METCALF MOAT UPDATE

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METCALF MOAT
IFA LIMITED

'Growing by recommendation'

Please note, Buy to Let mortgages and Commercial Borrowing are not regulated by the Financial Services Authority.

A Balancing Act!

Financial advisers are in a difficult position (don't worry, I'm not going for the sympathy vote as you will hopefully see) when it comes to predicting how investments are going to perform over the foreseeable future. On the one hand we are subjected to the same onslaught of bad news from the mixture of press and TV media as yourselves, and on the other, we receive updates, press releases, and fund information from the various investment houses that put some of this into context. In fact if you judged the state of the economy purely on how the 'Footsie' performs, with it standing at 5300 at this time last year (time of writing 20/12/2010) and see it standing today flirting with 5900+ a rise of over 10% then you would be inclined to look at our situation a little more positively. However if you examined this year's figures a little closer you will notice it touched a 52 week low of 4805 (early July 2010) a drop of just under 10%. So to refresh our memories I thought we would look at what has happened, because the older I get the more I need to be reminded!

> "Those who cannot remember the past are condemned to repeat it."
> **George Santayana**

In our work we spend most of our time looking forward, but composing articles like this require a certain amount of time travel. A trawl through a year of BBC's Robert Peston's blogs gives some insight as to why there has been so much volatility in the market. January 2010 'Kraft takeover Cadbury', February 2010 'Lloyds loss of £6.3bn', March 2010 'Prudential attempt to takeover AIA, the Asian arm of AIG', May 2010 'BP leak loss soar', June 2010 'Has there been a bigger budget?', July 2010 'Eurozone debt: Good money after bad?', August 2010 'Barclays, 'Big and Bad' or 'Great and Good'?', September 2010 'Make or break for Irelands finances'. In addition, of course, we have had a change of Government, which in turn led to a change in the handling of the economy. Not to be drawn into the politics of the situation, but subsequently, Sterling has strengthened, and the Stock Market has also improved. It is the writer's view that the UK market will certainly continue to trend upwards, but with a fair amount of volatility, over the next year, and a number of fund managers are suggesting a FTSE figure of 6500 for the year end. Whilst we are in the prediction mood I do not believe there will be much movement in interest rates either, reaching a maximum 0.75% - 1% base rate if it moves at all, as I believe that inflation figures will reduce over the coming year too.

Despite all this turmoil in the UK, the Metcalf Moat Portfolios have delivered positive returns, varying from a healthy 6.63% (as at 30/11/2010) in our Cautious Portfolio, to a satisfying 14.33% (30/11/2010) in our Adventurous Portfolio. In addition this has been achieved with a lower level of volatility than their benchmarks. These returns have been helped in no small part by having exposure to global markets. As I think Robert Peston's blog shows (and what the events of 2008 highlighted) we now live, both from an economic, and, an investment perspective, in a Global village and that the big companies operate on an international scale. This needs therefore to be replicated in your investments. Diversification has always been important, but now with the help of Platforms like Cofunds, not only is it easy for us, the adviser, to monitor, analyse, compare and switch funds, but, as all your holdings are in one place (and online if you wish) it is easier for our clients too!

Introducing Rebalancing

We are pleased to say that due to the economies of scale we have been able to negotiate reduced charges from Fund houses for our portfolio clients, which would not be available to them if they went to the companies directly. This in turn makes any switching that becomes necessary, cost efficient. The latest innovation that is on offer is rebalancing of portfolios.

Continued Over

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This allows us (with clients agreement) every 6 months, to sell down funds that have outperformed and buy those areas that have underperformed (e.g. if they have grown in value from 15% of the fund to 20%, we would switch 5% so that stays in proportion within your portfolio). The reason for doing this is to stop portfolios getting out of proportion (i.e. if the more 'growth' orientated portion of the portfolio grew, it would increase the level of 'risk', and, in turn, increase volatility). In addition it has the benefit of taking profit when it is there, and buying less favoured areas when they are good value. It is the nature of investment cycles, that areas that are out of favour this year, will come back into favour in due course.

More about 'Attitude to Risk', 'Asset Allocation' and 'Fund Selection'

...to gauge a clients tolerance to loss, as well as how much they want to gain.

Attitude to Risk

The Portfolios available are graded by risk, these being 'Cautious', 'Cautious Balanced', 'Balanced', 'Balanced Adventurous' and 'Adventurous'. To assess which of these would be appropriate for a client, Metcalf Moat use an 'Attitude to Risk' Questionnaire. This poses certain situations, sometimes visually, (i.e. graphs) to gauge the clients tolerance to loss, as well as how much they want to gain. The answers to these questions are then given a value, which when totalled indicates into which of the 5 risk gradings they fall. This outcome is then discussed with the client, and, if they feel comfortable with the result, we will then proceed to look at the relevant portfolio. The other element that can have a dramatic effect on the 'Attitude' is timescale, as investing for say, a year, you would expect a different 'Attitude' than when investing for ten years for, say, a pension. This is also covered in the questionnaire. The risk level can also be reviewed, as, and when, required to reflect clients changing circumstances.

...construction of optimum portfolios from a range of possible asset's

What is Asset Allocation?

Metcalf Moat outsources this important area, and via Cofunds uses software from a specialist company, Distribution Technology. They were established in 2003 and currently provide software tools for Companies such as AIG, AXA, Citibank, F&C, Friends Provident and Lloyds TSB. The software is designed to show an efficient asset allocation based upon the client's level of risk. It is based upon the principles of 'Modern Portfolio Theory' (not that 'modern' as it was written in 1952, but still holds good!) and provides for the construction of optimum portfolios from a range of possible assets, over a medium to long term (5 years+). In addition, it builds in a number of economic assumptions, which includes the expected real return for each Asset Class, the volatility of each Asset Class, inter -asset return correlation, expected inflation, salary inflation, and, the distribution of asset return. The benefit of all this is highlighted by the make-up of the Cautious Portfolio, which holds International Corporate Bonds 15%, UK Corporate Bonds 15%, UK Gilts 25%, UK Equities 10%, European Equities 2%, North American Equities 3% , Property 20%. The 15% holdings in Equities contrasts for example with funds in the IMA (Investment Management Association) 'Cautious Managed' sector of being able to hold up to 60% in Equities (which would be comparable with our Balanced Portfolio!).

Fund Selection

So, we have arrived at a client's Attitude to Risk, decided what Asset Classes fit into the chosen portfolio, we then have to select what funds are to be held within the respective portfolios Asset Class. Whilst historic performance of funds is important, and indeed we look for 'Top Quartile' performance over 1, 3, and 5 years, it is the consistency of this performance over those periods and, in particular, over the last 1 or 2 years. We also, where appropriate, try to blend styles, so for example, in the Balanced Portfolio, in the UK Equity Sector, we may have Invesco Perpetual High Income fund, balanced by Fidelity Special Situations fund, both have completely different styles, both very successful, but tend to do well in different economic conditions. In addition we would select funds appropriate for the situation. Therefore, funds with a more aggressive style of management would be more suited for the Adventurous Portfolio, than the Cautious. Then when we have done all that, we have 'back tested' the data, to ensure that it has produced the desired effect

We have also recently taken a view that where appropriate, if, following the quarterly review of the Portfolios, a fund replacement is required, then we would use a fund endorsed by Old Broad Street Research agency (OBSR), if available. As their name suggest, they are a ratings agency that rate funds by a number of criteria and award certain grades, and are a useful resource.

So how have we done? Summary as at 30/11/2010

Portfolio	Cumulative growth 3yr %	Cumulative growth 5yr %	Volatility 30/11/07 - 30/11/10
Cautious	14.41	20.79	5.98
Weighted Sector Average	6.41	12.64	8.12
Cautious Balanced	16.67	28.30	11.71
Weighted Sector Average	2.58	11.87	13.43
Balanced	13.76	32.71	12.47
Weighted Sector Average	2.29	15.52	15.3
Balanced Adventurous	20.77	42.85	16.13
Weighted Sector Average	4.94	21.21	17.32
Adventurous	22.43	58.51	18.82
Weighted Sector Average	8.37	34.25	21.03

Colin Moat, Director

Past performance is not necessarily a guide to future performance.
The value of an investment, and any income from it, is not guaranteed and can go up and down depending on investment performance.