Discretionary Management:
A Client-Driven, Forward-Looking Approach

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The Need for a Closer Partnership

In today's volatile and complex market, institutional investors want a strategic partner to help navigate the uncertainties of the economy and financial markets. To meet this need, the use of discretionary investment services, also referred to as Outsourced Chief Investment Officer (OCIO)[1] services, have become increasingly popular. To decide if an OCIO is right for them, many institutional investors seek a partner that can potentially:

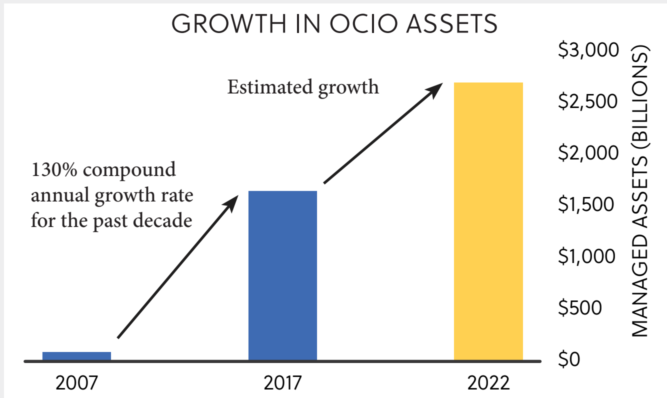
- Bring more expertise and research capabilities than is possible in-house
- Improve risk management and add to fiduciary oversight
- Improve performance

Because institutional investors have varying degrees of time, expertise and technology for implementing their investment decisions, one of the most important choices an investor faces is selecting an investment advisor that can understand its organization's needs and goals so as to deliver optimal value. In this edition of InvestEd, we will provide an overview of the value of discretionary management, and considerations in choosing an investment advisor.

1 These services are also sometimes described as delegated investment services.

AN OCIO IS…

- A strategic partner that assumes responsibility for risk management, performance, and implementation
- Ideal for investors that do not have the time or resources to be fully immersed in the markets or sufficiently research investment opportunities
- A way to become more nimble without sacrificing due diligence processes or requiring more time from decision-makers



Source: Pensions & Investments, Cerulli Associates, as cited in "Maximizing the OCIO Growth Opportunity," Chestnut Advisory Group, February 2018. http://www.chestnutadvisory.com/wp-content/uploads/2018/01/CAG_Maximizing_the_OCIO_Growth_Opportunity.pdf

What Does a Discretionary Manager Do Differently?

Discretionary management means delegating daily investment decisions for a portfolio to an investment advisor. As shown below, discretionary managers execute an investment program, often without day-to-day oversight from the client. That does not mean that institutional investors give up fiduciary duty or lose control. Rather, instead of researching, analyzing, retaining and managing many individual money managers, they use those same controls to manage one, the OCIO.

- Traditional investment consultants generally provide performance measurement, manager research, capital market research and best practice advice, but do not execute decisions.
- Discretionary investment managers provide similar services, but also serve as a core component of the investment decision-making process.
- Discretionary investment managers are often a good fit for institutional investors who lack the capacity to research potential investments and may end up missing opportunities to take advantage of market anomalies.
- Additionally, by being able to react efficiently to rapidly moving markets, discretionary investment managers can help institutional investors reduce risk.

	Traditional Consultant	OCIO
Governance		
Acts as a Fiduciary	○	●
Investment Policy Statement	◐	◐
Portfolio Management		
Construct Portfolio	◐	●
Dynamic Allocation Shifts	◐	●
Cash-flow Management	◐	●
Monitor & Select Managers	◐	●
Terminate Managers	◐	●
Other Support Services		
Education & Research	●	●
Performance Measurement	●	●

● Implements with Discretion or Delivers ◐ Provides Recommendations ○ N/A

Managing Fiduciary Responsibility and Risk

One reason discretionary management has gained favor is because markets have grown more complex. As market complexity increases, the necessary due diligence to execute a prudent investment strategy also increases. Adding a discretionary investment advisor can help offset resource-intensive requirements of that duty.

- A fiduciary partner in the form of a discretionary investment advisor can actually increase oversight and transparency while addressing problems more quickly. That can translate to better risk management overall.
- Many investors elect a discretionary model in order to find the best relative value—investments with returns that best compensate for the investments' inherent risks.
- A successful discretionary investment advisor continually monitors the relative value between all permitted investment sectors or asset classes. The OCIO will emphasize and implement different investments, choose among various securities and decide when to hire or terminate underlying investment managers based on market dynamics and performance relative to the established investment strategy. This form of active management can help offset risk during volatile markets while adding incremental return.

Selecting a Discretionary Investment Advisor

When evaluating a discretionary investment advisor, it is important to consider such factors as depth and breadth of experience. Many institutional investors specifically look for the following:

- Portfolio management expertise and the ability to implement cost-effective strategies and assume fiduciary responsibility
- Well-defined processes for delivering highly transparent reporting to keep investors aware of investment activity and performance
- Compliance with Global Investment Performance Standards (GIPS®) is voluntary, but by choosing to comply, investment managers assure prospective clients that the historical investment performance records they report are both complete and fairly presented[2]
- Approach to disclosing, managing or avoiding conflicts of interest.

It is also important to consider the investor-advisor relationship itself. We believe intelligent financial advice and creative consultation require attention and partnership to flourish. To lay the groundwork of an investor's portfolio, the discretionary investment advisor must first listen attentively to understand the investor's current situation, unique opportunities and challenges, as well as what the investor is looking to achieve. This consultative approach is key in helping to uncover innovative solutions focused on optimal outcomes.

2 For the complete GIPS® standards, please visit www.gipsstandards.org.

PFM's Approach

Since 1980, we have created investment advisory services focused exclusively on institutional clients. Our clients know they can rely on us to understand their financial needs and serve their interests above all else, because we have done so for years.

- PFM's OCIO investment philosophy is designed for institutional clients. We believe most of the performance is attributed to asset allocation and we focus on making prudent, tactical shifts in allocation based on continuous monitoring of the markets.
- When we consider an asset class or manager, we contemplate how our decision would suit you and clients with similar objectives.
- Our Multi-Asset Class Investment Committee seeks to make investment decisions that are cost-effective, capitalizing on passive strategies while carefully using active management when warranted.

Our goal is to forge lasting relationships grounded in trust and collaboration. Our hope is that clients consider us a strategic partner and an indispensable extension of their teams. On behalf of our clients, our best minds collaborate and share knowledge, drawing insights from our specialist teams across PFM. This is why PFM forges a close working relationship with each of our clients, providing intelligent, objective and forward-looking investment management services designed to help them navigate change and achieve tomorrow's goals.