



ScotiaMcLeod PAG Fund Research

ScotiaMcLeod Mutual Fund Recommended List

How we Select
Mutual Funds

Quantitative and
Qualitative Analysis

Key Benefits

Who we are: The ScotiaMcLeod PAG Fund Research Group is a “team of experts” providing mutual fund, hedge fund, and PPN advisory services, specifically focused on the retail full service brokerage of ScotiaMcLeod. Our goal is to provide value-added services and actionable ideas related to mutual funds, hedge funds, and PPNs, including portfolio construction services and investment strategies either individually or in combination with a broader portfolio of securities.

How do *we* select mutual funds?

With over 5,000 mutual funds to choose from in Canada, the first challenge is to find a way to effectively shorten the list. We find that quantitative factors work well in accomplishing this task, but it is only one part of our process. Although past performance plays a role in the fund selection process it should not be the primary focus of an investor’s fund search.

Our process focuses on both the *quantitative and qualitative* analysis of funds

The Quantitative side. In terms of our quantitative assessment, we use a proprietary model that is essentially comprised of three “buckets”. The first bucket includes *performance metrics* such as excess return, batting average, and alpha, among others. The second bucket includes *risk metrics* such as tracking error, downside deviation and skewness. And the third bucket focuses on *risk-adjusted metrics* such as the Sortino and Sharpe ratios. Combining the three buckets in our model produces a ranking of funds over one-, three-, and five-year time periods. We then produce a combined scoring of the funds, which in the end, generates a fund ranking based on all of the quantitative results.

This process is repeated on a monthly basis, and ultimately assists us in accomplishing a couple of things. First, it assists us in narrowing down the universe of funds on which to focus. The model “rewards” funds that have exhibited very consistent performance over time, which for our Recommended List, is an important factor. If we were “chasing returns”, we would only focus on those funds that had exhibited higher, more recent returns. Second, the quantitative model assists us in monitoring the funds. We are able to observe, on a monthly basis, any changes that are occurring with the funds, which allows us to further investigate funds that raise “red flags” in terms of the parameters we’ve indicated.

The Qualitative side. In terms of the analysis, some of the qualitative factors we consider are manager tenure, staff turnover, firm-level support, investment idea generation, the philosophy behind the investment process and the consistency in how it is implemented. All of these factors, and more, help us form an opinion about a fund. As time passes, and firms inevitably experience organization changes and/or staff turnover, we assess the changes and what impact they will have, if any.

People may argue that the quantitative side is more important than the qualitative side. We don’t really see it as a situation of one being more important than the other. In our view, understanding the qualitative process employed by a fund manager will ultimately assist us in explaining the quantitative results they achieve. In other words, both sides of the analysis are critical to forming a well-rounded opinion on a fund.

The qualitative side of the analysis has a multitude of moving parts, which makes analysis both interesting and occasionally frustrating. In the end, we believe our experience in this area provides us with an advantage. We may decide to keep a Fund on the Recommended List despite displaying deteriorating quantitative metrics in a specific time frame. While we do not focus on short-term performance, short-term returns can raise questions requiring further investigation. It is important for us to determine if there are factors that may affect our thesis for recommending a fund, factors that may have long-term adverse impact on the fund.

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ScotiaMcLeod Mutual Fund Recommended List (continued...)

Key benefits for using the ScotiaMcLeod Mutual Fund Recommended List

Now that we've explored some of the rationale behind identifying great funds in which to invest, we will provide some background and highlight some of the many benefits that you have available through the ScotiaMcLeod PAG Fund Research team, and the Mutual Fund Recommended List.

This is what we do. Everyone has a job to do. In addition to product approval, our job is researching and analyzing mutual funds, hedge funds, and structured products. Since this is what we do every day, naturally there is an advantage to utilizing the expertise and the work that goes into the Recommended List and Guided Portfolios, as well as the portfolio construction work we do.

In-depth due diligence. As highlighted in the previous section, our investment process in identifying quality mutual funds in which to invest is robust. From our quantitative modeling to our qualitative work, we cover as many angles as possible on an ongoing basis to ensure advisors can rely on us for support as it relates to the funds we cover.

Access to fund managers. We meet with every fund manager on our Recommended List at least once per year, and more often than not, multiple times per year. With over 200 meetings a year, we also meet a wide variety of fund managers that are not on our Recommended List on a regular basis. In this way, we see first hand what the portfolio managers are thinking from a big picture perspective and are able to question them on what their plans are for the portfolios they manage.

Ongoing monitoring. Most investors purchase a fund and will not revisit their investment unless either great returns or poor returns attract their attention. The same effort used in making the initial purchase decision should carry into the monitoring of the investment. As part of our process, we run the entire mutual fund universe through our quantitative model on a monthly basis. This analysis allows us to look at how the funds perform over time, highlighting long-term trends, consistency and most importantly, any anomalies. We proactively investigate any issues of concern to ensure that our thesis for recommending the funds remain unchanged.

In summary, with the abundance of choices and information available, selecting a mutual fund can be a complicated and time-consuming task. There are many more factors to consider beyond looking at recent performance and Star Ratings. We feel our robust analytical process consisting of both quantitative and qualitative methods allows us to effectively compare and contrast the funds in the universe. With our focus on quality and consistency, we believe the funds on the Recommended List are best-in-class funds within each of the investment categories.

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PAG FUND RESEARCH

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