Case Study

Title: Controlling Investment volitility

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We are trustees for some monies which were inherited eight years ago by our three children via their grandfather's will and are held in a discretionally managed portfolio. We are concerned that we are exposed to too much volatility bearing in mind one of the children may need their share in less than two years. What action should we take?

If you can take a long-term view with each child's 'share' of the investment then it is not unreasonable to have the monies managed collectively. However, when you reach the stage as you have now, whereby each child's timeline is markedly different, then different strategies most certainly need to be incorporated for each 'share'.

You are right to focus on the levels of volatility, particularly for a remaining investment term which is potentially as short as two years. Tolerance to volatility is a fundamental aspect of the risk assessment process. Simply completing a risk profile questionnaire will not be a sufficiently comprehensive assessment; we need to ascertain your ability to take risk as well as your willingness to take risk. Clearly the proportions of the trust monies which have a longer timescale can tolerate greater volatility in exchange for potentially greater returns; nonetheless, this is still a strategy which you need to be willing to adopt.

In consideration of these circumstances I suggest that a third of the portfolio be managed with a very cautious strategy and this could include a blend of low volatile equities, fixed interest, fixed-term deposits and cash management. The remaining two thirds can be managed higher up the risk scale; to be determined by timescales, the completion of the risk profile questionnaire and your expressed sentiments. Periodically, each segmented strategy will need to be de-risked as the remaining time reduces.

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The review process will incorporate the following options for restructure:

1. Keep the portfolio with the current discretionary manager providing we are satisfied that they truly understand our objectives and their service can incorporate segmenting the portfolio into three 'shares' which have different investment strategies applied.

2. Transfer to an alternative manager if they can better meet our requirements.

3. Adopt a part and part strategy by using two or more managers.

In considering the merits of each option we need to understand and factor in: restrictions and permissions of the trust, confidence in the manager's ability to deliver the service required, initial charges, on-going costs and tax implications for which accountancy advice should be sought.

By adopting a de-risked strategy you may of course lose out on potential growth in overall value, particularly should there be sharp market upturns in the next few years. However, if no action is taken there remains the real risk that market downturns lead to capital loss which cannot be recovered in the remaining time before partial withdrawal is required. I believe the latter scenario is a greater risk than the former.

It is strongly advised that the exercise of reviewing and effecting a revised strategy is not a one-off exercise. Trustees are obligated to conduct regular reviews to ensure that the financial planning arrangements remain appropriate for the trust objectives and the beneficiary's evolving requirements.

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