

*P*ATTERSON-MILLS

INDEPENDENT FINANCIAL ADVISERS & CHARTERED FINANCIAL PLANNERS

# Our Investment Management Approach and Philosophy

About our distinctive wealth management style, how we add value to Clients' portfolio management and seek to optimise your returns.



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# Our Distinctive Investment Management Approach

We understand the complicated nature of the financial world and help everyone create clear paths towards better outcomes. We have close links with one of the UK's leading fintech and support services companies: Fintel plc and its investment business service companies for the UK advisory sector, Simply Biz Services Ltd. Fintel's Chairman, Ken Davy, has over 50 years' experience in providing services to firms like us. Simply Biz do not offer retail investment services, but instead provide the necessary high-level infrastructure needed for Adviser Firms.

This enables Patterson-Mills to provide our Clients with a personalised service and offer its own distinct Investment Management Approach (our 'IMA'). For this, we have contracted with specialist analysts in fund management to provide the necessary hands-on analysis of the whole of the market, covering both asset class and investment types, right down to individual fund manager selections.

We use cutting edge, market-leading, technology from Defaqto, part of Fintel plc, that results in an ongoing well-defined, measurable and consistent approach. Our process gains our Clients cost efficiencies on their investments, whilst ensuring that all investment management is formulated with the utmost propriety and without the possibility of personal preferences that have historically too often been found to cloud some Adviser Firm's 'house view' and so their advice.





## The Ideal Solution

For most private investors, the selection of investment types, asset mixes and individual fund managers is a highly time-consuming exercise. Furthermore, ensuring that, once selected, a particular investment strategy and its associated fund choices remain programmatically up to date, are reviewed and changed/modified regularly (quarterly being the standard) is all but impossible.

This next point may surprise you, at least be refreshing openness to read, so here goes! We believe such issues are also too much for a retail investment business / adviser firm to handle on its own too! This is because, with the many thousands (literally) of investment funds out there, it's a full-time job purely to analyse and continue to re-analyse all funds and fund managers, including keeping track of those important key management staff who move from fund group to fund group.

This is why we use the **Simply Biz Centra System** for Client and Portfolio risk assessment, together with **Defaqto** and **Moodys Analytics** forming the backbone of our asset allocation tools, to enable Patterson-Mills to ensure its investment selections are choices that match the Client risk analysis that we undertake. Two important additional layers of analysis at the outset, for any risk-based investment strategy, is consideration of an Investor's capacity for loss and investment experience, which forms an inherent part of any recommendations made to our Clients.

These investment selections are re-balanced quarterly (Jan, Apr, Jun, Oct and subject to market drift analysis to avoid unnecessary costs). This locks in profits and buys better value existing funds, also changing fund / manager selections as deemed appropriate from updated research by our Analysts at Rayner Spencer Mills Research (no relation!).

**For investments above £2m we may also appoint discretionary managers, subject to the suitability for our Client financial situation / objectives.**

At Patterson-Mills, having such a specialist team behind us ensures that key aspects of running investment portfolios are identified and addressed (see overleaf for detail on these key aspects).

These key aspects of running investment portfolios cover specifically:

**Selection of the Best Investment Manager** - Using Rayner Spencer Mills Research's (RSMR) award winning analysis for the optimum selections of investment manager and the matching investment fund for each asset class / category. Simply Biz, through its Centra system, has comprehensive management contracts that give complete control over the choice of research analysts going forward. There are important 'soft factors' when making the selection, such as the individual's supporting team, the internal discipline structure at the investment firm and the style of investment management.

**Monitoring the Managers** - To ensure they remain focused. Each fund manager provides ongoing updates to the Investment Policy Committee (IPC) at Centra and is also interviewed personally by the Analysts at RSMR regularly each year, including monthly updates on all holdings. The IPC has access to the views and strategies of other fund managers, stockbrokers and analysts, vital market intelligence for being proactive with our monitoring.

**Changing Managers** - This is judged not only upon investment performance, but the soft factors outlined above also come into play. However, once it is deemed necessary, we can act fast and, due to the wholesale pricing of our investment platform technology, Client investments can be moved at negligible or no cost (free if in our core fund range, or at a small transaction cost otherwise). This keeps investment management costs to an absolute minimum.

**Diversification of Risk** - By using investment managers with differing styles, our Clients can obtain valuable diversification of risk

It is a reality that no one investment management house or individual fund manager can possibly always be the top performer, so putting all of your money with one, or even two managers

(whether via a large high street institution or directly via, so-called, 'wealth management' groups) is far too high a risk to take.

It is this Investment Management Approach that offers our Clients the potential for optimum investment performance over the longer term for, we believe, three important reasons:

- 1) **Reduced annual running costs** – our costs are usually covered within our competitive nil initial and institutional annual management charges on each fund, included within the already competitive Total Expense Ratios (TERs).
- 2) **No cost fund switches** – 100% of the initial charge is waived (only cost is transaction costs for quarterly re-balancing, then only if and where applicable).
- 3) **A clearly defined investment management process** – one which is distinct in the market place today. Long term performance needs the best processes, putting the Client first: the Centra system from our management partners at Simply Biz has such a process and Patterson-Mills has the financial planning processes ideally suited to determining how you decide to invest, in what way, exactly where.

# The Importance of Passive Investments

The degree of out-performance from active fund management varies tremendously between different Fund Managers. This out-performance is known as “Alpha” and is measured by out analysts when choosing investment managers that meet the ‘added-value’ criteria.

It cannot be denied that, even with the analytical resources needed being available to us, any Alpha identified cannot be guaranteed to continue in the future. Qualitative analysis techniques, as employed by our analysts at Rayner Spencer Mills, serve to increase the efficiency of fund managers greatly.

However, in terms of downside risk – this being that a given fund manager under-performs the stated benchmark and by how much, for how long – one way of reducing the risk is to take a passive approach to investing. There continue to be discussions within the fund management industry and trade press about how much value one can obtain from active fund management, bearing in mind it has a given cost. There is no right, definitive answer, primarily because this is a moving feast, so to speak!

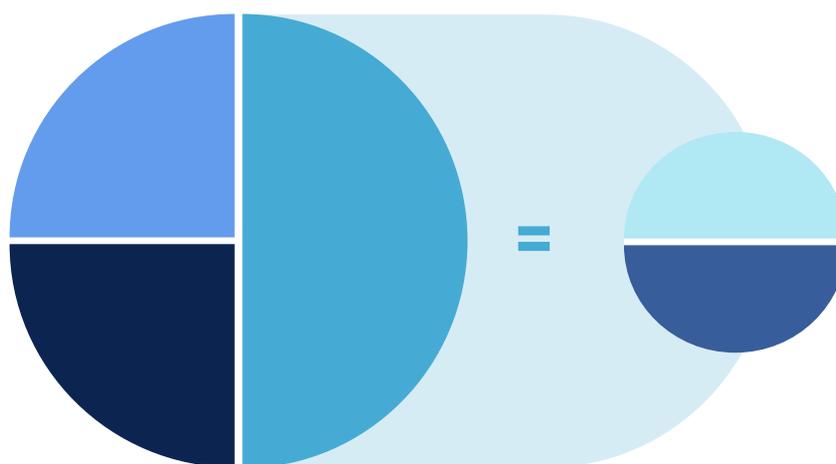
At Patterson-Mills Financial Planning, in assessing your attitude to investment risk and overall strategic objectives – whether this be for ISA, other investment funds or UK or overseas pension funds – we take a pragmatic approach. We view it as important not to claim that either active management is a panacea, or that passive investment is simply the only way to obtain close to market-driven returns for any given asset class.

Instead, we offer four versions of each of our main 6 risk-graded Model Portfolio approaches.

This approach is straightforward and aimed at you choosing to meet you chosen investment returns and volatility levels, with a truly bespoke diversification and downside risk management that suits you best.

**Portfolios can be focused on Environmental, Social Governance (ESG) aspects, with specific concentration on Sustainable, Responsible Investing (SRI).**

Example of a 50% Passive Model



● Active Equity 25%    ● Active Other Assets 25%    ● Passive Equity 25%    ● Passive Other Assets 25%

# Our Investment Philosophy

This is our Investment Philosophy. It describes our approach to the provision of investment advice. It outlines our beliefs about investment which form the foundations of how we manage your money. It also has details about how you are involved with the decisions about investing; after all it is your money.

**If you don't understand anything here please ask us, there is no such thing as a silly question when it comes to looking after your money!**



# Our Beliefs

## #1 Investors should understand the reasons for investing and how their portfolio is designed to meet their goals

The world of investing can be complex and often not transparent. We believe in keeping things simple. So while there is a lot of science and evidence behind our investment philosophy and process, we are keen that every Client understands our recommendations and how they fit with their own financial objectives.

The first step of any investment philosophy is to understand the customer's needs. We explore this via a conversation with you and look into factors such as:

- Your need for capital security
- Your age
- Your family commitments
- The need for income and / or growth and any future regular income needs
- Whether there is a specific item that needs funding e.g. school fees
- Your investment time horizon
- Your exposure to interest rate risk and inflation risk
- The impact of charges and penalty fees
- Your attitude to risk, risk tolerance and capacity for loss

When delivering investment advice, we always start with a detailed understanding of your financial planning objectives. These inform decisions about the level of investment risk that needs to be taken.





## #2 A conversation about risk and its many dimensions is the essential first step when investing

When it comes to investing, risk and reward are inextricably entwined. Don't let anyone tell you otherwise. **All investments involve some degree of risk - it's important that you understand this before you invest.**

The reward for taking on risk is the potential for a greater investment return. If you have a financial goal with a long time horizon, you are likely to do better by carefully investing in asset categories with greater risk, like equities, rather than restricting your investments to assets with less risk, like cash. On the other hand, investing solely in cash investments may be appropriate for short-term financial goals.

To help understand risk we break it down into four elements:

1) **Investment risk** – These are the risks associated with different types of investment. There are many different risks (and rewards) but common ones include: volatility – the ups and downs; liquidity risk – can you get your money back when you need it; company risk – the risk that one company goes bust; default risk – the risk that a bond doesn't pay you back; emerging market risk – the fact that some markets are less efficient and transparent.

2) **The need for risk** – All these risks might start to put you off. But even investing in cash carries risk e.g. inflation risk – your spending power goes down; default risk – your deposits may not be 100% safe. For some investors, and certainly for short term savings, cash is still likely to be the best fit with your needs and objectives.

3) **Your attitude to risk** – Risk attitude has more to do with the individual's psychology than with their financial circumstances. Some will find the prospect of volatility in their investments and the chance of losses distressing to think about. Others will be more relaxed about those issues.

4) **Your ability to tolerate risk / accommodate losses** – If things go wrong what would that mean to your finances? You may be a risky investor but can you afford to be? You may be a risk adverse investor but are you saving enough? This is about understanding your ability to withstand the shocks that might come along with the aim of ensuring your portfolio meets your capacity for risk.

Generally speaking, a person with a higher level of wealth and income (relative to any liabilities they have) and a longer investment term will be able to take more risk, giving them a higher risk capacity.

**Your ability to tolerate risk is very different to your attitude to risk** – understanding this is a key part of our investment process. A conversation with you will help inform decisions about the level of investment risk that needs to be taken and that you can afford to take, rather than simply the maximum amount of risk that you feel happy with.

We will use a **specialist risk profiling tool** to help us establish the risk profile that is right for you. But we will also have a conversation with you about the profile to make sure that you understand what it means and how the profile needs to change to meet your particular situation. The great benefit of the tool is that it creates an unbiased view of your risk profile, and therefore is an excellent starting point for the conversation.

### #3 Tax and access are important

**Making investment tax efficient is a sensible objective and wherever we can we will try to reduce the tax your investments will pay.** Use of pension wrappers and ISAs will assist in this objective.

We also use new technology platforms, known as **wraps** or **fund supermarkets**, to hold your investments. These offer safety, access to your valuations (so you can see how your investments are doing) and tax wrappers (pensions and ISAs for example). They also allow us to move your money between funds cost effectively if we need to in future.

### #4 Investing for the long term is very different than saving for the short term

While there is an understandable desire to keep things safe when investing, the corrosive impact of inflation and thus the value of investing for the long term in more risky assets are compelling.

Real assets such as equities, property and commodities tend to make a better investment than the apparently safer option of cash deposits in the long run, but it isn't that simple.

In the last 50 years Equities have outperformed Gilts.

**Table 1. Real returns (after inflation) over 50 years %pa.**

<b>Asset class</b>	<b>Return</b>
UK Equities	5.3
Gilts	4.4
Cash	1.5

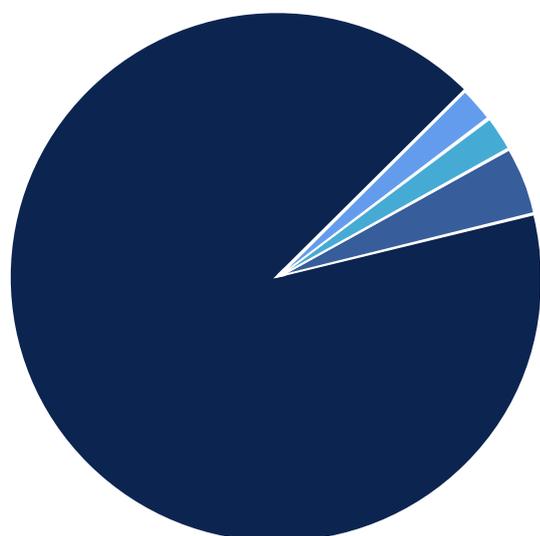
Source: Credit Suisse 2018

But it isn't the case over every time period – for example over the twelve most recent 10 year periods going back to 1902 (1902 – 1912, 1912 – 1922 etc.) – Equity returns were better than Gilts eight times, whereas Gilts beat Equities four times.

Our view is that basing investment decisions on the longer term historic behaviour of asset classes enables investors to participate in market growth. But that regular review is critical.

## #5 The bulk of long-term returns come from asset allocation

Academics will continue to argue about the precise amount of value that comes from strategic asset allocation rather than stock selection, investment style or market timing, but it is widely accepted that asset allocation has the biggest influence over the variance in portfolio returns.



- Market Timing 2%
- Other Factors 2%
- Security Selection 5%
- Strategic Asset Allocation 91%

(see appendix 1 for more)

This means that investors and their advisers should be devoting the bulk of their effort to constructing the most **suitable asset allocation model**, based on individual investment objectives and individual attitude towards investment risk. This is where we focus our attention when delivering investment advice.

It's like making a cake. The most important part is making sure you have the right amount of flour, eggs, butter etc. rather than worrying whether the ingredients come from Harrods or the corner shop.

We use the **risk profiling tool** to propose a suitable asset allocation to meet your needs based on long term historic information. We will discuss this with you to make sure that you are comfortable with the recommendations.

## #6 Diversification using mainstream asset classes can reduce risk without destroying returns

Diversification is a strategy that can be neatly summed up by the timeless adage "**Don't put all your eggs in one basket.**" The strategy involves spreading your money among various investments with the intention that if one investment loses money, the other investments may more than make up for those losses.

A diversified portfolio should be diversified at two levels: **between asset categories and within asset categories.** So, in addition to allocating your investments among stocks, bonds, cash, and possibly other asset categories, you'll also need to spread out your investments within each asset category.

Investors may find it easier to diversify within each asset category through the ownership of mutual funds (unit trusts), rather than through individual investments from each asset category. A mutual fund is an investment vehicle that pools money from many investors and invests the money in stocks, bonds, and other financial instruments. Mutual funds make it easy for investors to own a small portion of many investments. A total stock market index fund, for example, may own stock in hundreds of companies. That's a lot of diversification for one investment.

We use specialist fund managers to build portfolios, which are diversified at both asset class and stock level. But importantly **they stay close to the asset allocation outcome which has been determined as appropriate for you.**

The use of these multi-asset approaches has the benefit of "**automatic rebalancing**" inside the fund wrapper. This means that the asset mix of these portfolios stays true to the asset allocation that meets your risk need, and is often conducted at lower cost than we can probably achieve by rebalancing it directly. Although we also re-balance as necessary to account for fund changes, internal re-balancing by fund managers is an important and often unrecognised benefit of using diversified fund holdings for portfolio management, as well as adding to cost- efficiency. Also, where the investments held are non-pension and non-ISA, the switching around of portfolios outside the general fund wrapper could lead to Capital Gains Tax (CGT) liability and so that risk is reduced or removed.



## #7 Costs are certain and returns are not – so they deserve your attention

Costs are certain and fund performance is not – it therefore makes sense to reduce costs wherever it is safe to do so. One of the major issues in fund management is that not all the costs are transparent.

There are three main costs to investing in funds:

- 1) **The Annual Management Charge (AMC)** – the fee that the manager charges.
- 2) **The Total Expense Ratio (TER)** – the AMC plus legal, audit, depositary, safe custody and other costs.
- 3) **Trading costs** – the costs of buying and selling the investments inside a fund. These include stamp duty, bid / offer spreads, stockbroker commissions, the costs of settling transactions etc.

Even though TERs are not the whole cost of running a fund, they are a powerful predictor of fund returns.

Morningstar (a large global fund ratings agency) conducted analysis in August 2010 to identify the best historic predictors of performance. The results are remarkably clear:

- “If there is anything in the whole world of mutual funds that you can take to the bank, it’s that expense ratios help you make a better decision
- In every time period and every data point tested, low cost funds beat high costs funds
- Expense ratios are strong predictors of performance. In every asset class over every time period, the cheapest quintile produced higher total returns than the most expensive quintile”

**Understanding and seeking to reduce costs where safe to do so is a key part of our investment process.**

## #8 Active management and passive strategies can both play a valuable role

There is a role for active (where the fund manager tries to beat the market, but incurs higher costs), and passive funds (which track the index at low cost) within a well-managed investment portfolio.

Rather than take an evangelical view of one option over the other, we appreciate that there are arguments for both approaches and accordingly we include both strategies in the portfolios we recommend.

Our preferred approach is to use passive funds to form the core of an investor’s portfolio. In some cases the whole portfolio will be constructed from passive funds, especially with smaller portfolios to maximise effective diversification, and at lower risk profiles. As a customer’s risk profile increases we may add active funds which have the potential for higher returns, though the costs will be higher and the risk of not matching the performance of the asset profile will be increased.

To use the jargon – this is about optimising your governance and risk budget – or more simply tailoring the best solution to your needs and financial goals.

## #9 Investment success comes from the consistent application of a robust process

There are numerous ways to approach the construction and on-going management of an investment portfolio. Without the application of a robust process, the emotional aspects of investing can prevent investors from making the best decisions. As a firm, we consistently apply a multi-stage investment advice process designed to deliver suitable advice to every Client. **The outcome is tailored to meet individual objectives but the process itself is always the same.**

As with any plan we need to regularly review progress to make sure we are on track. We will discuss and agree with you the best way to achieve this.

## #10 Success is often about the things you don't do as much as the things you do.

We have some simple rules that we apply to all portfolios unless the Clients specifically request a different approach:

- No individual bonds / shares No direct hedge funds
- No direct unauthorised funds
- Only use funds run by FCA regulated managers
- We use expert analysts to help assist in selecting risk managed portfolios.



# Risk Warnings

**All investments carry risk.** These are a few of the important ones:

- The risk that the buying power of your capital decreases over time.
- The risk that the growth you experience is variable.
- The risk that you might get back less than you invested.
- The risk that you do not achieve one of your objectives.

# Appendices

## #1

Three academics, Brinson, Hood and Beebower (1986, Financial Analysts Journal), who studied the performance of 91 large US pension plans between 1974 and 1983, analysed the impact of key decisions made by investment managers: long term asset allocation (i.e. 60% in equities, 40% bonds), stock picking and short-term tactical changes to the asset mix. The results concluded that 80% - 90% of return and risk in a given fund was determined by the long-term asset mix, with both stock picking and short term tactical changes having a negligible impact.

This research was further supported by additional analysis by Kaplan et al in 2000 and yet again by Ibbotson et al in 2010. See next page for further explanation.

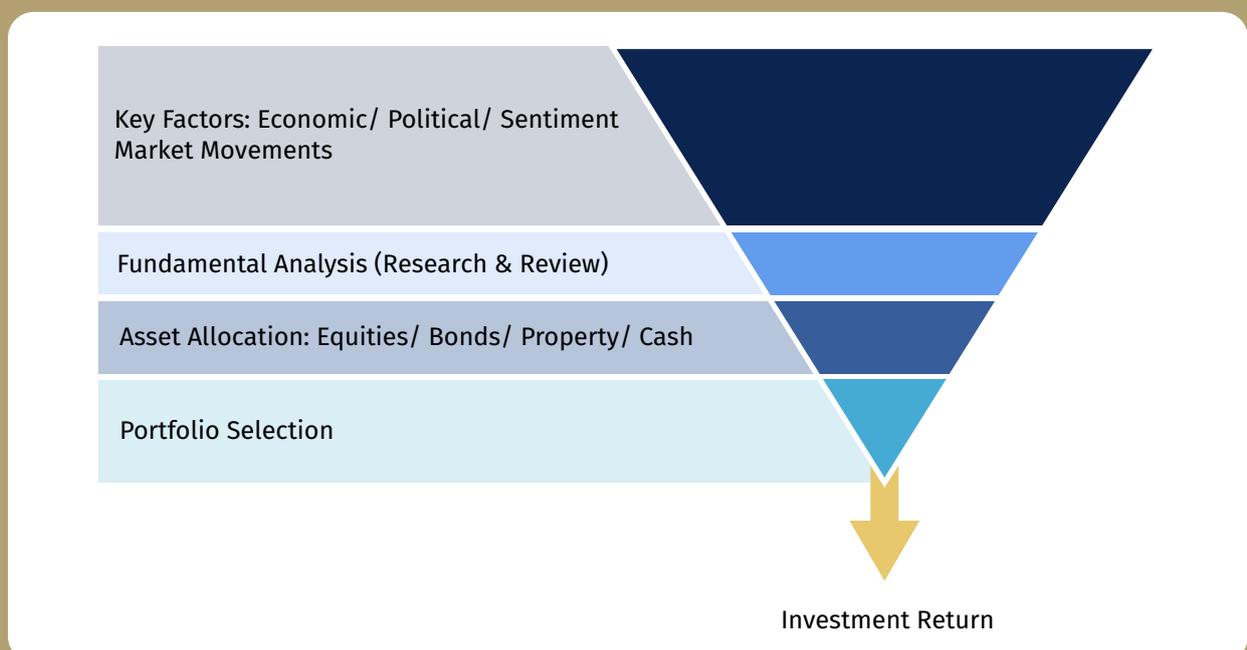
## #2 How Relevant is Asset Allocation?

In constructing an ideal investment Portfolio, studies have shown that general market movement is the most important factor in determining future returns (between 70% - 80%). However, fundamentally, any positive difference to returns, relative to markets, emanates from the success of the underlying analysis and choice of asset allocation, together with the stock / security choices made by individual fund managers. These combined factors govern whether the 'actively managed return' is above 'the benchmark return' (i.e. your fund managers' returns -v- that of the relevant market Indices' returns, allowing for management costs).

The inverted pyramid diagram is intended to reflect how your final investment return is generated by way of fundamental analysis of the key factors surrounding economic, political and market sentiments and specific asset allocation\*. The conclusion, perhaps somewhat disappointingly, is that merely around 10% of your final investment return is generated from the specific stock selection within your Portfolio and the same for asset allocation decisions.

This 'investor conundrum' demonstrates that individual stock-picking and self- managing that some private investors undertake is, quite frankly, simply a gamble, without remotely the depth of research available to fund management houses. Instead, having a well defined, measurable and consistent approach to investment management is essential. Vtally, good, active fund management with pro-active asset allocation has been shown to beat benchmark indices over the longer term.

(from research conducted in the US by Brinson, Hood and Beebower 1986 and subsequent papers by Ibbotson and Kaplan in 2000, updated by Xiong, Ibbotson, Idzorek & Chen in 2010 for CFA Institute of North America)



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