Whitechurch
Securities Ltd
WEALTH MANAGERS

Whitechurch Updates

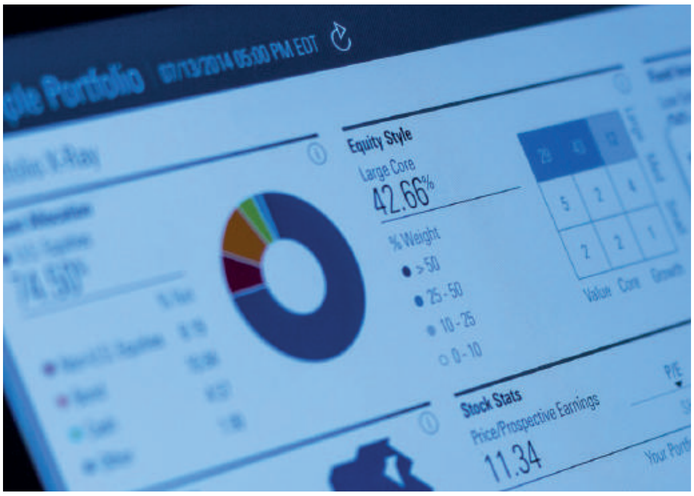
Award Winning Wealth Managers

The Magnificent Seven

rules to building a diversified portfolio

Whether we are managing monies for a first-timer or for a seasoned investor, to have a good chance of achieving your clients' goals, it is essential we employ a robust and disciplined investment process.

When it comes to portfolio management, there are a number of key rules which are employed to ensure that a portfolio is sensibly structured, that risk is controlled, and a careful eye is kept on costs to ensure the best possible risk-adjusted returns over the longer term.



1. Stringent risk management

The importance of stringent risk management has been a key reason why more and more advisers are outsourcing to a DFM in recent years. In order to be effective, it is important that, when managing a portfolio, we work within clearly defined risk parameters.

It is also very important that your clients understand the risk they are taking and the risk parameters we are working within with regards their portfolio. Technical terms such as volatility and drawdown mean very little to most investors. When risk rating portfolios, we use a starting point in terms of the maximum exposure a portfolio will have to equity-based, risk investments.

For example, our 4 out of 10 portfolios will have a maximum equity allocation of 35%, while a 5 out of 10 would see a maximum of 60%. However, it is important that a wide range of risk measures are employed when managing a portfolio and advisers should take time to understand our risk process before investing their client's monies.

2. Meeting a client's objective

Fundamentally important as it is, it is not just about risk ratings. It is also important to have an equally strong focus on the actual return objective of the portfolio. One size does not fit all. A portfolio with a balanced risk profile looking to maximise growth will be markedly different from a portfolio looking to maximise income for your client.

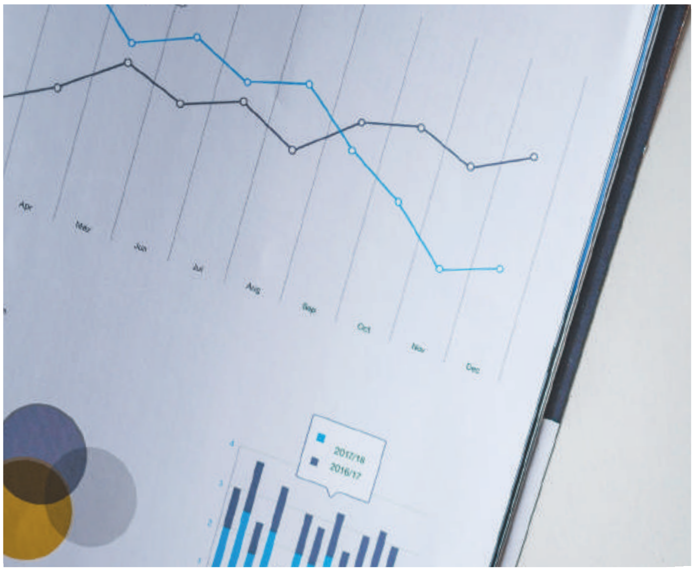
For example: an income portfolio is likely to have a materially higher bond content. This is where a discretionary tailored portfolio solution can provide more options than a simple multi asset fund.

3. Diversification

We always ensure a well-diversified portfolio of investments spread across different asset classes and different markets. Portfolios that concentrate on only a few investments are likely to give the wrong results and fail in their objectives.

If the portfolio is using collectives, then a combination of no more than 20 funds should provide sufficient diversification for most investors' needs. Portfolios with significantly more holdings show a lack of conviction and dilute the impact of the management team's best ideas.

Diversification is not just about the number of underlying investments. We also need to understand how the different investments are likely to perform in different economic climates, so as to ensure that the portfolio holdings are not going up and down in tandem.



4. Asset allocation

Different asset classes offer diverse characteristics that, in turn, provide differing levels of risk and potential performance at different stages of the economic cycle. Even within asset classes, different areas have totally different characteristics (a short-dated high yield bond fund bears little relation to a long-dated Gilt fund!).

Active asset allocation doesn't mean we are making big calls about what we believe will happen in the future. You only have to see how bad institutions such as the Bank of England are at making projections (despite having access to the best sources of data) to understand that this is not a formula for success.

We take a pragmatic approach, and although we will position the portfolio based on our view of the investment backdrop, the process is not based on following a benchmark. We will insure the portfolio against our basic investment case being wrong. Our focus is on creating marginal gains (not taking big bets) and on ensuring consistency.

5. Fund selection

Once we have ascertained a suitable asset mix to both meet your client's needs and the prevailing economic environment, our fund selection process aims to look for best of breed funds across the whole market.

The active versus passive debate will continue to rage, of course, but for us the starting point is to look for the lowest cost (passive) solution. If the client is going to be charged more than this, then we want a high degree of confidence that we will be receiving value for money.

However, the fact that the majority of our portfolios are invested into active funds means that we do go for value rather than the cheapest possible solution!

6. Stress testing

With all the portfolios we manage, we go through the very valuable process of stress testing. Using risk management software, we can undertake scenario analysis to gain an understanding of how a portfolio may perform in different climates (e.g. rising interest rates, stockmarket crash etc).

This can highlight any potential holdings that may be exposing the portfolio to greater levels of risk or damaging the performance profile and arrange for us to make any necessary changes at the design stage.

7. Day to day management

Ensuring the correct asset mix and fund selection against a constantly changing backdrop is the most complex and time consuming part of day to day investment management.

Over time, things change a lot and quickly. Sectors, regions and fund managers that have performed well in the past can suddenly struggle or fall out of favour. As portfolio managers, we can review portfolios constantly, react quickly if needed, and ensure that potential underperformers are removed and any recognised investment opportunities are introduced.

Although we are long-term investors and not short-term traders, it is important to be prepared to change direction when the facts change if we are to achieve our goal of delivering the best possible results for your clients on a consistent basis.

Head Office: The Old Chapel, 14 Fairview Drive, Redland, Bristol, BS6 6PH
Telephone: 0117 916 6150
Website: www.whitechurch.co.uk

1681b.06.12.17