Putting the OB Model Portfolio to Work

By Ross Turnbull, CPA, CA, CBV, CFA, ICD.D | Vice President, Director, Portfolio Manager

The Odlum Brown Model Portfolio ("the Model") is a hypothetical all-equity portfolio which is managed by the Odlum Brown Research Department. The Model was created over 25 years ago as a way for our Research Department to track the overall performance of their equity selections and communicate their favoured investment strategy. Portfolio Managers and Investment Advisors are provided with a spreadsheet of the Model's holdings so that the Model can be emulated in client accounts.

The long-term performance of the Model is outstanding and is one of the reasons why Murray Leith, Odlum Brown's Executive Vice President and Director of Investment Research, is regarded as one of the top equity strategists in Canada. As of December 15, 2019, the cumulative annual growth rate (CAGR) of the Model since its inception on December 15, 1994 was 14.6%. This figure compares favourably to the performance of Canada's S&P/ TSX Index of 8.4% and the S&P 500 (in Canadian dollar terms) of 9.9% over the same time period.*

I was a Research Analyst in Odlum Brown's Research Department in the years 2000 through 2005. During this period, I generated investment ideas and research that contributed to the Model Portfolio (some of those ideas remain holdings in the Model today). I developed a strong appreciation for the process and thinking behind Odlum Brown's individual investment ideas, as well as the management of the Model's holdings and equity weights. However, I was also aware that there are restrictions, costs and issues that Portfolio Managers and Investment Advisors must take into account when attempting to follow the Model.

Considering that the Model is hypothetical, we must be careful comparing the Model's returns to that of Mutual Funds and segregated portfolios because these real world portfolios incur management fees and trading costs that the Model does not. Taxes and liquidity needs are other factors that the Model does not address. However, even with a provision for these costs and practical restrictions, the long-term performance of the Model remains very good. So how do we best utilize this valuable resource?

An exact replication of the Model in client accounts is seldom practical or advised. The weights of the various stocks within the Model are a function of both the conviction of our Analysts and the history of that holding. At any given point in time there are holdings in the Model that our Research Analysts are very bullish on and holdings that are likely to be sold over the near-term. Our Research Analysts communicate this information at our weekly research meetings and this information will influence which stocks are added or removed from client portfolios.

Not all holdings in the Model are appropriate for all investors. For example, sometimes there may be a few holdings in the Model that pay no dividend or perhaps are smaller and more risky in nature. Some clients have a conservative bias or seek the income provided by dividends and that will influence which stock selections from the Model are added to portfolios. Also, some clients have significant exposure to a particular economic sector or company and it may not be appropriate to add Model holdings that exasperate this concentration risk. A family with a large commercial real estate portfolio or a senior executive with significant company shareholdings are two examples. The structure of any portfolio must be well diversified and should also include an appropriate mix of fixed income and money market instruments, which will depend on an investor's risk tolerance, individual circumstances and time horizon.

Tax is another important consideration. For example, if the favoured Canadian banks in the Model are TD Bank and Scotiabank; should we sell a long-held position in Royal Bank, trigger a capital gain, and add to the two favoured banks? Given the long-term parity of performance among these three banks, and the cash tax cost of the change, such a trade would likely be imprudent.

Fortunately, my experience with the Model is that by following the general sector weights and large holdings, investors can achieve the success of the Model (less fees) over time. There will always be performance differences from quarter to quarter due to the impracticality of following the Model trade for trade, but over multi-year periods, the differences tend to be immaterial.

Odlum Brown's highly-regarded Research Department is an important resource for Investment Advisors and Portfolio Managers like me. The success of the Model is a testament to the quality and value of the advice they provide. By pairing this research with thoughtful and careful portfolio construction, it is possible to emulate – but not exactly duplicate – the performance of the Model.

**Trades are made using the closing price on the day a change is announced. These are gross figures before fees. Past performance is not indicative of future performance.*

For more information, please contact:

Ross Turnbull, CPA, CA, CBV, CFA, ICD.D
Vice President, Director, Portfolio Manager
Phone: (604) 844-5363 | Toll-Free: (888) 886-3586 | rturnbull@odlumbrown.com