FAC
The Financial Advice Centre

Our Investment Process

This is our Investment Process. It describes our approach to the provision of investment advice. It outlines how we build the investment portfolios for each of our customers.

It is based on our investment beliefs (found in our investment philosophy document).

If you don’t understand anything here please ask us.

Principles

We use our Investment Philosophy to help us determine the most suitable portfolio for each customer:

- Understanding risk is important.
- Matching your portfolio to your risk profile is essential.
- Asset allocation is the key to success.
- Costs are important.
- Diversification (not putting all your eggs in one basket) is a sound principle (see appendix 3).
- Funds are a cost effective way to access investments for many customers, though specialist managers may be appropriate for part of larger portfolios.

Our approach

- **Customer**
    - Risk profiling and individual customer needs’ assessment are the key inputs – so we will spend time with you to discuss and understand this.
    - We also need to understand your need for income and capital and any special requirements (such as trust funds).

- **The portfolio**
    - We know which asset classes we want to use. We also know those we wish to exclude such as pure commodities and unregulated investments due to liquidity concerns, less rigorous regulatory oversight and their opaqueness.
    - We have a process for building client portfolios – driven predominantly by asset allocation as this is the biggest driver of return and risk.

- We have investigated how the portfolios are likely to behave (drawdown, return, volatility). They have been tested historically using Distribution Technology software.
- We can map our portfolios to the different customer risk profiles (including attitude to risk, risk tolerance, time horizon). This is the key to making sure that they are suitable for you.
- Our client portfolios are selected to meet client needs and not the other way round - we are outcome driven, not product driven.
- You should be aware that although we know how the portfolios have performed historically, the future will be different so we need to regularly review them.
- Our process is designed to give a good outcome for each and every client commensurate with their risk need – the process is bespoke to each client.

- **The process**
    - We use expert external and internal resources to monitor and select expert fund managers. These in turn research and select the optimum investment funds / stocks for their portfolios from the wide range that are available in the market.
    - Our investment process is designed to avoid poor investment funds – as asset allocation and costs are the best predictors of future returns this is where we focus our efforts.
    - Independent expertise is used to enhance our offering (Synaptics, Distribution Technology etc.).
    - The portfolios we select are matched to the risk profile that is appropriate for each client – they are monitored on an ongoing basis (see appendix 5/6). Larger portfolios may have a greater divergence from the preferred asset allocation as we may give some discretion to managers for part of the portfolio (but only when it is cost effective so to do).
    - We use a specialist risk profiling tool provided by Distribution Technology.
    - The Distribution Technology risk profiling tool has a good range of questions, gives issue reporting and publishes regular asset allocation data.
    - This creates a number of risk profiles between 1 and 10.
    - Clients with risk profiles of 8,9 and 10 need a bespoke conversation as this is a very high risk level and may need specific external advice from a specialist stockbroker / portfolio manager.
    - We use multi asset funds to give us access to multiple asset classes, good diversification, and reduced risk by using more than one underlying fund, and use the skills of different experts to select the funds for us.
    - The funds we select are managed in line with the risk levels.

The portfolios

- Portfolios need to be rebalanced regularly and this is a normal part of a multi asset investment management process.

- Fund of funds are most effective for smaller portfolios – pooling and rebalancing makes them cost and tax efficient.
- The most effective tax wrapper for the client's tax position may impact the selection of the method of investment.
- The higher the "risk budget" of the client and the greater their wealth the more potential scope they have for active management.
- We have a **preferred list of risk managed core solutions** that we select for our clients. We consider both passive and active solutions.

- **CORE AND SATELLITE SERVICE**
  - We believe that a core and satellite approach (similar to that adopted by the largest pension schemes in the world) is appropriate. We use active or passive multi asset funds for the core holding and then select the most suitable active funds as "satellites" where appropriate.
  - Importantly we must be confident that the core funds are managed in line with the asset allocation that our risk profiling determines so that outcomes are aligned.
  - Typically we may split the active element between 2 or 3 managers. This gives us access to different investment styles while staying close to the asset allocation we need.
  - We would expect to hold at least 70% in a core holding with up to 30% being distributed between suitable alternative funds.

- **DISCRETIONARY MANAGED SERVICE**
  - For clients with larger sums to invest we may recommend that part of the portfolio is managed on a discretionary basis by an external expert.
  - We may also recommend the core and satellite service depending on your input (need for simplicity, tax position etc).
  - We may still use a multi asset fund as the core of the portfolio, to keep costs low, and ensure that the majority of the portfolio is run precisely to the asset allocation required.

Platform

- Wrap platforms or fund supermarkets offer a cost effective way for you to access tax wrappers (e.g. pension and ISAs). It also reduces your paperwork.
- They also allow you to hold investments from more than one fund manager. Any switches that are made may be faster using platforms.
- You can also see the value of your investments online – some with analysis to see how your investments have performed.
- Platforms also allow us to manage your investment tax effectively – "bed and ISA" for example.
- Your investments are held by an independent custodian, potentially offering an additional layer of security.
- We select the best platform based on your needs from a short list of those in the whole market.

- Our selection of platform will be partly driven by the costs of trading and availability of our preferred investment solutions.
- If we use a discretionary manager they are likely to use their own investment platform to manage your portfolio – the reports and valuations for this are likely to be quarterly.

Client specific requirements

- There will be occasions when our standard investment proposition might not fit an individual client requirement. It may be that the client requires a particular level of income, or has specific investment needs and objectives. On those occasions our advisers will undertake bespoke research to ensure that the solution delivered is the solution requited. Naturally, this level of individual research may take a little longer and may cost a little more.

Time horizon is a key driver of risk level.

- We may restrict the risk level (subject to client override) based on time horizon: This is based on historic drawdown of the asset mixes and is designed to reduce specific client loss.

Time horizon	**0-4 years**	**5- 9 years**	**10 years plus**
Observed Risk Level		**Allocated Risk Level**	
3	1	3	3
4	1	3	4
5	1	3 - 4	5
6	2	3 - 5	6
7	2	3 - 5	7
8	2 - 3	3 - 6	8

Appendix (some more detail)

There are a number of key stages we have used when screening funds / managers and other investments.

1. Costs

The fund’s fees and expenses annual management charge (AMC) and total expense ratios (TER) are all important to assess. Research has shown that low-cost funds have outperformed high-cost rivals on a consistent basis.

2. **Portfolio turnover rate.**
A fund's portfolio turnover rate measures how often a manager buys and sells securities. A high turnover rate indicates that the manager does not hold on to stocks for very long. This may indicate active management but on the flip-side it can lead to higher trading costs and indicate a short term investment approach. These costs are not always as easy to discover as you might like! By contrast a low turnover rate would indicate a manager with a long term buy and hold view to investment.

3. **Diversification.**
Making sure you have a good mix of funds, either directly via a model or through a fund-of-funds, that meet your long term needs is a key to long term success. You also need to make sure that the funds you own have a good spread of holdings. A small number of holdings may be indicative of a manager who backs his convictions while a large number may suggest the manager is going to try and match the index. Both have their place, with the former being more risky yet more likely to give you outperformance / underperformance while the later may have a lower investment risk but not outperform the market.

4. **Does it do what it says on the tin?**
It’s important that you know what a fund can and does invest in. If you want exposure to Far Eastern equities then there is little point picking a UK corporate bond fund. But perhaps more importantly: don’t judge a book by its cover. The exact index that a passive fund tracks is key. And for active funds making sure you understand the exact mandate the manager has is crucial. It wasn’t long ago when the Cautious funds could hold up to 60% in Equities – and a number of investors may not think that sounds very Cautious!

   Also consider what impact the fund will have on your overall portfolio's asset allocation and risk. If you are picking a fund to complement others within your portfolio from the same sector, e.g. UK equities, is the new fund sufficiently different to your existing ones to offer some form of diversification? Diversification reduces a portfolio's risk – duplication does not!!

5. **Past performance is not a guide!**
The standard risk warning that you will see on all financial literature is that ''past performance is not indicative of future returns”, or a variation thereof. Now this is true for a number of reasons. The research that the regulator conducted when it introduced the warning showed that there was in fact a link between past performance and the future – but only unfortunately that poor performing funds tended to be poor in future.

6. **Tax - Income or growth**

Check whether the fund is focused on providing income, capital growth or a mixture of the two. This information can be found on the fund's factsheet. It's important that this matches your requirements. For example a young high rate income tax payer may be more inclined for capital growth as they do not need access to their funds in the short term. But obviously income from investment funds can be reinvested but you will still be taxed on it. So a high rate income tax payer probably won't want to generate any unneeded income. Capital gains on the other hand are only taxed once you sell the investment. So make sure you also know the tax implications of your chosen fund as you may want to invest in it via a wrapper such as a Stocks and Shares ISA to avoid tax altogether.