CARDINAL | POINT

THE CARDINAL POINT SOLUTION
INVESTMENT PHILOSOPHY

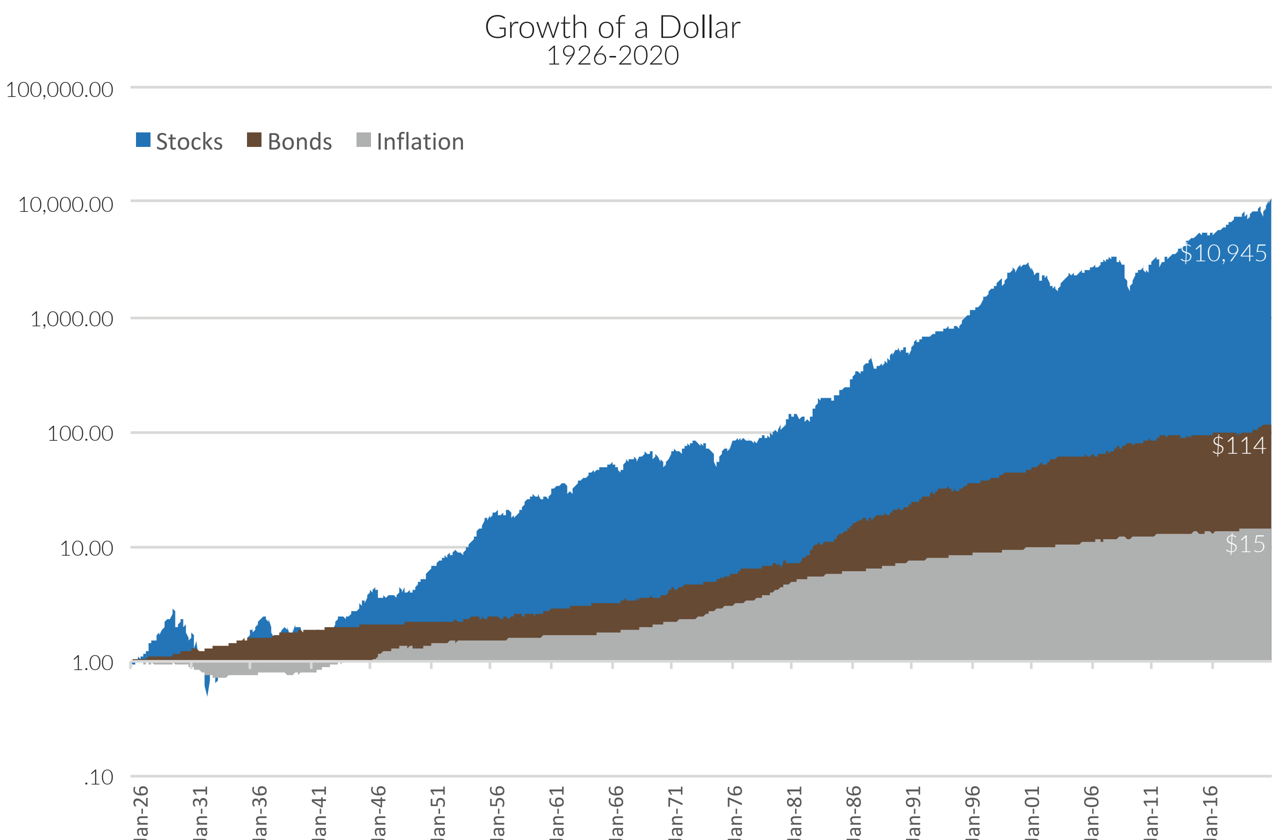
The core of Cardinal Point's strategy is a rigorous and time-tested investment philosophy. Our disciplined approach pairs diversified security selection with appropriate risk levels to help achieve a client's long-term goals. For those with cross-border planning requirements, we provide an integrated platform to wealth management that includes financial and tax planning considerations in addition to investment management. In this scenario, both U.S. and Canadian assets can be structured within a single investment strategy.

The firm's investment philosophy is molded by the Cardinal Point Investment Committee, which includes five investment professionals with numerous industry credentials such as CFA, CFP®, CIM®, CIWM, and FSCI® and more than 100 years of combined investment management experience. The Committee meets formally on a quarterly basis, complemented by ongoing informal discussions, to review all aspects of the investment management process.

Our investment management process comprises these three key components: discovery of your risk tolerance and capacity, formation of a customized asset allocation, and implementation of that allocation across multiple currencies and jurisdictions.

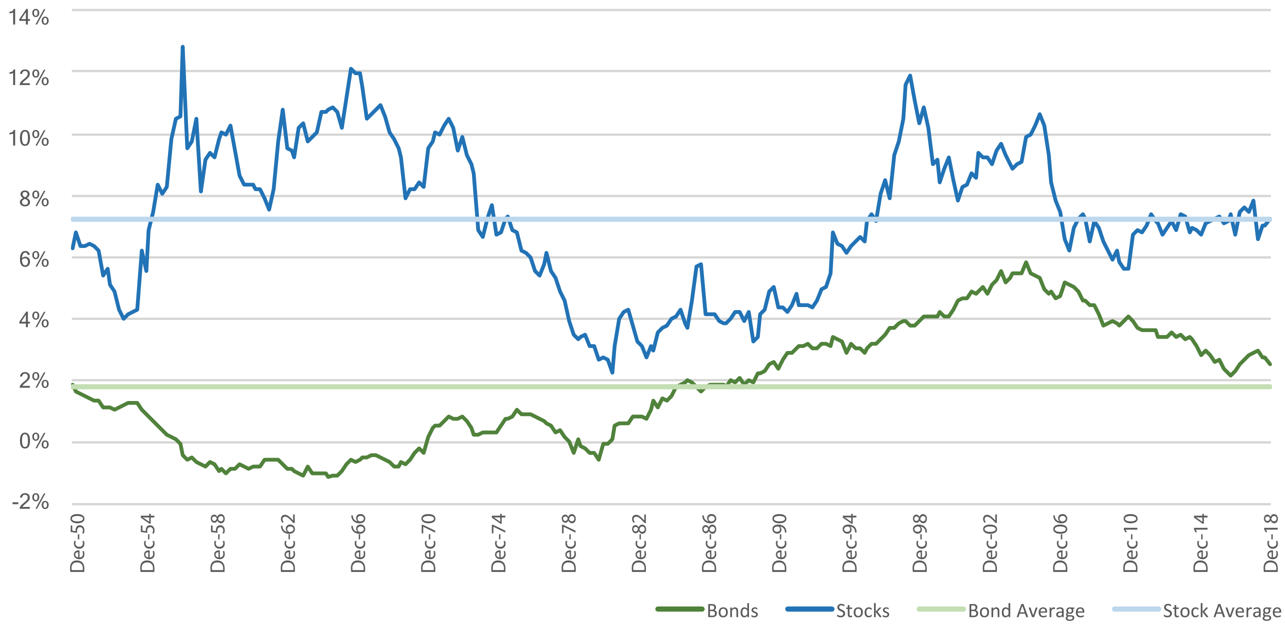
Understanding Your Risk Capacity & Tolerance

All of us have lifestyle goals and aspirations. Perhaps that's as simple as ensuring a certain standard of living in retirement or as complex as planning for multiple generations spread across multiple countries with specific mandates. One baseline goal for many investors is to maintain their purchasing power over time, growing their assets faster than the rate of inflation. In order to do so, investors need to take on some level of risk. As shown on the chart below in U.S. dollars (USD), stocks over the long run do a much better job at this than bonds, which only marginally outperform inflation.[1]



Another way to view the broad differences in stock and bond returns is to look at them on an inflation adjusted basis over 25 year rolling timeframes. In the following chart you can see that over the long-term, stock returns are more than double that of bonds after adjusting for inflation but do see a high level of variability even over 25-year timeframes.[2] The real rate of return for stocks was 7% annualized on average over 25 year rolling periods, while bonds had an average real return of 2% over those rolling periods. We feel these are good starting points for expectations over long time periods of real growth in wealth.

25 Years Annualized Returns, Inflation Adjusted
1926-2020



However, this 25-year span does gloss over the shorter time periods when both broad asset classes can see negative returns, and for stocks this includes years like 2008 when the global stock market was down 41%.

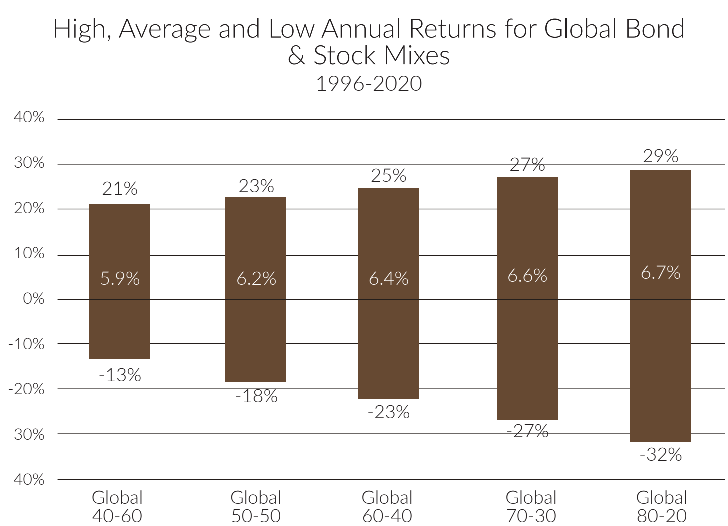
Determining the right amount of stocks and bonds for your situation is a comprehensive task, involving multiple conversations with Cardinal Point professionals in combination with an industry leading risk profile tool created by Finemetrica, a firm with expertise in creating and validating risk tolerance solutions. There are two main considerations needed for this decision: your risk capacity and your risk tolerance.

Risk capacity

Your risk capacity encompasses the constraints put on the portfolio, namely the time horizon and liquidity needs of the client. For example, the need for a 15% withdrawal for a home purchase in three years, or entering retirement and supporting a 4% withdrawal rate each year may necessitate that a meaningful portion of the account be held in lower volatility investments. Alternatively, money set aside for future generations or charitable giving likely has time horizons beyond your own, and therefore may have the ability to take on more risk in hopes of achieving higher returns over the long term. Your occupation can also have an impact. A tenured university professor is likely to experience far less volatility in annual income than an executive for an oil exploration company. Employment and income stability can have ramifications for what types of investments may make the most sense for your portfolio.

Risk Tolerance

Your risk tolerance has to do with your relationship to risk. Do you view a riskier investment as having the potential for higher returns, or does the idea of a holding dropping 40% in value make you queasy? Our risk profile questionnaire presents several scenarios to gauge your comfort level with risk, thereby ascertaining what portion of your assets should be in riskier investments versus more conservative ones. For example, do you prefer a job where most of your income was from a steady salary or do you prefer potentially higher pay from a commission style compensation package? Higher allocations to stocks will have higher expected returns but come with considerable volatility. Bonds historically have had lower rates of return, but also much lower risk.



As shown on the chart, the mix of stocks and bonds can help determine the range of investment returns experienced over time.[3] Finding the balance that will both help you reach your goals and allow you to sleep peacefully at night is an important task.

Asset Allocation

We approach investing from a scientific perspective. We leverage academic research, starting with the pioneering work done by Dr. Harry Markowitz, who won the Nobel Prize in 1990 for Modern Portfolio Theory. Markowitz's now well-known theory uses mean variance optimization to help put together the most efficient portfolio allocation possible, taking into consideration not only the expected returns and volatility of asset classes, but also how their returns move in relation to one another.[4]

Professors Eugene Fama and Ken French put forth the notion of premiums within different types of stocks with their research on value and small companies.[5] Their work showed that by tilting a portfolio towards stocks which were trading on a cheaper relative basis to their peers, or were smaller less proven companies, investors could receive positive expected premiums compared to the market over the long term. Later work by others showed similar results when sorting companies by momentum or relative profitability. Sorting stocks in a quantitative manner like this is often known as factor investing or smart beta.

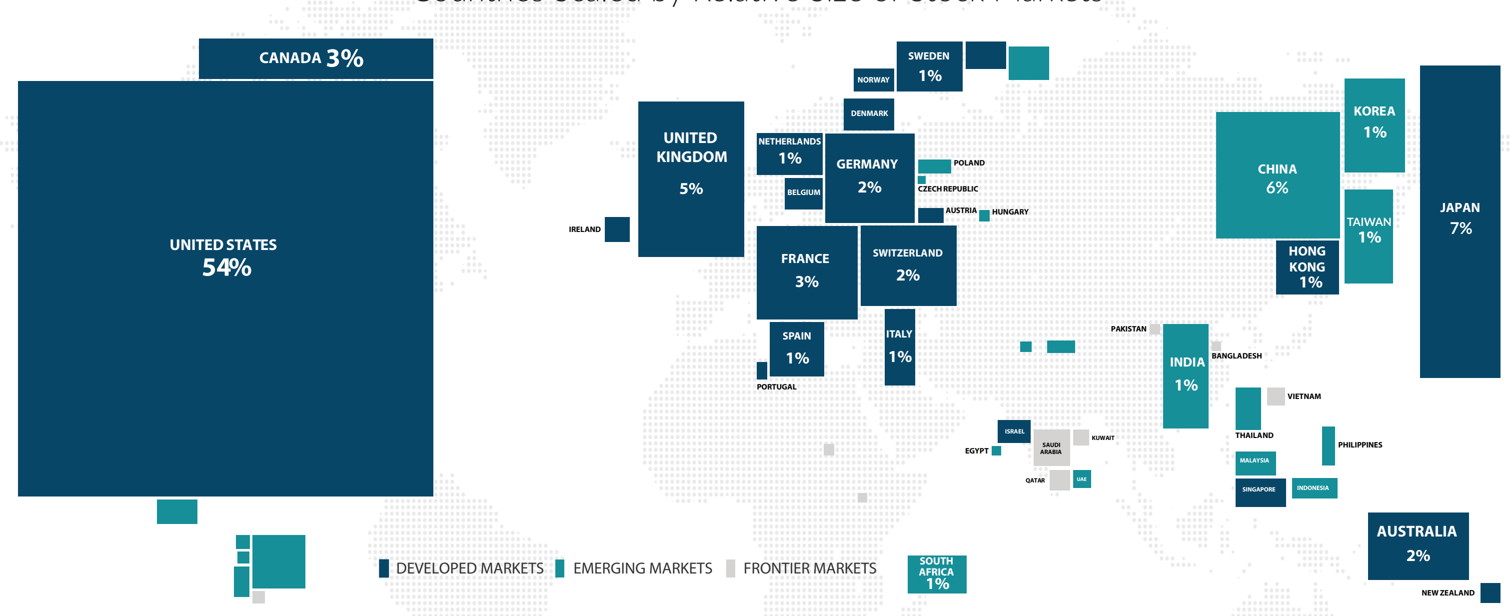
A recent focus of the industry has looked at the behavioral side of investing- trying to identify those mistakes investors commonly make which can derail long term returns. Examples of this would be hindsight bias (of course I knew the market was going to fall), familiarity bias (I should invest in all medical companies because I'm a doctor) and home bias (I live in Canada so I should own 80% Canadian stocks). These biases can hurt an investor's returns by exposing them to uncompensated risks like concentrated positions or costly attempts to try to time the market. One of the biggest problems is taking on more risk than you can tolerate and selling at inopportune times.

Taking advantage of the opportunity to invest in great companies around the world is also a key component in asset allocation. We believe clients should have exposure to over 40 developed and emerging markets beyond their home exchanges. As shown in the world map found on the following page, which illustrates the size of the stock markets by country, the U.S. stock market represents just over half of the global stock market. It also represents the largest single country exposure within all our models.

We build our asset allocations by looking at your desired risk tolerance and risk capacity and then applying academic research to determine first, the balance of stocks and bonds in your portfolio, and then the composition of the stock and bond portions. In practice this is done by utilizing a Core and Satellite approach.

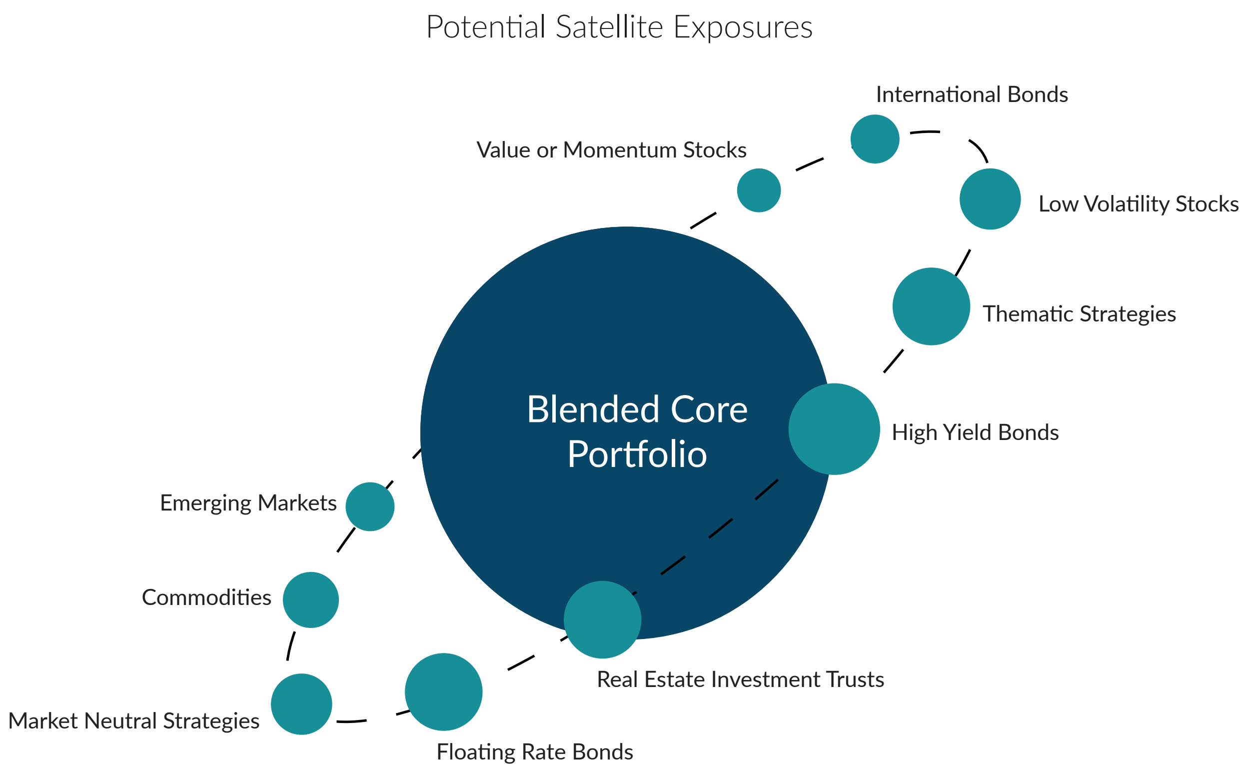
This approach assigns the largest weights to core areas of the market, such as U.S. stocks, Canadian stocks, international stocks and investment grade bonds. These positions target relative asset class returns, broad diversification at minimal cost, low turnover, tax efficiency and a high degree of transparency. This allows investors to benefit from market returns regardless of where or what type of companies those returns are coming from.

Countries Scaled by Relative Size of Stock Markets



Source: Dimensional Fund Advisors, Data as of 2020

We then add on smaller satellite positions with the goals of either higher expected returns or enhanced diversification. Examples of these positions are funds targeting factor premiums, like value, small, momentum, or high profitability stocks. Other asset classes such as low volatility stocks, international bonds, emerging market stocks, real estate investment trusts, market neutral strategies or commodities may be added. These positions are meant to broaden overall diversification and deliver lower correlation to the core positions, and can be utilized in more of a tactical manner. For example, the addition of a floating rate bond position if interest rates are forecast to rise. These positions are normally held for at least one year.

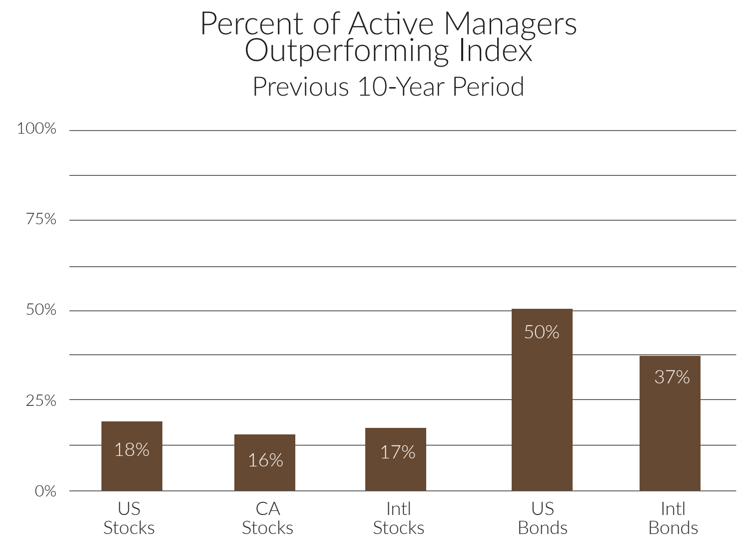


Investment Implementation

After the risk tolerance and asset allocation has been set, we determine what securities should be used. One major question that comes up regarding implementing investment allocation strategies is whether to use actively or passively managed options.

Within the investment profession, most investments were historically overseen by active managers that were buying and selling stocks based on research they had done on the companies in question or on guesses about which way the market would head next. However, extensive academic research has shown that on average, active managers struggle to provide value to investors. Over the last 10 years only 18% of U.S. stock active managers and 16% of Canadian stock active managers have beaten simple index returns.[6] Bond managers have fared slightly better but are still only roughly as good as a coin flip.

Active managers may fail because of high fees, unnecessary concentration, excessive turnover, or by falling for many of the same behavioral biases that investors face. In many cases, investors are better served finding a cost-effective manager aiming to match an index or follow a specific quantitative strategy. This is particularly true for the core portions of the portfolio, which are meant to deliver asset class returns in the most efficient manner possible. We then consider using active managers in those areas of the market which may be less liquid, or in which we feel some edge can be gained, particularly on the fixed income side, where the biggest bond issuers may not be the healthiest companies, yet represent the largest weights within the index. This idea is illustrated in the chart to the right, which shows about half of bond managers were able to outperform the index.



Cardinal Point adheres to a transparent and conflict-free investment philosophy in which our clients' interests are always put first. As a fee-only firm, our clients are charged a fully disclosed and agreed-upon fee for the services provided. We do not invest our clients' assets in investment products that directly compensate our firm through hidden commissions, trailer fees or 12b-1 fees, and we do not offer proprietary products for investment. We feel these products can create a conflict of interest between the advisor and client. Instead, our investment committee puts an emphasis on investment process and researching best-in-class investment solutions for our clients.

When looking at the entire investment universe in the US and Canadian markets, the investment committee weighs a variety of factors such as:

- Cash Efficiency
- Expense Ratios
- Fund Size
- Volatility
- Trading Liquidity
- Liquidation Costs
- Max Drawdown
- Turnover of Vehicle
- Track Record
- PFIC Compliant Reporting
- Tracking Error
- Purity of Exposure

Weighing these aspects, we construct model portfolios of institutional mutual funds and exchange traded funds (ETFs) to match your unique situation. For example, if you are living in the U.S. and earning a high income there, municipal bonds may be utilized as part of the bond portion of your portfolio in order to minimize the tax impact of bond coupons. Another example is when Canadian dollar assets are held by investors living in the U.S.; we want to ensure the proper investment vehicles are utilized in order to minimize potential double taxation. Additional considerations include low tax basis legacy positions and environmental, social and governance (ESG) preferences.

We continually monitor our exposures and conduct an in-depth quarterly due diligence process, frequently speaking with investment managers of the underlying funds and discussing fund and model level performance against benchmarks. Changes are made to our recommended funds list for a variety of reasons, including the identification of more efficient implementation vehicles or the emergence of opportunities for further diversification. To help further protect our clients' assets, all investment accounts are held and safeguarded through third-party institutional custodians.

Research over the past thirty years has found that in well-diversified portfolios, the asset mix accounts for over ninety percent of the variation of returns over time.[7] Our investment management process aims to provide exposure to a well-diversified portfolio of thousands of global stocks, including moderate tilts toward areas of the stock market academically shown to have higher expected returns. These are mixed with the appropriate amount of high-quality bonds to meet your specific needs and aspirations, established in your Investment Policy Statement. Cardinal Point is uniquely situated to offer licensed advice, ongoing maintenance, and reporting on your assets across the U.S. and Canada.

Sources:

[1]Morningstar Direct 2021, Ibbotson Associates SBBI US Inflation, Ibbotson Associates SBBI US Intermediate Term Government, Ibbotson Associates SBBI US Large Stock TR Ext

[2] Morningstar Direct 2021, Ibbotson Associates SBBI US Intermediate Term Government Inflation Adjusted, Ibbotson Associates SBBI US Large Stock Inflation Adjusted TR Ext

[3] Morningstar Direct 2021, Global mixes represent percent in stock and percent in bonds as represented by MSCI World NR USD and BBgBarc Global Aggregate TR USD respectively

[4] Harry Markowitz, Portfolio Selection, The Journal of Finance, March 1952

[5] Eugene Fama and Kenneth French, The Cross-Section of Expected Stock Returns, Journal of Finance, June 1992

[6] Standard & Poor's Index Versus Active Scorecard, US Data 10 Year through year end 2020, Canadian data through year end 2020.

[7] Gary Brinson, Randolph Hood, Gilber Beebower, Determinants of Portfolio Performance, Financial Analysts Journal, 1986

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