HYBRID PORTFOLIOS:

INVESTMENT PROCESS

A new era
in investment
management

Seeing the big investment picture

With the client outcome in mind, our investment process combines our strategic and tactical asset allocation with granular portfolio construction and stock selection to add further value. Our portfolios are built around core holdings with satellite tactical investments aiming to take advantage of shorter term themes.

Our hybrid portfolios consist of active and passive investments. Passive investments are used where we believe active managers are not able to add value sufficiently to justify the higher charges. As a result, we believe our hybrid portfolios have the ability to outperform while having a lower overall cost.

Key stages

- ***Portfolio Objective & Risk Profile***
- ***Strategic Asset Allocation***
- ***Tactical Asset Allocation***
- ***Stock Selection***
- ***Portfolio Construction***
- ***Ongoing Monitoring, Investment Changes & Rebalancing***

Strategic asset allocation

Our Strategic Asset Allocation (SAA) at each risk level is derived from the Wealth Management Association, flexed to our in-house view. We analyse the long term real returns of different asset classes and geographic areas as well as the ability of active fund managers to add value in those sectors. The SAA is generated on a long term view, being longer than 5 years.

Tactical asset allocation

Our Tactical Asset Allocation (TAA) is a shorter term view and is a result of our outlook on the global economy, monetary and fiscal policies, valuations and currency. There is ongoing idea generation and changes are formally discussed at quarterly investment committee meetings.

We will look to adjust a portfolio, within the bounds of the risk profile, depending on our views. Overweight and underweight positions will be limited to ensure that diversification is maintained and there is no concentration of risk.

We will look to tilt the portfolios towards areas we believe represent the best opportunities, yet are not fully appreciated by the market. In the shorter term we will look to identify catalysts for positive change.

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Selecting the best performing investments

We maintain a panel of researched, approved and monitored investments. Our panel includes a range of potential holdings that can be used in different scenarios and to exploit varying opportunities.

Where we believe that active managers are unable to generate positive net relative returns, we will use passive investments. This removes an element of selection risk from the portfolio in addition to reducing the overall cost. The amount of passives held will vary dependent on asset allocation, availability of appropriate investments and the relevant portfolio objective.

Active fund research process

Our active fund research process includes both quantitative and qualitative criteria. Fund ideas are primarily generated from a quantitative sector analysis to ensure that we look at the whole of the market. Meetings with fund managers and opportunity driven ideas supplement the quantitative screen.

Quantitative performance criteria will vary, dependent on the fund sector and its objective, however, it is likely to include; Downside risk, volatility, risk adjusted return (Alpha, Sharp), relative outperformance vs sector/market, size and cost.

Once the opportunity set is reduced to a manageable level qualitative measures are used to determine the best in class fund. We will assess the primary manager(s) experience, education, reputation and past performance as well as the strength of the direct team. Judgement of a key person risk is also considered. Wherever possible we will meet with the primary fund manager.

The reputation and sector specialism of the investment house is assessed as well as their transparency and accessibility.

The style and investment philosophy of the fund is important. While we do not have a bias it is essential that we do have a range of investment styles on the panel to enable us to use an appropriate fund in specific portfolios. A range of styles also enables us to make more nuanced tactical investment decisions. Nevertheless, we prefer all funds, regardless of style, to outperform over the full market cycle.

It is important for us to understand the fund's strategy as this will help us predict the performance of the fund in different

market conditions. Furthermore, we will look to find diversifying strategies to other panel investments to ensure there will not be an unforeseen concentration of risk. This will reduce the risk of overlapping holdings.

We will ensure that a panel fund has a strong investment process and adheres to its buy and sell discipline. Consideration for a fund's portfolio construction will vary between sectors. However, we look to ensure that there is not an over concentration of holdings which unnecessarily increases risk. We also ensure there are not too many holdings as an over diversified portfolio dilutes the manager's ability to add value through stock selection significantly, and will compromise the potential for outperformance.

Fund reputation and net fund flows are a consideration as strong outflows not only point to an underperforming fund but also limit the manager's ability to make purchases and sales based on investment merit. Strong fund outflows may also cause liquidity concerns in some cases.

Finally, the "fit" of an investment with other panel investments and the target portfolio are central to the overall investment process. Ensuring that there is good diversification between holdings enhances the risk adjusted returns of portfolios. This means that we may not hold the highest rated funds in a sector if we believe that they do not complement others that we hold.

> *"Our panel of approved investments includes a range of potential holdings that can be used in different scenarios and which can be used to exploit a range of opportunities."*

Portfolio construction

Appropriate investments are selected from the panel to meet the tactical asset allocation determined by the portfolio's risk profile and objective. Core holdings are used to build the bulk of the portfolio. Such holdings are likely to have a long time horizon and are investments we expect to outperform consistently, compounding outperformance.

Tactical holdings are used when there is a perceived opportunity in the market, whilst ensuring the investment will work well with other holdings within the portfolio, and where appropriate for the risk level.

For portfolios with higher income objectives, we may adjust the tactical asset allocation to ensure that the income target is met. The changes will not affect the overall risk level of the portfolio and are only done to the satisfaction of the investment committee.

Ongoing monitoring, investment changes & rebalancing

Sales of a fund will be made if it is removed from the panel, the rationale for the fund being held within a portfolio is no longer valid, or the fund objective changes to the extent that it is no longer appropriate. Furthermore identification of a more attractive opportunity or a change in the asset allocation that requires a reduction will also result in the sale of a fund.

Investments that have performed particularly well will become rebalanced downwards on a quarterly basis and for poorer performers, vice versa. Quarterly rebalancing ensures that a portfolio does not become over concentrated in areas that have done well and realigns the portfolio fully with our most recent asset allocation decision.

Performance contribution analysis of the portfolio enables us to identify areas that require addressing as well as furthering our understanding of the interaction of funds' returns and their implications at a portfolio level.

All the model portfolios are subjected to a comprehensive quantitative risk analysis on a six monthly basis to highlight areas which could present a previously unforeseen risk.

We are more than happy to help.
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