# My Legacy: A Dozen Innovations

- I'd really like to see my life's work survive. You can take over any innovation on my list.
- I provide a brief description of a dozen of my favorite innovations: 6 investment innovations and 6 performance evaluation innovations.
- Some innovations have already succeeded. All could be much more successful with the right marketing and sales.

I started my career in 1970 with A.G. Becker, the largest pension consulting firm in the US at the time. As senior VP of Investment Policy I consulted to $trillions of large defined benefit pension plans, where I learned a lot. Fast forward 20 years later to 1990 when I set out to scratch some itches. I became a serial entrepreneur diving into a variety of opportunities and having a lot of fun. It's been great. Now I'm semi-retired and mostly working on target date funds.

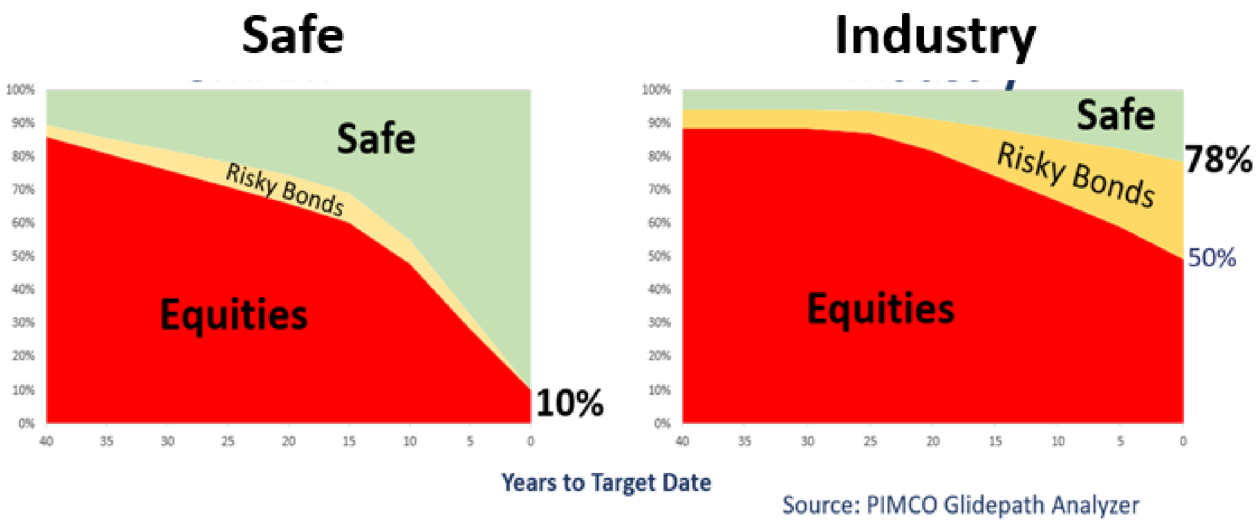
I'd like to share some of my best ideas with you that I hope you'll like and use. Some have "worked" as commercial successes. Some not yet. The biggest lesson I've learned is that marketing and sales are THE key to success. Even the best ideas will not succeed if they are not professionally sold. If you have a strong sales force, any one of the following innovations will be a winner for you. Pick a few.

I've developed six investment innovations and six investment performance evaluation innovations, detailed in the following.

## Six Investment Innovations

### 1. Safe Target Date Funds and Portfolios (Better Models)

I developed and patented the Safe Landing Glide Path for target date funds. There's only one other patented glidepath. No other Safe glidepath has a live 12-year track record. You probably think all target date funds are safe for those near their target retirement date, but you're wrong.  In 2008 the average 2010 Fund lost 35% and TDFs have become riskier since. Today, there's $2.5 trillion in TDFs and the average TDF is 80% in risky assets at the target date, with 50% in equities plus 30% in risky long-term bonds. The first quarter of 2020 reminded beneficiaries of the risk, when 2020 Funds lost 20%. By contrast, my glidepath is 80% in safe assets at the target date, namely T-bills and intermediate TIPS. My 2010 fund lost 4% in 2008 and my 2020 Fund lost 2% in the first quarter of 2020.




This innovation has been a success and had more than $60 million invested in its heyday.

**Opportunity**: I'm looking for strong marketing to bring my TDF to the next level. That's your opportunity: a free suite of collective investment funds with a twelve-year track record of winning by not losing. Ordinarily this suite of 20 collective investment funds (CIFs) would cost more than $150,000 just to start up, but they're yours for free if you can market them.

And there are a couple other related opportunities. A couple years ago I branched beyond one-size-fits-all to provide my design to individual investors in the form of personalized  target date portfolios / models. With the right help, individual investors can manage much better target date structures than the big guys. A recent academic study concludes that these customized approaches are less expensive and far superior to the popular one-size-fits-all mutual fund TDFs.

**Opportunities**: One opportunity is to provide better models to your clients. Model portfolios are ubiquitous and undifferentiable. Michael Kitces and other leading thinkers advocate the inclusion of risk capacity in investment models. Simply put, most investors cannot afford to take risk as they transition from working life to retirement. That's why it's called the Risk Zone. In particular, 78 million baby boomers need protection now although most don't know it and are not safe. Another related opportunity is to become an investment advisor to those who appreciate my design.

## 2. Centric Core in Core-Satellite Investing

Core-satellite investing is extremely popular. The idea is to round out a team of active investment managers with a passive low cost "Core." The problem is that the S&P500 and the Russell 1000 are usually used as core. This choice undermines active manager decisions by bringing in growth and value companies that active managers view as unworthy. You pay active managers well for their best ideas and then you contaminate their choices by bringing in rejects.


Centric core is an alternative that complements active managers by holding stocks that are not in the active manager mandates, namely the stocks that are in the middle between value and growth. Centric core does not dilute active managers; it completes them.

This innovation was successful for awhile when it was marketed by United Capital Management, but investors misunderstood and thought it was supposed to outperform the S&P5000. Centric Core is designed to be a better core in core-satellite portfolios, not to outperform the S&P500.

**Opportunities:** You can follow my straightforward [rules] to maintain this 40-stock portfolio, and to aggressively seek to displace the S&P500 and Russell1000 in core-satellite portfolios. A related opportunity is to sell Centric as a "Pure" core that competes against other core manages who are a [blend of value and growth].

## 3. POETs: Portfolios of Exchange-traded Fund (ETFs)

When ETFs were first introduced by Barclays Global Investors in 1996, I envisioned a variety of ways they would be used, most of which are available today. Portfolios of ETFs are immensely popular. I assigned the names of Poets to these applications:

- Tennyson or Longfellow: Diversification, take a vacation
- Thoreau : Completeness, A for neatness
- Hogg : Alpha Capture, total rapture
- Shelley : International, very rational

35 years later all of these Poets are currently being offered except Hogg that tries to "hog it all" and target date portfolios of ETFs (not in my original list).


**Opportunities:** Your Hogg opportunity is to use ETFs in pairs trading, a common hedge fund structure. Pick your favorite mutual funds that you believe will outperform. Then go short an ETF benchmark for each of these mutual funds. The result will be low volatility alpha if your mutual fund picks are good. In addition, this construct can be a loss harvesting machine, selling losses on both sides and replacing with similar funds. You'll need substitutes for each mutual fund and ETF. In summary, Hogg could be a cash substitute that will earn a premium in this low interest rate environment.

The target date application is mentioned above. Using low-cost ETFs, target date portfolios can be maintained for less than 4 bps, essentially free. Most importantly, these are customized to individual investors, rather than one-size-fits-all.

## 4. SCAVRS: Small Cap Value Rising Stars

The small cap value effect is well known. These stocks tend to earn a return premium. This has led to products with a small cap value tilt like "smart beta" and Dimensional Fund Advisors (DFA) indexes. Generally speaking, small companies are not good investments; if they were, they'd be bigger.

I did additional research and found that this effect can be improved upon because small cap value stocks come in two flavors: falling knives and rising stars. Falling knives are stocks that have fallen upon hard times and are on a trajectory of declining prices, falling into the cheap small company space. By contrast, rising stars are on a trajectory of increasing prices, on their way to becoming bigger companies.


**<u>Opportunity:</u>** This is another marketing/sales opportunity. Use my discovery to outshine small cap value products, especially smart beta – smarter beta.

## 5. Objective-based and Factor-based Investing

I've worked with the pioneers in objective-based and factor-based investing. Dr. Frank Sortino, best known for his Sortino ratio, introduced Post-modern Portfolio Theory (PMPT) that redefines risk as the possibility of failing to achieve objectives. Dr. Robert Haugen shocked the academic community with his proclamation that the stock market is easy to beat if you know which economic factors are working, and he provided lots of proof. Both Frank and Bob wrote a lot of books and articles and both are quite successful, and you can be too.

**Dr. Frank Sortino**

**Dr. Robert Haugen**

**<u>Opportunities</u>**: Dr. Sortino has provided his legacy in the form of [free software] that discovers investment manager talent and optimizes a portfolio to best use that talent to achieve your objectives. It's remarkable. The source code, written in Java, is also provided. The opportunity is to carry on Frank's work. It would help to have a Java programmer fine tune the software's interfaces, making it easier to use. The software requires 3 input files to operate that I can help you with.

Dr. Haugen died several years ago, but his company, Haugen Equity Signals, continues on. You can hire Bob's company or create your own forecasting tools using multivariate analyses that he perfected and wrote about.

## 6. The Baby Boomer Investing Show

This idea is 11 months new at the time of this writing. 78 million baby boomers are in the Risk Zone and most are taking more risk than they should, so we provide live streaming educational videos and articles on YouTube and Facebook.  This is more of a public service (good will) idea than it is an investment innovation, but it can be used to reach out to this huge niche.


**<u>Opportunity:</u>** You're invited to work with us as our guests on the show, and to tell everyone about our shows and articles. Clients and prospects need and appreciate education. Please share our articles and videos, and support us on YouTube, Facebook and Patreon.

## Six Performance Evaluation Innovations

### 1. Portfolio Opportunity Distributions: PODs

This is one of my most important innovations, even though it has not yet caught on. Many smart well-known people see it that way too. Peer groups have failed to identify skillful managers for reasons that are well understood and documented. But peer group providers are powerful forces who are threatened by this innovation. Aggressive marketing can overcome this obstacle, as is the case with all disruptive innovations.

Hedge fund investors are the most in need of PODs because hedge fund peer groups are worse than useless – they're misleading. PODs create all the portfolios a manager might have held, replacing peer groups with the manager's unique opportunity set

**Surz introduces the world to Mr. Hedge in fourth film**

By: Christine Williamson

Published: September 16, 2013

Pensions&Investments

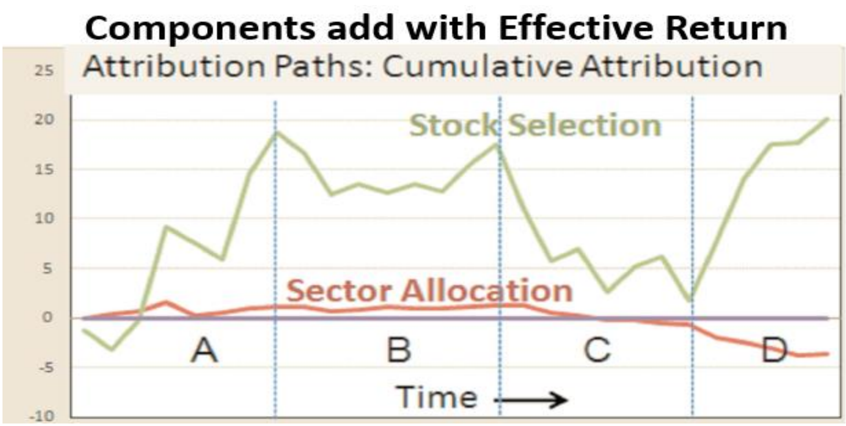
I've created an entertaining and informative video that explains the reasons that hedge fund investors need to replace hedge fund peer groups with the science of PODs.

**Opportunity**: The opportunity is to aggressively market this important innovation and earn fees for providing this invaluable service. Hedge fund investors should be willing to pay a lot for better decision making; they certainly invest a lot.

## 2. Effective Rate of Return on Stocks

The return a stock earns in a portfolio is not the same as that stock's return held in isolation because allocations to the stock change through time. If more is held when the stock is performing well, the "Effective Return" is greater than the stock's stand-alone return. Conversely, Effective Return is less than the published return if more is held when the stock underperforms.

Effective Return has two applications. It can be used to evaluate investment decisions to increase or decrease allocations to a stock. It can also be used in multi-period attribution analysis to solve the "smoothing problem." Because of compounding, multi-period attribution components do not add, but they do add if you use Effective Return,




**Opportunity**: The opportunity is to revolutionize the attribution world. Numerous articles have been written about smoothing techniques that force attribution components to add, but none of these approaches gives the evaluator a look at what is really happening – (s)he has to trust the black box. Again, marketing is key.

## 3. Surz Style Pure Indexes

In the mid-1990s there were no style indexes that met the criteria I believe are important, so I developed my own set of styles that are mutually exclusive and exhaustive. A few years later, Morningstar introduced their indexes that are also mutually exclusive and exhaustive.  No other style indexes have these desirable characteristics.


Dr. William F. Sharpe specified the make-up of the style indexes that should be used in the returns-based style analysis (RBSA) that he introduced. They should be mutually exclusive (no stock should be in more than one index) and exhaustive (the combination of all indexes should be the entire market). Users pay a lot of money to license RBSA and totally disregard Dr. Sharpe's recommendation. Consequently, the results are incorrect, although you can't tell because the black box doesn't tell you, so you get misleading results for an expensive price.

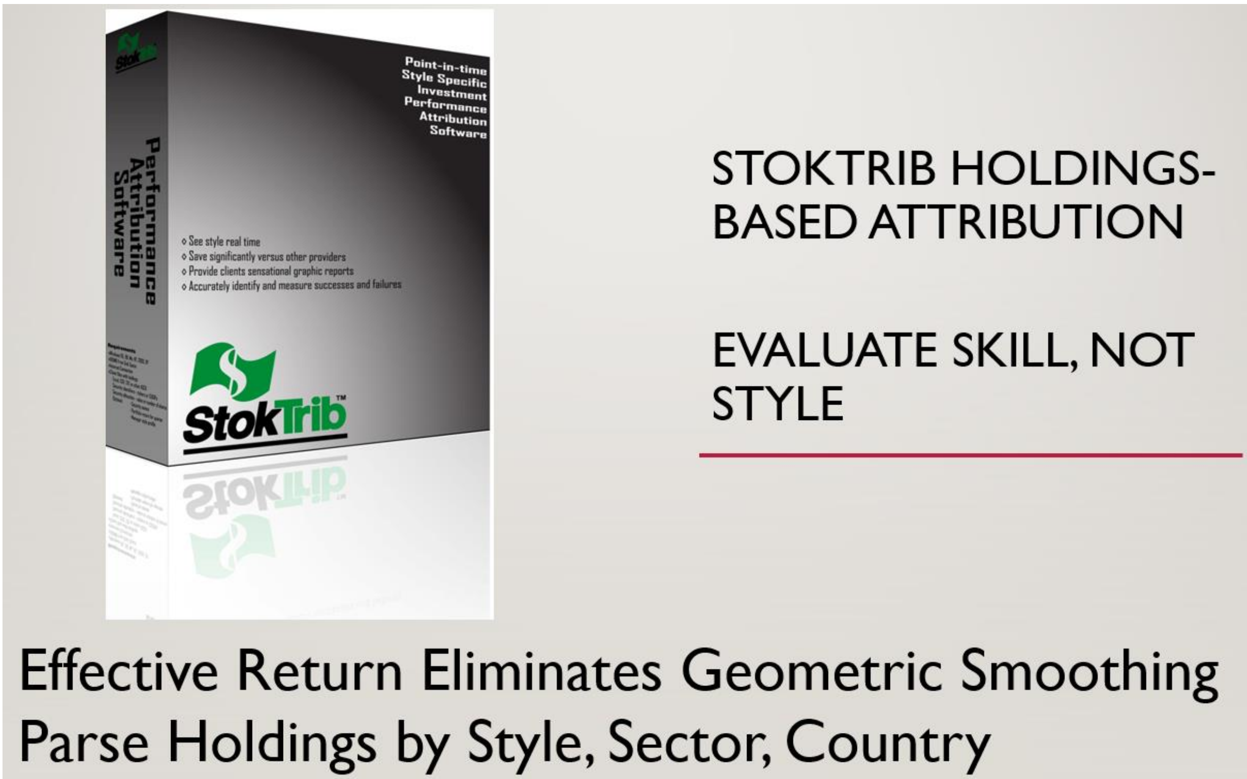
Similarly, Dr. Frank Sortino uses my style indexes in his optimizer.

**Opportunity**: Advisors and investors need to be educated on the differences among style indexes and the superiority of mine. The economic opportunity is in licensing the make-up of the indexes to index providers, especially ETFs.

## 4. Holdings-based Performance Attribution Analysis

Attribution analysis aims to explain why investment performance is good or bad, but if the benchmark is wrong, all of the results are wrong – GIGO (garbage in, garbage out). Most, if not all attribution programs, get the benchmark wrong unless you're analyzing managers with an S&P or Russell index mandate. So, I developed StokTrib to "Evaluate skill, not style."

My attribution program allowed users to customize their benchmark by style, economic sector and country, using blends as appropriate. And it went a giant step further by complaining when the benchmark was wrong – different than the manager. StokTrib was extraordinarily successful. Subscribers included Northern Trust, Deloitte, Genworth, SunGard, UBS, RW Baird etc. I sold StokTrib in 2012 to eVestment in Marietta Georgia, who made it even more successful; they have an extraordinary marketing team.




**Opportunity:** My 2 year non-compete has long passed. I'd like to create something totally new that also focuses on getting the benchmark right, probably using the heat maps described in the next section. Would you like to participate?

## 5. Heat Map Portfolio Analysis

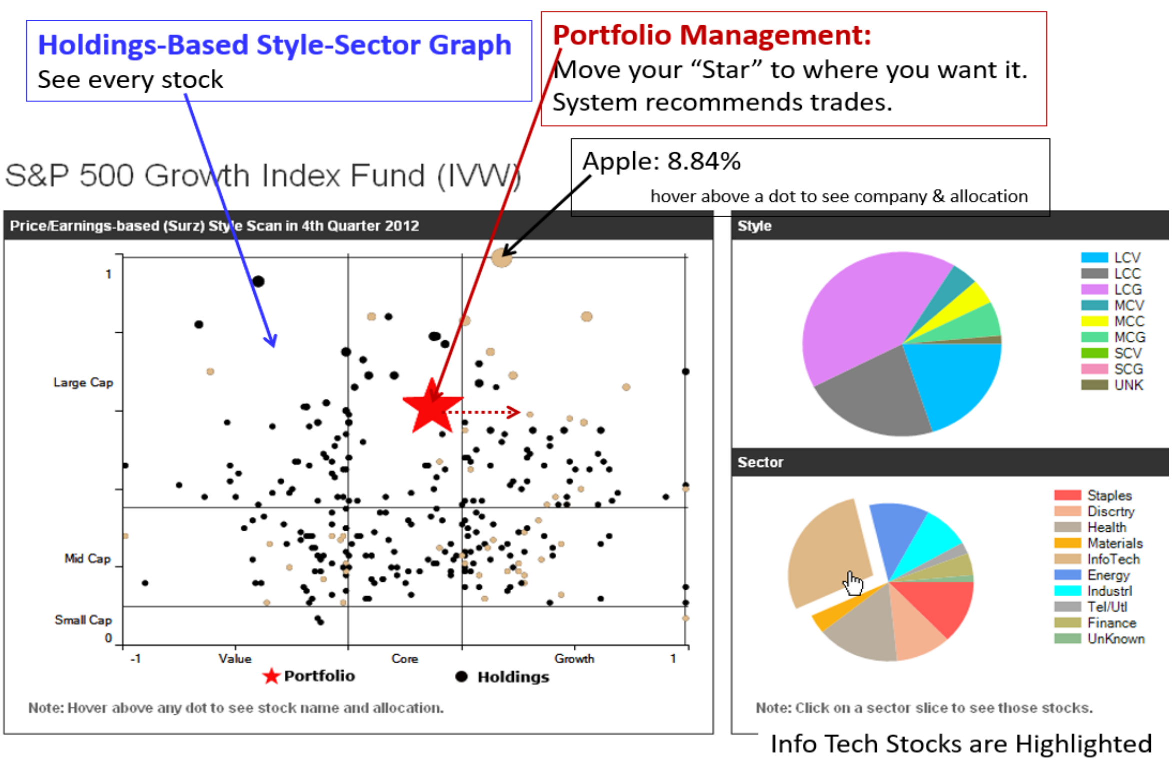
Attribution determines why performance is good or bad. Heat maps highlight where performance is good or bad. I break portfolios into cells. US portfolios are broken into style-sector cells and foreign portfolios are broken into style-sector-country cells. Performance is shown for each cell, with good highlighted in green and bad highlighted in red. This provides an immensely powerful visual for identifying what worked and what didn't.

| | STAP | DISC | HLTH | MATL | TECH | ENER | INDU | UTEL | FINC | TOTL |
|---|---|---|---|---|---|---|---|---|---|---|
| UK | -7.2 | 2.3 | 16.6 | 4.5 | -3 | 15.9 | 5 | -13.2 | -5.7 | 1 |
| JAPN | 4 | 1.2 | 15.9 | -6.5 | -2.3 | 4.3 | 3.8 | 17 | 0.1 | 2.7 |
| CANA | -6.5 | -3.3 | 29.1 | -12.5 | 19.8 | 2.4 | 12 | -7 | 0.3 | 0 |
| AUST | 1.2 | 4.8 | 14.5 | -1 | 6.2 | 16.2 | 5.1 | -3.8 | -3.3 | 1.3 |
| APXJ | -7.5 | -12.5 | 0.9 | -9.2 | -8.8 | 17.6 | -13.7 | 0.5 | -2.5 | -5.5 |
| EURO | 0.1 | -1.4 | 7.1 | -3.5 | 8.8 | 18.6 | -0.2 | 4.3 | -1.6 | 1.9 |
| EMRG | -10.5 | -24.5 | -10.3 | -9.1 | 1.4 | 14.5 | -18.3 | -12.1 | -6 | -8.6 |
| LATN | -11.1 | -2.3 | -28.6 | 13.3 | -27.8 | 16.6 | -10.1 | -13.7 | 0.9 | -1.6 |
| OTHR | -5.1 | -9.8 | -6.9 | -14.9 | -13.4 | 4.3 | -3.2 | 3.6 | -6.2 | -7.6 |
| TOTL | -3.6 | -5 | 7.2 | -5.4 | -2.3 | 14.4 | -2.8 | -0.5 | -2.4 | -1.3 |

**Opportunities**: One opportunity is for investment managers. My heat maps have a demonstrated ability to time market segments by identifying momentum – trends. An opportunity for advisors is to use heat maps for attribution, identifying cells where value has been added or subtracted relative to an accurate benchmark.

## 6. Style Scan

I developed a visualizer that plots every stock in a portfolio in Cartesian style space.



You can choose the style lens through which you want to view your stocks. It defaults to my style classifications. Hover above any dot to see the company name and its allocation.

**Opportunities**: An opportunity for investment managers is a "drag-and-drop your style star" where you move your style star where you want it, and the software recommends transactions to get you there. This could be tax optimized. An opportunity for advisors is to make the size of the dots proportionate to value added or subtracted in green and red dots.

## Conclusion

There you have it: decades of exploration and development. I'd love to work with you to see these innovations survive and thrive. Thanks.

Ron Surz is CEO of Target Date Solutions, Age Sage, GlidePath Wealth Management, and co-host of the **Baby Boomer Investing Show** that you can binge watch on Patreon.

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