

# Three Pillars of Portfolio Customization

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# Introduction

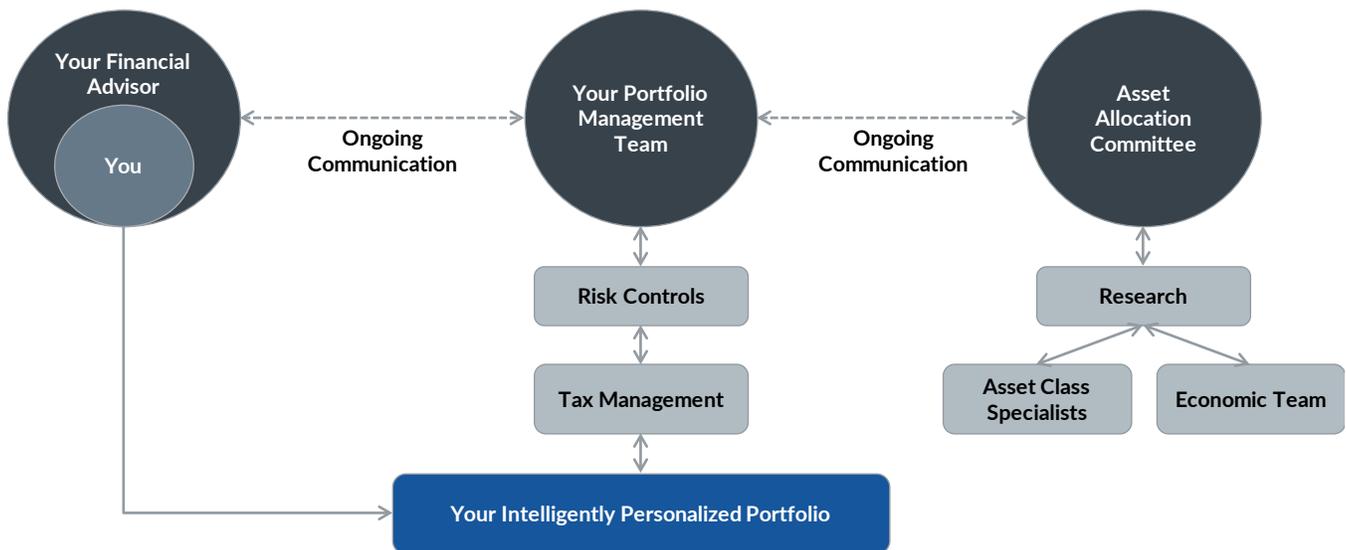
For more than three decades, we at City National Rochdale have designed and managed customized investment portfolios for high-net worth clients. We take pride in our ability to deliver a first-class investment management experience to clients that is completely tailored to their individual needs. Unlike many investment managers, we go well beyond the mere essentials of asset management by offering a completely personalized portfolio to each of our clients.

Our approach is multi-faceted and encompasses extensive research and analysis to help clients reach their financial goals through well-managed investment strategies. We go beyond the mere essentials of asset management and take it a step further through a personalized touch. The following outlines what we see as our three pillars of portfolio customization.

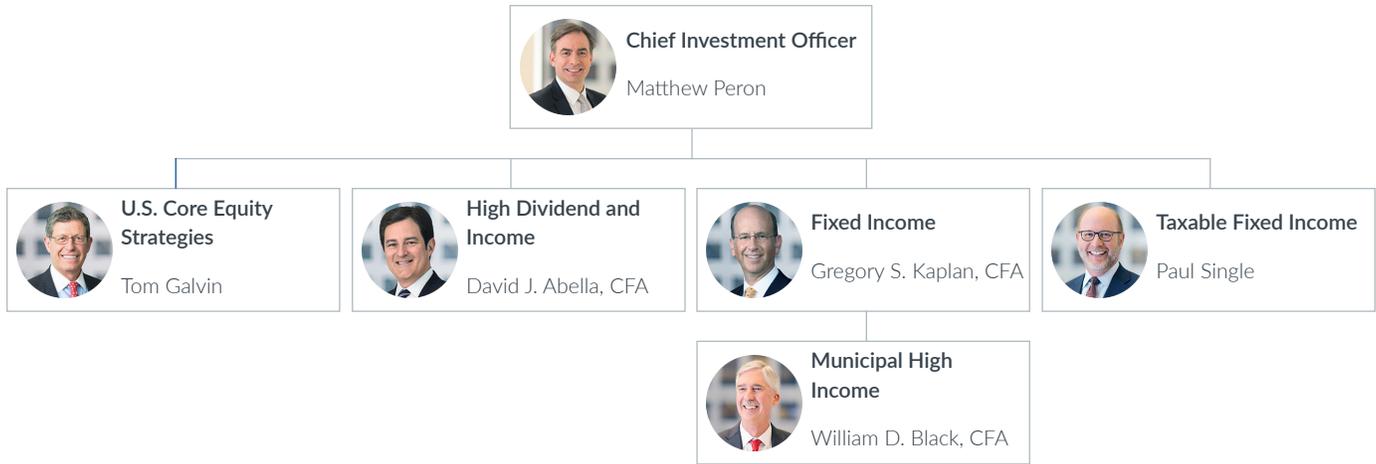
## Pillar One: Personalized Portfolio Management

One of the cornerstones of our firm is the ability to personalize a portfolio. High-net worth clients tend to be sophisticated investors with complex needs—assets in many different places and in many different types of vehicles. Each client has unique investment goals, and many also express the desire to align portfolios with their moral compasses and personal feelings about the economy or markets. In addition, it is rare that a client comes to City National Rochdale with a completely blank slate, so we often need to work around existing portfolios, unrealized gains/losses, and other various behavioral biases that may exist with the client and his/her investment holdings.

To meet the goals and expectations of high-net worth clients, we work with their advisors to develop unique plans for each unique goal. Once the plan is in place, we build an Investment Policy Statement (IPS) that serves as a guide for portfolio construction and investment decision making.



Specialized strategy managers oversee certain asset classes in-house. For some other asset classes, such as opportunistic income, small cap, and international equities and bonds, we partner with outside managers.



Taking direction from the Asset Allocation Committee, whose members average more than 30 years of experience, individual portfolio managers are empowered to customize and implement strategies from a variety of global options tailored to each client. Based on each client’s unique circumstances, our portfolio managers design unique investment strategies and proactively manage them to help drive performance.

36  
portfolio managers

19  
investment consultants

75+%  
investment consultants and  
portfolio managers who are  
CFA charterholders

We include personal benchmarks to measure each portfolio’s performance and adjust investment allocations to suit client needs. Using our proprietary analytic tools, we develop a plan based on each client’s target return goals.

Our proprietary portfolio analysis software, Galaxy, helps us illustrate how our custom strategies work for each client. We input key data about the client’s portfolio and investment strategy into the tool, which simulates the portfolio’s outlook over the long term and helps give clients a complete financial picture. The result is one comprehensive report that takes a holistic look at clients’ assets—retirement accounts, trusts, IRAs, etc.—including the tax aspects. Based on variations in strategies and asset allocations, Galaxy generates possible portfolio outcomes. What makes this tool particularly powerful is that it’s not just a hypothetical portfolio—it shows the possibilities for a client’s existing assets. With these simulations, clients can compare and contrast our recommendations to what they’re currently doing.

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## Pillar Two: Active Tax Management

Active tax management is a key element of any wealth management plan. According to industry studies, while it is difficult to pinpoint what percentage of after-tax return is added through tax alpha, it may be 1-2% a year<sup>1</sup>. Furthermore, the lack of tax management can cost an investor as much as 25% of returns<sup>2</sup>.

At City National Rochdale, we take a methodical three-step approach that's a function of open communication between the client, financial advisor, tax professional, and portfolio manager:

### STEP 1: PLANNING AND TAX BUDGET

One key element of the Investment Policy Statement (IPS) is tax. We formulate a tax budget for each client which defines the annual budget for ordinary income, short-term gains, and long-term capital gains. We work closely with the client's financial advisor and tax professional (CPA) to develop and manage the tax budget.

From the very start of the relationship, when we transition assets to City National Rochdale, we proactively manage to the tax budget. It then becomes an ongoing part of the portfolio's active management at City National Rochdale.

### STEP 2: ASSET LOCATION AND IMPLEMENTATION

As we begin building a client's portfolio, the first step to tax management is the idea of "Asset Location"—in other words, putting the right securities in the right accounts to maximize benefits to the client.

Asset Location also applies to the mutual fund space. We typically prefer to minimize mutual fund holdings in high-net worth client portfolios, opting to own individual stocks and bonds as core holdings, but understand that there are situations in which mutual funds may be appropriate (particularly with regard to specific market niches). Mutual funds control their capital gains annually, which can provide a tax management challenge. Nevertheless, we strive to implement appropriate strategies to minimize the tax burden.

### STEP 3: TAX BUDGET MANAGEMENT

Our portfolio managers take active steps toward managing to the client's tax budget and finding efficiencies where possible through:

- Long-Term Capital Gains
- Realizing Losses
- Offsetting Gains with Losses
- Realizing Gains
- Tax Lot Management
- Billing Strategies
- Additional Strategies

The key to tax management is ensuring that the financial advisor, the accountant, and the portfolio manager are all on the same page. We take pride in our work helping clients create and implement their own custom tax plan. To learn more about these individual steps and strategies, please see our in-depth white paper, *Tax Alpha: Enhancing Returns Through Active Tax Management*, or talk to your local City National Rochdale investment consultant.

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## Pillar Three: Customized Risk Management

Last but not least, any sound investment management plan includes a robust risk management strategy. At City National Rochdale, we customize these strategies to each client—a necessary step since individuals have unique levels of risk tolerance. People tend to dislike losses more than they like gains—a concept known as loss aversion. At the same time, some risk is necessary to achieve financial goals. It's our job to help clients develop and define a risk budget and then adjust the investment strategy to match.

Perhaps the most salient story about the markets recently has been the return of volatility. The U.S. is currently nine years into the bull market, and the present economic expansion is on its way to becoming the longest in history. Eight years of federal intervention has suppressed market volatility and removed risk management as a source of alpha.

However, we believe the extended period where low volatility and beta have dominated will change over the next few years. When the market declines, active risk managers have historically outperformed beta managers since active managers have the ability to reduce risky asset exposure and take advantage of opportunities.

At City National Rochdale, we provide active risk management techniques such as strategic asset allocation, rebalancing, and downside loss controls, implemented through three levels of portfolio risk management:

### **LEVEL I: STRATEGIC ASSET ALLOCATION** at the Portfolio Design Level

We undertake an extensive review of each portfolio's holdings to determine how they may fit within an overall target portfolio specifically with regard to contribution to growth and desired diversification, taking into account the current gains or losses of each holding. We then determine which stocks or funds to hold or sell, keeping in mind the potential tax impact, to create a personalized asset allocation for each client.

In addition, we establish how Level III actions will be implemented by the portfolio manager through discussions with the client to determine the number of metrics ("floors") that will be used to trigger monetization of assets to preserve wealth.

### **LEVEL II: PERSONALIZED DYNAMIC ASSET ALLOCATION** driven by fundamental and economic research

We work closely with advisors and clients to determine their risk budget by establishing dynamic risk management parameters that reduce equity exposure at various levels of market decline. Utilizing our proprietary capital markets outlook and economic and financial models, we adjust financial allocations and tactically overweight/underweight risk exposures.

### **LEVEL III: PERSONALIZED DOWNSIDE RISK MANAGEMENT** focused on non-normal market periods

Our third level of risk management takes into account a client's personal downside limits to limit the downside potential of the portfolio during severe market declines. We monetize assets, converting securities to cash, as established "floors" are approached and begin reinvesting. Through continuous communication with the client, we evaluate

whether the risk of each investment portfolio is consistent with the client’s risk tolerance and budget.

Most firms do not offer this kind of personalized risk management tailored to each individual client. At City National Rochdale, we offer a level of customization not common in the industry.

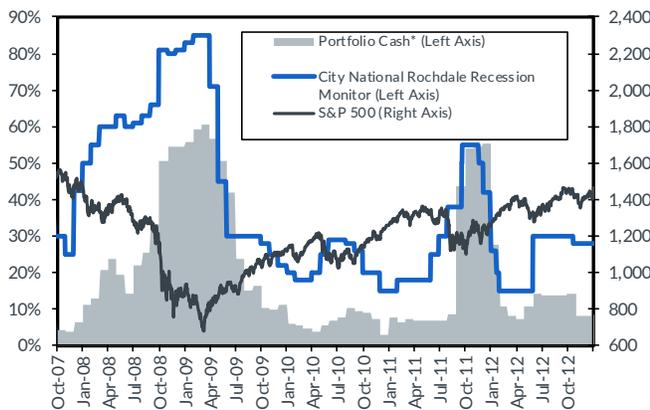
Dynamic Equity Risk Management (DERM) is our proprietary process for managing downside risk and acts as a circuit breaker for limiting losses on specific assets and security holdings.

During times of adverse market conditions, active managers have the ability to protect client assets from downside risk by moving some equity risk capital to cash. The below graphs show how we’ve historically converted assets to cash as part of Level III risk management during bear markets:

### Raise Cash to Manage and Mitigate Risk

#### Historic Implementation

High-Net-Worth Large Cap & Mid Cap Strategies\*  
(Critical Event Periods Oct. 1, 2007-Dec. 31, 2012)



#### Current Methodology

Targeted Portfolio Cash Levels  
(Balanced Portfolio\*\*)



Source: City National Rochdale, LLC. FOR ILLUSTRATIVE PURPOSES ONLY.

The chart represents City National Rochdale's historic implementation of a methodology used to determine when cash was raised in the Large Cap and Mid Cap portfolio strategies for the periods shown above. These do not represent actual City National Rochdale client portfolios. Client portfolios will not perform in the same manner as the ones depicted in this chart. Clients should not interpret this to indicate how City National Rochdale will currently manage their investment accounts.

\*Portfolios used in this graph are comprised of City National Rochdale's Large Cap & Mid Cap investment strategies with an 80/20 split between Large Cap & Mid Cap investment strategies, respectively. The portfolios are represented by model portfolios and do not purport to depict any actual prior client experience.

\*\*Reflects actual cash holdings under management, including funds set aside for transactional purposes, upcoming portfolio disbursements, new account holdings, account liquidations, etc. Cash allocation targets from a portfolio strategy perspective could be significantly lower.

Past performance is no guarantee of future performance. As of December 31, 2012.

Source: City National Rochdale, LLC.

Targeted portfolio cash levels are derived from the outcomes of City National Rochdale's proprietary economic forecasts and monitors.

\*\*A City National Rochdale Balanced portfolio assumes a 60/40 split between Equities and Fixed Income asset classes.

Actual client portfolio target cash allocations will vary.

As of June 2018.

What makes our risk management strategy so powerful is that it’s fully customized to each client, providing a truly personalized investment management experience. No two investors are exactly alike, and so no two strategies at City National Rochdale are exactly alike. For the clients who choose to utilize DERM in their portfolios, the strategy is unique to them.

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## Conclusion

At City National Rochdale, we believe our leading investment management capabilities can help clients protect and grow their assets, helping them achieve their financial goals. We lean on the three pillars of portfolio customization to add further value. Through personalization, tax management, and risk management, our portfolio managers are empowered to implement and customize individual strategies tailored to each client.

Each client's dedicated portfolio manager personally implements and manages the investment strategy, assessing ongoing market volatility and changes to each individual's financial circumstances. They will consistently examine the portfolio to expose inefficiencies and highlight additional investment opportunities.

The best way for us to demonstrate our value to clients is to show how it works in action. Through our proprietary Galaxy software, we can provide a complimentary analysis of a client's current portfolio as a test drive of our services. Contact your local Senior Investment Consultant to schedule a free analysis.

<sup>1</sup>Polyak, Ilana (2017, October 16). 'Tax alpha' is much more than simple tax-efficiency. CNBC. Retrieved from <https://www.cnbc.com/2017/10/16/tax-alpha-is-much-more-than-simple-tax-efficiency.html>

<sup>2</sup>Weinberg, Ari I (2012, October 16). A magical tax-loss harvesting machine? Forbes. Retrieved from <https://www.forbes.com/sites/ariweinberg/2012/10/16/a-magical-tax-loss-harvesting-machine/#6f09b0f47a5e>

## Important Disclosures

City National Bank provides investment management services through its wholly owned subsidiary City National Rochdale, LLC, a registered investment advisor.

The information presented does not involve the rendering of personalized investment, financial, legal, or tax advice. This presentation is not an offer to buy or sell, or a solicitation of any offer to buy or sell, any of the securities mentioned herein.

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Any opinions, projections, forecasts, and forward-looking statements presented herein are valid as of the date of this document and are subject to change.

As with any investment strategy, there is no guarantee that investment objectives will be met, and investors may lose money. Returns include the re-investment of interest and dividends. Investing involves risk, including the loss of principal. Diversification may not protect against market loss or risk.

Past performance is no guarantee of future performance.

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