



the lang cat

ASKS THE QUESTIONS

NUMBER 2

SIMON MUNDAY



Prosperity IFA



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?

As independent financial advisers, we feel it's our duty to have analysed all types of investment when putting together portfolios for our clients, considering unit trusts, investment trusts, ETFs and whatever else is out there as part of building a suitable client recommendation.

Investment trusts have to be part of the review process. After the EU referendum in 2016 we saw most property unit trusts close their doors to trading. Clients trying to take an income from those property funds lost the ability to maintain the goals of their portfolio. Investment trusts offer a point of difference here in having better liquidity. Yes we have to be aware of premiums and discounts, but it's important to consider investment trusts. If we didn't then we wouldn't be independent.

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2. What advantages do you feel investment trusts have over some other investment types?

The liquidity – being able to get in and out of an investment trust very quickly – is key, as already mentioned. The other advantages are that they are run in a different way. For instance, the fact that we can buy at a discount can be beneficial at certain times. In the unit trust world, we are fixed to the unit price.

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

We have a CIP. We have seven advisers across the firm and it's very important that a client should get a similar outcome regardless of which of those advisers they come to see.

We have an in-house investment committee – me, the other director, Andrew Brady, and Mark Grunwell, our most senior adviser, who is a chartered planner. The three of us have a monthly investment committee meeting where we use FE Analytics to analyse all the funds, ETFs and investment trusts across the ABI sectors we want to include in our clients' portfolios. From that, we generate a list of around 100 different unit trusts and investment trusts.

Advisers then use the portfolio optimiser in the client back office system to asset allocate from those funds on the basis of the client's attitude to risk, time horizon and goals. The process is exactly the same for every client who comes to the firm.

This maps into model portfolios, with around 50 risk profiles. It's a matrix approach. If a client is risk profile five but with a 25-year investment horizon, their asset allocation will be completely different to someone who is also risk profile five but only has a seven-year time horizon. While they are essentially model portfolios, they are more bespoke because we also take time into consideration.

“ We have enhanced risk profiling questions built into our fact-finds, one of which looks at gearing and how the client feels about an investment of borrowed money. If they are adamant that they don't want that additional risk in a portfolio then we would eliminate investment trusts from that client's optimisation and their asset allocation.

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4. 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?

I think that depends on the client. We have enhanced risk profiling questions built into our fact-finds, one of which looks at gearing and how the client feels about an investment of borrowed money. If they are adamant that they don't want that additional risk in a portfolio then we would eliminate investment trusts from that client's optimisation and their asset allocation.

Where clients are accepting of that gearing, we cap borrowing at a level we think is acceptable. We're a fairly conservative firm and won't have gearing above 20%, but in the current markets we're looking at the potential benefits of allowing a higher level of gearing.

Premiums and discounts are just an extra level of due diligence when putting together the client's portfolio, so a small premium might not be an issue. You always have to ask if it's worth paying it or whether it pushes you back to a unit trust alternative.

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5. Is the fact that you invest in investment trusts a consideration when you're thinking about where to place business in terms of platforms, product research and due diligence?

Absolutely. One of the biggest platforms in the UK is limited because you can only hold unit trusts there. It's a bit old school. There are so many options now for fully open-architecture platforms that enable us to hold pretty much anything we want. As well as unit trusts, investment trusts, ETFs, direct equities, some are now allow VCTs. If clients aren't interested in gearing and the enhanced suitability questions steer them away from the investment trusts, then it broadens our platform universe a bit.

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6. Which platform would you use for a client with investment trusts?

The majority of that business at the moment would probably go to Zurich. We have had a lot of platforms in the past and we're currently going through a replatforming exercise as

part of our annual due diligence, so that could change in the not-too-distant future, but at the moment that would be our preferred option. However, Zurich charges for investment trust trading. We give clients the total cost for the year, but the platforms that allow you to hold investment trusts these days are very good at reporting and showing everything, down to the penny, that the client has spent.

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7. Do you feel there is sufficient technology to support your recommendations, such as risk ratings and risk profiles?

I think that's down to how you use the information that is available to you. Mark, the chartered planner who sits on our investment committee, is registered on the AIC website so he gets all sorts of information that he brings along to the meetings, such as updates on investment trusts that we're using.

The information that we get from FE is pretty comprehensive and it's then up to us how we use that with our asset allocation and risk profiling for clients, which is currently provided by Evalue. I don't think there's a lack of information, if I'm honest.

I know there is a perception among advisers that the industry is geared towards open-ended funds. I don't want to tar everyone with the same brush, but with a lot of advisers out there there's an element of 'we've always done it this way' and 'it's easier this way'.

We have time on a monthly basis to run an analysis and make sure all of our clients' portfolios are doing what they should be doing, but we can't do it on a daily basis and I think probably for a lot of advisers, it's just easier to pick unit trusts.

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8. How do you describe investment trusts to your clients? To what extent is the conversation different to discussing open-ended funds? Do you feel like you have to go into more depth to explain them?

There are differences in terms of the content, but generally I think it's the same. Our job is to educate our clients. Of course more clients would have heard of or used unit trusts at some point. It's not a different conversation, it's just explaining to them the slightly different structure of an investment trust. We would only be having that conversation if we thought it would be beneficial to that client anyway. I had a conversation recently about what clients want when you report to them on their portfolio. We're moving away from 'your portfolio has achieved x%' and it's becoming much more about

where they are in relation to their goals. Once you've explained the investment trust structure to the client, how it benefits the portfolio and how it helps to achieve their goal, it's not a different conversation, it's just part of being an adviser.

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9. PROD rules encourage a segmented approach to customer needs and ultimately their product and investment choices. Looking at your suitability process, is there a specific customer type or set of needs that you think investment trusts are less or more suitable for, and how does that fit into your view of customer segmentation?

Good question. We take a case-by-case approach rather than segmenting our clients. I know that's not what the FCA wants to hear, but I'm a great believer that everyone's entitled to financial advice.

We have the enhanced suitability questions built into our fact-find and therefore risk profiling process; we don't have segmentation. Of course it would be very difficult to make a recommendation to an elderly client who perhaps has limited funds to invest and is looking for a 100% reliable income. Would you go on to recommend a highly geared investment trust? Definitely not. You have to assess the needs and goals

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of the individual in front of you. That's why we always find it difficult to segment our clients.

The danger of segmentation is that it can be simplistic and generic, and potentially you get shoehorning. Where PROD helps is alongside a CIP. We do all the due diligence on all the platforms and come up with what we feel is best for the client. Now that would be down to a multitude of things such as the technology, reporting, what the client sees and costs. Then we take an overall view of what we think is the best platform on the market.

If we're doing that at company level, we would expect to ensure that all clients receive the same advice from all advisers and then theoretically get the same outcomes. So PROD can possibly help there operating alongside a CIP.

As a multi-adviser firm, from a compliance and from a client outcome point of view, we can't have advisers going here, there and everywhere, doing as they please, because most advisers again don't have the time to run the proper research.

I think there's still a myth around using investment trusts and ETFs in order to class ourselves as



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independent advisers. We take into consideration all investments in the market. That doesn’t mean you can’t have a preferred platform. At the end of the day, the platform is just the custodian – it’s the investments that give you independence. You’ll never get a product that would fit 100% of clients, but over time we expect that

our CIP and what then goes under the bonnet should fit nine out of ten clients. I think that’s when you know you’re getting there in terms of a good client proposition.



Prosperity IFA

Prosperity IFA is a firm of holistic financial planners dedicated to providing independent, unbiased advice to our clients.

We have no target group as we believe everyone is entitled to financial advice and our technology enables us to service clients from all walks of life.

We currently have around £100 million AUA.

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