, May 1968. Mark M. Carhart, Jennifer N. Carpenter, Anthony W. Lynch and David K. Musto, "Mutual Fund Survivorship," unpublished manuscript, September 12, 2000. Christopher R. Blake, Edwin J. Elton and Martin J. Gruber, "The Performance of Bond Mutual Funds," The Journal of Business, 1993: 66, 371–403. Edwin J. Elton, Martin J. Gruber, Sanjiv Das and Matt Hlavka, "Efficiency with Costly Information: A Reinterpretation of Evidence from Managed Portfolios," The Review of Financial Studies, 1993: 6, 1–22.

FIVE KEY CONCEPTS FOR FINANCIAL SUCCESS

"The measure of who we are, is what we do with what we have."

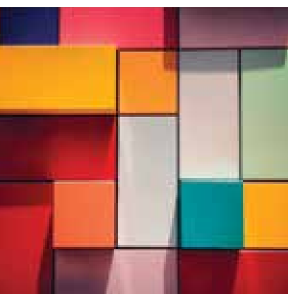
While investing can seem overwhelming at times, the academic research can be broken down into what we call the Five Key Concepts for Financial Success.

If you examine your own life, you'll find that it is often the simpler things that consistently work. Successful investing is no different. However, it's easy to have your attention drawn to the wrong issues.

These wrong issues—the noise—can derail your journey.

In this section, we'll walk through these five concepts and then explain how successful institutional investors incorporate them into their investment plans. These plans meet their fiduciary responsibilities and achieve their financial goals. You owe yourself and your family nothing less than what the institutional investors have.

It's important to note here that while these concepts are designed to maximize return, no strategy can eliminate the risk inherent in all investments. Whenever you invest, you have to accept some risk. It's also important to remember that you're responsible for reviewing your portfolio and risk tolerance, and for keeping your financial advisor current on any changes in either your risk tolerance or your life that might affect your investment objectives.



1. LEVERAGE DIVERSIFICATION TO REDUCE RISK

Most people understand the basic concept of diversification: don't put all your eggs in one basket. That's a very simplistic view of diversification, however. And it doesn't stop people from making some common financial mistakes.

For example, many employees have a large part of their investment capital tied up in their employer's stock. They understand that this is risky, but do nothing about it. They may cite the large capital gains tax they'd have to pay if they sold, or they may imagine that the stock is just about ready to take off. Often, employees are so close to particular stocks that they develop a false sense of comfort.

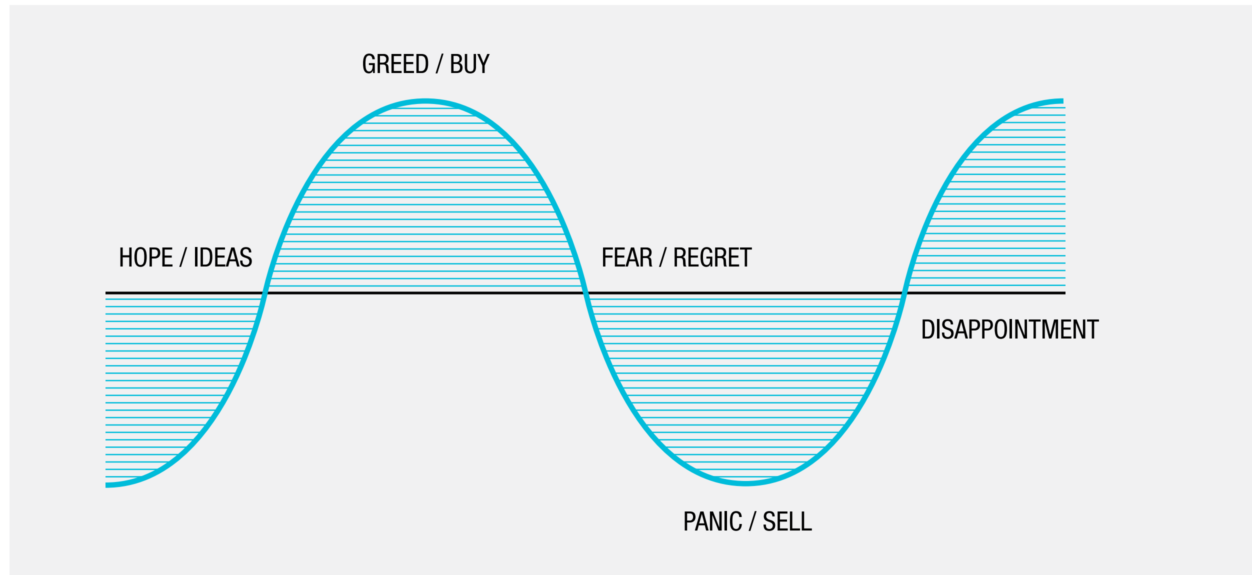
Other investors believe that they have effectively diversified because they hold a number of different stocks. They don't realize that they're in for an emotional roller-coaster ride if these investments share similar risk factors by belonging to the same industry group or asset class. "Diversification" among many high-tech companies is not diversification at all.

To understand the emotions of investing and why most investors systematically make the wrong decisions, let's look for a moment at what happens when you get a hot tip on a stock. (See Exhibit 2.)

EXHIBIT 2

THE EMOTIONAL
CURVE OF INVESTING

Source: CEG Worldwide



If you're like most investors, you don't buy the stock right away. You've probably had the experience of losing money on an investment—and did not enjoy the experience—so you don't race out and buy that stock immediately based on a hot tip from a friend. Instead, you follow it for awhile to see how it does.

Let's assume it starts trending upward. What's your emotion? Confidence. You hope this might be the investment that makes you a lot of money. It continues its upward trend. You encounter a new emotion, greed, as you let yourself believe that this just might be the one. You decide to buy the stock that day.

Of course, soon after you buy it, the stock starts to go down, and you feel yet another set of emotions: fear and regret. You're afraid you've made a terrible mistake. You promise yourself that if the stock just goes back up to where you bought it, you'll never do it again. You don't want to have to tell your spouse or partner about it. You don't care about making money anymore.

Now let's say the stock continues to go down. Here comes one more emotion: panic. You sell the stock. And what happens next? New information emerges and the stock jumps to an all-time high.

We're all poorly wired for investing. Emotions are powerful forces that cause you to do exactly the opposite of what you should do. That is, your emotions lead you to buy high and sell low. If you do that over a long period of time, you'll cause serious damage to your portfolio and to your financial dreams.

But truly diversified investors, those who invest across a number of different asset classes, can lower their risk without necessarily sacrificing return. Because they recognize that it's impossible to know with certainty which asset classes will perform best in coming years, diversified investors take a balanced approach and stick with it despite volatility in the markets.

2. SEEK LOWER VOLATILITY TO ENHANCE RETURNS

If you have two investment portfolios with the same average or arithmetic return, the portfolio with less volatility will have a greater compound rate of return.

For example, let's assume you are considering two mutual funds. Each of them has had an average arithmetic rate of return of eight percent over five years. How would you determine which fund is better? You may expect both to have the same ending wealth value.

However, this is true only if the two funds have the same degree of volatility. If one fund is more volatile than the other, the compound returns and ending values will be different. It is a mathematical fact that the one with less volatility will have a higher compound return.

You can see how this works from Exhibit 3. Two equal investments can have the same arithmetic rate of return but very different ending values because of volatility. You should design your portfolio so that it has as little volatility as necessary to achieve your goals.

EXHIBIT 3

LESS VOLATILITY= GREATER WEALTH

Source: CEG Worldwide

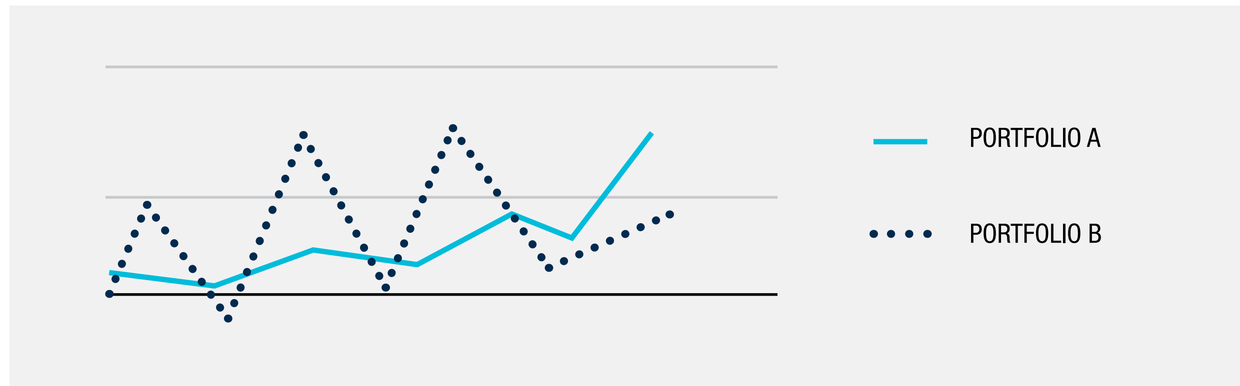
	Consistent Investment		Volatile Investment	
	RATE OF RETURN	**ENDING VALUE**	**RATE OF RETURN**	**ENDING VALUE**
YEAR 1	8%	$108,000	30%	$130,000
YEAR 2	8%	$116,640	-20%	$104,000
YEAR 3	8%	$125,971	25%	$130,000
YEAR 4	8%	$136,049	-20%	$104,000
YEAR 5	8%	$146,933	25%	$130,000
	ARITHMETIC RETURN	**8%**	**ARITHMETIC RETURN**	**8%**
	COMPOUND RETURN	**8%**	**COMPOUND RETURN**	**5.39%**

Exhibit 4 shows two portfolios with the same average return. As a prudent investor, you want the smoother ride of Portfolio A not only because it helps minimize the emotional jolts but, more importantly, because it will create the wealth you need to reach your financial goals.

EXHIBIT 4

TWO PORTFOLIOS WITH THE SAME AVERAGE RETURN

Source: CEG Worldwide



3. USE GLOBAL DIVERSIFICATION TO ENHANCE RETURNS AND REDUCE RISK

Investors in the U.S. tend to favor stocks and bonds of U.S.-based companies. For many, it's more comfortable emotionally to invest in familiar firms and household-name products than in companies located on another continent.

Unfortunately, these investors' emotional reactions are causing them to miss out on one of the most effective ways to increase their returns. That's because the U.S. financial market, while the largest in the world, still represents less than half of the total investable capital market worldwide.[2] By looking to overseas investments, you increase your opportunity to invest in superior global firms that can help you grow your wealth faster.

Global diversification in your portfolio also reduces its overall risk. American equity markets and international markets generally do not always move together. Individual stocks of companies around the world with similar risk have the same expected rate of return. However, they don't get there in the same manner or at the same time. The price movements between international and U.S. asset classes are often dissimilar, so investing in both can increase your portfolio's diversification.

2. World Federation of Exchanges, 2014.

4. EMPLOY ASSET CLASS INVESTING

It's not uncommon for individual investors to look at their returns and wonder why they're not doing better. Unfortunately, many use tools that leave them at a significant disadvantage compared to institutional investors. Investing in actively-managed mutual funds can be like trying to fix a sink with a screwdriver when you really need a pipe wrench. You need the right tools for the job—and asset class investing is a key tool for helping you reach your financial goals.

An asset class is a group of investments whose risk factors and expected returns are similar. Originally, institutional asset class funds were not available to the great majority of investors. Often the minimum investment for these mutual funds was in the millions of dollars, placing them beyond reach of everyone except large pension plans and the wealthiest individuals. Fortunately, these institutional asset class funds are now accessible to all investors working with an advisor. You can gain the same advantages previously enjoyed only by large institutional investors.

Asset class funds are attractive for several reasons:

1. **Lower operating expenses**
2. **Lower costs due to lower turnover**
3. **Lower taxes due to lower turnover**
4. **Consistently maintained asset classes**

We'll look at each factor in turn.

1. Lower Operating Expenses

All mutual funds and separately managed accounts have expenses that include management fees, administrative charges, and custody fees. These are expressed as a percentage of assets. According to the Investment Company Institute, the average annual expense ratio for all actively managed stock funds is .92 percent.[3] By comparison, institutional asset class funds have an expense ratio that is typically about one-third of that level. And, all other factors being equal, lower costs lead to higher rates of return.

2. Lower Costs Due to Lower Turnover

Many investment managers do a lot of trading in an attempt to add value. But each time a trade is made there are transaction costs such as commissions, spreads, and market impact costs. These hidden costs may amount to more than a fund's total operating expenses if the fund trades heavily or if it invests in small-company stocks for which trading costs are relatively high.

Institutional asset class funds generally have significantly lower turnover rates because their institutional investors want them to deliver a specific asset class return with as low a cost as possible.

3. ICI Research Perspective, Vol. 19, No. 3 | April 2013

3. Lower Taxes Due to Lower Turnover

If a mutual fund sells a security for a gain, it must make a capital gains distribution to shareholders because mutual funds are required to distribute 98 percent of their taxable income each year, including realized gains, to remain tax-exempt at the corporate level.[4] They distribute all their income annually because no mutual fund manager wants to have his or her performance reduced by corporate income taxes.

In one study, Stanford University economists John B. Shoven and Joel M. Dickson found that taxable distributions have a negative effect on the rate of return of many well-known retail equity mutual funds. They concluded that a high-tax-bracket investor who reinvested the after-tax distribution ended up with an accumulated wealth per dollar invested of only 45 percent of the fund's published performance. Furthermore, an investor in the middle tax bracket realized just 55 percent of the published performance.

The lower turnover of asset class funds results in lower taxes for their investors—and thus a higher rate of return.

4. Consistently Maintained Asset Classes

Most investment advisors agree that the greatest determining factor of performance is asset allocation—how your money is divided among different asset categories. But for this strategy to work, the investments in your portfolio must maintain a consistent asset allocation. Your investments need to stay within their target asset classes.

Most actively-managed funds effectively have you relinquish control of your asset allocation. Institutional asset class funds, on the other hand, must stay fully invested in the specific asset class they represent because of their investment mandates.

5. DESIGN EFFICIENT PORTFOLIOS

How do you decide which investments to use and in what combinations? Since 1972, major institutions have been using a money management concept known as Modern Portfolio Theory. It was developed at the University of Chicago by Harry Markowitz and Merton Miller and later expanded by Stanford professor William Sharpe. Markowitz, Miller, and Sharpe subsequently won the Nobel Prize in Economic Sciences for their contribution to investment methodology.

The process of developing a strategic portfolio using Modern Portfolio Theory is mathematical in nature and can appear daunting. It's important to remember that math is nothing more than an expression of logic, so as you examine the process, you can readily see the common-sense approach that it takes—which is counterintuitive to conventional and over-commercialized investment thinking.

4. Subchapter M, Internal Revenue Code.

Markowitz stated that for every level of risk, there is some optimum combination of investments that will give the highest rate of return. The combinations of investments exhibiting this optimal risk/reward trade off form what is known as the “efficient frontier line.” The efficient frontier is determined by calculating the expected rate of return, standard deviation, and correlation coefficient for each asset class, and using this information to identify the portfolio with the highest expected return at each incremental level of risk.

By plotting each investment combination representing a given level of risk and expected return, we are able to mathematically describe a series of points, or “efficient portfolios.” This line forms the efficient frontier.

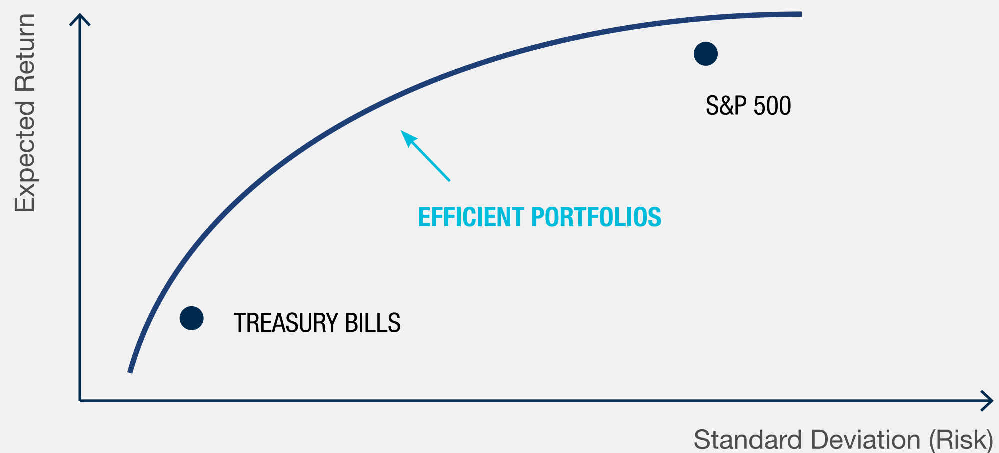
Most investor portfolios—including the S&P 500, which is often used as a proxy for the market—fall significantly below the efficient frontier. An asset class portfolio allows investors to obtain the same rates of return with much less risk, or higher rates of return for the same level of risk.

Exhibit 5 illustrates the efficient frontier relative to the “market.” Rational and prudent investors will restrict their choice of portfolios to those that appear on the efficient frontier and to the specific portfolios that represent their own risk tolerance level. Our job is to make sure that, for whatever risk level you choose, you have the highest possible return on the efficient frontier so that we can maximize the probability of achieving your financial goals.

EXHIBIT 5

THE RANGE OF EFFICIENT PORTFOLIOS

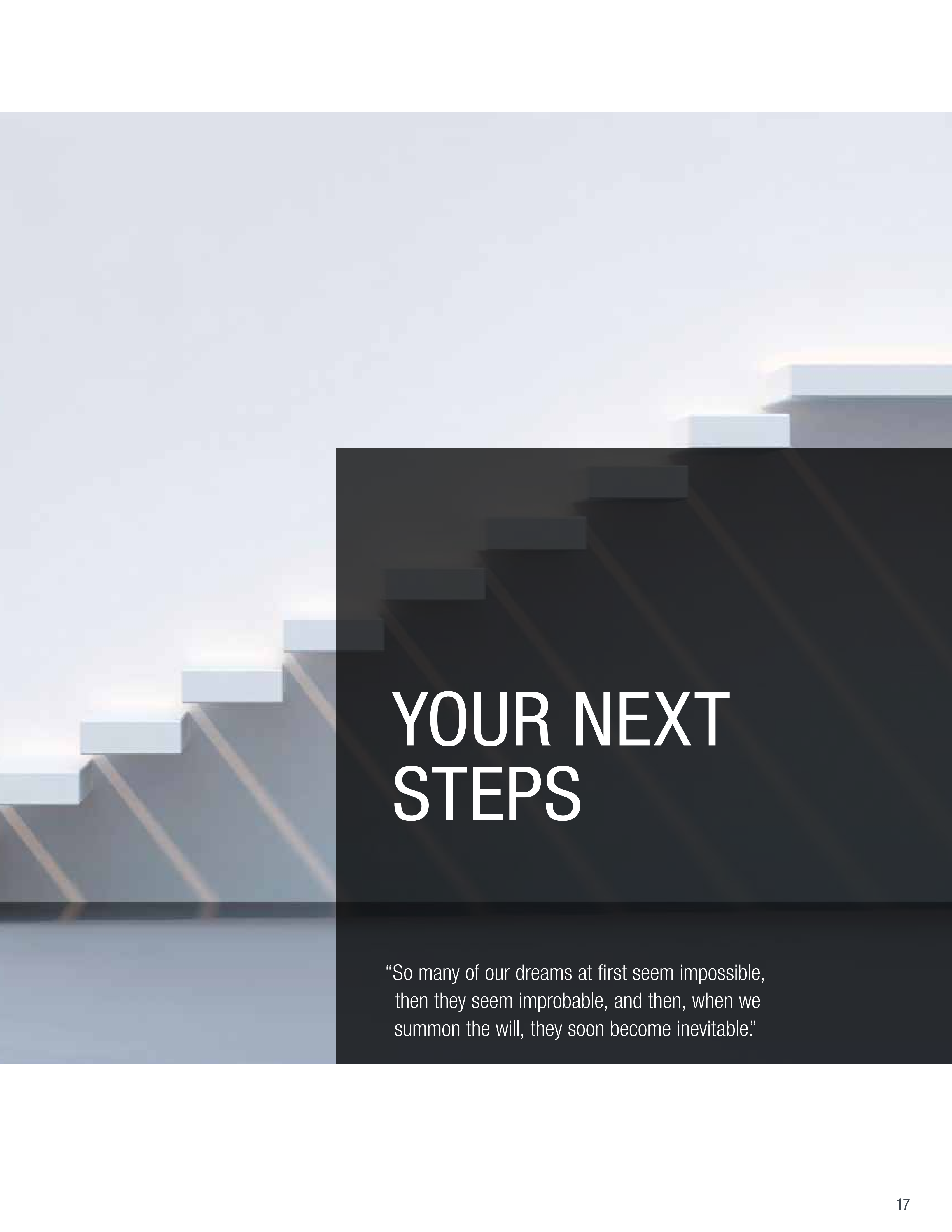
Source: CEG Worldwide



Expected rate of return is typically calculated as the risk-free rate of return plus the risk premium associated with that equity investment.

Standard deviation is a description of how far from the mean (average) the historical performance of an investment has been. It is a measure of an investment’s volatility.

Correlation coefficients measure the dissimilar price movements among asset classes by quantifying the degree to which they move together in time, degree, and direction.



YOUR NEXT STEPS

"So many of our dreams at first seem impossible, then they seem improbable, and then, when we summon the will, they soon become inevitable."

As we discussed at the beginning of this guide, achieving all your financial dreams requires comprehensive wealth management.

This means more than just taking care of your investments. It also means addressing your advanced planning needs by helping family, protecting lifestyle, managing net worth, and building a legacy.

Such a wide range of financial needs requires a wide range of financial expertise. Because no one person can be an expert in all these subjects, the best wealth managers work with networks of experts—financial professionals with deep experience and knowledge in specific areas.

Effective wealth managers, then, are experts at relationship management—first building relationships with their clients in order to fully understand their unique needs and challenges, and then coordinating the efforts of their expert teams in order to meet those needs and challenges. Wealth managers must also work with their clients' other advisors—such as attorneys and accountants—in order to ensure optimal outcomes.

Many in the financial services industry call themselves wealth managers but offer little more than investment management. How then do you know whether you are dealing with a true wealth manager?

First, the advisor should offer a full range of financial services, including the four areas of advanced planning that we mentioned above. He or she should have the backing of a network of experts to provide these services.

Second, the wealth manager should work with you on a consultative basis. This allows the wealth manager to uncover your true financial needs and goals, craft a long-range wealth management plan to meet those needs, and build an ongoing relationship with you to stay attuned to your changing needs.

This consultative process usually unfolds over a series of meetings:

At the discovery meeting, the wealth manager determines your current financial situation, where you want to go, and the obstacles you face in achieving what is important to you.

At the evaluation meeting, the wealth manager uses information from the first meeting to present a complete diagnostic of your current financial situation and a plan for achieving your investment-related goals.

At the engagement meeting, assuming that the wealth manager can truly add value, both you and the wealth manager decide to work together. You now officially become a client.

At the implementation meeting, the wealth manager helps you organize your new account paperwork and answers any questions you may have.

At review meetings, typically held quarterly, the wealth manager reports on the progress toward your goals and checks in with you on any important life changes that might call for an adjustment to your investment plan.

EXHIBIT 6

THE CONSULTATIVE WEALTH MANAGEMENT PROCESS

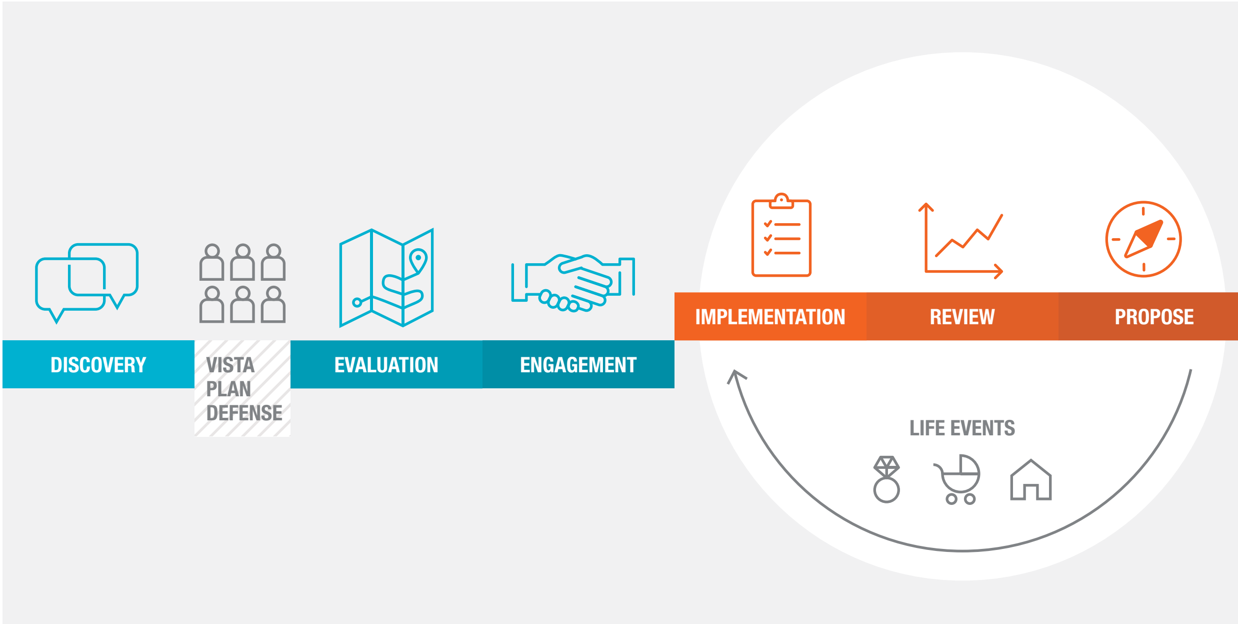


Exhibit 6 shows an overview of our consultative wealth management process.

In addition, you should always expect outstanding service from any financial advisor you choose. Your phone calls should be returned promptly, you should receive quick and complete responses to all your questions, you should be able to meet with your advisor as often as you wish, and your advisor should always take your unique needs and preferences into account.

If you are currently working with a financial advisor and are unsure whether he or she is using the consultative wealth management approach we've discussed here, we recommend that you have another advisor complete a diagnostic of your situation so that you have a second opinion.

You owe it to your family and yourself to make sure that your investment plan—and overall wealth management plan—is designed to effectively address your very specific financial needs so you have the best chance of meeting your financial goals.

We wish you complete success in achieving all that's important to you.

ABOUT VISTA WEALTH MANAGEMENT, LLC

Vista Wealth Management (Vista) acts as a family CFO. Our firm specializes in serving individuals and families who want to build financial security and achieve peace of mind.

We work with a limited number of high net worth individuals, and do not take on clients unless we have determined that we can add substantial value and help them achieve their financial goals.

Vista uses a consultative approach to take our clients and prospective clients through a series of meetings to fully understand their values and goals, and then deliver truly comprehensive advice. Our wealth management process includes financial planning, investment consulting and management, wealth enhancement and transfer planning, wealth protection, and philanthropic planning.

Vista's investment philosophy is based on building globally diversified portfolios through asset class investing, and using tax-efficient institutional investment vehicles.

At Vista, we handle your financial life so that you don't have to.

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The Informed Investor: Five Key Concepts for Financial Success

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