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| **Procedure:** |  Investment Committee Procedures | **From (date):** |  2023 |
| **Replacement?:** |  Y | **Produced by:**  |  TCD |
| **Signed off by:**  |  (SMF16)  |

Our investment methodology

We have a constituted Investment Committee (IC) which is governed by a Terms of Reference (Appendix 1) whose responsibility is to define our investment beliefs relative to the most appropriate, measurable and predictable outcomes for clients. The following is the IC’s current position on investment methodology

We believe in diversification

One of the most important views to arise from modern portfolio theory is that investors should avoid concentrated sources of risk by holding a diversified portfolio. There are three primary factors which influence portfolio performance; asset allocation, stock selection and market timing.

Diversification of an investment portfolio across a variety of different low correlated asset classes should help to reduce the overall level of risk compared with, say, a portfolio which only includes bonds. For example, the inclusion of a small investment in a higher risk fund invested in a completely different area, in a portfolio comprising solely of UK bonds, can actually serve to reduce the overall level of risk in the portfolio when viewed as a whole. This is because the behaviour of the higher risk fund differs to that of UK bonds in how it reacts to varying economic events. An effective combination of different asset classes can significantly reduce the risk of a portfolio without reducing its potential for growth.

**We believe that cost is an important investment criteria**

We believe that cost is a critical factor in selecting a product or investment fund. We recognise the need to select companies with sufficient financial strength and adequate levels of service, however cost is one of the few known criteria at outset and it has a demonstrable impact on future investment returns. This informs both our asset allocation strategy and fund selection criteria.

In addition, every time an investment is bought and sold costs are incurred. These include the bid/offer spread, price effects, and stamp duty, and are not included in the Total Expense Ratio (which assumes the funds are to be held and not traded through the period). We aim to keep the Portfolio Turnover Rate, as low as possible using strategic asset allocation, and limiting the movement of funds wherever possible. The cost of a higher portfolio turnover is often hidden, taken out of investment returns.

We believe in strategic asset allocation

One of the most important investment decisions we make for clients is what assets to invest their money in. Depending on their financial goals we will build a corresponding mix of assets that produces the most appropriate level of risk and expected return.

The reason why we emphasise asset allocation so much is Modern Portfolio Theory (MPT), a mathematical quantification of the benefits of diversification. It states that by combining different types of assets the collective investment will have a lower level of risk (defined as variance in investment return) than if the money was held in a single investment. This works through the assumption that the risks of different assets are not perfectly positively correlated and therefore returns may move independently from each other. For example, during a recession, equities usually fall in value, but bonds often rise; therefore a diversified portfolio will be less volatile than one made up exclusively of equity securities.

The importance of this theory for our firm is that it states that the vast majority of the behaviour of a portfolio is due to the asset allocation. Famously, in 1986 Gary Brinson, L. Randolph Hood and Gilbert Beebower (BHB) analyzed the returns of 91 large U.S. pension plans between 1974 and 1983 and concluded that asset allocation explained 93.6% of the variance in returns.

We believe in tactical asset allocation

Tactical asset allocation is an active management portfolio strategy that rebalances the percentage of assets held in various classes and sub-classes to take advantage of short, and intermediate term market inefficiencies. It has the goal of raising investment performance above the market average. This is in contrast to a strategic approach where an adviser will stick to the client’s initial investment allocation in the long-term, ignoring short-term fluctuations in price, until their financial goals or circumstances change. Tactical asset allocation is used by most active fund managers.

This approach is based on our belief that investor psychology and market forces can lead to periods of misevaluation. It is therefore a direct contradiction to the Efficient Market Hypothesis, which would imply that tactical asset allocation cannot increase risk-adjusted returns, since markets are already efficiently priced.

Tactical asset allocation attempts to increase returns by overweighting asset classes or sub asset classes that are expected to outperform on a relative basis and underweight those expected to underperform. It goes through and analyses financial and economic ‘signals’ to predict performance and assign relative short-term asset class weightings.

We adopt a blended investment approach incorporating active and passive investment styles

Our approach to passive investing

Passive investing is a style of investment management where a fund's performance aims to mirror a market index. Passive management works in conjunction with Modern Portfolio Theory and the Efficient Market Hypothesis, which renders individual stock picking or tactical asset allocation futile. Instead we concentrate on strategic asset allocation to arrive at the right level of risk for clients, Through minimising costs, passive investors hope to generate better returns over the medium to long term.

**Advantages of passive investing:**

* Passive funds tend to have lower charges than active portfolios. Since they simply replicate the index, there is little intellectual input and thus management fees are relatively low.
* Risk of significant underperformance versus their chosen index should be limited.
* Trackers are also ideal for investors that may not be able to carry out due diligence to ascertain which active managers best suit their needs.
* Passive government bond portfolios can be an efficient way for pension funds to match assets and liabilities.

**There are also risks in passive investing, which our Investment Committee need to keep under review:**

* It can be difficult to discriminate between trackers. Since they are required to mimic their benchmark indices, there is no simple way to tell whether one index fund is better than another. One of the very few ways to compare index funds is to use the tracking error, which is a measure of the degree to which a fund’s performance deviates from that of its target index. Tracking errors can vary widely between different passive funds. However, tracking errors are backwards looking and complex and can be calculated in different ways, making comparisons difficult.
* Passive funds tend to buy at the top of the market. All indices are rebased regularly, with stocks moving up to take greater weightings, entering the index for the first time or dropping out completely. As a stock becomes a greater proportion of an index, a tracker will take a greater stake. However, this tends to happen after a company has performed well, which means that the tracking fund is buying as the share price increases, and this can be exacerbated by market trends or investing fads.
* The dotcom boom of 1999 illustrates a risk with passive investment. The fever for technology stocks led to an increased representation of technology stocks in many indices. However, indices rebalanced towards tech stocks just as the market hit its peak in March 2000. Consequently, while passive investors would not have gained fully as these shares shot up in value (as some were not significant parts of the index), they were fully exposed to the technology sector just when the bubble burst. Indeed, this exemplifies one of the key criticisms of index funds: they replicate past performance rather than looking at the future.

Our approach to active investment

Active fund managers attempt to beat the market through security selection and tactical asset allocation, as they believe that the market is not completely efficient and that it is possible to add value for their clients by exploiting pricing anomalies. Whilst actively managed funds may have an overall strategic asset allocation, they will have the remit to change this, moving in and out of assets as well as different securities to chase higher return or lower risk.

A series of more recent studies involving Roger Ibbotson et al (2010 onwards) have suggested that the much cited Brinson, Hood and Beebower study has not separated the overall market returns from the total returns. Their studies suggest that whilst a large proportion of the returns from funds are from simply being in the market itself (75%) the remaining returns can be equally attributed between asset allocation and out-performance by active managers.

**Advantages of active investing:**

* These types of funds offer different investment aims rather than just tracking the market as a whole. Therefore by managing investments actively, investors can choose to manage volatility by investing in funds that are deliberately targeting higher or lower levels of risk, as they are not tied to the index sector weightings.
* As passive funds tracking indices are rebased regularly, with stocks moving up to take greater weightings, entering the index for the first time or dropping out completely, active managers can take advantage of these movements by buying stock before they enter an index or selling as a stock looks likely to leave.
* Investors may disagree with the [efficient market hypothesis](http://en.wikipedia.org/wiki/Efficient-market_hypothesis), and therefore believe that there is the ability to generate additional performance by finding undervalued companies in the market place.
* Investments that are not highly correlated to the market are useful as a portfolio diversifier and may reduce overall portfolio volatility.
* Some investors may wish to follow a strategy that avoids or underweights certain industries compared to the market as a whole and may find an actively-managed fund more in line with their particular investment goals. For instance, an employee who receives company stock or stock options as a benefit may prefer not to have additional funds invested in the same industry.

**There are also risks in active investing, which our Investment Committee need to keep under review:**

* The most obvious disadvantage of active management is that the fund manager may make bad investment choices or follow an unsound theory in managing the portfolio.
* The fees associated with active management are also higher than those associated with passive management, even if frequent trading is not present.
* Large managed funds can begin to take on index-like characteristics because they must invest in an increasingly diverse set of investments instead of those limited to the fund manager's best ideas.

**Portfolio build dynamic**

* Passive element of portfolios aims to deliver target risk/return over long term and will cover the majority of a clients wealth

* Active element of portfolio will include higher risk assets to deliver higher returns where clients can afford to take those risks
	+ Passive portfolio focuses on Strategic Asset Allocation based on 10 year views of risk and return
	+ Model portfolios developed to optimise risk/return based on 10 year views
	+ Portfolios focus on delivering a target return within risk boundaries to align with goals based financial planning and cash-flow modelling
	+ Implementation primarily through low cost, passive instruments, with an active overlay to deliver alpha in the higher risk portfolios
	+ Re-balance back to strategic model if significant drift
	+ No tactical re-balancing

## Review strategic asset allocation on annual basis

## Manager Selection Criteria

The above principles on investment allow us to populate model portfolios with suitable underlying holdings. To make an informed decision on the most appropriate security or instrument to hold within the portfolios the following due diligence criteria was followed:

Tracking error / difference – As advocates of passively managed trackers, we seek to minimise tracking error when index trackers are used, which are usually a result of poor management or excessive fees.

Low expenses – We aim to keep the costs of running the portfolio as low as possible to maximise potential returns over the long term. The following expenses are therefore scrutinised, aiming to mitigate costs wherever possible:

* Total Expense Ratios (TER) – This includes the management charges of running the fund and the additional fees / expenses associated with accounting and reporting activities
* Performance fees – We believe performance fees should only be levied where genuine value is added by fund management expertise. We also scrutinise the benchmark which the performance fees are based to ensure the investor is not subject to an excessive charging structure
* Dilution levy – We aim to identify implicit expenses such as dilution levies, which exist when fund managers levy a fee to an investor purchasing units / shares to negate any impact on the performance of the fund. These are typically associated with actively managed strategies
* Portfolio Turnover Rate (PTR) – Where fund mangers are buying and selling underlying investments on a regular basis the inherent transaction charges can impact the performance of the fund. This includes stamp duty reserve tax on UK equities. An FSA paper published in 2000, The Price of Investing in the UK, suggests that a UK equity fund with a portfolio turnover of 100% results in an additional 1.80% charge levied on the fund per annum, excluded from the TER. We aim to avoid holding funds which turnover funds frequently for avoid this implicit cost which is typically associated with actively managed funds also.
* Initial and redemption fees – Charges as investment and encashment should only be levied where value is added.

Liquidity – We aim to invest in securities which can be traded daily, and only weekly by exception. A sufficient secondary market and fund size should exist to facilitate encashment in the case of a change in client circumstances or portfolio restructure.

Currency hedging – For a global, multi-asset portfolio the consideration of exchange rate risk on foreign investments is important. We take the view that currency exposure should be included in the portfolios to offer a true global holding where this is our objective. This is the case for our exposure to Global Bonds and Global Equity trackers which are unhedged.

Counterparty risk associated with ETFs – We aim to use UCITS holdings only which ensures that no more than 10% of the fund is exposed to one counterparty institution where derivatives are employed. The collateral used in the replication of the index is important as the use of swaps derivatives to provide replication can add additional risk and expense to the investor. We aim to use ETFs which are cash backed as opposed to backed by credit swaps, where feasible.

Stock-lending process – Where mutual funds and ETFs lend stock to short sellers in return for a premium, Asquith scrutinise this process to ensure that excessive risks are not being taken. Borrowers should be required to provide collateral of above 100% of the value of the stock on loan, and in the form of cash / gilts typically.

Eligibility for tax efficient wrappers – We may look to use ISAs, SIPPs and Investment Bonds (onshore and offshore) as tax wrappers to hold client investments. It is important that holdings are permissible in these wrappers for this reason

The UK tax status of ETFs – Any ETFs selected for investment should have UK Reporting Status, to ensure investors are subject to capital gains tax on encashment rather than their highest marginal rate of income tax (up to 50%). The domicile of ETFs are paid close attention to, ensuring withholding tax is reclaimable if applied.

Track record – We aim to employ fund manager groups which have a strong track record of delivering to their investment objective. Where actively managed strategies are used, this should be justified with strong and consistent returns above the index (alpha).

Investment Objective – The objective of the fund or security should match the rationale of the Asquith investment team for providing exposure to this asset class. Put simply, the fund should target the desired outcome and provide exposure to an appropriate index.

Appendix 1

Investment Committee Terms of Reference

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| --- | --- |
| Authority | The committee provides an escalation point for investment research and investment management issues. It sets the direction on investment research and investment management issues and provides oversight to relevant processes, risks and internal controls  |
| Chairman |  |
| Membership: |  |
| Quorum: |  |
| Frequency of meetings: |  |
| Role/principal functions: | **General**1. Provide a decision making forum where representatives of the firm can discuss investment proposition and service issues which may affect, sales and operations with the aim of ensuring that clients receive reasonable fund performance, and operational processes and controls are maintained and continuously improved;
2. Undertake appropriate reviews to ensure the firm’s status for investment advice (independent or restricted) is maintained. This will also involve a review of products falling within the definition of a retail investment product (as this may be updated).
3. Review the effectiveness of the business’s investment proposition strategy and review/agree initiatives to improve this (where relevant)
4. Maintain a control framework, ensuring that appropriate controls exist within the firm to allow operation within given risk tolerances;

**Specific**1. Review and sign-off appropriate Management Information as a means of gaining assurance regarding the effectiveness of the investment proposition strategies against client risk appetites and tolerances;
2. Review of relevant investment products and strategies to ensure the firm’s status (independent or restricted) is maintained. This may involve reviews of products, panels or other related elements of the firm’s investment strategy.
3. Review of current list of investment products falling under the definition of retail investment product, as this may be updated from time to time.
4. Review and address instances of investment performance issues;
5. Review and manage risks such as reviewing tax wrappers, CIPs platforms, underlying investment performance, market outlook, Adviser compliance to the investment proposition and service
6. Consider the impact of change, reviewing and agreeing product, marketing and other initiatives;
7. Oversee the performance of Investment proposition procedures and compliance with those procedures
8. Progress to resolution Investment proposition issues that have a material impact on the business
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| Agenda: | * Market overview & fund performance recommendations
* Review Regulatory Changes
* Process Changes
* Product and fund due diligence update
* People Changes
* AOB
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| Documentation: | The following documents will form the basis of the standing agenda:1. Previous meeting minutes and action point list
2. Board Meeting minutes
3. Investment proposition analysis reports
4. Compliance reports & outstanding actions
5. Marketing reports
6. Internal sample checking monitoring programme
7. Feedback from the team representatives
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| Distribution list: |  |