Investment Philosophy

Introduction
Our investment philosophy is the overall set of principles and strategies that guide and steer our recommendations. It helps us simplify a complex industry by filtering out its wide variety of marketing communications, fund launches, and special offers, allowing us to concentrate on our client relationships, safe in the knowledge that we are doing our best to protect and grow their assets in line with their risk and reward profile.

Knowledge & experience of financial products
Knowledge and experience is about assessing what our clients' previous experiences have been in relation to various types of financial products. As part of this we consider what different financial products have been previously purchased and whether this has been done having received advice or whether the client has acted on their own. This helps us to assess levels of understanding.

Strategy
While investment performance hinges on many factors out of an investor's control, most notably the return on markets, we can control other factors. These are the ones we deem the most important in creating and managing a portfolio such as: the types of funds we invest in, the cost of the investments we choose and what we look for when choosing the investment companies we do business with. It is therefore important to be able to justify our investment decisions to ourselves and ultimately our clients and make it clear why we have made recommendations to invest their money in a particular way.

There are a number of different investment philosophies available to us, and various theoretical approaches to investing. Namely:

- Strategic Asset Allocation
- Tactical Asset Allocation
- Security Selection
- Active versus Passive
- Ethical Issues
- Alternative Assets

Strategic Asset Allocation
Asset allocation is the practice of diversifying assets between different asset classes and is recognised as a very important part of the process of building a portfolio. In fact, a number of studies have found that the decision as to how to divide up a portfolio into several classes is more important than the process of choosing the actual stocks, bonds, and funds that are owned.

The model portfolio theory (MPT), a mathematical quantification of the benefits of diversification, states that by combining different types of assets the collective investment will have a lower level of risk and reward (defined as variance in investment return) than if the money was held in a single investment.

As advisers, one of the most important considerations we make for our clients is what assets we invest their money in. Depending on their financial goals, strategic asset allocation attempts to build a corresponding mix of assets that produces the most appropriate level of risk and reward, and expected return.

While many adviser firms include Strategic Asset Allocation as part of their investment process, there can be great disparity in both the importance placed on it and the sophistication of the chosen allocation process.

Tactical Asset Allocation
Tactical asset allocation is an active management portfolio strategy that rebalances the percentage of assets held in various classes and sub-classes to take advantage of short and intermediate term market inefficiencies. It has the goal of raising investment performance above the market average. This is in contrast to a strategic approach where the adviser will stick to the client's initial investment allocation in the long-term, ignoring short-term fluctuations in price, until their financial goals or circumstances change.

Tactical asset allocation attempts to increase returns by overweighting asset classes or sub asset classes that are expected to outperform on a relative basis, and underweight those expected to underperform. It goes through and analyses financial and economic 'signals' to predict performance and assign relative short-term asset class weightings.

At Invest Southwest we adhere to this theory but accept we do not have sufficient market knowledge, practical investment skills and constant dedication to maintain a successful tactical approach. To assist us in the process of asset allocation we employ generic efficient frontier methodology and the eValue FE calibration of Towers Watson's Global CAP:Link™ asset model to create the most efficient portfolio for our clients.

The option to rebalance the allocation is presented to our clients at least once in any 12-month period. For clients looking for a more active approach and when such an approach is suitable, we offer an external Discretionary Fund Management Service (DFM), which has asset allocation as its underlying principle.

We believe that asset allocation primarily determines the results of a broadly diversified portfolio, and we concentrate on doing everything we can to get this right for every client.

Fund Philosophy
Like Tactical Allocation, fund selection is an active investment management strategy that picks specific funds in an attempt to make higher risk and reward-adjusted returns. While tactical allocation attempts to take advantage of systematic risk and reward (e.g. interest rates or business and industry shocks) fund selection strategies take advantage of firm-specific risk and reward.

Active v Passive
Advantages of Passive Investing

- Passive funds tend to have lower charges than active portfolios, since they simply replicate the index with little or no intellectual input from managers.
- The risk of significant underperformance measured against the relevant index should be limited but of course investors must be aware that markets can fall as well as rise.
- Passive government bond portfolios can be an efficient way for pension funds to match assets and liabilities.

Disadvantages of Passive Investing

- There is no simple way to tell whether one index fund is better than another other than measuring past performance, making comparison difficult as performance data is collected in different ways by different funds.

Advantages of Active Investing

- These types of funds offer different investment aims rather than just tracking the market as a whole.
- Investments that are not highly correlated to the market are useful as a portfolio diversifier and may reduce overall portfolio volatility.
- Some investors may wish to follow a strategy that avoids or underweights certain industries compared to the market as a whole and may find an actively-managed fund more in line with their particular investment goals.

Disadvantages of Active Investing

- The most obvious disadvantage of active management is that the fund manager may make bad investment choices or follow an unsound theory in managing the portfolio.
- The fees associated with active management are also higher than those associated with passive management, even if frequent trading is not present.
- Large managed funds can begin to take on index-like characteristics because they must invest in an increasingly diverse set of investments instead of those limited to the fund manager's best ideas.

At Invest Southwest, we believe in a combination of active and passive investment dependent upon our clients' situation, preferences, attitude and objectives.

Fund Selection

Having established our clients' objectives, risk and reward profile, capacity for loss, the likely term of the investment and the resultant asset allocation, and ensuring the client has adequate funds held in cash for emergencies and planned spending, we select funds using one of two broad methods of fund selection determined by the client:

- A researched selection of funds provided by Threesixty Services LLP reflecting a stringent methodology of meetings with investment departments, monitoring of fund manager movements, performance measurement against sector over various time periods, industry ratings from inter alia, FE Analytics, Mornsingstar OBSR, Rayner Spencer Mills, City Wire comparisons among others. These tend to be funds with high ratings and a proven track record and as such do also tend to attract higher fees.
- The 'in-house' funds of the recommended product provider, which approximate to the sector average performance. It could be argued that, if adhering to the principles of asset allocation, 'star' fund managers may not be necessary and may not add value. These 'in-house' funds tend to levy lower fees, which over many years can have a significant effect on performance.

When an external Discretionary Fund Management service is appropriate, the resulting portfolio is also based on objectives, risk and reward profile, capacity for loss and the likely term of the investment.

Attitude to Risk and reward and Capacity for Loss
It is important that when making decisions in relation to financial planning that our clients are aware of and fully understand the potential risk and rewards involved. For example:

- Capital risk – not getting back as much as originally invested / losing some of the return already achieved
- Income risk – the risk and reward that the income level achieved is less than expected.
- Liquidity risk – not being able access money when needed.

When making an investment and during the time it is held, we need to help our clients take account of the risks, rewards and consequences. Risk and reward profiling is the process for determining an appropriate investment strategy. It has four primary aspects which we take into account in making our recommendations.

1. **Assessing risk and reward required -** We have detailed discussions with our clients to understand their goals, current and anticipated income and expenses, and current and anticipated assets and liabilities. We help our clients establish the return needed to meet their future objectives and in turn agree the most appropriate investment solutions.
2. **Capacity for loss -** Capacity for loss is the second key element of our clients' overall appetite towards bearing capital risk and reward. When undertaking the assessment of our clients' financial position, we discuss the effect the loss of any capital invested in relation to the standard of living and/or future objectives.
3. **Risk and reward tolerance -** Unlike risk and reward required and capacity for loss, which are financial calculations, tolerance is psychological. Through discussion we assess risk and reward tolerance and any inconsistencies are highlighted and discussed.

Investment Committee
Invest Southwest employs an investment philosophy combined with the fund research panel provided by Threesixty Services LLP. This process provides clients with a clearly defined investment proposition and as such we do not use an investment committee. Where we recommend the use of an external Discretionary Fund Management service, we carry out extensive due diligence to ensure the activities of the fund managers are a close fit with our beliefs and culture.

Research and Due Diligence
With regards to due diligence, we subscribe to the methodology and outcomes of the Threesixty Services Advisory Panel Process. This is based around thorough research on a product by product, rather than provider by provider basis and is undertaken using tools including Defaqto Engage, Synaptics Research and FE Analytics. In addition, we have a documented open forum amongst our advisory community highlighting current issues and developments. Resulting issues are formally discussed at quarterly Advice Team meetings and amendments to policy/best practice are minuted and/or communicated in update emails.

In terms of provider selection, we again subscribe to Threesixty Services methodology, supported by the use a variety of research tools such as Adviser Asset, Defaqto, Assureweb and Selectapension. We provide details of all research conducted during client meetings.

WRAPs and Platforms

We do not exclusively use any single WRAP or platform to provide our clients with investment solutions. Each individual case is taken on its merits and where appropriate a WRAP or platform may be recommended if it can be demonstrated that it best meets clients' needs and objectives.

Ethical
Ethical investing, also known as socially responsible, sustainable or socially-conscious investing, describes an investment strategy which seeks to maximise both financial return and social good.

We fully appreciate that there are a variety of different ways in which we can engage with ethical investing for those of our clients, for whom achieving a social good is just as important as a financial return. However, by heavily restricting the range of funds on offer, we are conscious this may put the average investor off. Invest Southwest's policy therefore is to offer the client an informed choice. By this we mean we do not advise on ethical investing by default.

Alternative Assets
Alternative assets are investments that do not fall into the traditional asset types. As they are generally characterised by higher costs and less liquidity than traditional investments, we at Invest Southwest feel they are not likely to be appropriate for the majority of our clients.

However, for some high-net worth individuals &/or sophisticated investors we accept there may be a place. We accept there are a number of advantages to Alternative Assets and they may be appropriate in some individual circumstances. In particular, their returns have a low correlation with those of standard asset classes, and are therefore very useful in diversifying portfolios. For Invest Southwest this is a rarity relevant only to exceptionally diverse portfolios and in the main this is for experienced/sophisticated investors in line with their overall objectives.

Non-Mainstreamed Pooled Investments (NMPI)
NMPI are defined as "Pooled investments or funds characterised by unusual, speculative or complex assets, product structures, investment strategies and/or terms and features." They include:

- A unit in an unregulated collective investment scheme (UCIS)
- A unit in a qualified investor scheme (QIS)
- A security issued by a special purpose vehicle (SPV), other than an excluded security
- A traded life policy investment
- Rights to, or interests in, investments that are any of the above

The FCAs view is that these investments are unlikely to be suitable for 'ordinary' retail investors described as 'retail clients who are neither sophisticated investors nor high net worth individuals'. These are the investors of more ordinary means and experience, who make up the vast majority of Invest Southwest's client profile.

We believe that such investors face difficulty understanding the terms and features of complex financial products and are at particular risk in relation to inappropriate promotion of non-mainstream pooled investments. With this in mind such products will not be promoted or recommended by Invest Southwest at present, but could be in future. Our advisers are aware of how they work and can refer any specific requests or circumstances where they think they could be relevant to the Compliance Manager or Managing Director.

INVEST SOUTHWEST
INDEPENDENT FINANCIAL ADVISERS

Sophisticated High Net Worth Investors
Clients with extensive investment experience and knowledge of complex instruments are better able to understand and evaluate the risk and potential rewards of unusual, complex and/or illiquid investments such as NMPIs, ETFs and Investment Trusts.

At Invest Southwest we recognise that experience and knowledge isn't necessarily dependent on wealth and take each case on its merits, however, we have identified that in order to bring complex instruments into a discussion, it is likely the clients will have an annual income of more than £150,000 and/or have investable net assets of more than £500,000. These criteria are subject to review.

Structured Deposits
In simple terms, structured deposits are a combination of traditional savings accounts and a stock market investment. The deposit is guaranteed to be returned at full on maturity and therefore it is only the interest that is at risk. Typically, interest depends on an index, stock or commodity.

Due to the cost of the guarantee, investors will not receive the full benefit of the return, investors will not receive dividends and calculating the interest is likely to be confusing. For these reasons, they are deemed to be a complex product and as such, structured deposits are unlikely to be suitable for the majority of our clients.

Discretionary Fund Management
When appropriate and suitable, we appreciate there is a place for a more active approach and as a result, we will consider the services of a Discretionary Fund Manager. For this a typical client is likely to be one or a combination of:

- High net worth
- Sophisticated
- Already have assets with a DFM
- Rationally expressing a knowledge of and preference for DFM
- Have specific circumstances that suggest a DFM is appropriate

Given the makeup of our clients and the inherent additional cost, it is likely our recommendation will be to use a Platform Managed Portfolio Service. As such the DFM does not have direct contact with our client and we solely manage the relationship.

On occasion we may recommend the use of the more bespoke Wealth Management Service, where our client will deal directly with the DFM. It is very likely that this will only be available to high net worth and sophisticated clients.

Product Governance
In a proportionate and appropriate way our aim is to understand the products that are available to our clients and in doing so identify who is likely to be suitable and unsuitable for them. We review products regularly to ensure they remain suitable and offer our Ongoing Service clients a suitability assessment at least once a year.

Conclusion

As a fully independent firm, we consider a wide range of financial strategies and products, and we constantly review the market to ensure the services and products we offer are appropriate for our clients. We believe the number and variety of products we consider is representative of the relevant products available. As a general rule of thumb, we aim to provide 'mainstream' products in most cases. This means that with a past proliferation of products such as 130/30 funds, absolute return funds, esoteric and alternative investments, complex tax mitigation products and guaranteed equity linked funds, our position is to be sceptical as to their suitability to our clients.

We aim to stay true to core values of simple, time-honoured investment principles such as asset allocation, spread of investment, short/medium/long term investment horizons and the division of a client's portfolio. We only advise on the use of higher risk and reward solutions in very specific, strongly justified individual cases. The adherence to the 'mainstream' philosophy is a risk avoidance strategy on behalf of our clients and our firm.

We accept there is no right answer to investing. Throughout history there have been enough financial crises to demonstrate everyone's incomplete knowledge of how markets work and how markets fail. Academics continue to debate the theory and the results of empirical studies continue to reflect the methodology employed by researchers. We have utilised a combination of theory, evidence, and practical considerations to create our investment philosophy.

Since the inception of Invest Southwest in 2007, the turbulent investment climate has provided a stern test of our investment methodology. By consistently applying a scientific approach, our clients' portfolios have proven to be robust and balanced. In addition, we have been able to achieve excellent levels of understanding within our client base due to the simple and clear process followed in achieving a sensible investment strategy.