TFP...

FINANCIAL PLANNING

How we invest your money

A guide to our investment philosophy and how it works.

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“Our favourite holding period is **forever.**”

- Warren Buffett, Investing Legend

All good investing starts with a thorough understanding of your goals, aspirations & risk profile.

This is why we begin **every** client relationship with a thorough discussion about your goals and aspirations, their hopes and fears, and their willingness to take risk.

We then create a long term financial plan that is designed to meet your retirement objectives. It's only after building this foundation , that we begin to look at what investment strategy is suitable for you.

Our key ethos is to construct your investment strategy based on **extensive academic evidence** of what drives returns in the global capital markets. Unlike many others in the financial industry, we don’t follow the flavour of the month.

We don’t react to the day-to-day movement of stock prices. Instead, we rely on **robust empirical evidence** about how best to capture long-term returns.

Our approach to investing is founded upon Nobel Prize winning academic research.

The result is a range of low-cost, evidence-based, globally diversified portfolios, which are designed to capture the capital market return over the long-term. While eliminating unnecessary costs, inefficiencies, and anxiety for our clients.

The power of diversification

Diversification across asset classes, geographies and sectors is core to our investment philosophy.

We achieve this by holding different asset classes that complement one another in the portfolio; when equities zig, bonds tend to zag and this reduces volatility (ups and downs) in our portfolios, while improving returns in the longer term.

The origins of diversification within the context of investing, lie in the work of Nobel Prize winning economist **Harry Markowitz**. He described diversification as the only "free lunch" when seeking investment returns, but the concept has been around for hundreds of years in other domains of life.

The good old saying "don't put all your eggs in one basket" apparently has its origins in the Spanish novel Don Quixote. This was first published in 1605, and is considered one of the most influential works of literature from the Spanish Golden Age.

Diversification is as powerful today as it was in the Spanish Golden Age! It is indeed one of the few timeless investment strategies!

Our Investment Philosophy...

Our investment process is guided by a hundred years of empirical data, decades of academic research by renowned economists and the practices of leading institutional investors.

Diversification is Essential

Diversification is the principle of spreading your investment risk around. Our portfolios hold thousands of shares and bonds of many companies and governments in many countries around the world.

Costs Matter

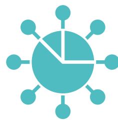
Costs reduce an investor's net return and represent a hurdle for a fund. Before a fund can outperform, it must first add enough value to cover its costs. Sadly, most professional fund managers fail to add value and high cost is a strong predictor of poor fund performance.[1]

Investor behaviour is a key determinant of their long-term outcome

All too often, investors let their emotions get the better of them with dire consequences for investment returns. As financial planners, a key part of our role is to help clients maintain a disciplined approach, especially in extreme market conditions.

Risk and return are related

There is good risk and bad risk. Higher exposure to the right risk factors or premia leads to higher expected returns but is no guarantee of them. Risk is the premium investors pay for the expectation of a greater return.



Asset allocation and portfolio structure drive portfolio return

The most important factor determining the level of risk and variability of return in a portfolio is asset allocation.

[4,5,6]

The capital markets work

The prices of securities reflect the expectation of all market participants[1]. The capital markets are far from perfect[2], but they do a good job of fairly pricing all available information and investor expectations about publicly traded securities.[3]

Consistent outperformance is rare

Economic uncertainties, random market movements, and the rise and fall of individual companies mean it is extremely difficult for anyone - including professional fund managers – to beat the market in the long term. There is a significant body of research to suggest that outperformance by most fund managers is down to luck rather than skill.

[7,8]

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Why Global Asset Allocation?

Have you ever played the game, guess how many sweets in the jar? Did you just come up with a wild guess, or did you try to count as many sweets as you could see?

Either way, you probably found out that your guess was nowhere near the correct answer. Strangely, if you took the average of all the answers given by the other participants, you're far more likely to have been closer to the correct answer.

This is what's known as the wisdom of the crowd!

We rely on robust academic evidence in order to make informed investment decisions and our approach is to allocate portfolios broadly based on global market capitalisation. Global market capitalisation is the measure of the value of all shares held by investors globally. As of 31st March 2022, the global stock market was valued at £89.1 trillion! UK stock markets account for just £2.8 trillion of this.

Global market capitalisation is very useful for asset allocation purposes because it reflects the aggregate view of how investors across the world are allocating capital. Investors will allocate more to an asset class if they believe that asset class has greater expected return and vice-versa.

While it's impossible for us to know how each of the millions of investors across the world are allocating their capital, the global market capitalisation gives us a snapshot of the collective decision.

And this collective allocation of capital among investment professionals across the globe is far more accurate than that of each individual investor. Much like the 'guess how many sweets in the jar' game, allocating assets based on the global market capitalisation enables us to benefit from the wisdom of the crowd. It provides a more accurate result than trying to out-smart the crowd.

It's a big world...

4-5%

However...

20-50%

The UK makes up **4 - 5%** of the Global Market Cap (£89.1t).

Many portfolios suffer from **'Home Bias'** - with **20 - 50%** of their portfolios allocated to UK Equities & Bonds.

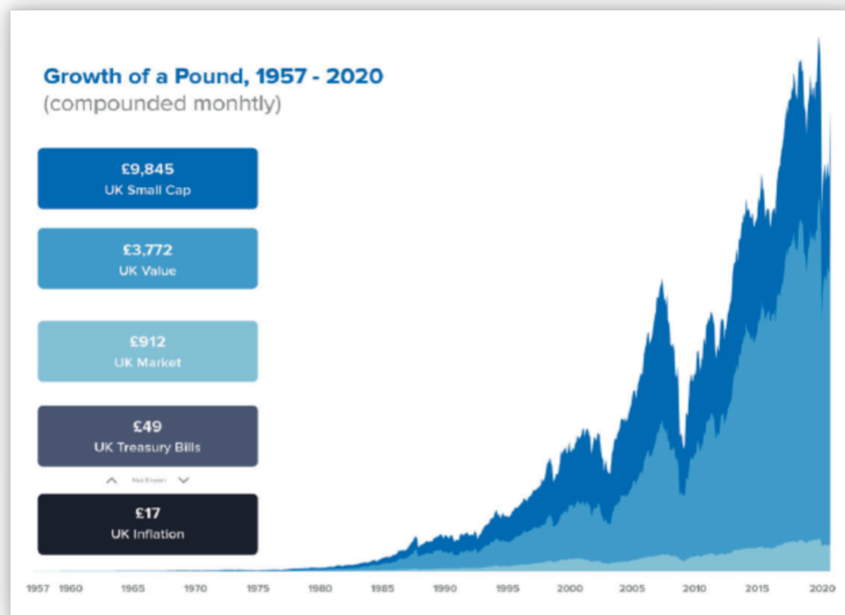
Value & Small-Cap Allocation

The key drivers of return are well documented in different global markets and across different time periods.

When we built our portfolios, we incorporated important findings based on the works of the **Nobel Memorial Prize** in Economic Sciences winner **Gene Fama** and his colleague **Ken French**. Their research shows that, over the long term:

Smaller companies have higher expected returns than larger companies

Value companies have higher expected returns and outperform growth companies



A value stock is a stock with a price that appears low relative to the company's financial performance, as measured by things such as the company's revenue, dividends, yield, earnings and profit margins.

This chart clearly demonstrates that over the longer term, smaller companies and value companies tend to outperform the overall stock market. This is not unique to the UK. A similar trend has been documented in the US, European and global equity markets. So, we built our clients' portfolios to capture the premium offered by small and value companies. Unlike conventional approaches, the strategies don't hold securities in their market-value proportions.

We increase the relative portfolio allocation to value and smaller companies with higher expected returns. It's important to note that this in no way suggests that value and smaller companies will give excess returns every year, or that they're guaranteed.

Indeed, value and smaller companies sometimes underperform for short periods relative to the overall market. However, academic evidence suggests that this is a price worth paying over the longer term.

Rebalancing...

Each asset within a diversified portfolio performs differently over time, drifting away from its initial target that was set to achieve the desired risk/reward balance. This difference between the target allocation and the actual allocation to a particular asset is known as portfolio drift.

Rebalancing is an important aspect of managing risk. It may appear counterintuitive because it involves selling assets that have performed well and buying assets that have performed less well.

This is the exact opposite of what many investors do - they pile in on assets that have performed well recently and sell those that have underperformed, unwittingly increasing risk within the portfolio.

One of the key aspects of investing is to ensure that the portfolio stays within its risk parameters and in line with its goals.

Rebalancing requires a disciplined and structured approach. We monitor drift and carefully reset the portfolio back to its targets when drift breaches acceptable limits. It's important not to let emotions get in the way. Time-based rebalancing has historically sufficed for many investors, but this is not the most efficient method.

The research, evidence and data clearly shows that rebalancing on a tolerance basis provides better long term returns and keeps the portfolio in line with investor risk tolerances. Our rebalancing strategy allows for a 10% drift in asset class allocation before we rebalance.

Rebalancing is essentially a process of buying low and selling high, to improve the potential risk-adjusted return. In finance as in life, there's no free lunch. Rebalancing may be the closest you get. In the long run, it tends to pay great dividends, compared to the efforts required.

FUND	CURRENT ALLOCATION	TARGET ALLOCATION	DRIFT	CURRENT DRIFT FROM TARGET ALLOCATION
Asset A	17.25%	16.67%	0.58%	
Asset B	17.71%	16.67%	1.04%	
Asset C	17.6%	16.66%	0.94%	
Asset D	7.24%	7.5%	-0.26%	
Asset E	22.67%	23.4%	-0.73%	
Asset F	14.06%	15.6%	-1.54%	
Asset G	3.48%	3.5%	-0.02%	

REBALANCE

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