On Target Wealth Partners believe that over the long term, a disciplined and diversified investment approach based on efficacy of the capital markets and financial science will add greater value with higher reliability, confidence and less stress than a philosophy based on intuition and speculation.

But what exactly is the financial science?

Trying to summarize decades of academic research and real world practical application into a top-line, approachable summary is difficult, but financial science has yielded several critical principles important to investors:

- **Markets work and are generally very efficient**

  - Current prices incorporate all available information and expectations
  - Current prices are the best approximation of intrinsic value
  - Price changes are due to unforeseen events
  - Mistakes in pricing do occur but not in predictable patterns that can lead to consistent outperformance

- **Diversification is key**

  - Comprehensive, global asset allocation can neutralize the risks specific to individual securities

- **Risk and return are related**

  - The compensation for taking on increased levels of risk is the potential to earn greater returns

There are five factors that help determine expected return:

Three Equity Factors

- Equity Market Factor – Stocks have higher expected returns than fixed income
- Company Size Factor – Small company stocks have higher expected returns and risk than large company stock
- Company Price Factor (measured by ratio of book value to market equity) – lower-priced “value” stocks have higher expected returns than higher priced “growth” stocks

Two Fixed Income Factors

- Maturity Factor – the current status of the yield curve may dictate optimal maturity, but historically, longer-maturity fixed income instruments have higher standard deviations and have not provided consistently greater returns
- Default Factor - high quality debt instruments tend to have less risk

It is then necessary to apply these principles, learnings and science when evaluating an investing approach or philosophy.

The three main investing philosophies include:

Active Management

- Attempts to beat the market through security selection and market timing
- Undermines asset class exposure to keep up with the most “promising” securities
- Generates higher fees, trading costs and tax consequences due to increased turnover

Passive Index Management

- Accepts asset class returns minus tracking costs
- Allows commercial benchmarks to define strategy
- Accepts higher transaction costs and turnover in favor of tracking

Passive Asset Class Management (OTWP strategy of choice)

- Grounded in the efficiency of the capital markets
- Captures specific dimensions of risk identified by academic research and data-based science
- Minimizes transaction costs
- Enhances returns through strategic trading and portfolio engineering
- Capitalizes on the urgency to trade by active and index management philosophies

The implications are critical:

- Active management strategies cannot consistently add value through security selection and market timing
- Passive investment strategies reward investors with capital market returns
- Passive asset class investing permits targeting of enhanced market returns versus indexing through strategic cost reductions and risk factors identified through quantitative models

On Target Wealth Partners embraces financial science and performs portfolio engineering to target investment returns that are directly related to the desired level of risk taken. The result is true investing versus speculating.