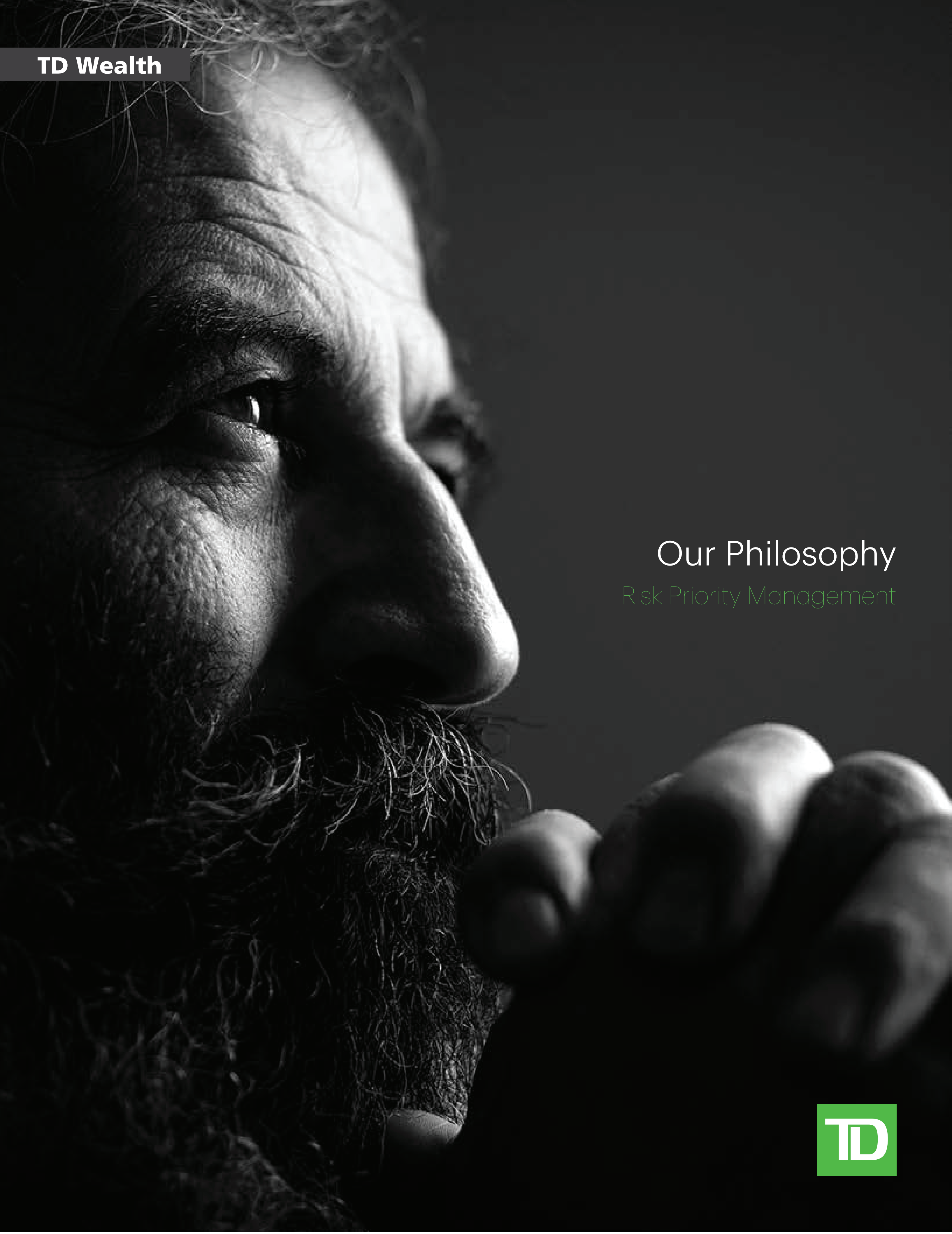
TD Wealth



Our Philosophy

Risk Priority Management

A commitment to a strategy that is aligned with your investment philosophy is key to the successful selection of investments for your portfolio. Failing to have a core set of principles can result in an endless cycle of switching from one poor product solution to another. The potential net result: a collection of reactionary ideas that seemed good at the time, instead of a well-tailored portfolio that aims to deliver at all times.

Brad Simpson, Chief Wealth Strategist, TD Wealth the big idea

Time changes everything

Over the past decade, the financial environment has created a challenging landscape for investors. Many of the investment strategies that have worked so well for the past thirty years are less likely to be effective going forward.

The key risk is that portfolio returns result in a shortfall. Interest rates have fallen to historic lows, equity markets have become increasingly volatile, and global financial issues are numerous and highly interconnected. In this new environment, traditional 60/40 portfolios and traditional market benchmark indices are becoming less and less relevant as most investors' objectives involve absolute return requirements, while ignoring relative performance.

> To prosper in the new environment, investors need a new way to manage their wealth. Building contemporary portfolios with enhanced risk-factor allocation is the new standard.

The new standard

Philosophy

Portfolio management begins and ends with a well-defined investment philosophy, a determined portfolio construction process and a robust commitment to risk management.

Asset Allocation

Global pensions and endowments have been rapidly shifting their investment strategy away from a traditional 60/40 approach to broad asset allocation and/or risk-based allocation.

Risk Factors

Risk-factor management is critical: minimize unintended and unrewarded exposure, while building portfolios based on outcomes, not benchmarks.

Our profession is remarkably simple

Listen to our clients, discover their wants and needs and hold precious their trust as we perform our responsibility as the steward of their wealth.

We listen

Clients do not want one-size-fits-all products that fail to meet their unique needs and objectives. They want a customized and flexible portfolio construction and management platform. Simply put, they want a scalable modelling system built on defined criteria guided by an innovative approach to portfolio management.

Criteria

- Are managed to help meet the personal goals and future needs of clients
- Are designed to achieve individual outcomes and target returns
- Provide income without chasing yield
- Afford returns that are taxable but not taxing
- Deliver a better balance between risk and return
- Reduce the impact of market volatility by better managing risk
- Offer new sources of return that are less reliant on the direction of equity markets

Approach

- Adheres to a proven investment philosophy and allocation methodology
- Leverages diverse thought leadership from TD Wealth and external wealth management partners
- Recognizes the strengths and flaws of the traditional 60/40 portfolio
- Guides advisor crafted bespoke investment portfolios
- Is inspired by best practices from pensions, endowments and family offices

Philosophy

Portfolio management begins and ends with a well-defined investment philosophy. It is how we balance investors' desire for capital growth with their fear of capital loss. It is how we harness the best investment practices of pensions, endowments and individuals to provide institutional-grade risk protection and real return portfolios. It is how we aim to meet your needs.

Risk Priority Management I **Principles**

Innovate and look forward

A critical component to investment success is the relentless pursuit of being prepared for what comes next. Grand distortions caused by recent years of unorthodox monetary policy may mean that the era of gathering data and simply optimizing it to calibrate future allocations is over. We believe investors are better served by directing their efforts to what they can control: building a robust portfolio that can weather the inevitable volatility and unknown elements of financial markets.

Invest like an owner

The era of big data, low trading costs and massive product proliferation has created an environment where, far too often, client investment portfolios have more in common with casino-like statistical strategies than they do with a well-constructed foundation for wealth. A banker's methodology towards credit, a prudent stance to fiscal policy and a visionary approach to products and services are the foundation of why, how, and with whom, we deploy capital.

Embrace human behaviour

Traditional finance assumes that all investors are rational and well-informed, and that the economic environment in which they operate has a very mechanical business cycle that follows understood patterns. In practice, human beings learn and adapt as they go along, and so the financial environment in which they function changes accordingly. We believe it is wiser to think of investment world as a complex adaptive system, and to pursue returns and manage risk based on this view.

Mitigate outside and inside risks

On the outside, fixed-income and equity investments appear very different. But inside, at their core, similar to human DNA, their similarities are greater than their traditional categorizations imply. We call these similarities "risk factors," and while there are many, we deem the following six as the most important to the management of risk and returns: Equity Risk, Volatility Risk, Real Asset Risk, Income Risk, Liquidity Risk and Foreign Exchange Risk. We believe an approach that takes risk factors into account provides better diversification than the traditional 60/40 portfolio, enabling us to achieve balance across a greater spectrum of asset classes, as well as the underlying sources of risk and returns.

(Continued on next page)

Our philosophy sets our core principles and provides the foundation of what we do at TD Wealth

Risk Priority Management I **Principles** (continued)

Pursue real returns

Instead of using traditional benchmarks to measure performance, we focus on attaining positive returns over time, regardless of financial market conditions. We measure investment success in absolute terms centered on client based behaviours around risk and desired outcomes. Grounded with the knowledge of the ups and downs that accompany investing, we strive to minimize the pain that comes with investing, which is measured by the depth, duration and frequency of losses. As a result, we consider the potential depth of a portfolio's decline, the frequency of its possible losses and the amount of time that an investor's capital could conceivably be less than their original invested capital.

Expect value

The question of active versus passive investment is not a matter of better or worse, it is about how to best use both to construct and manage portfolios. Fees impact returns and, consequently, receiving value in terms of risk and returns for higher cost is critical. We use active managers for assets that tend to have limited liquidity, smaller size or larger complexity. In areas where the opposite is true, we use passive management mandates.

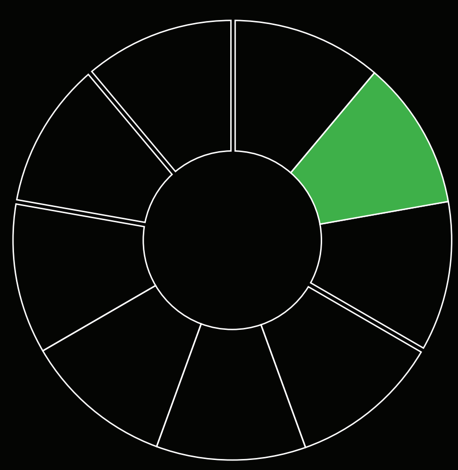
Provide for lifetimes over market cycles

philosophy

Rarely are goals only about maximizing the value of investments over a single period of time. For example, a goal might be to maintain the same standard of living or save for retirement, or in the case of entrepreneurs, to prepare for the sale of their business. Another goal may be the purchase of personal use real estate or the funding of a child's education. Passing on a proportion of wealth, setting up a philanthropic foundation, and being able to cover unexpected financial needs may all be goals and each will likely make up a specific portfolio and require a strategy based on the utilization of an asset-balanced and risk-factor diversified portfolio approach.

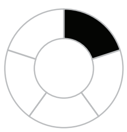
Asset Allocation

The evidence to support the use of a risk-factor diversification is rich and compelling. The most significant challenge to overcome in incorporating this solution is some managers' reluctance to change. Despite its long list of shortcomings, portfolio managers continue to cling to traditional allocation processes.



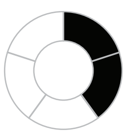
Shift to risk-based allocation

Risk Factors



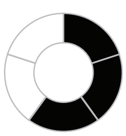
Modern portfolio management

The usefulness of Capital Asset Pricing Model and Mean Variance Optimization is limited in an increasingly complex and open financial system. These theoretical portfolio-management tools were devised half a century ago and are, remarkably, still driving much of the investment industry.



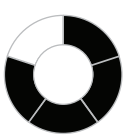
Correlation

Historical correlation does not seem to provide adequate risk diversification. Portfolio risk may be better managed directly through risk-factor adjustments, rather than only across asset-class correlation management.



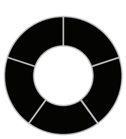
Portfolio risk

Risk priority over parity. Much can be learned from the first wave of risk-parity research and providers, but risk parity, due to its backward-looking nature, should be seen as a starting point, not an end.



Endowment and risk factor models

Today we see a fusion between two of the most compelling investment philosophies: the Endowment Model with its broader range of asset classes and the Risk Factor Model built on carefully considering the risk elements found inside of portfolios, regardless of asset class.



Risk-based asset allocation

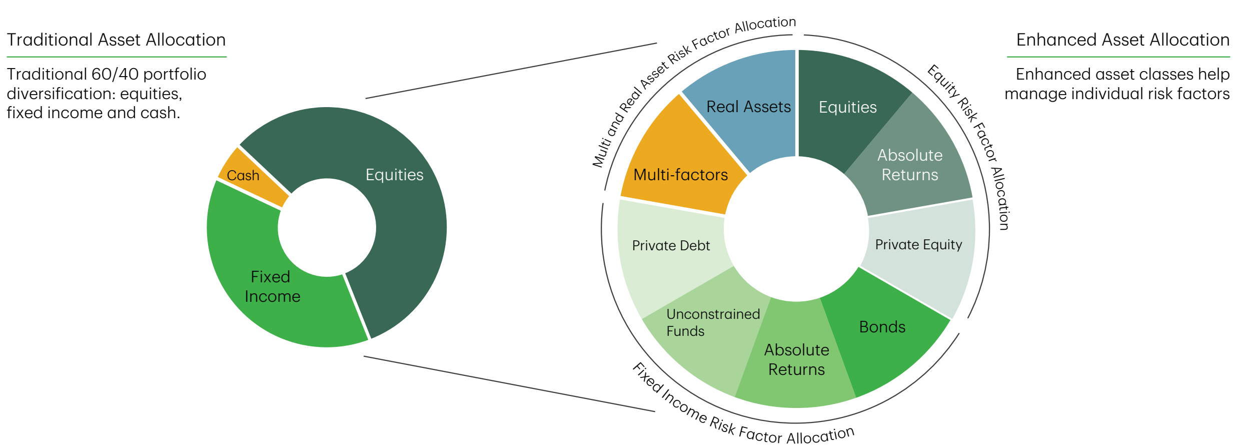
Our analysis suggests that risk-based allocations are preferable in almost all contexts (both multi-asset and equities). Risk allocation can outperform traditional asset-allocation benchmarks with higher Sharpe ratios, lower downside risk, better diversification, and less tail dependence.

Point of interest I The Canadian Pension Plan Investment Board calls the mixture of asset-class and risk-factor diversification the "Total Portfolio Approach." They do not allocate assets through conventional labels, such as "real estate" or "equities." Instead, they rigorously delve into the more independent, fundamental return-risk factors that underlie each asset class, strategy and type of investment. This allows them to better understand and quantify the various return-risk characteristics of each investment program. With this understanding, they can more effectively combine investments into a truly diversified total portfolio that is designed to maximize expected returns at a targeted level of risk.

Risk diversification

It is important to recognize that, while traditional asset-class diversification strategies may help investors reduce volatility in normal market conditions; they generally struggle during extreme events, when asset-class correlations increase. These correlations increase due in large part to the fact that inside every asset class and security are multiple shared risk factors, which can be thought of as the DNA of a portfolio.

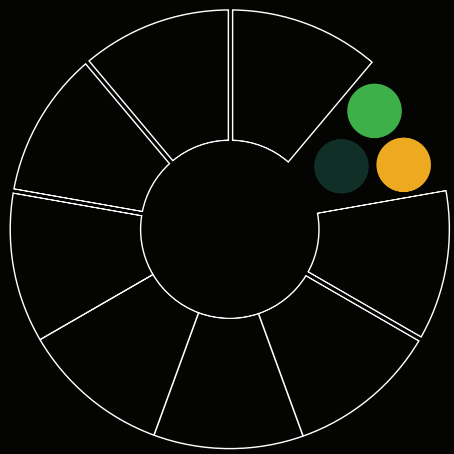
Figure 1: Expanding Portfolio Risk Factor Allocation



Risk-allocated portfolios look to harvest these different risk factors, seeking to pursue returns and manage risk. In contrast, traditional asset-allocation portfolios almost exclusively use fixed allocations to bonds in order to control risk. Utilizing risk factors, we employ a greater spectrum of strategies and mandates including: equity, absolute return (hedge funds), private capital, unconstrained funds (not "constrained" or limited to certain asset classes) and real assets. This approach is designed to help us better understand the key sources of long-term returns across asset classes. It also provides a better approach to portfolio diversification, empowering us with the ability to focus not only on diversification across asset classes, but also on diversification across the underlying sources of return.

Risk Factors

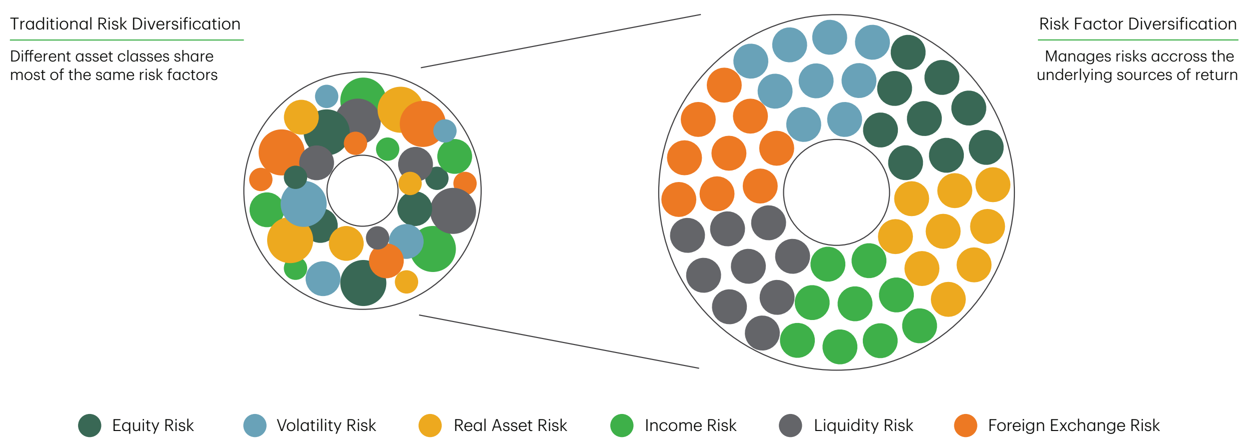
Our evolutionary asset allocation allows for revolutionary risk-factor diversification. Risk Priority Management provides enhanced asset allocation designed to manage the individual risk factors below the surface of a portfolio.



True diversification

True diversification is achieved by managing risk factors at the allocation level (figure 1) and at the mandate level (figure 2). While there are four primary risk factors at the mandate level, there are six secondary risk factors that make up the biggest part of a portfolio's DNA: equity, income, volatility, liquidity, real asset and foreign exchange.

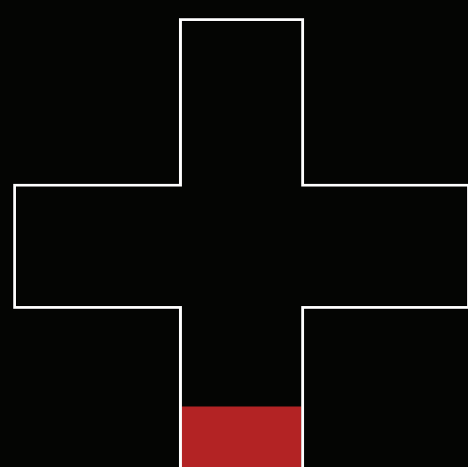
Figure 2: Risk Factors at the Mandate Level



When selecting mandates, consideration is given to diversifying overall risk-factor exposure, investment style, market capitalization, and geographical exposure.

Pain Relief

Losing money hurts. Although the pain is not physical, neuroscientific research has shown, using MRI technology, that the human brain experiences financial loss similarly to the way it experiences a physical attack. In very real terms: it causes pain. This fact is an essential component of Risk Priority Management, providing a critical catalyst as to why and how we manage risk.



pain relief

Seeking to quantify more consistent, risk aware returns, with less downside capture.

Measuring risk (pain)

Today, one of the most widely used measures of risk utilized by portfolio managers is standard deviation. Derived from academia, this statistical measure considers risk in terms of volatility (frequency of fluctuations) of returns. While helpful, we believe there may be a better, more meaningful measure that considers how investors experience pain of financial loss.

Key sources of pain

When it comes to money, many investors are ultimately concerned about the size of losses, how long they last and how often they occur. With this in mind, we use a risk measurement tool known as the Pain Index, which quantifies the three key measures:

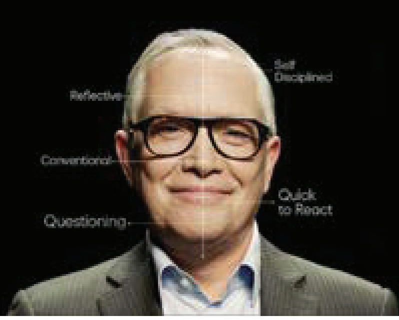
- the depth (how much)
- the duration (for how long), and
- the frequency of financial losses (how often)

By focusing on reducing these three measures, we seek to reduce the amount of time and extent to which investors feel emotional angst due to losses. This can be a real form of pain relief.

How is this done?

A traditional balanced benchmark model derives much of its return from an allocation heavily reliant on equity and fixed-income risk factors. Risk Priority Management seeks returns with a greater balance in terms of risk factors. This is achieved with an enhanced asset allocation, which diversifies the risk factors in a portfolio and reduces the exposure to equity and fixed income risk factors.

Investment success can't be understood with just a set of numbers



Our discovery process harnesses the cutting-edge field of behavioural finance, which we use to understand your Wealth Personality and what influences your wealth decisions, including your financial blind spots.

To learn more about the importance of investment behaviour, speak with your investment advisor about the TD Wealth Discovery Tool.

We believe risk-factor allocation will change the way the investment industry constructs diversified portfolios

Anticipating the effect of planned spending, inflows, inflation and taxes on the distribution of future portfolio values is a critical part of portfolio construction. This is particularly true for high-net-worth wealth clients with spending requirements. Risk factors help advisors avoid the use of supposedly normally distributed returns and traditional benchmarks in favor of more realistic factor-based distributions.

From day one, our goal was to create a bespoke, guided portfolio-construction and management service that would empower advisors to build institutional-grade protection and real return portfolios for clients. Specifically, we wanted these portfolios to have the following attributes:

Focused on client goals

Properly places investor goals and needs ahead of “benchmark” performance.

Reduced volatility

Reduces the reliance on interest-sensitive low-return/high-risk investments to protect against expected volatility.

Consistent returns

Aims to deliver consistent returns with less pain: lower losses, less often, and for shorter periods of time.

Enhanced asset allocation

Enhances the traditional asset-allocation process, which is full of equity risk and rising correlations.

Proper diversification

Provides the foundation for a properly diversified portfolio

> The key to managing a contemporary portfolio in the current environment is in the clarity of the investment process.

Let us help you establish yours.

important
information

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