

# Square Mile Managed Portfolio Service Investment Process



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 Square Mile Investment Consulting & Research Limited



## Managed Portfolio Service Investment Process

Our Managed Portfolio Service builds on our expertise and knowledge of the funds universe and financial markets. By partnering with Square Mile, we aim to work within and build upon advisers' processes to help produce the investment outcomes that investors are seeking to meet. To achieve these aims, our investment managers work closely with advisers to understand their requirements. Our investment managers can produce investment solutions that:

- Are consistent with advisers' attitude to risk tools
  - Incorporate our asset allocation views.
  - We are positioned for the long-term and select funds that ought to collectively perform well over most market conditions.
  - Are designed to meet the different outcomes that investors seek, whether:
    - Capital accumulation
    - Income
    - Or a combination of growth and income
    - Responsible (socially and environmentally)
  - Operate across a range of carefully selected platforms
- Our Investment Managers will work with adviser firm clients to discuss appropriate risk tools and the range of portfolios required, to establish suitable mandates.

**Strategic asset allocation will be the key determinant of long term returns and risks.**

### 1. Strategic Asset Allocation

- The formulation of a strategic asset allocation approach is a crucial step in meeting the outcomes that an investor seeks over the longer term. The Strategic Asset Allocations are the key determinant in setting the long term risk and return framework. In shorter time frames however, returns from the markets can be more volatile. Defining the correct strategy requires a thorough understanding of the investors' needs, time horizons and risk tolerances. This is a task at which advisers excel and they will be well versed in the tools and systems that can help. There are a number of approaches to modelling strategic asset allocations and for the risk grading of investors; advisers are likely to have their own preferred approach. Square Mile is happy to produce portfolios that meet the requirements of a number of different risk rating tools.
- To do this, we feel that it is important for our investment managers to understand the different approaches adopted by the providers. We have reviewed many of the asset allocation modelling tools widely employed in the market place such as DT, EValue and Towers Watson, and we are happy to share our opinions on these.

### 2. Tactical Asset Allocation

- Strategic asset allocation is usually set with a multi-year time horizon. We believe that additional returns can be generated through judicious tilting of the portfolio over the shorter term. As investment managers we seek some latitude to favour certain asset classes and permit our fund managers to build cash positions when markets become extended.

It is important to stress that while good tactical asset allocation can help to mitigate losses during bear markets, it cannot be expected to eliminate periods of drawdown entirely.

Some strategic asset allocation tools incorporate tactical tilts within their assumptions, so care is required to ensure that any tactical overlay is consistent with these and that the portfolios remain suitable for the mandates set by the adviser firms.

When determining tactical allocations, we believe that valuation is the most important metric to assess. History has often shown that valuations can be pushed to extremes only to revert to more normal levels in time.

Economic growth rates do affect the valuations that investors should be willing to pay but in reality, growth rate changes tend to be secular in nature and long-term growth rates across economies have remained remarkably stable. Over the short term, liquidity tends to be the driving factor that determines market momentum, and this key factor can push valuations to extremes. Only when liquidity conditions change do valuation excesses tend to correct.

- We review a range of metrics at our regular tactical asset allocation meetings. These include macroeconomic conditions, market and asset class valuations and input from the fund managers in which we invest.

- We at Square Mile are in a fortunate position of regularly coming into contact with some of the industry's foremost investment professionals. We undertake many hundreds of meetings each year with a wide range of the top investment managers in this and other countries. Through our regular cycle of meetings, we begin to build relationships with the managers, and as the trust develops, they become more candid in sharing their market views with us. In addition to meeting with fund managers, we also have regular consultations with prominent economists, strategists and investment specialists. These meetings allow our team to develop both broad and more focused insights into what is occurring within economies, markets and regions. These factors help the Square Mile teams to keep abreast of events and investments.
- Each week we hold Research team meetings where the analysts discuss the managers they have met through the week. These are designed to spread information across the team, and they are useful in developing investment ideas. On a regular basis we invite external parties to talk with us about a specialist area of the market, provide detailed comment on a pertinent issue affecting markets or to give a broad economic update.
- As well as formal tactical asset allocation meetings in which we consider the opportunities and risks across asset classes, we regularly meet with the Research Team including formal quarterly review meetings. In this meeting Square Mile's senior analysts, who are specialists in their asset classes and regions, provide informed views and insights which are an invaluable part of the process. These meetings also help us formulate a broad investment policy.

### 3. Fund Selection Process

- Our analysts are charged with finding the best funds available. Funds are assessed over appropriate time frames, which in many instances are likely to be lengthy.

To warrant a rating these funds should be capable of meeting their investment objectives and/or performing ahead of passive strategies. The analysts make no attempt in the rating process to identify the most suitable funds for the current market conditions.

- We acknowledge that certain investment strategies can remain out of favour for extended periods. In Square Mile's Academy of Funds, we cover a wide variety of fund strategies. We expect some to be performing strongly while others may be in the doldrums. No type of investment strategy predominates indefinitely and

we expect underperforming strategies to return to adding value once market conditions swing back into their favour.

- The ratings process produces an 'investable universe' of about 300 to 350 funds. Our investment managers will only use Square Mile rated funds, including those deemed Positive Prospects, in the portfolios they run. The portfolios will sometimes include passive funds, although these must also be rated by Square Mile. Certain markets (e.g. US large capitalisation equities) tend to be very efficiently priced and historically active managers have struggled to add value in a consistent manner. We may also choose to use passive funds in other regions when we hear from active managers that attractive opportunities are hard to come by.

The Investment Management and Research teams will then collaborate to refine the list of possible funds depending upon asset class, geography and underlying fund strategy. This process results in a short list of funds for consideration, and from which the most appropriate will be selected for the portfolios. We believe it is imperative that the analysts, who all have sector specialisms, are a part of the fund selection process as this builds upon our strengths as a business and utilises the wealth of knowledge and expertise that our experienced team have built up over many years to the full.

- It should be stressed that all our Investment Managers work closely with the Research team. The teams operate in a collegiate manner with constant dialogue and interaction.



*Investment Management and Research operate in a collegiate and close manner.*

#### 4. Portfolio Construction

- The portfolios are constructed according to the prescribed strategic asset allocation with any tactical asset allocation tilts overlaid within the tolerances set out in the investment mandates. The precise choice of funds lies with the Investment Managers, however:
  - Complementary funds will be favoured as this broadens diversification and enhances the risk reward profile of the portfolios.
  - We normally prefer our fund research analysts highest conviction funds as core constituents of the portfolios with smaller satellite positions employed to add risk.
  - We are aware of the growing importance of fund costs, and we can be sensitive to advisers' requirements in this regard.
  - We favour funds which meet the outcomes of the mandates, or which can be blended to produce such outcomes.

#### 5. On-going Monitoring

- The analysts are responsible for maintaining a quarterly cycle of reviewing the funds held within the portfolios to ensure that our knowledge remains current. The Investment Managers will monitor macroeconomic events and market conditions and if necessary, interim tactical asset allocation meetings may be convened.
- Portfolios will be continually monitored by the Investment Managers. In practice, much of the activity in the portfolios is likely to be either centered around changes to the underlying strategic asset allocation, the tactical asset allocation meetings or in response to changes in the fund ratings by the analysts. We manage portfolios with lengthy time horizons, and we expect turnover levels to be modest.
- Portfolios will be monitored to ensure compliance with the mandate and risk classification. Monthly Investment Oversight Committees are held to provide independent oversight on the actions of the investment managers and to ensure that the portfolios comply with the mandate and positions remain consistent with the current investment policy.
- In addition to the weekly Research meetings, every three months the Investment Managers will formally hold a Fund Review session. The analysts will review the funds in the portfolios and can propose alternatives that may be more appropriate for the current market conditions. We expect informal challenges and discussions between the analysts and managers to take place throughout the year. The weekly Research meetings are also an excellent forum for these, when information which has come to light during the normal course of our quarterly reviews is discussed.

#### 6. Reporting

- The format of the reporting cycle will depend upon each adviser firms requirements; however, we would typically expect to provide quarterly reviews of the portfolios, covering our current strategy, changes made to the portfolios and a review of performance. Macroeconomic/ market updates will be available on a quarterly basis. We will also provide ad hoc updates when opportunities are particularly compelling or market volatility spikes. Advisers will also receive notifications of any changes made to the portfolios during the quarter.

#### 7. Investment Oversight Committee

The board of Square Mile Investment Services (SMIS) has appointed an Investment Oversight Committee (IOC) to conduct formal oversight of the Managed Portfolio Service investment process. The IOC meets monthly, is chaired by the Strategic Relationships Director and comprises the senior members of the firm and other individuals as deemed necessary by the Board.

The role of the Committee is to:

- Review changes to high level asset allocations and to strategy and to ensure these are reflected where appropriate in model portfolios.
- Review, agree and monitor adherence of all portfolios to the Investment Policy.
- Review and agree the Investment Policy, Statement of Objective and/or Mandates for the portfolios.
- Monitor the investment performance and risk profile, if appropriate, of each portfolio against stated objective and benchmark.
- Review any investment transactions within the portfolios.
- Review any breaches to the agreed investment mandates and review remedial action taken. Ensure that reasonable precautions have been taken to avoid excessive investment concentration.
- The Investment Oversight Committee shall report its discussions to the Board by distributing the minutes of its meetings, and, where appropriate, by an oral report at the next Board meeting.



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