the lang cat ASKS THE QUESTIONS

NUMBER 4

COLIN LOW

Kingsfleet Wealth

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.

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

Providing the choice of investing in an investment trust is part of being an independent adviser. We feel they should be offered or considered alongside any open-ended funds. We don't see why they should be any different when it comes to comparisons.

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

The ability to leverage is obviously there but I know that can be a plus and a minus. The ability to retain income and not pay everything out within a 12-month period. Obviously, we're very much aware of liquidity as an issue, but at least there's always a price for the trust. It will be whatever price people think it's worth.

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

Yes we do. I wear two different hats – one is the DFM business, which feeds into managing the underlying funds with the underlying client holdings, and the other is the IFA business. We use the DFM service for managing some clients and multi-manager and multi-asset for many others. We rarely recommend specific funds in the IFA business anymore.

We think investment trusts should be considered in any recommendation. The reason we outsource from the IFA business is exactly for that purpose; when we ran our own funds and portfolios we incorporated investment trusts, but we took the view that we need someone who could do that research for us.

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

We outsource, but this does still come up in due diligence. For multi-manager we tend to work with smaller firms, so we know the process well and we know that they use investment trusts within their solutions, and that's one of the compelling reasons for using them.

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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?

The net result over time is that it makes no difference; these things even themselves out. There are short-term issues to be managed, but that's what you employ a manager to do. Just a bit of extra understanding of how trusts work can illustrate how these various issues are handled by investment trust managers.

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

Yes, absolutely. We carry out annual platform due diligence and one of the first questions we ask is whether you can buy investment trusts on the platform. And not just a handful, but all the trusts on the market and how easy it is to buy them.

It's my responsibility as an adviser to get the best for my clients. We have cautious, balanced and adventurous clients, but some will look at the adventurous portfolios and think they are not sufficiently adventurous for them, so we will use investment trusts within more bespoke arrangements so we can add risk and pursue extra opportunities.

If we weren't able to offer investment trusts we'd be working with one hand tied behind our back. We're great believers in not overlooking investment opportunities just because they are extra work. But fund groups have been very slow to get feet on the ground for investment trusts and many advisers are still not prepared to do the extra work or take the extra risk.

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

We don't rely massively on tools like Dynamic Planner. When we first used investment trusts we decided to do so only in adventurous portfolios, because we were aware they could have a distorting effect on portfolio volatility. We wanted to understand them properly before we brought them into other portfolios.

In terms of technology, it's not ideal. We have to take an educated position and allow more leeway from a risk perspective. The various tools often don't really cater for investment trusts, which means that we are then having to make something of a judgement call.

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

Our objective is to model risk in a portfolio rather than explain the different components. I use the cake analogy – you don't need to know the ingredients, but when you eat it you do know if there is too much or too little of something. It's about how you put the whole thing together rather than explaining the constituent parts.

Clients don't generally want to interrogate us; most are just not that interested. If clients do want to know, we explain pricing, premiums and discounts, borrowing and how investment trusts tend to behave in rising and falling markets.

Underneath it all, what governs returns generally is how good the manager is.

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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?

We carry out annual due diligence that we apply to every aspect of our business, looking at what we do and how we justify doing it. We've tried our best to get information from firms and platforms to model for PROD. But it's hard to find fund groups who know what we're talking about when we talk about PROD, and the same goes for platforms.

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We model solutions against client needs and their risk profile and PROD is actually a bit too generic, because we want to drill down further into different outcomes.

PROD is easy if you've only got eight or 10 different outcomes, but what we're dealing with is much more fully formed.

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We currently have £92m assets under management.

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