**BENCHMARKING**

**BIVIO PRESENTATION**

We like to think about being in an investment club as a group of people running a little business. In fact, we are a group of people managing a mutual fund. When you make a contribution to your club, you are purchasing

shares of your fund. You, of course, do that with the intent that those shares will increase in value, just like anything else you invest in. You want to manage your portfolio so your money grows as much as it can. Ideally, you want the amount of effort you put into managing your investments to produce an increase in the rate of growth you achieve.

You’d like your growth to follow the red line rather than the blue one. Comparing your rate of return to another investment is called benchmarking. There is a report in bivio that lets you do this. It is called the Portfolio Benchmark report. You get to it on the Accounting>Reports page. You select the investment you want to compare to and the time period over which you want to make the comparison. The comparison that is made is between IRR or Annualized Internal Rate Of Return for the two investments. You should be watching this because it will give you a birds eye view of how good you are at making investing decisions. A higher number means your investments are growing faster than if you’d put the money into whatever you are comparing with. How do you pick what to compare to?

A common selection is the Vanguard Index 500 fund. Why is this? Because it is commonly recommended as an investment choice for those who want to be invested in the stock market but do not want to have to choose investments. As we all know, it is not easy to beat. Most active mutual fund managers do not beat it. You actually can compare to investing in almost anything that has a ticker symbol.

Another popular comparison is to compare to the Vanguard Total Stock Market Index. And finally, it’s always good to see how you’re doing compared to Warren Buffet.

You need to pick a time frame over which to make your comparison. The longer the time period, the better you have a chance that you are seeing your expertise in managing a portfolio rather than just luck. It should be at least a year. Since IRR is an annualized return, it can be misleading if you extrapolate short term changes out over a year time frame.

One thing to be aware of. If you have switched to bivio using the Edit Opening Balances method (possibly because you were previously doing manual accounting), you can only calculate IRR for the time period since you’ve switched. If you’ve switched by importing your data from another program, you do not need to worry about this.

What is good about this tool is that you are comparing actual cash flows for your investments. In the bottom half of the report, you will see the cash flows you had for the time period you selected. You will also see how many shares of your comparison investment the cash purchased. It’s very important to make the comparison this way. Cash flow

will have an effect on investment return. Otherwise you are not making an apples to apples comparison. Based on the beginning and ending values of your account and the cash flows that you had, an IRR or Internal rate of return is

calculated for each of the two investments. One for the investment in your club and one for the investment in the security you are comparing to.

Determining the IRR using your actual contribution amounts and contribution dates involves solving for an unknown in a series of equations. It’s a complicated trial and error process which fortunately is handled by our computer. You may be familiar with a function in Excel called XIRR which can make this calculation also. I Think of IRR as a magic CD rate. Every time you invest money in your club during the time period you are looking at, it is as if you have found a CD which pays the IRR rate of interest to put your money into.

Here’s an example: On May 1 you received $500 in member contributions. On that day, it was invested in this club’s “Magic CD” which earned them 43.8% It was invested for about 2/3 of the year. The Ending value of that $500 invested in that CD can be calculated using this formula to be $649.82.

This calculation is made for each contribution that you make during the year. At the end of the year, sum the value of each of the CD’s and that’s the ending value of the account. Why do you want to compare your IRR to an investment in something else? Over the long run, it can tell you whether your investing efforts are having an impact or whether you’d be better off just investing in an index. It focuses you on what is important as you make investing decisions. You want to make Investing decisions that will maximize your IRR.

Here’s an example: Suppose we have $50,000 to invest. We can find a “high yield” 4 year CD that will pay 2.59% APY. On Jan 1, we put our $50,000 into this CD. At the end of a year, we have $51295 (50,000\*1.0259)

W‘e’ve earned $1295. Suppose we didn’t have the entire $50,000 available on the first of the year. Instead, we started with $40,000 invested on one of the 2.59 % CD’s on Jan. 1. At the end of the year it was worth $41033.13

Then, each month we put in these amounts. The total of all the amounts contributed during the year was still $50,000 but we spread out the contributions over the year instead of putting it all in at one time at the beginning. Each months contribution was invested in one of those CD’s earning 2.59% APY. We ended up with 12 CD’s.

At the end of the year, we figured out how much each one was worth. We added them together. The total is $51153.42. This was $141.58 less than the amount we earned when we put all our money in in the beginning. Cash flow has had an effect on our investment returns.

Now, suppose instead we had put those same amounts into our club. Remember, our IRR was 43.8%. It was as if, each time we invested in the club, we put the money in a CD with a 43.8% Return. At the end of the year, we totaled how much each CD was worth and we totaled them up. It was $69358.83. We ended up with $18205.41 more by investing in our own club than the Bank CD’s.

Now, suppose instead we had put those same amounts on the same dates into the Vanguard Index 500 fund, VFINX.

The IRR we achieved there was 25.0.%. Again, each investment had gone into a 25% APY CD. Our ending total for the year was $61084.32, $9930.90 more than the bank CD’s $8274.51, less than investing in our club.

What’s usually most useful is to track “relative return.” This is the difference between the return you achieved by your club investment management efforts and the return you would have received if you had done a lot less work and just purchased shares of a fixed income investment or your benchmark investment. If your relative return is greater than zero, your investing decisions are paying off and you are earning more money than you would have in the investment you are comparing to. Even a 1.5 percent relative return is something you should be proud of. Due to the magic of compounding, over the years, it will add up to a much higher ending value of your account.

Here’s an example: Suppose you had started your investing 10 years ago with $100,000. You had the choice of two different investments, one where you achieved a 10% IRR and the other where you achieved “only” a little bit better

return of 11.5% IRR. At the end of 10 years, this is what you would have had in your accounts:

* Investment 1‐(10% IRR) ‐ $259374.25
* Investment 2‐(11.5% IRR) ‐ $296994.68

An increase of $37620.43

The 1.5% yearly difference in your IRR has meant that you have ended up with 14.5% more money. This is because IRR is an annualized return. Due to the magic of compounding, you earn money not only on your principle but

also on the income you’ve earned in previous years. So, when you look at your club returns related to your

benchmark returns, please pat yourselves on the back for almost any increase over the benchmark that you see. Your efforts are paying off more than it might seem. It is interesting to plot relative return over a period of time. If

your returns are consistently higher than your benchmark returns, you’re efforts are paying off.

If you see a nice upward slope like this in the magnitude of your relative returns that may be an indication that you’re learning something and getting better at making investing decisions. It’s a lot of work to manage a portfolio. If you aren’t producing a return that is better than putting the money in a Bank CD or in the Vanguard Index 500 mutual fund, you need to make some changes to the way you are doing things.

Each time you look at your portfolio, you should be thinking, how can I get the best “CD” rate for the assets I have? One really important thing you should be doing is making sure you are focusing your decision making on the future, not on the past. I think many of us tend to look at reports like this and one of the first things we do is go over to the gains and losses column. When we see a positive number, we are happy, we “like” that stock. When we see a negative number, we are not so happy, that stock is not our friend. So, we tend to want to keep the stocks that make us happy and get rid of the ones that we don’t like looking at. We need to try not to do this. There is actually no information on this report that tells us how to invest the $51004.76 in assets we currently have, to achieve

optimal results. That is why we need to be looking at this report (or something equivalent) to make our portfolio decisions.

This is a Manifest Investing Dashboard which you can pull up for your portfolio using the Manifest button on the Accounting>Investments Screen. This 12.0% projected annual portfolio return is part of what is going to affect my IRR. We need to keep our eye on this and keep making sure we are making investing decisions which optimize it. Your projected portfolio return will be affected by the projected returns of your various stocks and the amounts

you have invested in each of them. To help making decisions, it is interesting to compare our club Projected Annual Return (PAR) to the Projected Annual Return of our benchmark. If we make decisions that keeps our portfolio PAR above what is projected for our benchmark, we will have a greater chance of beating it’s returns.

Many things affect your portfolio performance.

* Choice of Stocks
* Quality‐So you have increased confidence in predictions of future performance and hopefully minimize your downsize risk
* High growth potential‐For your entire portfolio. Statistically, you have more chance of “getting it right” if you are making a projection for a group of stocks than for an individual stock.
* Buying and Selling. Buying the stocks when growth potential is high; Replacing them when growth potential is not as high
* The dates of your cash inflows (member contributions), can affect your returns. Did you have cash to invest when the conditions were optimal?
* Market Momentum.
1. Up‐Are you invested when the market is rising in general or are you sitting on cash that might be growing better elsewhere?
2. Down ‐If the market seems high, have you pulled out some cash to keep it safe to use when the inevitable correction comes?

All of these things affect what your “Magic CD” Rate will be. These are all things you’ve heard before. The thing we need to talk about more is how we’re doing if we apply them. What is your club’s Magic CD Rate? Is it better than putting your money in the bank? Is it better than your benchmark rate? If not, what might you try and do to change it? I suggest you set a goal for your club (or yourself).

First, decide what you want to benchmark against. You might try starting with the default, VFINX. Then, check how you’ve been doing. Look at your IRR and Relative returns for different time frames such as 1 year, 5 years and the life of your club. How are you doing? If you need improvement, talk about how you might do that.

Start tracking your relative return. If you’d like, I can set up a graph like this for your club that you can look at each month to see how you’re doing. Just fill in your club information in the survey when you leave the webinar today.

I think we may even start handing out bivio friends for when you’re successful. You’ll get a yellow friend for every time you beat the benchmark 3 months in a row. Three yellow friends earns you a green friend and green friends will earn you bivio bucks toward your annual subscription. I’ll post the details of how we’ll do this on club café this week. So, what is your club’s Magic CD rate? Keep your eye on the ball and the dollars will take care of themselves.