

For professional advisers only

# 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. The service is designed to be an insourced solution for financial advisers, working within and building upon advisers' processes to help produce the investment outcomes that investors are seeking to meet. To achieve these aims, our portfolio managers work closely with advisers to understand their requirements. Our portfolio managers can produce investment solutions that:

- Are consistent with advisers' attitude to risk tools
- Incorporate our asset allocation views, if required
- Contain the most appropriate funds for the market conditions
- Are designed to meet the different outcomes that investors seek, whether:
  - Capital accumulation
  - Income
  - Capital preservation
  - Inflation protection
- Operate across a range of carefully selected platforms

We will work with clients to discuss appropriate risk tools and the range of portfolios required, to establish a suitable mandate for our portfolio managers. In doing this we shall produce a range of portfolios that will best suit your clients' requirements.



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. Strategic asset allocation will be the key determinant of long term returns and risks. Defining the correct strategy requires a thorough understanding of the clients' 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 clients; 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 portfolio 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 Barrie & Hibbert, 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 portfolio managers we seek some latitude to favour certain asset classes or permit them 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 clients. During discussions with each adviser firm, we shall agree a mandate that sets out the parameters of any tactical allocation discretion that is employed.
- 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. Growth rates do

affect the valuations that investors should be willing to expect 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.

- Valuation, growth and liquidity conditions are formally assessed at our regular asset allocation meetings and monitoring these three factors helps to set the agenda of our allocation decisions. Information is taken from a number of sources but these can be broadly classified into two areas. Firstly we derive a great deal of knowledge from regular interaction with the fund managers that we meet as part of our fund research process and secondly, through our own monitoring of global macroeconomic conditions and the geopolitical situation.
- 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 analyst team to keep abreast of events outside of their respective specialist fields.
- Each week we hold Investment 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.

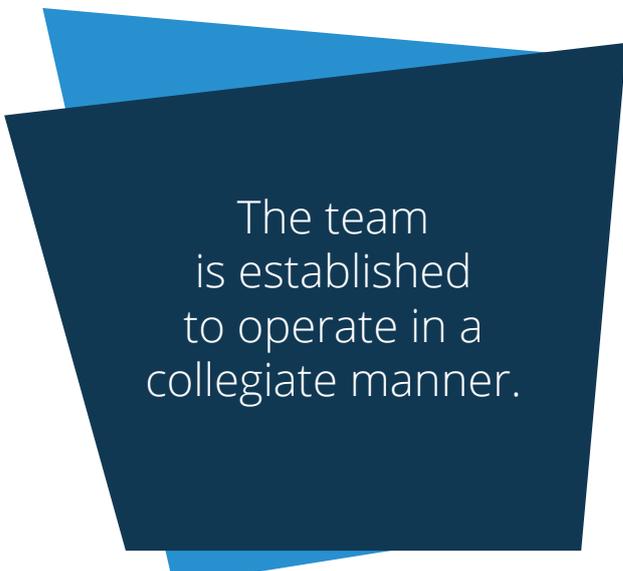
- Each quarter we hold formal asset allocation meetings in which we consider valuations across asset classes, the growth outlook and liquidity conditions. These meetings, chaired by the Head of Investment, are obligatory for the portfolio management team and analysts. The analysts are specialists in their asset classes and regions and can thus provide informed views and insights which are an invaluable part of the process. Recent macroeconomic events are considered along with an analysis of the market reaction to them. At the conclusion of these meetings we formulate a broad investment policy, highlighting which asset classes and regions we wish to favour or avoid. During these meetings, we also consider what types of investment strategies are likely to flourish in the current market and this helps inform the portfolio management team as to which fund strategies will be most appropriate for their portfolios.

### 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 200 to 250 funds. Portfolio managers will only use Square Mile rated funds 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 portfolio management team and research team will then collaborate to refine the list of possible funds depending upon asset class, geography and underlying fund strategy. This process results in an informal short list of funds which have the most potential, are the most appropriate for the current market environment and which we believe are best placed to meet our clients' needs. Funds from this short list can then be used in 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. It 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 portfolio managers have analyst responsibilities and sit within the analyst team. The team is established to operate in a collegiate manner and the portfolio managers are described as such to highlight their additional client related responsibilities. The investment team sits as one.



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### 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 mandate. The precise choice of funds lies with the portfolio managers, however:
  - Complementary funds will be favoured as this broadens diversification within the portfolio and enhances the risk reward profile of the portfolio.
  - The portfolio will be tilted towards certain strategies that have favourable macroeconomic tail winds.
  - We normally prefer defensive funds as core constituents of the portfolio with smaller satellite positions employed to add risk. We believe that most investors are more tolerant of underperformance during bull markets than they are of underperformance in down markets. However, when compelling opportunities in markets present themselves we will not shy away from taking positions in more aggressive funds.
  - 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 specific client outcomes, 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 of the funds remains current. The portfolio 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 portfolio managers. In practice, much of the activity in the portfolios is likely to be either centred around changes to the underlying strategic asset allocation, the quarterly 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 portfolio 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 meetings, every six months the portfolio managers will formally hold an analyst challenge session. The analysts will review the funds in the portfolio and can propose alternative funds that may be more appropriate

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for the current market conditions. The portfolio managers are expected to justify their positions to the investment analysts, otherwise the analysts' proposals will be adopted. We expect informal challenges and discussions between the analysts and managers to take place throughout the year. The weekly meetings are an excellent forum for these, when information which has come to light during the normal course of our quarterly reviews is discussed as a team.

### 6. Reporting

- The format of the reporting cycle will depend upon each clients' requirements, however, we would typically expect to provide quarterly reviews of the portfolio, covering our current strategy, changes made to the portfolio 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 portfolio during the quarter along with the rationale for that change.

### 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 managing director and comprises the directors of SMIS and other individuals as deemed necessary by the Board.

The role of the committee is to:

- Review changes to the high level asset allocation strategy and to ensure these are reflected where appropriate in client portfolios.
- Review, agree and monitor adherence of all portfolios to the Investment Research Policy.
- Review and agree the Investment Policy, Statement of Objective and / or Mandate for the Investment Models and / or Investment Portfolios.
- Monitor the investment performance and risk profile, if appropriate, of each Investment Portfolio against stated objective and benchmarks.
- Review any investment transactions within the investment portfolios and investment recommendations within the investment models.
- Review any breaches to the agreed investment mandates and review remedial action taken.
- Ensure that the Investment Mandate for each portfolio has taken reasonable precautions 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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