



consilium
asset management

Our Investment Process Document

Investment research and analysis to help develop
a repeatable investment process.

Independent Financial Advisers

Introduction

Consilium Asset Management is continually conducting research into investments and the most appropriate investment solutions according to our clients needs. The aim is to help us provide a framework to follow when making investment recommendations. Over the years investment markets have changed and developed to an extent whereby financial advisers need to have a solid and repeatable investment process.

When we look at creating the most appropriate investment strategy for our clients the issues we need to consider are:

- 1 Attitude to Investment Risk
- 2 Passive or Active Fund Management
- 3 The effect of Charges on investment performance
- 4 The importance of Asset Allocation
- 5 How we select investment funds
- 6 Undervalued Assets
- 7 What is Herd investing
- 8 Traditional versus new IFA (Independent Financial Adviser) approach
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Attitude to investment risk

For any client requiring investment or pension advice an investment risk questionnaire is required. Consilium Asset Management uses an independent risk questionnaire produced by Oxford Risk. The questionnaire is incorporated into our fact finding questionnaire. We use a number of different portfolios to match our client's attitude to risk. Portfolio one is most defensive through to ten that is growth orientated.

Oxford Risk

Oxford Risk is a global professional services firm that helps organizations improve performance through effective people, risk and financial management. The firm provides innovative solutions in the areas of human capital strategy, program design and management, and in the areas of risk and capital management, insurance and reinsurance intermediary services, and actuarial consulting.

Passive or Active Fund Management?

For many years a debate has continued over the benefits of active fund management versus passive investment Strategies. Active fund managers attempt to outperform an index or indexes by identifying assets or investments that they consider to be undervalued.

Passive investment strategies use indexes for example the FTSE 100 and will typically construct a portfolio to mirror the index in question. Passive funds are, by their very nature cheaper to run when compared to actively managed funds. Many research papers have been produced to analyse whether in fact active fund managers do contribute sufficient out performance in comparison to passive investment strategies to justify the additional costs incurred.

We have reviewed and conducted research over a number of years to establish whether a passive or an active approach to investment management is more appropriate for our clients.

Our research found that:

- The total costs of running an actively managed portfolio (Total Expense Ratio) will be higher than a passive strategy. This means that an active approach needs to consistently outperform the relevant index to warrant this approach. A combination of product costs, commission, Capital Gains Tax within the fund and management fees means that active fund management needs to add significant value over and above the passive strategy.
- Over the longer term, the costs of running a passive or active strategy will have a compounding effect on performance. One thing that is known is the costs of using an active or passive investment approach.
- Many research papers in the US and the UK have demonstrated that most active fund managers do not outperform the relevant index on a consistent basis.
- Efficient investment markets make it much more difficult for active fund managers to add long term value compared to passive investments.
- Although some active fund managers seem to add value over and above the index on a consistent basis they are a very rare breed. The longer the fund managers' tenure, the increased risk that they will under perform their benchmark in the future.
- Many active investment funds will experience a change of mandate or fund manager to some point. This could have an effect on the active investment process.

Effect of charges on performance

When investments produce high returns most investors do not seem to be too concerned about the costs of investing into actively managed funds. Most investment funds have an annual charge that is applied to cover the costs of research, transactions within the portfolio and rewarding the fund manager.

There are however additional costs that are not immediately apparent to the investor such as administration and custodian fees. Total expense ratios (TER's) are a clearer indication of the costs a client incurs whilst investing into the relevant fund. A total expense ratio of 2% per annum is not unusual. This effectively means that if the fund in question achieves an investment return of 7% in one year and the total expense ratio is 2% then the return on the clients investment will be 5%. We must also point out that in addition to the total expense ratio a client may also have to pay and initial charge for entering the fund plus potential annual costs for the policy or platform the fund is held on.

The long term effects of a high total expense ratio are shown below.

Based on an investment of £100,000 Fund growth of 7% .pa internal fund growth:

<i>TER</i>	<i>1 Year</i>	<i>5 Years</i>	<i>10 Years</i>	<i>20 Years</i>	<i>30 Years</i>
0% .pa	£107,000	£140,255	£196,715	£386,968	£761,255
0.5% .pa	£106,500	£137,008	£187,713	£352,364	£661,436
1% .pa	£106,000	£133,822	£179,084	£320,713	£574,349
2% .pa	£105,000	£127,628	£162,889	£265,329	£432,194
2.5% .pa	£104,500	£124,618	£155,296	£241,171	£374,531

Example for illustration purposes only

Our conclusion

Clients and advisers should be aware of the total expense ratio for investing into a particular fund. Total expense ratios are equally important especially in times of low or negative returns. Investment returns are an unknown quantity, whereas costs are identifiable. It is important to reduce costs wherever possible.

Passive investment strategies offer

- Lower cost
- Indexed performance
- Less issues with fund manager changes
- Clearer and simpler approach

For asset classes such as emerging and specialized investment markets then an active approach may be more appropriate.

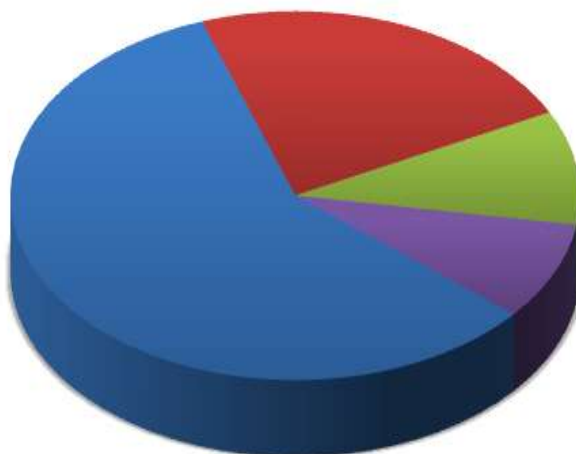
Research used

A list of the research papers used to compile our investment process is listed in the reference section at the end of this document.

The importance of Asset Allocation

The studies we have read concluded that asset allocation is the most important element to providing long term consistent returns.

Over the last few years IFA's have used investment planning tools. Many of the tools are supplied by product providers to help IFA's construct investment portfolios for their clients. The majority of the planning tools use mathematical combinations of past performance to calculate the most suitable portfolio for the client. This process is called stochastic modelling. The aim is to build a portfolio that will in theory provide the best return for the lowest level of risk the client is prepared to accept.



We have reviewed a number of the available tools over the last twelve months and have used independent software to conduct a technical review of the tools available. We have found that the model portfolios provided by asset allocation tools can vary considerably. This conclusion has been reinforced by the Financial Services Authority discussion paper DP07/02. They have stated that advisers need to be aware of the assumptions such tools use.

Our research showed that:

- The data used varies wildly depending on the investment period selected.
- The assumptions used by each tool vary. This in turn has an effect of the recommended portfolio.
- Many tools apply restrictions to the amount that could be invested into one particular asset class.
- Stochastic modelling does not take into account current market conditions.
- The model does not take into account assets that are currently undervalued.
- There is a requirement to re balance the portfolio back to recommended percentages on a regular basis. If an asset class continues to under perform year on year then the amount allocated to that asset class will also continue to reduce.

Our conclusion

On balance, Stochastic modelling provides diverse asset allocation to a client's portfolio. It is an effective tool to help advisers recommend how investments should be allocated. Advisers do however, need to factor into account current market conditions and match the assets to the client's specific circumstances. As a consequence, Consilium Asset Management prefer to recommend funds where the manager has specific expertise in asset allocation.

This allows us to take a consistent approach to asset allocation with each client. Clients that subscribe to our Premier Investment service will receive an annual meeting to assess their attitude towards investment risk and to ensure their portfolio's asset allocation is appropriate.

How we select investment funds?

The task of choosing the most appropriate investment funds can be tricky as most IFA's will have a limited amount of knowledge to make informed decisions about the funds to select.

Although a reasonable amount of information is available from the fund managers either over the Internet or in hard copy, in our view the knowledge is normally out of date and most IFA's do not have the ability or time to discuss individual fund information with a fund manager.

After careful consideration our view is that IFA's have historically made investment recommendations based on a small amount of information.

In addition, different processes are used to choose investment funds. Processes used include the following.

- Flavour of the month (see herd investing)
- Partial knowledge
- Third party information such including fund research websites such as Morningstar*, S&P**, OBSR ***
- Investment Presentations
- Discussions with Fund Manager or representative

Our conclusion

Most IFA's are finding increasing pressure on their time, with the additional compliance requirements and the need to treat customers fairly.

A future consequence is that most IFA's will not have the time, capability and sufficient resources to be able to choose the most appropriate investment funds for a client and to review these funds on an ongoing basis.

With this in mind it is necessary to ensure the investment process is robust and that sufficient knowledge is available for the adviser to make rational decisions about fund selection.

Investment fund selection combined with the cost differences when using a passive investment strategy creates a compelling case for passive(indexed) investments.

We have concluded that for most clients a passive investment strategy combined with outsourced asset allocation is the most appropriate investment recommendation.

Fund comparison websites

*Morningstar Fund performance www.morningstar.co.uk

** S&P www.standardandpoors.com

***OBSR www.obsrfundratings.co.uk

Undervalued asset classes?

The ability to identify undervalued asset classes is an important part of our investment process.

As you can see from the diagram below the best performing asset class will vary from year to year.

This demonstrates that there are no outright winners or losers and that have a diversified portfolio across a range of asset classes is vitally important.

Ranked Asset Class Returns (1999 to Dec 2006)

1999	2000	2001	2002	2003	2004	2005	2006
66%	50%	10%	32%	56%	31%	34%	37%
41%	20%	7%	14%	31%	24%	26%	32%
29%	16%	4%	12%	29%	17%	16%	17%
26%	11%	3%	9%	24%	12%	12%	10%
26%	6%	-1%	6%	21%	11%	12%	10%
4%	4%	-3%	1%	13%	7%	8%	6%
1%	-8%	-14%	-6%	12%	5%	5%	3%
-4%	-31%	-32%	-25%	3%	4%	5%	-15%
Global Equities	Global Bonds	Emerging Equities	Emerging Bonds				
Real Estate	Commodities	Hedge Funds	Managed Futures				

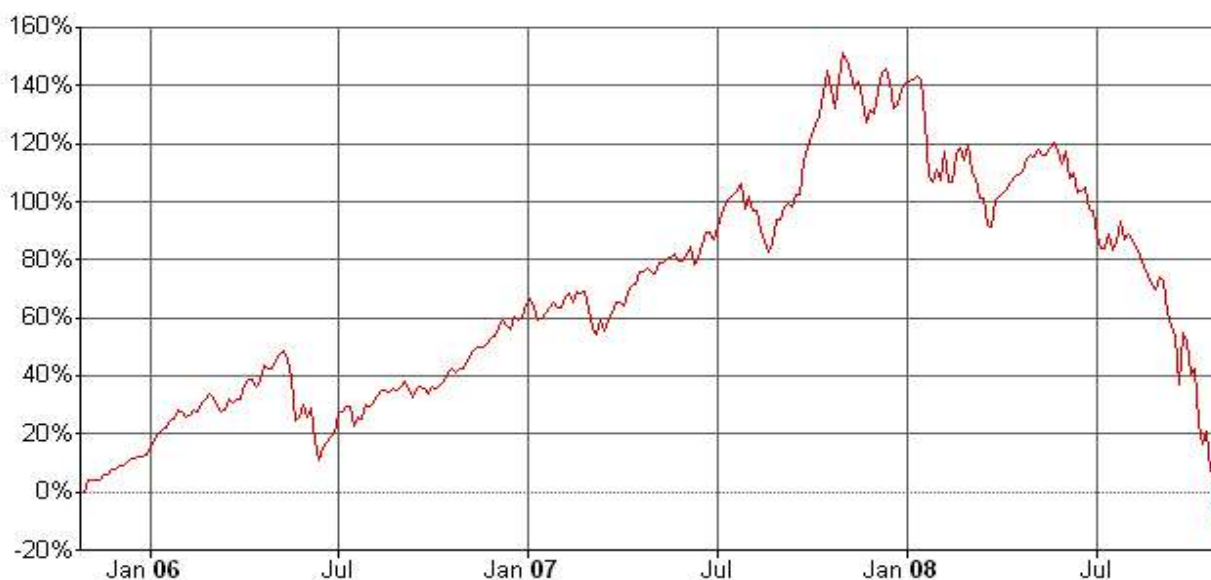
Frontier Capital Management - April 2009

We believe that it is difficult to specifically identify which asset class will perform best over the short term. Timing investment into the markets has always been difficult to get right. A broad spread of diverse asset classes will help to potentially capture positive returns.

What is Herd Investing

Is a term or phrase describes the concept where an increasing number of individuals purchase a particular investment or asset class. The primary reason for doing this usually relates to the fact that other people are also doing the same.

The popularity of investing into developing countries such as Brazil, Russia, India and China is a recent example Although there was an increase in the amount invested by UK investors during the second half of 2007 to mid 2008, the performance of these types of funds was extremely poor.



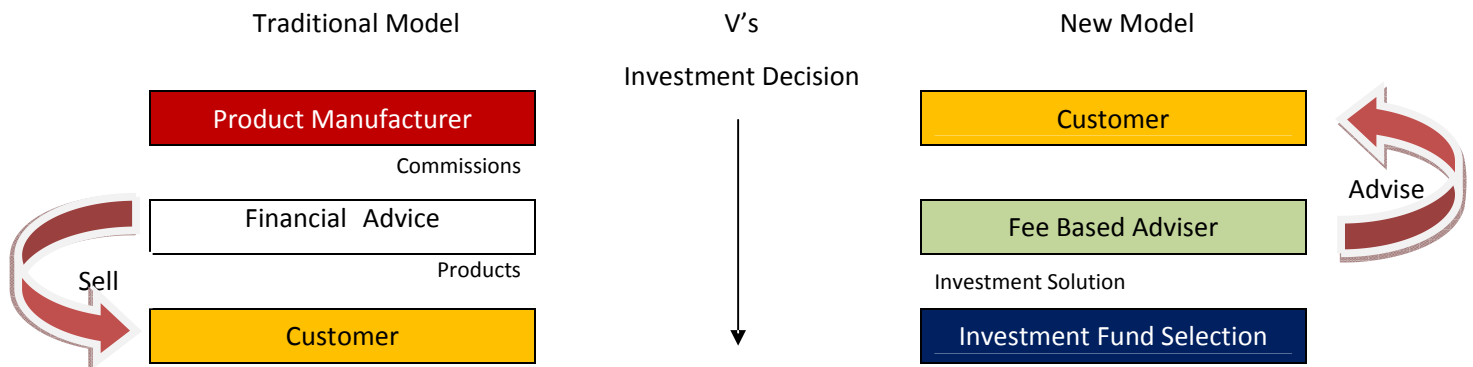
28/10/2005 - 28/10/2008 © Financial Express 2008

Our conclusion

Investors and financial advisers need to be very aware of the pitfalls of herd investing. If someone says that a certain asset class has produced fantastic returns, then it is probably too late to consider investing into this type of investment. It would be far better to delegate this aspect of the investment process to a third party that has greater access to information and is less affected by the herd investing issues.

Traditional versus New IFA model

The new adviser model puts the client at the top of the decision making process and is a fundamental change to the way advisers help clients. Rather than hoping that an adviser provides a suitable solution at the right time, the new model reassures the client they are getting advice which enable them to reach their financial goals.



Discretionary Fund Managers

Many Independent Financial Advisers use the services of discretionary fund managers. This allows the adviser to delegate the day to day investment decisions to a third party. Many of the issues concerning Discretionary Fund Management are similar to the issues already raised earlier in this document.

The issues include:

- Does the fund manager have the ability to outperform the required benchmark on a consistent basis?
- What research capabilities are implemented?
- Costs and Total expenses ratios
- How is asset allocation assessed?
- Whilst the ability to outsource the day to day responsibility for making investment decisions to a third party is attractive, it does not absolve the IFA from due diligence. The IFA will need to ensure on an ongoing basis that the fund manager is meeting their objectives.

Our Conclusion

Any discretionary fund manager must be able to demonstrate value in comparison to the benchmark. Total expense ratios are a concern as many Discretionary Fund Managers operate an opaque charging policy.

Summary

Based on our findings over the last few we believe the following approach should be implemented.

- Risk Questionnaire should be used for all clients to assess attitude to investing. Each client should be reviewed at least every two years.
- Passive investment funds should be recommended for most asset classes apart from specialist funds where active fund management could potentially add value.
- Total expense ratios should be kept realistic. Passive investment funds TER's should be capped at 1% p.a. Active funds at 2.00% per annum. Funds with TER's over this level will not be used.
- Discretionary fund managers may in some circumstances be used to add value to actively managed asset classes, but TER's and charges must be clear and not opaque.
- Consilium Asset Management's Investment charge to client should ideally be kept separate to any annual management charge the fund provider levies.

Virtually all investments involve the risk that you may receive back less than you put in. Even low risk investments can involve a significant loss of capital in untoward market conditions.

If you are in any doubt as to how the recommended investment works or the risks it involves seek further clarification from your Adviser.

Reference Section

The following reference material has been used to help us compile our Investment Process.

A copy of the reference material is available on request or can be downloaded at www.consilium-lfa.co.uk/IP.pdf

- Vanguard Research - The Active/Passive Debate : Bear Market Performance (2008)
- Eugene F. Fama and Kenneth R. French- The Capital Asset Pricing Model : Theory and Evidence (Jan 2004)
- K R French - The Cost of Active Investing (2008)
- Does Asset Allocation Policy Explain 40%, 90%, or 100% of Performance? - Ibbotson & Kaplan (April 1999)

Publications read

Richard A Ferri - All about Asset Allocation

Robert Kiyosaki - Rich Dad Poor Dad (1&2)

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