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ASKS THE QUESTIONS

NUMBER 3

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adcock financial

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 for your clients?

We think they can be more flexible than mutual funds. They can be cheaper too and can offer more specialisation. In certain sectors we will use them in preference to funds, for example in the global equity sector where performance is often better than the equivalent fund.

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2. In terms of how your firm operates, do you have a centralised investment process (CIP)?

We don't yet have model portfolios, but we do have asset allocations where we would use our recommended list of funds to create portfolios suited to our clients. The list of funds is reviewed bi-monthly by our investment committee. So, in the sense that we are continually reviewing the fund list and operate asset allocations, then yes, we do operate a CIP.

> *There's got to be some account taken of these 'challenges' but the main criteria I'd consider are track record, charges and volatility, with a check on gearing, premium or discount.*

We use a few different research sources to help define our asset allocations, but the main one at present is Defaqto. We use a combination of Defaqto, Morningstar and we also review the Wealth Management Association portfolio asset allocation quite regularly. We don't slavishly follow what these tools tell us though; we might step outside these allocations if we see something in the market that we think we need to react to.

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3. How, if at all, does your research process for investment trusts differ from open-ended funds? Do you have sufficient tools available?

Our research process isn't hugely different, although you have to look at slightly different things because of the nature of investment trusts; the gearing and discounts. I suppose the standard tool we use is Morningstar, but we also use FE Trustnet. Citywire, New Model Adviser and the AIC are also good sources of information. We tend to use independent tools because model portfolios on platforms ignore exchange traded funds (ETFs) and investment trusts because they assume everyone is going into funds.

> *Quite often if you want a model portfolio, you'll find a lot of providers exclude investment trusts and ETFs. It can cause problems and we've had to adapt our processes for that.*

I think the tools that are available are broadly similar. Morningstar has a very good tool where you can compare individual trusts against individual funds. That's quite useful. FE Analytics or Trustnet also offer very good online research tools. I use them both really.

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4. Investment trusts present some challenges that don't apply to open-ended investments, like gearing, discounts, premiums and liquidity. What is your view? Does it influence your processes? Do you actually view some of those as advantages?

I don't mind because the discounts can be positive or negative. I'd probably be worried if gearing was over a quarter. That's the benchmark we have but I don't suddenly buy because it's gone to a discount. Most clients are in it for the long term. You know the saying, 'It's time in the market, not timing the market'.

It influences me but not to a huge extent. It's tricky because I can think of one particular trust which has had ridiculously good performance, so its premium has gone through the roof. I'm not buying that trust at the moment because it's just too expensive.

We've not had any liquidity issues so far, probably because we look at specific sectors. In fact, investment companies can avoid many of the issues that their mutual fund counterparts face. This issue is important in some sectors, as we have recently witnessed with Neil Woodford's woes and the suspension of his mutual fund. An investment trust normally remains tradeable in volatile markets, even if you don't like the price being offered for your investment.

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5. Which platforms and providers do you use, and does the fact that you recommend investment companies influence your selection process?

Yes, it does at the moment. We've used a few platforms over the years and we're using four just now, though this will shortly reduce to three. Our favourite platform is Transact and has been for about four or five years. We place new clients and new business on this platform. Using more than one platform means we can place clients in the one most appropriate to them. So, long-standing clients who don't need the extra flexibility of Transact, we would leave in FundsNetwork, where our legacy business is held. We also use Standard Life, but if it's set up as pension-only and I want to

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invest in a trust or an ETF, there's an extra charge applied, which is really frustrating. The result of that is that most of the client portfolios with a value under £500k will be moved to Transact, if the portfolio includes a pension fund.

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6. How well do you think investment trusts are accommodated in other technology and processes that support your research and recommendations – such as risk profiling and risk ratings?

They're not accommodated as much as they should be. We're taking a suite from Defaqto at the moment on risk profiling and it doesn't cause us a huge problem because the risk profiling is divorced from the portfolio asset allocation, although you can do both together. Quite often if you want a model portfolio, you'll find a lot of providers exclude investment trusts and ETFs. It can cause problems and we've had to adapt our processes for that.

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7. How do you explain investment trusts to your clients? Does it differ from how you describe open-ended funds or is that not an issue at all?

Not really. We have a generic report which we send to all new clients which sets out the difference between open-ended funds, ETFs and investment trusts.

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8. The PROD rules encourage a segmented approach to customer needs and ultimately their product and investment choices. How do you feel that your use of investment trusts fits into your suitability processes? For example, is there a specific customer type or set of needs that you think investment trusts are more suitable for?

We wouldn't use investment trusts for all of our clients because we have to consider things like the discount and the gearing. For example, if we've got particularly cautious clients, they'll probably tend to not have as much in equities. Therefore, to get full exposure to fixed interest securities we'd stick with mutual funds, especially passives.

The jury's still out on whether we can deal in trusts for clients with portfolios of £200k or less, for example. It's something we'll keep an eye on and adapt our processes to if it becomes easier and/or more cost-effective.

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