

Gibbs Denley Investment Strategy & Process Control *inc. glossary*

The use of Investment Models is now well established at Gibbs Denley and forms part of the 'Preferred Wealth Management' service. The model portfolios are consistent with a client's requested level of risk and provide a diversified and appropriate spread of investments that can be amended and moved between easily. The aim of the model portfolios is to outperform the benchmark – whilst remaining within the relevant risk categorisation.

The investment models have been intentionally aligned with a client's pre-determined 'Risk Categorisation'. The risk categories are Cautious, Conservative, Balanced, Moderately Aggressive & Aggressive. The categories each directly relate to one of the models, which are - Cautious, Conservative, Balanced, Moderately Aggressive & Aggressive. The models may be used within SIPPs, ISAs and Personal Portfolios.

Research into market movements and trends, political and economic factors, relevant circumstances in investment environments (especially within the appropriate sub-sectors), global concerns or opportunities and company information amongst other factors is undertaken to determine the most important themes for consideration. This process largely dictates the percentage of asset allocation to each investment sector.

Decisions relating to the selection of investments are taken by the Gibbs Denley Investment Committee, which meets on a quarterly basis, or more often if circumstances require this. This currently consists of Mark Denley DipPFS IMC (Chairman), David Ellis CertPFS (Deputy Chairman), Alan Pinney CertPFS, Peter Moore CertPFS and Tom Sparke IMC. The asset allocation of the investment models is debated as well as the merits of individual funds. Information on the performance of the current fund selection should be provided prior to the meeting to aid this process. The minutes of these meetings are recorded and retained.

Discussion regarding the sector allocation and specific funds used in the models takes place at the Investment Committee Meetings. Generally a consensus decision is made after some discussion of the subject at hand. Should a consensual decision not be reached, the ultimate decision lies with the Chairman, who would also carry the power to veto a decision. The minimum number of members that must be present for any decision to be made is three, one of which must be the Chairman. The committee will have the ability to appoint a replacement Chairman in the event of a long-term absence.

Specific fund selection is often discussed during the meeting but may be made afterwards, if further research is required into this area.

Once the model asset allocation levels have been proposed, these are supplied to the various Investment Committee members for approval. Once approved, the models may then be loaded onto the Standard Life Wrap ('the Wrap') for use on clients' accounts.

The new investment models will then be sent to all relevant clients, either in the post or via email, usually along with an investment review and a letter outlining the changes and the reasons for these. These will be specific to each client's account and if they wish to proceed with a rebalance, they will sign and return the 'Recommended Investment Spreadsheet' or reply via return email. These are free of any extra charge and invite further discussion of the models and of the changes made. Clients may be individuals, corporations, pension schemes or trusts.

Fund recommendations are made to the committee by our full-time Investment Fund Analyst, Tom Sparke, and are aided by the use of investment appraisal software, the most widely used of which is Analytics, provided by Financial Express. The models are monitored using the Analytics software and also other portfolio analysis tools.

Typically, the various models will contain a similar core of investments. Some of these are outlined below:

	Cash	Fixed Interest	Property	Equities	Absolute Return
Cautious	Up to 30%	50-70%	0-20%	20-30%	0-25%
Conservative	Up to 20%	40-60%	5-20%	20-40%	0-20%
Balanced	Up to 10%	20-30%	5-20%	40-60%	0-15%
Moderately Aggressive	1-5%	5-20%	5-20%	60-90%	0-10%
Aggressive	~1%	0-10%	5-15%	90+%	0-5%

The figures above are a guide to the likely proportions in each sector, but are not limited to these. It is unlikely that any model would contain 100% in any one asset class.

Fund Selection

Selected investments, specifically funds for inclusion in the investment models should fulfil the criteria used, and the evaluation and analysis process outlined below.

The sectors used in the models are split into Cash, Fixed Interest (eg. Traditional or 'flat' gilts and Index-Linked Government bonds & Corporate Bonds), Property, UK Equity, US Equity, European Equity, Far East Equity, Emerging Markets Equity, International Equity and Specialist (which may include commodities, Absolute Return funds or other less conventional assets). The vast majority of assets within the models will be Unit Trust or ICVCs (OEICs), but may also include Investment Trusts, Exchange Traded Funds/Commodities, Bonds or direct equities. The models will not have direct investment into hedge funds, currencies or derivative instruments, although some funds used will contain these.

As diversification is of great importance within our portfolios to minimize specific risks, we should not hold too much in any one fund. This amount will vary according to the amount of diversification required and there will be exceptions, where diversification is not advantageous, such as within a tracker or other homogenous sector.

Some of the factors taken into consideration when selecting or evaluating a fund for inclusion include:

Rating

- A MorningStar rating out of 5 'stars' is often used; the funds selected should carry 3 to 5 stars. Funds that carry a 1 or 2 star rating may be used but there will either be a specific purpose for this or further research may be required to ensure that the fund is of sufficient quality for the purpose or risk profile the fund is being selected for. Similar rating agencies are likely to be used, provided by, amongst others, Financial Express or Standard & Poors. These demonstrate the quality of investment process and control within a fund.
- Citywire Manager ratings will be used to monitor a fund manager's credentials. The Citywire rating achieved is a good indication that a manager, but not necessarily a specific fund, has performed well in the past and these are regularly updated to maintain relevancy. This may be especially useful when a manager joins or leaves a fund. The core funds of a model will usually contain funds whose managers carry a Citywire rating.
- While these ratings are a good guide to various aspects of funds, they are not always available to use on every fund, especially if the fund is relatively new or smaller in size. Other rating agencies will be used in these circumstances, most prominently Old Broad Street Research (OBSR), Financial Express, or Standard & Poors.

Performance

- A fund should have performed consistently well against its peers or benchmark for an appropriate period, any prolonged underperformance will be scrutinised and this may result in the fund being replaced. Performance is usually measured by total return, but this may be influenced by other factors, such as exceptional growth or yield.
- When assessing past performance many different factors are taken into account and measurement ratios/tools are employed, these will include (see glossary for definitions):

Sector Quartile – 1-to-5 years consistent high quartile performance.

Alpha – a high, or at least positive alpha figure to show how well the manager is adding value.

Sharpe ratio – a positive figure would be desirable, relative to risk.

Information ratio – a high degree of successful risk taken on by the fund, relative to the market or an appropriate benchmark.

Volatility – a low measure of volatility relative to the sector is usually preferable. Volatility is calculated as the standard deviation of the fund's returns over the last 36 months.

Beta – a high or low correlation to the market, dependent on the role of the fund in a model.

A newly launched fund may be used, but this would require exceptional circumstances, such as a very favourable manager or trusted company with a strong understanding of the proposition.

Pro-active, ongoing monitoring of the funds in the models is essential in identifying any problems that may occur and the performance of every fund is regularly scrutinised and may then be proposed for replacement at quarterly Investment Committee meetings. In exceptional circumstances a fund or funds may be sold or switched immediately.

Manager

- The manager of a fund is a hugely influential factor in actively managed funds and will be a major factor in whether to use a fund or not.
- The manager or managers of a fund should be experienced and have relevant measurable past performance within the fund or similar. If the management situation changes, there may be reason to replace the fund. Citywire manager ratings are useful in this context, how long they have held a rating for and if their rating is improving or declining can give an indication of whether we should continue to use a fund or funds.
- One element of the model portfolios is that different management styles are often used together such as defensive/aggressive (or bearish/bullish), growth/income, or large small cap. These combinations should diversify within a sector, reducing the overall risk.
- With regard to a change in the manager of a fund, the level of action required by Gibbs Denley will depend on how reliant the fund is perceived to be on the departing manager. If a team of managers or analysts are running the fund, one departure will likely not require any action, whereas if it is an individual, further action will be more likely.

Holdings

- Holdings within a fund will be examined to ensure that they are relevant and appropriate for the purpose of the fund (the amount of scrutiny is largely dependant on the size of the fund/number of holdings etc). The geographical and sector splits will also be scrutinised to ensure that they are relevant and appropriate.
- If a fund is found to have too much gearing or exposure to derivatives or similar, it may be deemed inappropriate.
- It is important to identify whether two or more funds in the same sector are too similar, ie. Holding the same securities as each other, which would increase specific risk and decrease diversification. The level of holdings in one stock or more specific, niche area will be analysed, though the degree of diversification required will vary vastly, but ultimately the aim of diversification is to reduce Specific Risk. As a guide, any single equity position that constituted more than 2% of the entire portfolio may be unacceptable.

Cost

- The initial and ongoing costs of a fund should not be excessive (in relation to its peers or acceptable alternatives). Annual Management Charges will vary depending on the sector and funds may also levy a performance fee (especially prevalent in the 'Absolute Return' sector). The total cost of a fund should be scrutinised and compared with similar funds.

Benchmarking

- The performance of the investment models is compared to a number of factors to gauge how well it has performed. These include: the relevant Investment Management Association (IMA) sector average; the relevant Adviser Fund Index (AFI) model; an index, such as FTSE 100 or All Share; a marketed managed fund; or a synthetic combination of indices, sector averages and/or funds to make up the same allocation as the model. The models are also compared with the prevailing cash deposit rates.
- This benchmarking is performed on at least a quarterly basis.

This list includes some of the factors employed, where appropriate, when choosing a fund for inclusion in the best advice panel. Other diagnostic and analytical techniques are employed at times and qualitative methods, such as meetings or telephone calls with fund managers or relevant individuals, are incorporated into the process. All of the funds used are evaluated on at least a quarterly basis and may be replaced at any time.

Gibbs Denley Investment Process Glossary

Absolute Return

The total return that an asset realises over a specified time period. This measure simply looks at the appreciation or depreciation (expressed as a percentage) that an asset, usually a fund, faces over a period of time. Absolute return differs from relative return because it is concerned with the return of the asset being looked at and does not compare it to any other measure. Absolute return funds look to make positive returns regardless of the direction of the market and may use different techniques to more traditional 'long only' funds.

Alpha

A measure of selection risk of a fund in relation to a specified benchmark. A positive alpha is the extra return achieved by the investor for taking a risk, on top of the market return. For example, an alpha of 0.3 means the fund outperformed the benchmark by 0.3%. An alpha of -0.5 means a fund's return was 0.5% less than would have been predicted from the change in the benchmark alone.

Asset Allocation

Apportioning of investment funds among categories of assets such as cash equivalents, equity, fixed income investments, alternative investments such as hedge funds and managed futures funds, and tangible assets like property, precious metals and collectibles.

Bear / Bear Market

Bear is a term describing an investor who believes that a market will fall. The term also refers to a short position held by a market maker. A Bear Market is a market where prices are declining over an extended period.

Beta

This co-efficient measures a fund's relative volatility to an index or benchmark. A fund with a beta greater than 1 is more volatile than the market while a fund with a beta less than 1 is less volatile than the market. A beta of exactly 1 indicates the stock is perfectly correlated with the underlying index. A beta value of 1.1 indicates a 1.1% movement for a 1% move in the index, regardless of the direction.

Bond

A debt investment, with which the investor lends money to an entity (company or government) that borrows the funds for a defined period of time at a specified interest rate. The indebted entity issues investors a bond that states the interest rate (or 'coupon') that will be paid and when the loaned funds are to be returned (on the maturity date). Interest on bonds is usually paid semi-annually.

AAA An obligation rated 'AAA' has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.

AA An obligation rated 'AA' differs from the highest-rated obligations only to a small degree. The obligor's capacity to meet its financial commitment on the obligation is very strong.

A An obligation rated 'A' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.

BBB An obligation rated 'BBB' exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

BB
B
CCC
CC
C Obligations rated 'BB', 'B', 'CCC', 'CC', and 'C' are regarded as having significant speculative characteristics. 'BB' indicates the least degree of speculation and 'C' the highest. While such obligations will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions.

D An obligation rated 'D' is in payment default. The 'D' rating category is used when payments on an obligation, including a regulatory capital instrument, are not made on the date due even if the applicable grace period has not expired, unless Standard & Poor's believes that such payments will be made during such grace period.

BRIC

A term used to collectively refer to the nations of Brazil, Russia, India and China. General consensus is that the term was first prominently used in a thesis of the Goldman Sachs Investment Bank. The main purpose of this 2003 paper was to argue that the economies of the BRIC countries are rapidly developing and by the year 2050 will eclipse most of the current richest countries of the world.

Bull / Bull Market

An investor who believes that the market is likely to rise. A Bull Market is a market where prices are rising over an extended period.

Core Fund

A fund that takes a prominent position in a portfolio to serve a purpose in its sector. This will usually provide the largest holding and may hold lower risk assets. It is usually focused to producing long-term results.

Correlation

A standardised measure of the relative movement between two variables, such as the price of a fund and an index. The degree of correlation between two variables is measured on a scale of -1 (perfect negative correlation) to $+1$ (perfect positive correlation). If two variables move up or down together, they are positively correlated and if they tend to move in opposite directions, they are negatively correlated.

Defensive Stock

A stock that tends to remain stable under difficult economic conditions. Defensive stocks include food, pharmaceuticals, tobacco, oil, and utilities. These stocks tend to be more resilient in hard times because demand does not decrease as dramatically as it may in other sectors. Defensive stocks tend to lag behind the rest of the market during economic expansion because demand does not increase as dramatically in an upswing.

Derivatives

Financial instruments whose value is tied to an underlying asset. Derivatives include futures and options.

Diversification

An investment strategy that involves buying a variety of different investment instruments that are not highly correlated to each other in order to reduce the overall risk of a portfolio.

Emerging Markets

Includes markets within countries that have an under-developed or developing infrastructure with considerable potential for economic growth and increased capital market participation for foreign investors. These countries or regions can exhibit high growth rates and high rates of inflation. Investing in emerging markets can be very volatile and may also involve currency risk, political risk and liquidity risk.

Equities

Ownership positions in companies that can be traded in public markets. These assets produce income which is paid in the form of dividends. In the event of the company going bankrupt equity holders' claims are subordinate to the claims of preferred stockholders and bondholders.

Fixed Interest

A fixed Interest fund will usually carry a mix of bonds, including gilts, Index-linked gilts and corporate bonds. They are generally deemed to be at the lower end of the risk scale.

FTSE 100

A market-weighted index of the 100 most highly-capitalised countries based in the UK and traded on the London Stock Exchange.

Futures Markets

Commodity exchanges where futures contracts are traded. Different exchanges specialise in particular kinds of contracts. Major exchanges include the Commodity Exchange, the New York Mercantile Exchange, the Chicago Board of Trade and the Chicago Mercantile Exchange.

Gilt-Edged Securities (Gilts)

Bonds issued by the government of the United Kingdom. A relatively risk-free investment, gilts bear fixed interest and are usually redeemable on a specified date. The term is now used generally to describe securities of the highest value. According to the redemption date, gilts are described as short (up to five years), medium, or long (15 years or more).

Hedge Fund

An unregulated, pooled investment vehicle that is privately organized and administered by investment management professionals and usually not available to the general public. Most hedge funds share similar traits; they hold long and short positions, use leverage to enhance returns, pay performance or incentive fees to their managers, have high minimum investment requirements and target absolute returns. Generally, hedge funds are not constrained by legal limitations on their investment discretion and can adopt a variety of trading strategies.

High-Yield Bond

Often referred to as 'Junk Bonds', these are low-grade fixed income securities of companies that show significant upside potential. The bond must pay a high yield due to significant credit risk.

ICVC – Investment Company with Variable Capital (or OEIC)

An investment vehicle that is not bound by a specific number of units (Open-Ended). Similar to a Unit Trust but formed as a company, ICVCs pool investors' deposits and these are invested in relevant securities.

Index Linked Gilt

A gilt, the interest and capital of which increase (or decrease) in line with the Retail Price Index.

Information Ratio

A fund's Information ratio is calculated in a similar way to its Sharpe ratio, except that the fund's returns are compared to its sector average rather than cash. Therefore, it is an expression of the risk-adjusted extra return, which an investor is getting compared to the average fund in the sector. The Information ratio is greater than zero if the fund has beaten the sector average.

Investment Grade

A bond that is classified as investment grade holds a current rating of BBB or higher.

Leverage

Also known as 'Gearing', the use of borrowed funds to increase the amount an investor has in a particular position. Managers may use leverage to enable them to put on new positions without having to take off other positions prematurely. The amount of leverage used by the fund is commonly expressed as a percentage of the fund. For example if the fund has £1 million and borrows another £2 million to bring the total invested to £3 million, then the fund is leveraged 200%

Liquidity Risk

Risk from a lack of liquidity, for example an investor having difficulty getting their money out of an investment. One example of this is in Property investment, as it may take time to sell an asset.

Long

A long position is taken by an investor who believes the security involved will increase in value.

Money Market Funds

Mutual funds that invest in short term, highly-liquid money market instruments. These funds are used when preservation of capital is paramount. They may be used to temporarily store money between investments, especially during periods of market uncertainty.

Net Asset Value (NAV)

The NAV is the closing market value of all assets within a portfolio after subtracting all liabilities including accrued fees and expenses. NAV per share is the NAV divided by the number of shares in issue.

OEIC – Open-Ended Investment Company

See ICVC

Open-ended Funds

These are funds (usually ICVCs) where units or shares can be bought and sold daily and where the number of units or shares in issue can vary daily.

Option

A privilege sold by one party to another that offers the buyer the right, but not the obligation, to buy or sell a security at an agreed-upon price during a certain period of time or on a specific date. Options are extremely versatile securities that can be used in many different ways, most often to speculate on the future price of an asset.

Property

In Gibbs Denley literature, Property usually relates to Commercial Property, as oppose to residential property. The funds that hold Commercial Property can do this directly, via owning the physical asset, or indirectly, through the use of REITs (See below).

REIT (Real Estate Investment Trust)

A security that trades on the major exchanges and invests in real estate directly, either through properties or mortgages. REITs receive special tax considerations and typically offer investors high yields, as well as a highly liquid method of investing in real estate.

Risk Free Rate

The level of return that can be achieved without taking on any extra risk.

Sector Quartile

The 25% margin that a fund's performance will fall within, usually over 1, 3 or 5 years. If a fund has ranked within the top 25% of all the funds in that sector, it is said to have achieved 'Top Quartile' performance. If it lies in the next 25% it has achieved 'Second Quartile' performance.

Sharpe Ratio

A calculation developed by Bill Sharpe to measure risk-adjusted performance. It is calculated by subtracting the 'risk free rate' from the rate of return for a portfolio and dividing the result by the standard deviation of the portfolio returns. The Sharpe ratio tells us whether the returns of a portfolio due to good investment decisions or a result of excess risk. The Sortino Ratio is a variation of this.

Short

A short position is taken by an investor who believes the security involved will decrease in value.

Sortino Ratio

Similar to the Sharpe ratio, the Sortino ratio measures the excess return (or risk premium) per unit of risk in an investment strategy, taking into account only downside volatility as upside volatility would be deemed as desirable and therefore not as relevant.

Specific Risk

Risk that affects a particular asset or very small number of assets. This is sometimes referred to as 'unsystematic risk'. Unlike systematic or market risk, specific risk can be diminished or eliminated by diversification.

Standard Deviation

How much the return on the fund deviates from the expected normal returns.

Strategic Bond Funds

Invest primarily in higher yielding assets including high yield bonds, investment grade bonds, preference shares and other bonds. The funds take strategic asset allocation decisions between countries, asset classes, sectors and credit ratings.

Systematic Risk

The risk inherent to the entire market or entire market segment. Also known as 'Market Risk', interest rates, recession and wars all represent sources of systematic risk because they will affect the entire market and cannot be avoided or assuaged through diversification.

S&P 500

Standard & Poor's Index of the New York Stock Exchange. A basket of 500 stocks that are considered to be widely held. The S&P 500 index is weighted by market value and its performance is thought to be representative of the stock market as a whole.

Unit Trust

A common form of collective investment (similar to a mutual fund) where investors' money is pooled and invested into a variety of shares and bonds in order to reduce specific risk. Its capital structure is open ended as units can be created or redeemed, depending on demand from investors.

Volatility

The relative rate at which the price of a security or fund moves up and down. Volatility is found by calculating the standard deviation of change in price over a specified time period. If the price of a stock moves up and down rapidly over short time periods, it has high volatility. If the price almost never changes, it has low volatility.

WRAP

A service that allows a customer to view their portfolio of investments online and enables an Adviser to buy, sell and switch underlying funds. Wrap platforms also offer a comprehensive range of financial planning tools that assist the adviser in maintaining and reviewing their client's investments. Gibbs Denley currently utilise the services of the Standard Life Wrap.

Yield

This usually refers to a fund's current dividend or distributable income.

