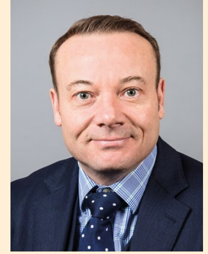
ASKS THE QUESTIONS

NUMBER 1

ANDY PARKES



In collaboration with the AIC, the lang cat has produced a series of factsheets to highlight how a selection of advisers have adopted investment companies (or investment trusts) into their investment propositions. With our Dictaphones fully charged, we were curious to discover how advisers are researching investment companies, their opinion of how investment companies are accommodated on platforms/with providers and also the role regulation plays in their processes.

the lang cat

1. Why do you recommend investment trusts to your clients?

We have model portfolios and discretionary portfolios and we tend to use investment companies on the discretionary managed side of the business. Investment companies can have some difficulties in terms of liquidity. The bulk of this money would be pension money, so is longer term. Investment companies will often give us the opportunity to look at more niche areas and we can take a view that the investment is there for a good number of years.

the lang cat

2. Do you have any specific examples where you find investment trusts have advantages over some other investment types?

Examples might be private equity or infrastructure and specialist property. Some of these assets are more suited to a closed-ended structure rather than an open-ended structure.

the lang cat

3. Do you have a centralised investment process (CIP)? If so, how do investment trusts fit in?

Fundamentally, we're looking for the same ideas, so we don't significantly change the process. There are some different issues, however. Ultimately what we're trying to do is look for high quality managers, and to provide clients with exposure to areas that we believe will outperform over the longer term. For that side of things, the process of looking at open-ended and closed-ended funds is much the same.

That said, we can isolate areas which we think are more likely to outperform. We can look at discounts on investment trusts, or areas where we see long-term value, but don't lend themselves to being in the model portfolio. On the discretionary side as well, we can manage this on an individual basis and can work around elements such as discounts and premiums. When we want to personalise portfolios and bespoke them, that's where using investment companies can be useful. It doesn't work as well in a model portfolio landscape where we need to add money on a regular basis or take it out.

the lang cat

4. How, if at all, does your research process for investment trusts differ from open-ended funds? Do you have sufficient tools available?

I guess it does differ. We piggyback with groups such as Raymond James and we get research from the underlying investment companies. We use that as part of the process, whereas in the open-ended space, we're looking at analytics to measure performance. It's easier to compare open-ended. Also, with investment companies, we're often adding money when they're raising, whereas we can buy open-ended funds at any point in the cycle. We would also look at liquidity to make sure we're

Ultimately what we're trying to do is look for high quality managers, and to provide clients with exposure to areas that we believe will outperform over the longer term. For that side of things, the process of looking at open-ended and closed-ended funds is much the same.

> *When we want to personalise portfolios and bespoke them, that's where using investment trusts can be useful.*

comfortable and we feel that they're going to raise enough capital to get to a size that's big enough to run across the portfolios.

the lang cat

5. Do you think that investment trusts present some challenges that don't apply to open-ended investments such as gearing, premiums or liquidity? Or do you view some of these aspects as offering additional advantages? Does this influence your process at all?

Absolutely, there are both challenges and advantages with investment companies. I think you've just got to do your research and understand how you think they're going to perform and the liquidity constraints that can come with owning them. Elements such as gearing clearly offer the opportunity for performance to be stronger than their open-ended equivalent. There's also the opportunity to buy something at a discount to the net asset value. But, again, liquidity can be an issue. We generally try and use investment companies where the money is longer term, and we're not going to need to pull down on the cash with any urgency. We also manage position sizes carefully; generally, the position size will be smaller in the investment companies than we would have in an open-ended fund. On top of that, we'll have a diversified mix of investment companies.

the lang cat

6. Are your choices of platform or product influenced by the fact that you recommend investment trusts?

100%, I think they need to be. If we are going to use the full array of assets out there, we need a provider that can accommodate that. It's important to find someone that does a fair amount of trading in these types of assets, because otherwise it becomes difficult to manage. They have dealers with experience of trading these things, that have good relationships with the underlying market makers, and they know where to go to buy and sell.

We tend to have a lower charging model, because it suits our management style better. Once we've invested, the amount of trades that we're likely to do on an ongoing basis is fairly low. We're at a size now where the trading costs are largely immaterial. It suits us to have a lower ongoing charge and pay for the trades because, again, we are generally looking to build a longer-term model that isn't going to get traded a massive amount.

> *If we are going to use the full array of assets out there, we need a provider that can accommodate that.*

the lang cat

7. How well do you think investment trusts are accommodated in some of the other technology and processes that support your research and recommendations – such as risk profiling and risk ratings?

We try and have a fairly flexible approach because I think it's possible to trip up and constrain our ability to use different assets by having too many control parameters in place. Investment companies provide plenty of information and are often independently researched. It's more about understanding what we're buying and doing the research at a grassroots level. We need to establish how we expect it to behave, the best- and worst-case scenarios and the blend with the other constituents in the portfolio. It's about trying to diversify the portfolio by understanding what we own, and it doesn't necessarily matter whether it's the investment companies or an open-ended fund. The first building block is to say: "Are we properly diversified? Do we feel that the mix of assets is right and what's the worst-case scenario now? How do we manage that and how do we blend that with other assets within the portfolio?"

Given the markets have had such a strong run for 10 years, we need to be careful. In a more normalised environment, how are some of these assets going to react? That's key to building a portfolio, particularly looking to the future where the

> *Elements such as gearing clearly offer the opportunity for performance to be stronger than their open-ended equivalent. There's also the opportunity to buy something at a discount to the net asset value.*

likelihood is, at some point, this whole central bank, low interest rate model might break down. I wish I had all the answers. It's just looking at and trying to make sure we understand how the assets that we hold might perform in different scenarios.

the lang cat

8. How do you describe and explain investment trusts to your clients? How does this conversation differ from those about open-ended funds?

It doesn't really make any difference. Sometimes, they may be slightly more specific, such as a private equity trust so that can make it easier. In that case, we'd say we bought it for these reasons. With open-ended funds, they're more generic.

the lang cat

9. The PROD rules encourage a segmented approach to customer needs and ultimately their product and investment choices. How do you feel that your use of investment trusts fits into your suitability processes? For example, is there a specific customer type or set of needs that you think investment trusts are more suitable for?

Again, coming back to the idea of longer term, where there is less likelihood of funds moving in and out – so pension money particularly – investment trusts fit very well because there is an agreed timeline. We know we're likely to be managing the money over 20 years plus – hopefully longer – so we can make decisions where, again, liquidity is much less of an issue. For us, it's more about the attitude to risk. It's about having a blended, diversified approach. I don't think investment companies or open-ended companies individually have all the answers. It's understanding what you're buying, or why you're putting it into the portfolio and whether it meets the client's needs.

FINANCE SHOP
Independent Financial Advisers

Finance Shop is a locally owned independent company that offers a range of wealth management, financial and tax planning services, on an advisory and discretionary basis. The company has grown, predominately through word of mouth referrals, to become one of East Anglia's largest advisory and wealth management practices.

As a company we welcome anyone who wants financial advice, mortgages and protection.

We have £632m AUA, as at July 2019.

Contact: Andy Parkes
E: a.parkes@fs-dpm.com
W: www.financeshopgroup.com
M: 07780685772
T: 01603 595960 Ext: 841