Appendix

Investment Strategy

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This document outlines Plan Money's investment planning process incorporating philosophies on managing risk and investment styles.

Contents

1. Have a Plan

There is nothing wrong with simply wanting to seek investment returns that are better than money in the bank. However, it is best to **set an objective** as early as possible. What are you aiming for, what are you trying to achieve? Is it for a specific purpose, such as funding retirement or maybe you want to just keep pace with inflation or are simply trying to accumulate capital reserves as a good practice? Or are you already retired or partially retired and need to achieve a certain level of income? It is quite feasible that you need to set different objectives for different assets or 'pots' of money.

The advantage of setting targets or objectives is that a viable strategy can be formed and revisited periodically to make sure that plans are on track. There are many distractions for investors, not least market volatility, and it pays to revisit the original objectives at such times.

2. Capital Reserves

Before investing money, you should set aside sufficient **capital reserves** which are to be kept immediately accessible and are not exposed to any volatility. Foreseen expenditure such as vehicle replacement, unforeseen expenditure such as property maintenance and just general 'rainy day' money. This money will not make you a profit and may not even keep pace with inflation. It is boring and unimaginative, but it is meant to be.

Don't be too concerned with poor interest rates. In this environment of persistently low interest rates, money on deposit can only serve the purpose of providing capital reserves, but that is all it needs to do; it is never going to make real (inflation-adjusted) returns. Capital on deposit should do the job of providing a safety-net which prevents the need to access investments which are designed for another purpose.

3. Establish Risk Tolerances

Investment risk is unavoidable if you want to get better returns than money in the bank. In fact, with inflation running at a higher level than deposit-based savings, risk is arguably essential, or you are losing money in real terms on savings. The acceptance of a degree of volatility is a necessary factor for any investor, but this can and should be carefully controlled.

Understand your **risk profile**, that is your risk appetite and sentiment. This incorporates your volatility tolerance, investment experience, need to take risk and willingness to take risk.

Ability to take risk is influenced by things like your level of overall wealth and income, relative to liabilities. Greater wealth results in greater capacity to suffer losses.

Willingness to take risk is driven by sentiment; how certain investment behaviours make you feel, what level of volatility would keep you awake at night.

Need to take risk comes back to the advantage of having a plan; set goals. It may be that your goals can be achieved by taking a lower lever of investment risk than your ability or willingness would indicate.

For more information see our document **Appendix Risk**.

4. Diversify

Understand behavioural difference of the four main asset classes.

Asset class	Key characteristics	Potentially suitable for
Equities/shares	Equities represent a share or ownership of a listed public company. They trade on a stock exchange and the price can be quite volatile on a daily basis. Of the major asset types, history has shown that equities have the highest potential to deliver strong returns over the long-term. That's why many people who invest for the long run make equities the biggest portion of their portfolios.	Medium to long-term investors (five years plus).
Bonds	Bonds represent a promise by a government or company to pay a certain amount of interest over a given period and to repay the sum borrowed at the end of the period. Bonds are traded, like shares. The long-term rate of return for bonds tends to be lower than equities, but prices and income have tended to be more stable. Bonds usually offer a higher interest rate, or yield, than cash.	Short, medium or long-term investors.
Property	Provides the benefits of diversification through access to properties in retail, office, industrial, tourism and infrastructure sectors.	Medium to long-term investors (five years plus).
Cash	Generally suitable for short-term needs, such as when capital access is predictable. Cash within an investment portfolio often includes higher interest paying securities, as well as bank and building society accounts or term deposits (a cash deposit at a financial institution that has a fixed term).	Short-term investors (up to three years).

When looking to invest in equities and bonds, it is sensible to do so via one or more managed funds. Managed funds are pooled investments that contain many different shares or bonds, so the risk is reduced by diversifying.

"Eggs in different baskets"

There are two fundamental reasons for diversifying. Firstly, to reduce risk because investment markets move in cycles with sectors behaving differently at different times, reflecting the underlying strength of the economy, industry trends and investor sentiment. Secondly, because it is notoriously difficult to predict which sector or geographical regions is going to be next years' best performer, to the extent that we are wary of anyone who claims to be able to do so. Therefore, global diversification is a sensible place to start.

The table below shows the ranking of different investment asset classes since 2007, emphasising the difficulty of picking the right markets to be over or under exposed to at different times.

2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
EM Equity 36.2%	Global Govt Bonds 50.7%	EM Equity 64.1%	Private Equity 41.1%	Index-Linked 19.9%	Private Equity 25.7%	Private Equity 41.2%	US Equity 20.9%	Japan Equity 16.5%	US Equity 33.6%
Gold 27.6%	Gold 42.8%	Private Equity 47.6%	Gold 34.7%	Gilts 15.6%	UK Property Shares 25.4%	US Equity 29.8%	Index-Linked 19.0%	UK Property 12.5%	Commodities 33.4%
Commodities 20.6%	Emerging Market Bonds 22.5%	UK Equity 30.1%	EM Equity 23.9%	Gold 10.3%	EM Equity 17.4%	European Equity 24.5%	UK Property 17.5%	Timber 10.5%	Emerging Market Bonds 31.5%
European Equity 17.1%	Timber 9.5%	European Equity 14.8%	Commodities 21.8%	Emerging Market Bonds 9.8%	Corporate Bonds 15.6%	Japan Equity 23.8%	UK Property Shares 15.7%	UK Property Shares 8.2%	Gold 29.6%
Global Govt Bonds 7.6%	Gilts 7.4%	US Equity 14.5%	US Equity 19.2%	Global Govt Bonds 8.0%	European Equity 14.8%	UK Equity 20.8%	Corporate Bonds 12.2%	US Equity 7.2%	Private Equity 29.3%
Cash 5.9%	Cash 6.2%	Gold 14.4%	Emerging Market Bonds 16.0%	UK Property 7.6%	Emerging Market Bonds 13.2%	UK Property Shares 19.1%	Emerging Market Bonds 12.2%	Emerging Market Bonds 7.0%	Japan Equity 24.6%
UK Equity 5.3%	Index-Linked 3.7%	Emerging Market Bonds 13.9%	UK Property 15.1%	Corporate Bonds 5.4%	UK Equity 12.3%	UK Property 8.7%	Timber 10.4%	Private Equity 6.6%	Index-Linked 24.3%
Index-Linked 5.3%	Japan Equity -0.6%	Hedge Funds 13.4%	UK Equity 14.5%	US Equity 2.5%	US Equity 10.8%	Hedge Funds 6.4%	Gilts 7.1%	Global Govt Bonds 2.0%	Global Govt Bonds 21.2%
Gilts 5.3%	Corporate Bonds -8.5%	Corporate Bonds 12.3%	Japan Equity 13.5%	Cash 0.8%	Gilts 7.6%	EM Equity 3.8%	EM Equity 5.6%	European Equity 1.1%	European Equity 20.2%
Emerging Market Bonds 4.9%	Commodities -11.8%	Commodities 12.0%	Index-Linked 8.9%	Timber 0.0%	Japan Equity 3.7%	Corporate Bonds 1.9%	Global Govt Bonds 5.1%	UK Equity 1.0%	UK Equity 16.8%
Hedge Funds 4.5%	US Equity -14.5%	UK Property Shares 11.8%	Corporate Bonds 8.7%	UK Equity -3.5%	Hedge Funds 3.4%	Timber 1.5%	Gold 4.5%	Cash 0.6%	Corporate Bonds 11.8%
US Equity 4.1%	UK Property -22.5%	Index-Linked 6.4%	Global Govt Bonds 7.4%	Commodities -7.8%	Gold 2.3%	Index-Linked 0.5%	Japan Equity 3.0%	Corporate Bonds 0.6%	EM Equity 10.1%
Timber 2.6%	Hedge Funds -22.8%	UK Property 2.2%	Gilts 7.2%	Hedge Funds -8.0%	UK Property 2.1%	Cash 0.5%	Private Equity 2.5%	Index-Linked -1.0%	Gilts 10.1%
Corporate Bonds 0.2%	European Equity -28.0%	Cash 1.5%	Hedge Funds 4.8%	UK Property Shares -10.1%	Cash 0.9%	Gilts -2.0%	UK Equity 1.2%	Hedge Funds -2.4%	UK Property 2.2%
UK Property -1.8%	UK Equity -29.9%	Japan Equity -0.2%	UK Property Shares 1.9%	Japan Equity -11.2%	Timber 0.8%	Global Govt Bonds -5.2%	Cash 0.5%	Gilts -4.9%	Timber 1.5%
Private Equity -6.7%	EM Equity -36.6%	Timber -0.2%	Cash 0.7%	European Equity -17.6%	Index-Linked 0.6%	Emerging Market Bonds -8.4%	Hedge Funds -2.8%	Gold -5.3%	Hedge Funds 1.4%
Japan Equity -9.5%	UK Property Shares -46.6%	Gilts -1.2%	European Equity -0.6%	Private Equity -17.6%	Global Govt Bonds -2.8%	Commodities -11.3%	European Equity -3.0%	EM Equity -5.4%	Cash 0.5%
UK Property Shares -36.7%	Private Equity -64.3%	Global Govt Bonds -7.0%	Timber -0.8%	EM Equity -18.1%	Commodities -5.4%	Gold -29.4%	Commodities -11.8%	Commodities -20.3%	UK Property Shares -12.4%

5. Understand the difference between Active and Passive management

<table>
<tr><th>Active management</th><th>Passive management</th></tr>
<tr><td>Fund managers who use an active investment approach aim to either outperform the market average by beating a selected index of shares (such as the FTSE 100) or bonds, or by achieving a specific investment objective.

They seek to do this by using their knowledge and skill to analyse the market and are backed by resources such as researchers, databases and analyst report. Then they buy shares which they believe are presently undervalued and so have potential to increase in price – or pay increased dividends – over time. This process is known as stock-picking.

Managers can also adjust their portfolios to minimise potential losses. For example, they can avoid individual shares or bonds, sectors, industries, or even countries which they believe may underperform over a certain period.</td><td>Passive managers generally believe it is difficult to out-think the market, so they try to match the performance of the market or a sector as a whole. They tend to do this by closely following or tracking an investment index, such as the FTSE 100. That’s why passive investments are often called tracker funds. These have a simple, precise objective: to match a specific index, rather than try to beat it.

Passive funds do not involve stock picking, since the equities will be chosen in direct proportion to the indices that they track. This can be done using computer programs, cutting down on the costs of management. They also do not need extensive research and consequently are cheaper to purchase than active funds.</td></tr>
<tr><td colspan="2">Benefits</td></tr>
<tr><td>Opportunity for outperformance. Because active funds aim to beat the index, they offer the potential to make higher returns than the average.

Research insights. Active managers carry out in-depth research to identify which companies to invest in. The quality of this research gives a fund its potential to outperform the index.

Defensive measures. Managers can minimise potential losses by avoiding certain securities, sectors, or regions.</td><td>Diversification. Indexing can be an ideal way to achieve diversification because Index funds provide a broad spread of risk because they hold all (or a representative sample) of the securities in their target benchmarks.

Low costs. As index funds track a target benchmark or index rather than looking for winners they generally have lower fees and operating expenses than actively managed funds.

Simplicity. An index fund offers an easy way to invest in a chosen market as it simply seeks to track an index therefore there is no need to monitor managers or chose between themes.</td></tr>
</table>

Active management	Passive management
Risks	
Expense. Professional market research costs money, which means active managers often charge higher fees. They can also have higher operating expenses such as transaction fees and taxes, as they are likely to buy and sell investments more frequently. **Style issues**. A manager's investment style may limit performance when this approach is out of favour with the market. (Typical styles might be a value style aiming to choose securities that could offer value for money, or a growth style focused on finding securities with the potential for growth). **No guarantees on picking a winner**. While successful share selection offers prospects of outperformance, there are no guarantees. It is not easy to pick winners consistently, year after year.	**Total market risk**. Index funds track the entire market: so when the overall stock market (or bond prices) falls, so do index funds. **Lack of flexibility**. Index fund managers are usually prohibited from using defensive measures such as moving out of shares, even if the manager thinks share prices are going to decline. **Performance constraints**. Index funds are designed to provide returns that closely track their benchmark index, rather than seek out performance. They rarely beat the return on the index, and are likely to return slightly less as a result of fund operating costs.

In the vast majority of cases, Plan Money believes that Passive management is the most appropriate solution for investors.

Beating the market – luck or judgement?

Active managers effectively aim to beat the market; often a benchmark based on the average performance in a sector or a particular index. They are up against a large number of other managers who look at the same investments as they do and price in any new information quickly and efficiently.

Financial markets are very difficult to predict with sufficient frequency (see table on page 5). Even when a manager or adviser or investor achieves out-performance, there is no sure-fire way to prove if this was luck or judgement. Furthermore, beating the market over the short-term is one thing, a far more difficult feat is to do so over the long-term.

The table below, from S&P Dow Jones Indices, shows how many European-domiciled funds (investing in a wide range of markets) have managed to beat the market over one, three, five and 10 years.

Eight out of nineteen categories managed the feat over one year,
that drops to four categories over three years,
three over five years and
none over 10 years.

In most categories over 10 years, you had a less than one-in-five chance of finding a fund that beat the market.

Source: economist.com 2017

The odds aren't good

European equity funds outperformed by benchmarks, %

Fund category	Comparison index	One-year	Three-year	Five-year	Ten-year
In euros (EUR)					
Europe equity	S&P Europe 350	50.90	59.46	72.95	87.38
Eurozone equity	S&P Eurozone BMI	66.67	78.51	85.83	89.23
Nordic equity	S&P Nordic BMI	48.84	47.73	59.46	72.73
Global equity	S&P Global 1200	60.23	92.93	93.97	98.37
Emerging-markets equity	S&P/IFCI	75.58	90.32	90.88	96.70
US equity	S&P 500	61.01	93.70	96.90	98.21
France equity	S&P France BMI	44.59	59.91	74.80	83.50
Germany equity	S&P Germany BMI	57.14	68.75	72.53	78.63
Italy equity	S&P Italy BMI	53.85	35.29	47.27	76.84
Spain equity	S&P Spain BMI	75.00	57.89	74.71	82.93
Netherlands equity	S&P Netherlands BMI	62.50	80.00	93.33	94.29
In sterling (GBP)					
Europe equity	S&P Europe 350	41.35	44.21	55.43	77.11
Europe ex-UK equity	S&P Europe Ex-UK BMI	61.42	65.00	70.08	75.18
UK equity	S&P United Kingdom BMI	20.40	45.78	46.72	71.76
UK large-/mid-cap equity	S&P United Kingdom LargeMidCap	24.34	41.03	40.54	73.98
UK small-cap equity	S&P United Kingdom SmallCap	6.25	50.00	61.11	73.68
Global equity	S&P Global 1200	46.10	80.91	83.23	94.06
Emerging-markets equity	S&P/IFCI	59.39	77.92	79.49	80.00
US equity	S&P 500	41.63	90.15	90.36	93.89

Source: SPIVA

Economist.com

Some Active funds can outperform the broad market and deliver on their promise. To identify them, however, is not an easy task and not one which can always be achieved on a regular basis.

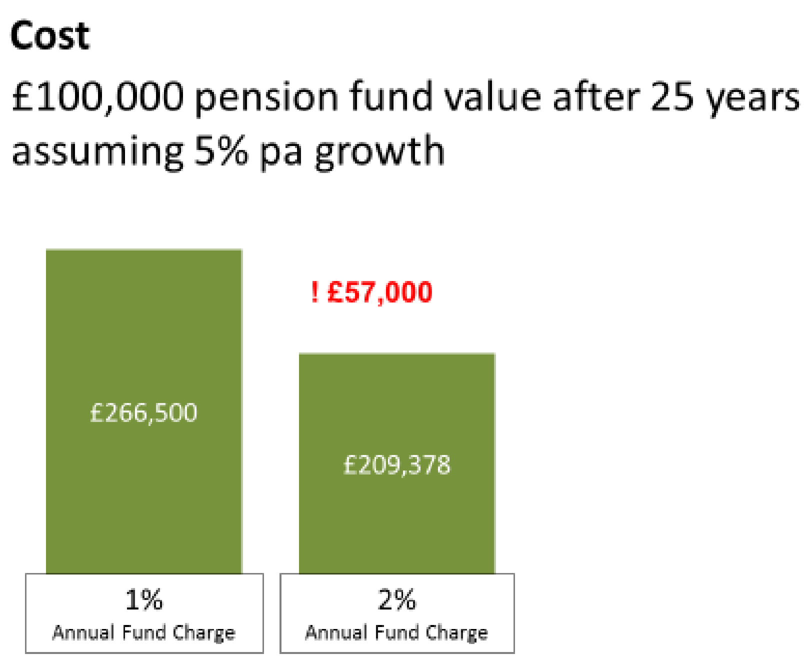
6. Focus on Low Costs

"You can't control what happens in the markets, but you can control how much you pay to invest."

All investments incur costs. Property purchase incurs stamp duty and legal fees and property sale can incur agent's fees, legal fees and Capital Gains Tax. Whichever investment solution and investment vehicle is used, make sure that all costs are transparently declared. Be particularly wary of investments which have tie-in periods during which exit fees are incurred. Also, those which seemingly have no initial costs but whereby they are effectively loaded into higher on-going management charges or hidden as early exit penalties. As with most things, <u>cheapest does not mean best, but cost must deliver value</u>. It is not possible to determine value if costs are not transparent.

The table below shows the effect of an investment with fund charges of 2% per annum compared to 1% per annum.

Plan Money



Actively managed funds generally incur higher costs than index funds, partly because they rely on expensive research to identify undervalued securities. They also have to try to time the markets, buy low and sell high, in order to generate alpha. This leads to higher transaction costs which can further diminish returns. While trading costs are inescapable, the excess performance they generate is much less certain. Likewise, Financial Advisers who operate a fund portfolio management service. Just like interest, costs compound over time and this can magnify the negative effect over the investment horizon. This is another reason why we generally favour Passive investment management.

7. Market Timing

"Time in the market, not timing the market"

We are firm believers in the well-worn investment phrase: *time in the market, not timing the market*. Very few people, professional or otherwise, have the proven ability to make consistently accurate market-timing calls and even when they do, one bad call can undermine all the good ones. Very often, the biggest rises in a market comes immediately off the back of the falls and so timing mistakes of getting in and out of different markets and asset classes can have a significantly damaging effect over the long-term if the call is proven to be wrong.

A common concern for investors, particularly novice investors, is whether the "time is right" to invest. If the "market is high", should the investor wait for fear of "buying high"? This is a genuine concern but ultimately the number of decisions that need to be made and made accurately mean that more can go wrong than right when trying to time the market.

If one waits for a market correction how does one know when the correction has completed and the "time is now right" to invest? Similarly, in a falling market, how does one know when to exit a strategy and then when to re-enter? The table below shows falling investment values through the financial crisis of 2008 and what happened should an investor have panicked and moved to cash. They protected themselves from further market falls but then missed a key part of the recovery, and as such had a lower value thereafter.

Some of the best gains in any investment cycle are made off the back of a downturn, so if we can't call the bottom of the cycle, there is a likelihood that the bounce-back is missed, and the investment ends up being made at the point they would have started at a number of weeks/months/years earlier. Or worse, at a higher point.

Many investment vehicles can facilitate a phased investment at inception, effectively drip-feeding into the investment strategy over a period of three or six months. In practice this means either 1/3rd or 1/6th of the planned investment is actually invested each month. This would go in the investor's favour if values are reducing but not if values immediately increase.

Dalbar, a financial market research firm, examine returns investors received relative to the market. They find over the past 20 years, investors in equity funds have lagged the S&P 500 benchmark by an average of 4.66% per year, on average. Part of this outcome is due to poor timing decisions according to Dalbar's analysis. For example, the greatest loss for investors according to Dalbar data over the past 30 years came in October 2008. This was a volatile month; the S&P 500 started above 1,100 but at times closed in the 800s, representing a decline of 27% within a single month. However, the S&P 500 then rebounded somewhat and finished the month 14% off the lows. But we can see that investors can be their own worst enemy - selling at the times of greatest panic, and potentially then missing out on subsequent gains.

Source: forbes.com 2016

Take a long-term view

You should not have a short-term investment horizon. Any equity-based investment should be considered for at least five years. The longer the investment period, the less the investor should be concerned with market fluctuations.

Viewing investment behaviours over the short-term will also make volatility appear greater than it is when looking at the bigger picture over the long-term and therefore can cause unnecessary anxiety for the investor.

Be mindful of being swayed too much by what you read in the Press. Most journalists are no more expert predictors than anyone else, nor are their sources. Newspapers have columns to fill. For every accurate prediction of a market shift in any direction, there are a greater number of counter predictions that were wrong. This is another reason to be wary of 'expert' market predictions either way. Which source does one believe?

Once the investments are up and running, in most instances it is essential to **stay the course**.

8. Appropriate Investment Vehicles

We believe that the suitability and effectiveness of an investment product and strategy can predominantly be determined by five main factors:

The **flexibility** of the investment vehicle used. Is the type of investment suitably flexible e.g. access to capital and/or income? Is there sufficient choice within the investment to enable diversification?

The **risk** profile. Is the volatility within your tolerance levels? Do the risks match the rewards?

The **charges** of the investment and the funds. The charges should be as low as possible. High charges have a detrimental effect on the growth potential of an investment. The charges need to be fully transparent.

The **performance** of the investment. Performance needs to be measured in absolute and relative terms.

Tax efficiency. The tax status of an investment suits different personal circumstances and objectives. Tax relief should be optimised where possible and when appropriate.

Periodic reviews

It is prudent that any financial plans put in place are reviewed periodically. Your circumstance may have changed and therefore the financial advice may well need to be modified to ensure it remains appropriate. A catalyst to necessitate the need for a financial review could include: a new job, a house moves, birth of a child, relationship change, a bereavement and so on. Furthermore, the financial market-place may have evolved, and new or improved products could be available which you could benefit from.