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Cameron Passmore, right, with a few of his Shopify clients (including COO Harley Finkelstein, in the black t-shirt) at its Ottawa headquarters.

JAMIE KRONICK FOR REPORT ON BUSINESS MAGAZINE

INVEST LIKE A TECH GAZILLIONAIRE

In Ottawa, that means handing your money to Cameron Passmore, who has attained rock-star status at companies like Shopify thanks to his low-risk, low-cost mantra

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The Globe and Mail
Last updated: Tuesday, May 24, 2016 4:45PM EDT

Tobi Lütke hails from a family with a penchant for losing money. The Shopify co-founder's father is a doctor in Germany who "got funnelled into all kinds of crappy investments like apartment buildings" in Berlin in the 1990s. When his parents bought stock, "it was always at the absolute height," says Lütke. He claims the only family member who's ever made money investing was his grandmother—and that's only because she liquidated her stocks to pay for a place to live in retirement.

When Shopify—which sells subscription software to retail merchants—began to attract serious venture capital a few years back and Lütke finally had money of his own to invest (the company went public a year ago), the CEO didn't want to repeat the mistakes of his kin back home in Germany. So he called the man who has become the go-to investment professional for Ottawa's tech mavens: Cameron Passmore.

Business at Passmore's boutique firm, PWL Capital Management, is booming, thanks largely to referrals from Lütke. Passmore's six-person team now manages $450 million in assets, up more than fourfold in just three and a half years. His client list has tripled, to 437 families, and their median age has dropped to 48 from 57. They include Aydin Mirzaee, who sold his company to SurveyMonkey in 2014; Lance Laking, an investment director with the MaRS Investment Accelerator Fund; and Luc Levesque, a renowned online search expert.

Shopify employees continue to dominate Passmore's book, however—following the lead of their boss, roughly 100 of them, including chief operating officer Harley Finkelstein, have handed their money to Passmore. This year, Shopify clients will represent more than half of new long-term assets invested with Passmore and his team. And Passmore expects that number to increase substantially as more "Shopifolk" cash in their options. His Ottawa-based team now travels to Toronto, Montreal and Waterloo to meet Shopify employees as the company ramps up its head count there.

So why is Passmore such a hit with the coding crowd? He doesn't offer exclusive access to sophisticated, exotic investment vehicles or funnel cash to star fund managers renowned for generating outsized returns. Rather, Passmore promises one thing: passive index investing for ultralow fees.

At first, this might seem anathema to the IT crowd: Why would these professional daredevils, who have staked their livelihoods on high-risk ventures, be so meek with their money? But there's something in the approach that speaks to them, that mirrors their modus operandi. Passmore sells a brand of investment advice that combines the best of automation with human know-how. It is data-driven and disruptive to the institutions that peddle expensive actively managed funds. "Once you get the rules [for passive investing] in place, it should be non-subjective—and they love it," says Passmore. "It's all about data."

Lütke and Finkelstein met with a lot of financial advisers before finding Passmore, and it wasn't just his investment philosophy they liked. "There's no bullshit with him," says Finkelstein. "And we've all decided with Cameron that these highly indexed funds are the best investment we can make."

PWL's Passmore at the Shopify offices in Ottawa.

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Index investing was barely on the radar when Passmore began selling mutual funds 26 years ago. The native of Lennoxville, Quebec—then a 24-year-old recent business graduate from McGill University—entered the business at the behest of a friend, abandoning a brief career as a beef salesman. He started with a national dealership called Money Concepts, armed with little knowledge and no experience. “It just shows you how ridiculously easy it was to get into the industry,” he says.

Midway through the long bull market of the 1980s and ‘90s, and with interest rates waning, regular people were stampeding into mutual funds—total Canadian assets under management grew from $25 billion at the end of 1990 to $426 billion at the end of 2001. Passmore was collecting big upfront sales commissions and ongoing annual trailer fees. But in his mind, he wasn’t adding value, just moving expensive product supported by the air cover of massive advertising campaigns that promised secure, flush retirement years to one and all. “We were making way too much money way too fast,” he says. “And it didn’t feel right.”

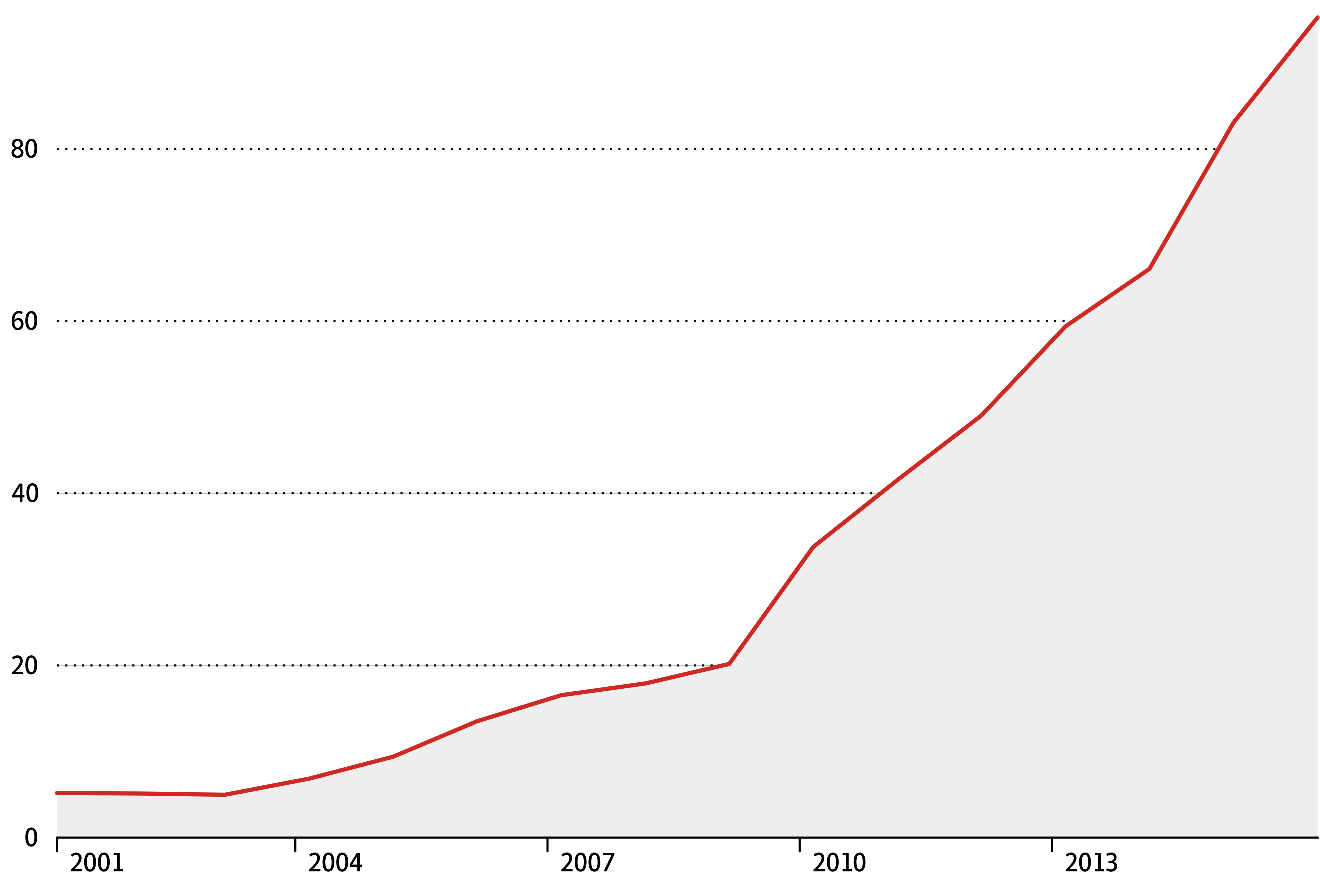
In 1995, while Passmore was running a branch of fund dealer Brightside Financial, a Fidelity executive warned him that the industry would face a day of reckoning as customers woke up to the high commissions they were paying for relatively unexceptional returns. Rather than moving product for commissions, Passmore decided to focus on charging customers fees based on their portfolio values. After Brightside sold to industry consolidator Assante, he and his team left in 1997 to join fledgling Montreal-based PWL. Passmore opened PWL’s Ottawa office and put his new fee-based preference into practice. “Once you go fee-based, you look at the evidence, and all the evidence points toward indexing,” he says.

Passmore’s timing was ideal. It was the dawn of a new era in investing as index funds, which had been around for about two decades, began taking off. The “efficient market” theory held that all available public information was priced into securities, making it difficult, if not impossible, for active fund managers to beat the market over the long run. That turned the focus toward mutual fund management expenses: If funds over time generated investment returns that were indistinguishable from one another, then those funds with the lowest expense ratios would leave their investors in the best financial position.

That set the stage for a new type of investment to gain popularity: exchange-traded funds. These funds traded on stock exchanges and, like mutual funds, were composed of a collection

of stocks and/or bonds. But they were generally programmed to track and closely replicate indexes, with algorithms doing much of the work in tandem with the market, rather than human stock pickers. That kept costs ultralow—the average asset-weighted management expense ratio on a U.S. stock ETF in 2013 was 0.45%, less than one-third the average for actively managed equity funds. The first ETF actually launched in Canada in 1990 (Toronto 35 Index Participation Units), but the first to hit the big-time was the stateside SPDR (pronounced "spider"), which tracked the S&P 500. Demand grew steadily, and by March, 2016, there were 4,500 ETFs globally managing $2.94 trillion (U.S.) in assets, according to research firm ETFGI.

Total ETF assets under management in Canada



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DATA SHARE

Passmore was heavily into ETFs when his firm discovered U.S. index fund company Dimensional Fund Advisors in the early 2000s. Dimensional charges asset-weighted average expense ratios of 0.36%, but adds a tilt to its approach. Inspired by the research of Nobel

economics laureate and Dimensional director Eugene Fama, the company focuses on smaller-cap stocks—which tend to outperform larger companies over the longer term—and favours underpriced "value" stocks (as measured by book-to-market value), which also outperform growth stocks longer-term on balance.

"The evidence is overwhelming," says Passmore. "Really, do you think some broker knows more than the markets when the SPDR trades 238 times a second? It's preposterous....Unfortunately, people don't make investing decisions based on evidence. It's usually based on some sales pitch or some broker."

That's not to say he has completely automated his business. His clients, he says, still need advice on proper asset allocation, tax structure, time horizons and retirement plans. "We're in the business of providing advice, with automation of portfolios," he says.

And as long as brokers and advisers keep spewing out the same pitches, he says, "my business is going to be set forever."

Advice from three fans of index investing

John Bogle: "Forget the needle. Buy the haystack."

Burton Malkiel: "The index fund is a sensible, serviceable method for obtaining the market's rate of return with absolutely no effort and minimal expense."

Warren Buffett: "Both individuals and institutions will constantly be urged to be active by those who profit from giving advice or effecting transactions. The resulting frictional costs can be huge and, for investors in aggregate, devoid of benefit."

What makes many tech entrepreneurs so successful in business makes them skeptical of glossy investment pitches. Their brains are hard-wired to work the numbers and so, newly wealthy, they plunge themselves into the bewildering world of wealth management. They pore over investing books and blogs in search of the best advice, build spreadsheets to catalogue investment approaches and risk. And many of them gradually come to realize a few things. First and foremost: Managing money is time-consuming, and they barely have energy for anything other than building their businesses, let alone trying to

consistently beat the market. “I don’t want to make investing in the stock market a big part of what I spend my time thinking about,” says Luc Levesque, who sold his company to TripAdvisor in 2007 and now runs its search-engine optimization business from Ottawa. He is still scarred, he says, by a money-losing experience with Canadian flow-through shares recommended by a Big Bank broker in the 2000s.

The second thing they realize is that their finances need a healthy dose of predictability. “If you work in tech, your livelihood is risky to begin with,” says Lütke. “You’ll find that what you should do with your investments is something fairly stable, to bring the overall risk exposure down. We want to grow our investments, but we don’t need to take crazy risks.”

Throw in the fact that actively managed funds don’t necessarily perform better than the mean over time—and cost more—and indexing becomes the natural choice. (Of course, there are active managers who log market-beating results over the long term. But they’re rare and, as Passmore points out, hard for fund advisers like him to find—particularly before they hit a hot streak.)

“I realized Shopify would probably create a lot of wealth for a lot of individuals,” says Lütke, “and I wanted to make sure that wealth was not simply being given to the various banks in the form of management fees.”

Lütke turned to Ram Balakrishnan, a.k.a. the Canadian Capitalist, a respected financial blogger and advocate of passive investing. Lütke asked for a referral. Balakrishnan gave him Passmore’s name.

This was fall 2011, and Shopify was still a young company, with just 40 employees crammed into an office above a ByWard Market restaurant. But it was beginning to distinguish itself as an early success in the North American cloud-based subscription software industry, and it was in the midst of raising its second multimillion-dollar early-stage venture financing in less than a year.

When Passmore first showed up at Lütke’s office, he left his tie behind, but still felt overdressed in a suit. He was impressed by Lütke’s piercing intelligence. The young CEO peppered him with pointed questions about topics like the tax sensitivity of corporate-class funds. In part, Lütke says he was testing Passmore, feigning interest in investments he would

never touch (as he'd done with other advisers he'd met with). Passmore passed. "That's complete garbage being scammed by the mutual fund industry," Passmore remembers telling him about corporate-class funds. "I let it fly. I think that might have been the argument that won the day. After that, he became a client."

The next time Passmore came to the office, to meet the entire Shopify team, he wore jeans. Gradually he became a fixture, doing regular seminars to walk employees through the basics of financial and estate planning, and the rationale for index investing. And he never oversold his firm. "He's almost the anti-salesperson," says Lütke. "Usually, he tells me to not do things."

"The whole notion of trying to sell something is completely foreign to me," says Passmore. "You just try to meet and help people, and the word just spreads."

That is particularly true in Ottawa's tight-knit tech cluster, where there's a natural inclination to help each other out and recommend service providers who "get it." A referral from someone like Lütke is taken very seriously. "With Tobi, it's usually, 'You gotta talk to this guy.' And you reply, 'Of course.' What else would you do?" says Aydin Mirzaee, who moved more than a quarter of his investible assets to PWL in late 2014 after his deal with SurveyMonkey.

And it's been gold for Passmore. As he was growing his business, people would come to him and say: "You're doing for me what you do for Tobi, right? If it's good enough for Tobi, it's good enough for me."

Passmore doesn't do Shopify seminars any more—he's so busy, he's had to hand that off to others at PWL (though he still looks after his original clients). But his firm's continued relationship with Shopify remains a key part of his success. "It's had a massive impact on our business," he adds. "We're like family now."

The trouble with ETFs

If one company dominates the index, it'll also dominate the ETF—and that means a big hit to the stock can have an outsized impact. Just look at Apple.

Apple's stock was down **16%** over two weeks in April, after reporting lower-than-expected revenue.

As a result, **$4 billion** vanished from U.S. ETFs.

Techies are used to being on the leading edge. So while Lütke and his peers have flocked to passive investing, Canadians as a whole are well behind. In the U.S., roughly one-third of mutual fund and ETF assets are in passive instruments. In Canada, passive investments account for just 13.7%.

Atul Tiwari, the managing director and head of Canada for ETF giant Vanguard Investments and chairman of the Canadian ETF Association, says there are a number of reasons for the slower uptake in Canada. Since the credit crisis, "the majority of fund flows have gone to passive funds rather than active" in the U.S., he says, partially because ETFs are more transparent than mutual funds, as their holdings are typically updated daily or weekly, not every few months.

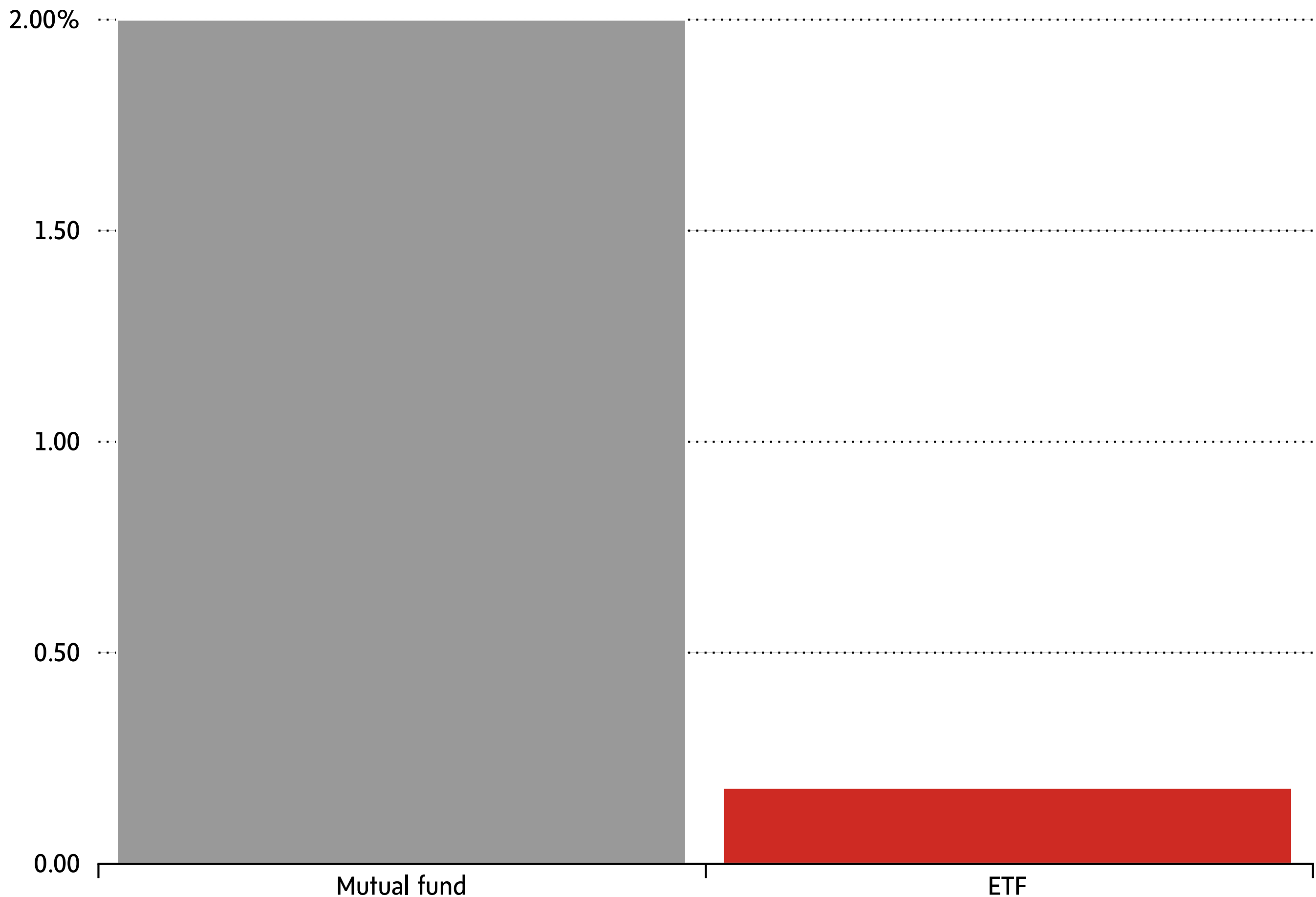
There's another reason: competition. In Canada, the funds business has become increasingly dominated by the Big Banks, which have swallowed up or marginalized the independents. Fund fees remain high in Canada, and the banks like it that way. In the U.S., the share of the investment-management business that operates on fee-based models like the one used by Passmore is 65%, says Tiwari; in Canada, it's less than half that. Of course—why would the banks and other mutual fund dealers trumpet low-fee alternatives?

Passmore adds: "There are some great index-based guys I know of at the banks. Clearly they're the lone wolves in the office. I think it's a sad commentary there seem to be so few, and it's not increasing, either."

The fact that far more people haven't woken up and switched to index investing seems to personally offend Passmore. "The awareness is so low in Canada," he says. In other markets, like the U.K. and Australia, regulators have banned trailer-fee commissions that puff up the costs of mutual funds. Not so in Canada. "Once you are willing and able to embrace the evidence," he says with the kind of conviction and single-mindedness his techie clients relate to, "it is just shocking what the investing industry has pulled off."

How fund fees eat into your returns

The average yearly management expense ratio (MER) for actively managed Canadian equity mutual funds is still about 2%. The most popular Canadian equity ETF, iShares S&P/TSX 60 Index, has an MER of just 0.18%. Suppose you invest $100,000 and leave it there for 10 years, earning a 4% annual return.



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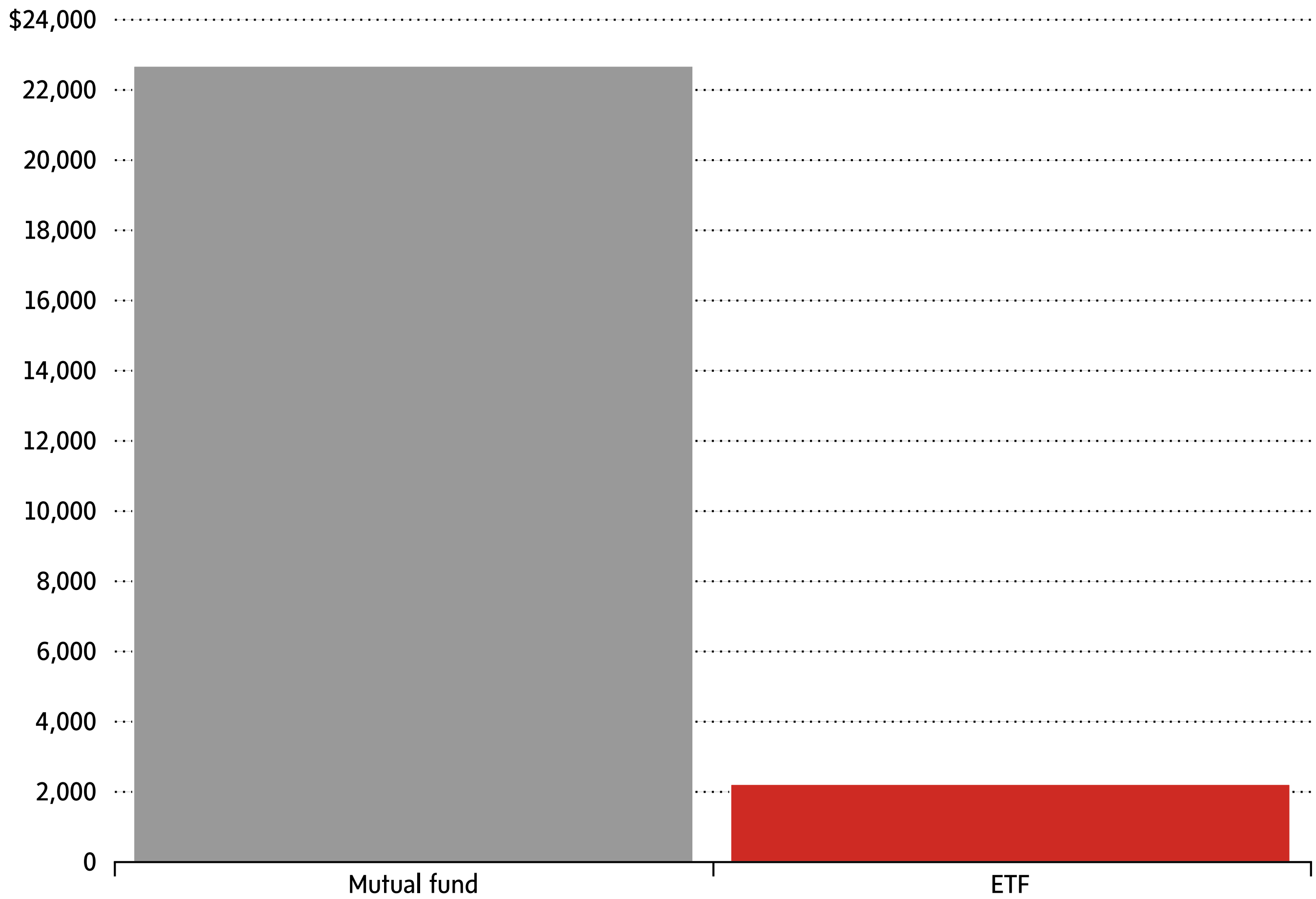
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22,000
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Mutual fund
ETF
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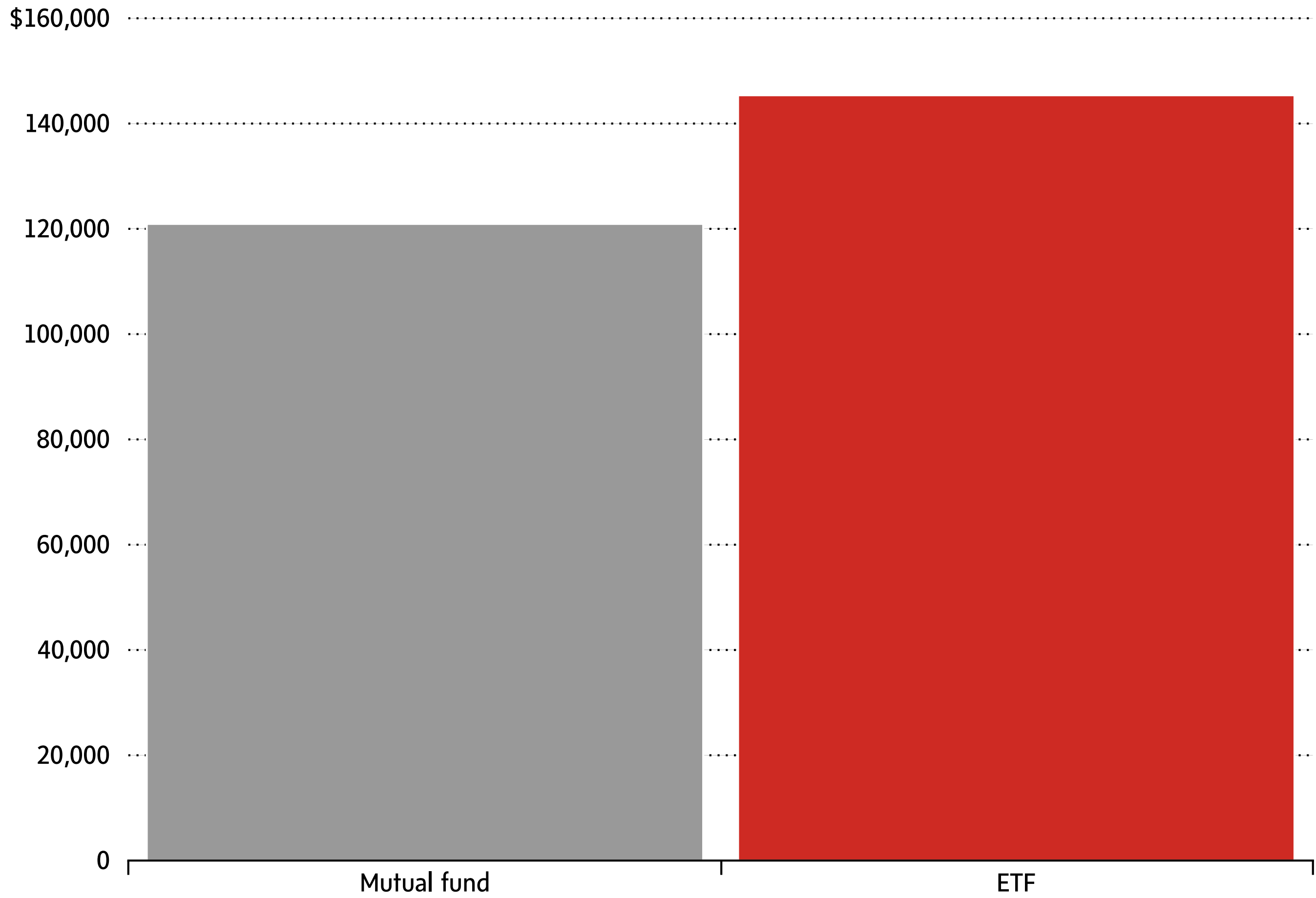
Fund value after 10 years
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120,000
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Mutual fund
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