

Opinion Letter



TO: Users and prospective users of YCharts' Comprehensive Overview and Comprehensive Comparison Reports

FROM: DALBAR, Inc.

RE: Analysis of Marketing Rule on Comprehensive Overview and Comprehensive Comparison Reports

DATE: September 20, 2022

I. Introduction

YCharts has engaged DALBAR to examine their **Comprehensive Overview Report** and **Comprehensive Comparison Report** (hereinafter referred to respectively as “Overview Report” or “Comparison Report”, or collectively as “Reports”) for compliance with new SEC rules that govern adviser marketing and advertising. The facts and assumptions specified below were used to form this opinion. Any material change or discrepancy in this information could reverse our opinion.

II. Background

Effective May 4, 2021, the SEC released its final rule on Investment Adviser Marketing (“Marketing Rule(s)” or “Rule(s)”), which amended 17 CFR 275.206(4)-1 and 17 CFR 275.204-2 under the Investment Advisers Act of 1940. The release was designed to modernize rules around investment adviser advertisements and to efficiently regulate adviser advertisements under a single Marketing Rule. The rule provided an 18-month transition period, resulting in a compliance date of November 4, 2022.

The use of these Reports by advisers will in most cases implicate the Marketing Rules, and therefore YCharts is seeking an expert, independent opinion on how the Rules apply to the Reports and their compliance with those Rules.

This Letter will discuss the various conditions under which the Reports will be subject to the Marketing Rules and the Reports’ compliance with the Rules, specifically rules surrounding hypothetical performance. This Letter will also highlight features that in DALBAR’s opinion, assist

advisers to facilitate policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the likely financial situation and investment objectives of the intended audience of the advertisement.

III. Statement of Facts and Assumptions

The following facts and assumptions were used in the analysis of the Overview Report and Comparison Report:

- A. YCharts users can create and save model portfolios on their account, which will ultimately serve as the centerpiece of the analysis presented in the Overview and Comparison Reports.
- B. Model portfolios can be constructed manually by entering tickers and percentage weights, uploaded through an excel spreadsheet, imported from an integration partner, or provided by an adviser's home office.
- C. Users can run a menu of reports on their model portfolios. One such report is the Comprehensive Overview Report, which analyzes a portfolio against a benchmark. A second report that can be generated on a model portfolio is the Comprehensive Comparison Report, which analyzes a portfolio against another portfolio.
- D. The Reports contain an abundance of data that is typical for a comprehensive portfolio analysis. This includes but is not limited to returns; fees and expenses; fundamentals; allocations based geographics, capitalization, style, asset class, sector, maturity, credit quality, holdings; and risk statistics.
- E. Both the Overview Report and Comparison Report display portfolio performance.
- F. The model portfolios created may represent an actual portfolio of the adviser, but will most often display *hypothetical performance* (i.e. performance results that were not actually achieved by any portfolio of the investment adviser).
- G. YCharts does not expect that users will include the report in social media, mass emails or other forms of dissemination to groups of people. In most cases, advisers will share these Reports with a single client, prospective client or household.
- H. YCharts has no knowledge of or control over how the Reports are presented or to whom the Reports are presented after they are generated.

IV. Analysis

DALBAR has examined YCharts' Overview Report and Comparison Report for compliance with Adviser Marketing Rules and reached the following conclusions:

A. Advisers who Present an Investor with an Overview Report or Comparison Report will be Engaging in an Activity that is Covered by the Marketing Rules when the Performance in the Reports was not Achieved by a Portfolio of the Adviser and the Communication Includes an Offer of Services.

The threshold question in this analysis is whether the use of the Reports implicates the Marketing Rules. When a communication is considered an advertisement, *performance* (*actual* performance or *hypothetical* performance) must be displayed in accordance with the new Adviser Marketing Rules.

A communication will be considered an advertisement and therefore subject to the Adviser Marketing Rules when (1) it is made to more than one person or to one or more persons if the communication includes *hypothetical* performance and (2) the communication includes an offer of services.¹ A one-on-one communication that includes hypothetical performance and an offer for advisory services will be considered an advertisement unless it is provided in response to an unsolicited request for such information.

Hypothetical performance is defined as “performance results that were not actually achieved by any portfolio of the investment adviser.” This includes performance derived from model portfolios, back testing, targeted or projected performance. Hypothetical performance does not include tools that produce simulations or statistical analysis of the likelihood of certain outcomes² or predecessor performance.

The entire content of the communication is also an important factor in determining if a communication is an advertisement. To be considered an advertisement, the communication must include an offer of services. This includes verbal communications that take place contemporaneously with the presentation of the Report. In a situation where an adviser is sharing a Report with a client and not offering additional advisory services, the communication would not be considered an advertisement.

A typical YCharts user will most likely be presenting *hypothetical performance* of model portfolios in both Reports unless the user was displaying returns that were actually achieved by a portfolio of the adviser (this will be discussed in paragraph IV(B)). Since both the Overview Report and Comparison Report are likely to contain *hypothetical performance*, the Adviser Marketing Rule will in most cases be triggered even during one-on-one conversations with a client or potential client if the communication includes an offer of advisory services.

¹ One-on-one communications that contain paid testimonials or endorsements are also considered advertisements; however, this aspect will not be discussed further in this Opinion Letter as it is not applicable to the Reports under discussion.

² This is subject to additional requirements. Given the fact that no such simulations were observed in the Reports under analysis, this Opinion Letter will not discuss those requirements in further detail.

Advisers who present an Overview Report or Comparison Report that includes performance that was not actually achieved by a portfolio of the adviser will be presenting *hypothetical performance*. That hypothetical performance will be considered part of an advertisement and subject to the Adviser Marketing Rules when presented with an offer for advisory service. Because the advertisement contains *hypothetical performance*, the Marketing Rules are triggered even when presented in a one-on-one communication.

B. Advisers who Present Investors with an Overview Report or Comparison Report that Includes Performance that was Actually Achieved by a Portfolio of the Adviser will be Engaging in an Activity that is Covered by the Marketing Rules when the Communication is to More than One Person and the Communication Includes an Offer of Advisory Services.

Actual performance (i.e. performance that is not hypothetical performance) is performance that was actually achieved by a portfolio of the adviser. Display of this actual performance will not implicate the Marketing Rules as frequently as *hypothetical performance* because actual performance is not considered part of an advertisement unless it is presented to more than one person³ and includes an offer for advisory services. This differs materially from hypothetical performance, which will trigger Marketing Rules even during one-on-one communications.

It is expected that in the vast majority of cases, actual performance within the Reports will not be considered part of an advertisement because it is not being shared with more than one investor or household at a time. In these cases, the Marketing Rules will not be implicated. Given the relative improbability that YChart users will disseminate Reports with actual performance to groups of 2 or more people, this Opinion Letter will focus on the application of the Adviser Marketing Rule as it relates to *hypothetical performance* because this is the scenario in which it is expected the Marketing Rules will be most often implicated.⁴

C. Report Disclosures Satisfy the Requirements of the Adviser Marketing Rules with Respect to Underlying Information that Must be Provided with Hypothetical Performance within Advertisements.

Certain “underlying information” is required to be provided with hypothetical performance in advertisements. Examination of the disclosures that accompany both the Overview and Comparison Reports revealed that all required underlying information related to hypothetical performance under the Adviser Marketing Rules is adequately addressed and communicated in a manner that is calculated to be understood.

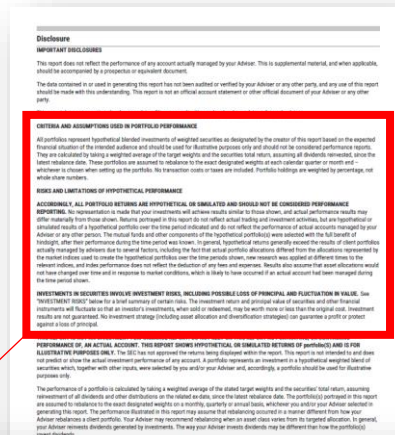
The first piece of underlying information that must be provided with hypothetical performance within advertisements relates to the *criteria and assumptions* used in the

³ A group of people representing a single account or household is still considered a one-on-one communication.

⁴ Additional rules apply to testimonials, endorsements, third-party ratings, related performance, extracted performance, and predecessor performance; all of which are outside the scope of this Letter for the reasons stated.

generation of the hypothetical performance. The second piece of underlying information that must be provided with hypothetical performance within advertisements relates to the ***risks and limitations*** of using hypothetical performance in making investment decisions.

The following language within the Reports' disclosures was found to satisfy the underlying information requirements of the Adviser Marketing Rule. The information is prominently displayed at the top of the disclosure page with clear headings to facilitate comprehension.



CRITERIA AND ASSUMPTIONS USED IN PORTFOLIO PERFORMANCE

All portfolios represent hypothetical blended investments of weighted securities as designated by the creator of this report based on the expected financial situation of the intended audience and should be used for illustrative purposes only and should not be considered performance reports. They are calculated by taking a weighted average of the target weights and the securities total return, assuming all dividends reinvested, since the latest rebalance date. These portfolios are assumed to rebalance to the exact designated weights at each calendar quarter or month end – whichever is chosen when setting up the portfolio. No transaction costs or taxes are included. Portfolio holdings are weighted by percentage, not whole share numbers.

RISKS AND LIMITATIONS OF HYPOTHETICAL PERFORMANCE

ACCORDINGLY, ALL PORTFOLIO RETURNS ARE HYPOTHETICAL OR SIMULATED AND SHOULD NOT BE CONSIDERED PERFORMANCE REPORTING.

No representation is made that your investments will achieve results similar to those shown, and actual performance results may differ materially from those shown. Returns portrayed in this report do not reflect actual trading and investment activities, but are hypothetical or simulated results of a hypothetical portfolio over the time period indicated and do not reflect the performance of actual accounts managed by your Adviser or any other person. The mutual funds and other components of the hypothetical portfolio(s) were selected with the full benefit of hindsight, after their performance during the time period was known. In general, hypothetical returns generally exceed the results of client portfolios actually managed by advisers due to several factors, including the fact that actual portfolio allocations differed from the allocations represented by the market indices used to create the hypothetical portfolios over the time periods shown, new research was applied at different times to the relevant indices, and index performance does not reflect the deduction of any fees and expenses. Results also assume that asset allocations would not have changed over time and in response to market conditions, which is likely to have occurred if an actual account had been managed during the time period shown.

INVESTMENTS IN SECURITIES INVOLVE INVESTMENT RISKS, INCLUDING POSSIBLE LOSS OF PRINCIPAL AND FLUCTUATION IN VALUE.

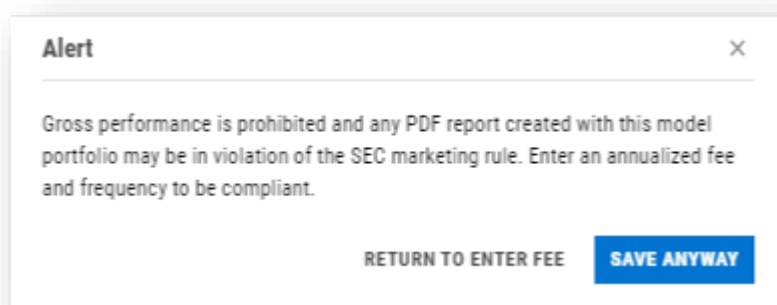
See “INVESTMENT RISKS” below for a brief summary of certain risks. The investment return and principal value of securities and other financial instruments will fluctuate so that an investor’s investments, when sold or redeemed, may be worth more or less than the original cost. Investment results are not guaranteed. No investment strategy (including asset allocation and diversification strategies) can guarantee a profit or protect against a loss of principal.

D. Advisers who use the Overview or Comparison Report to Display Hypothetical Performance are Aided by Additional Features and Guardrails to Facilitate Compliance with Adviser Marketing Rules.

When an adviser presents an Overview Report or Comparison Report in a manner that is considered an advertisement, that performance must be displayed such that it does not violate any of the performance prohibitions within the Adviser Marketing Rules. Since most advisers will not have an encyclopedic knowledge of the prohibitions, users of YCharts' Overview Report and Comparison Report are greatly assisted by having features and guardrails built into the tool to minimize the likelihood of an adviser unwittingly violating the Adviser Marketing Rules. The Tool also assists advisers in facilitating processes and procedures that are reasonably designed to comply with the rule.

1. Advisers may not Present Gross Performance in an Advertisement unless Net Performance is also Presented with Equal Prominence

YCharts has addressed the prohibition on gross performance through the functionality of the Tool. Validation prompts the user when no advisory fee is entered, greatly enhancing the probability that an advisory fee will be entered when appropriate. Users are able to run performance with no advisory fee when acknowledging the prompt.



2. Must Provide One-, Five-, And Ten-Year Periods

Performance in an advertisement must include 1, 5 and 10-year returns with equal prominence and be for the period ending no less recent than most recent calendar year-end. Performance charts are hard coded to display 1, 5 and 10-year returns and this cannot be overridden. Therefore, users of the reports would never violate this prohibition when presenting the report as produced.

3. The Tool's Model Portfolio Features Can Help Financial Advisers Facilitate Policies and Procedures that are Reasonably Designed to Comply with the Marketing Rule.

Advisers using hypothetical performance in advertisements must adopt policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the likely financial situation and investment objectives of the intended audience. The adviser must make a reasonable judgement about the likely investment objectives and

v. Conclusion

The SEC's new Adviser Marketing Rule puts clear restrictions on the presentation of performance within advertisements. The Commission added additional safeguards for investors regarding the presentation of *hypothetical performance* by constructing the Rule in such a way that all communications that contain hypothetical performance and an offer of advisory services are considered an advertisement. As a result, hypothetical performance presented to a single prospect in a one-on-one discussion would be considered an advertisement and subject to the Rules. This has led *hypothetical performance* to be one of the most scrutinized elements of the Adviser Marketing Rule, and rightfully so.

It is DALBAR's opinion that advisers using YCharts' Comprehensive Overview Report and Comprehensive Comparison Report to share *hypothetical performance*, along with an offer for advisory services, will be engaging in activity covered by the Adviser Marketing Rules. Advisers using the YCharts Reports to present *hypothetical performance* can rely on the following tool attributes to assist in complying with the Adviser Marketing Rule:

- Users will always be alerted when running any performance gross of fees, significantly reducing the likelihood of an adviser's unintended violation of the Marketing Rules by including gross performance in an advertisement.
- All required information related to hypothetical performance is hard coded to be included in the disclosure page, presented clearly and calculated to be understood.
- No open text options exist that could introduce other content or statements into the Reports that implicate the Marketing Rule
- Required performance timeframes are hardcoded into the report and cannot be overridden
- Tool functionality can assist firms with adopting and implementing policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the likely financial situation and investment objective of the intended audience.

It is important to note that nothing in the Tool is a substitution for advisers adopting and implementing policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the likely financial situation and investment objectives of the intended audience of the advertisement. While the functionality of the YCharts tool greatly assists in the implementation of such policies and procedures, it does not relieve an adviser from its duty of adopting and implementing their own policies and procedures.