Anderson Ross

Accountancy, Tax & Wealth Planning

Our Guide to Financial Planning and Investing

Financial planning is the holistic and continuous process whereby an individual is potentially enabled to:

- ❖ Enjoy enough net income to meet regular and occasional expenditure requirements during working life.
- ❖ Accumulate enough capital to ensure that regular and occasional expenditure requirements during retirement can be met.
- ❖ Ensure that income and expenditure, assets and liabilities are managed to most effectively with the objective of meeting their various financial planning objectives.

Effective Financial Planning works through a six stage process and helps to describe financial objectives, determine personal values, formulate a plan, set out advice and recommend appropriate products.

The total planning process provides clients with the answer to the most fundamental financial question:

Have I got enough…???

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The answers to this question (and the strategies to deal with them) are surprisingly simple!!

YES …

- ❖ What strategy preserves capital??
- ❖ What strategy manages a structured and planned reduction of capital??

NO …

- ❖ What enhanced rate of return is necessary to meet objectives??
- ❖ Save more
- ❖ Spend less
- ❖ Adjust objectives (amount / timescale)

Our aim is to help you understand how you can master

your financial circumstances and achieve confidence

and peace of mind about your future.

As part of this ongoing service, you will be kept informed about your general financial position as well as any products and services of which we become aware which may be appropriate to your overall planning and investment strategy.

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Our philosophy

It is clear that there is a general requirement for all to save and to plan. For all but the least well off, there is an imperative to make adequate personal provision for one's own future financial security.

More than that, many people of all ages and situations in life have plans and aspirations that go beyond mere 'adequacy' into achieving lifestyle objectives. However, modest or extravagant, selfish or selfless, it is a simple fact that, in most cases, money is required to fund those objectives and aspirations.

Each of us has a set of **values** which are important to us. These values are individual and we will spend time with you so that we can understand your aspirations and the values that lie behind them.

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We too have values which influence the way in which we run our business and the way in which we advise you. The adviser-client relationship works most effectively when we know and understand these values and when they are aligned.

Our money may have been hard earned or a gift.

Money is earned as part of a balanced lifestyle.

Our core belief is that money is earned or invested, not for itself but for its utility.

Money is a tool to be used for spending, saving and giving.

It is invested with wisdom and spent with care.

There are few certainties when we are discussing financial planning and investments. Neither the world we live in, nor the investment performance we seek are predictable and controllable.

However there are some certainties which will greatly influence how we advise you …

- **save more** : provision for your financial future requires you to commit resources to meeting your goals and objectives
- **spend less** : it may be that meeting your lifestyle objectives in the future means you need to adjust your lifestyle in the present
- **reduce charges** : higher costs are only worth paying if they lead to higher returns and while higher returns are by no means certain, higher charges cause a calculable drain on whatever market returns are available
- **reduce taxation** : taxation strategies and rates can (and do) change on a regular basis but the minimising of your liability to tax on income, capital and assets provides an important source of investment returns

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- ❖ **change the objective** : sometimes it is simply not possible to meet your objectives without unacceptable changes to your lifestyle or inappropriate risk to capital in which case you may for example need to postpone retirement for a couple of years, or adjust your plans in other ways

- ❖ **stay committed** : dipping in and out of investments will seriously harm your financial health so while your plans and investments are deliberately flexible, to cope with whatever circumstances you may face, they are designed to stay in place for the medium to long term with only minor adjustments as your plans develop

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Investment Objectives

In order to create a financial plan we first need to understand your lifestyle and financial planning objectives. We then look at your existing resources and current plans. Next we calculate any shortfalls and determine what action is necessary to help you achieve the desired outcomes.

This may involve restructuring existing investments or selection of appropriate new products or funds. It will certainly involve establishing an ongoing relationship that ensures that your plan stays on track even as your circumstances and objectives change.

How much money is enough?

The answer to this question is partly financial, but is also linked to your core beliefs and values: what has guided how you've lived your life, run your business, been a spouse, raised a family, lived in your community?

Think about this question another way :

- If you could have all the money you could ever need, how would you live your life?
- If you received a massive cash windfall, how would you spend it?
- What is really important to you to achieve?

What do you believe is the right balance between enjoying money now, preserving and investing it for future security, leaving it to family members, and using it to make a long term difference in some way?

- How do you want to spend your time? Your talent?
- What motivates you? What are your civic and social passions?
- What do you want to give back? How do you want to do that?
- What do you want your legacy to be?
- What will motivate you once you have achieved financial independence?
- What will you do then?

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Fulfilment of your dreams should not be postponed until after your death

- If money was no object, what would you do differently now?
- If you knew you only had five years to live, what would you do differently?
- With 24 hours to live, when you review your life will you say

"I'm glad I did ..." **or** "I wish I had..."?

With these questions in mind would you change anything now?

Are your goals SMART?

Usually this means :

Specific, Measurable, Action-oriented, Realistic, Time specific.

What if it meant:

Single-minded, Memorable, Awesome, Ridiculous, Treasured?

Investment Risk

There is a 'risk' attached to just about everything, even cash in the building society. The important thing, therefore, is to quantify & control risk, to understand it.

When considering your own attitude towards investment risk, investment advisers and clients often have different definitions of risk, which can cause confusion and investment in inappropriate portfolios.

So, what is risk??

❖ Systemic risk (war, taxation, natural disaster)	❖ Capital risk
❖ Non-systemic risk (incompetent management)	❖ Income risk
❖ Risk of loss	❖ Time risk
❖ Failure to achieve objectives	❖ Likelihood of an event
❖ Underperformance	❖ Impact of that event
❖ Volatility	❖ Inflation

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Because any discussion of risk inevitably involves a number of these definitions we approach things in a slightly different way:

- What return is required in order for you to meet your objectives?
- Is this realistically achievable based on what we know about investments?
- How important is that you achieve your objectives?
- How long can you stay invested?
- How much volatility can you bear in your investments?

The financial risk associated with the return required to achieve your goals may exceed the level of risk with which you are comfortable. The risk profiling questionnaire which we invite our clients to complete, offers a scientifically validated technique for assessing financial risk tolerance and a methodology for incorporating risk assessment into the financial planning process.

We will also show you examples of how your investments might have performed in the past, giving concrete examples of the maximum loss you might have experienced and the period of time it could have taken for your investments to recover.

This is simply because for most investors, whatever definitions of risk are used, it is the concrete experience of investment gains and losses that can be most influential in investment behaviour.

It is also worth noting that many portfolios are described as **low, medium** and **high risk**, or **income, balanced** and **growth**. They may combine these, such as **medium risk income** and **high risk growth**. Others may use words such as **adventurous** or **moderate**.

Here are our thoughts on these issues:

- Words such as moderate, cautious, adventurous have no real value as their meaning can be as varied as the advisers that speak them and the clients who hear them.
- It is rare that any client’s objectives can be simply categorised as ‘**income**’ or ‘**growth**’.
- Total investment return is always made up of varying degrees of capital growth and income, depending on the asset, and to focus on one or the other is not helpful in portfolio construction.
- It is part of the financial planning process to determine how best to realise investment returns; we may generate ‘income’ by regular encashment of investments (i.e. reducing capital) to benefit from tax allowances.

- Our approach is to look first at your own objectives, then at the rate of return required to meet those objectives, and finally to recommend how to allocate your resources to meet those objectives, ensuring that our recommendations lie within your tolerance of exposure to risk and the risk of loss.

- Should there be a conflict between the recommended allocation of resources and your tolerance of the risk associated with that portfolio, we will usually recommend that your tolerance of risk takes the higher priority, adjusting your objectives or investing timeframe accordingly. Taking more risk than you are comfortable with rarely has a happy outcome.

- We will ensure that you have sufficient capital in easily accessible accounts for your short term requirements, meaning you should not have to draw on your capital in the early years. However, the capital we allocate to longer term investments is expected to be held for a period of 5 years, preferably longer.

- On the basis that your investment portfolio will be established for the medium to long term we will maintain your holdings at all times. We do not believe it is possible to time the markets. Some of the steepest market falls have been followed quickly by equally dramatic market rises. Encashing investments when the market is low is a classic investment error, as is reinvesting when markets have risen again and the growth period has been missed.

- The advantage of investing for the longer term is that one can afford to live with shorter term market volatility. As financial instruments have become more sophisticated, a relatively small number of market participants can have a relatively large effect on the overall market. This situation often means that much of the growth in the market is seen in short, sharp movements rather than an orderly rise. Long-term investment eliminates this risk of 'missing the best days'.

Asset Classes

An asset class is simply a group of investments that exhibit similar characteristics and behave similarly when subjected to market forces. The three main asset classes are **equities** (stocks & shares), **fixed income** (gilts & bonds) and **cash** (deposits & money market instruments).

But remember that the return you obtain on your investment is 'compensation' for allowing an institution to use your capital, and the anticipated rate of return increases as the risk to which your capital is exposed increases.

Equities

Equity investors provide capital to enable companies to start up and / or expand. In return for their investment they are given a share in the company, which means that they have become a part owner of that company and will share in the profits and growth of the business if it does well (or its losses if the company does poorly).

The anticipated return is a share in the company's future profits (by way of dividend) and a share in the increased value of the company (by way of increased share price). Equities and those assets that are equity-like tend to carry more investment risk as there is no certainty of future share value and no certainty of dividend income.

Equities have delivered a useful ‘risk premium’ historically, which is expected to endure over the longer term in spite of the presence of short term market volatility.

Fixed Income

In contrast Fixed Income investments are loans made to institutions (governments in the case of gilts or treasury stock) or companies (in the case or corporate bonds). They usually have a known future redemption value and the income received is actually interest due on the loan made.

Whilst the capital repayment and interest payments are usually fixed their real purchasing power will vary depending on inflation and the market value of the holding will fluctuate, depending on market interest rates, inflation rates and the ability of the institution to meet its commitments to pay interest or repay capital.

Fixed income investments typically carry a lower level of investment risk than equities. However, interest rates increase as the perceived risk associated with the issuer increases.

Cash

Cash is often described as risk free, but this is subject to the strength of the institution holding the capital. Deposits are vulnerable to inflation risk, though easy access for cash flow still makes this asset an essential part of an investor’s portfolio.

In addition to these three primary asset classes, some fund managers add **commercial property**, **commodities**, and **derivatives** or **hedge funds** to the investment mix, as well as more esoteric assets such as **wine**, **art**, **antiques**, **forestry** and so on. These may be included in a portfolio, perhaps as part of other collective investments, but we take the view that they are usually too costly or too risky for individual investments.

Asset Allocation

Many people think that superior returns come from the selection of individual equities that are likely to outperform, and from timing the market, often chasing momentum themes such as technology, China or property. However, research has shown that the real opportunity to achieve superior results lies in adhering to efficient and disciplined asset allocation over the long term.

Whatever the asset class line-up, each one is expected to reflect different risk and return investment characteristics, and will perform differently in any given market environment. So investors should be better off with a well-diversified portfolio.

They will either be able to reduce their risk exposure or obtain a higher return for the same level of risk. Such diversification requires a spread of investments between asset classes. But how do you build a properly diversified portfolio? How much do you put in the different asset classes and regions?

Whilst history shows that, over the long term, equities provide the most attractive real return (after allowing for inflation), over shorter periods this has not always been the case, hence our view that investments should be made with a minimum 5-7 year view.

Many investors require (or seek) returns in excess of those available from ‘the market’, but the research alluded to earlier makes it clear that these returns are elusive and may be negated by the costs of seeking such active additional return. Instead of seeking to derive the **maximum** return available we focus on the **required** return.

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Professional investors determine the levels of return they require from an investment in order to compensate them for the use of their capital and for the risk taken in making the investment. Similarly, professional investors do not seek to expose their capital to any risk which is greater than that necessary to provide them with the required return.

It is relevant here to note the extent to which capital and income can vary over time and the extent to which capital or income may be totally lost. Another fundamental reason for diversification is that it minimises the effect of any one failed company on your entire investment portfolio.

Dividends have tended to be a relatively consistent source of investment return, even when stock market capital returns have been poor. They provide a significant proportion of total return with a degree of dependability. Accumulation investments are selected where available and income is reinvested (automatically if possible) whilst in the growth phase.

Tax considerations may influence investment decisions but should not dominate them. We will seek to make the most of mainstream tax-advantaged investment opportunities, though once these limits are exceeded it may be desirable to derive portfolio returns subject to the Capital Gains Tax regime rather than the Income Tax regime.

Currency movements can affect returns where holdings contain overseas investments. We will as far as possible seek to invest in sterling and sterling-denominated investments and avoid exposure to investments held in other currencies. Whilst favourable currency movements can enhance the return from an investment, it also provides another level of risk to your capital which we do not believe is helpful.

An Investment Philosophy

The traditional view is that advisers add value for clients by picking funds and products for them. Consider that there are in excess of 5,000 managers of active mandates and as many as 22,000 different portfolios or funds and it becomes clear that the task may be too great for all but the largest investment advisory firms.

Questions are also regularly raised about the value of active investment management. The traditional value proposition, that we can win, get better returns, beat the market, is increasingly proved either impossible or unpredictable.

Furthermore, while the vast majority of managers fail to outperform their investment benchmarks, even if you can find the winners, their results are not necessarily repeatable and evidence suggests that the charges applied to investment portfolios outweigh their enhanced investment returns.

So, having spent many years considering these questions we have chosen in the main to follow a passive investment philosophy, rather than an active one, which is consistent with our values and principles. On occasions, actively managed funds are recommended if specific managers hold recognised skills or there is no accessible and appropriate passive fund.

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Levels of Investment Management:

Concentration on long term goals and asset mix is a more successful investment strategy than focus on manager and stock selection.

Value Is Added	Long term goals and asset mix	
	Equity mix : Growth / Value, Large / Small, Domestic / International etc	
	Active vs. Passive	
	Manager selection	Cost
	Security selection	Is Added

Portfolio construction and ongoing monitoring are essential to the investment process, partly to keep pace with changing personal and financial objectives and partly to ensure that the portfolio asset allocation remains appropriate for the delivery of the required investment return.

Investment Portfolios

Our philosophy is driven by making sound long term asset allocation decisions and providing returns with the appropriate level of risk taking into account your attitude to risk, and the level of return required to meet your personal and financial objectives.

Our service offers two core asset classes:

- equity
- fixed income

Equity:

The objective of the portfolio is to achieve growth over the medium to long term from investment in a range of passive equity investments. Investments in this fund alone may be described as high risk, but we recommend exposure to equity assets as part of your overall portfolio which will include exposure to fixed interest (see below) and cash.

Fixed Interest:

The objective of the portfolio is to provide exposure to fixed interest holdings while aiming to preserve capital. While these assets may provide a reasonable level of income, this is not necessarily the primary purpose of this investment. Investments in this fund alone may be described as lower risk, but we usually recommend exposure to fixed interest assets as part of your overall portfolio which will include exposure to equities, (see above) and cash.

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Blended Portfolios

It is a fundamental part of our investment philosophy that all investments are allocated to a mix of capital growth and income investments over the long term. It is the blend of these two portfolios with adequate cash to maintain cash flow over a 3-5 year term which provides your total return within your risk tolerance.

A medium risk profile indicates a greater level of exposure to equities, which historically have been the most effective long-term hedge against inflation. A low risk portfolio provides a higher fixed interest content and so would be better insulated from a setback in equity markets, though would be more vulnerable to rises in interest rates and/or inflation.

As each investor is different (time horizon, obligations, aspirations, constraints, risk tolerance) the usual approach of matching a client to a pre-determined model portfolio simply cannot take account of the very individual and personal nature of your personal and financial requirements.

In the main, we recommend index tracking investments to provide **passive** and **low cost** exposure to a range of asset classes and markets. We minimise stock specific risk by using pooled collective investment vehicles such as unit trusts, open ended investment companies (OEICs), investment trusts and exchange traded funds (ETFs), and maintain long term asset allocation ('buy & hold' strategy).

Rebalancing

Rebalancing ensures that profits on higher growth investments are consolidated every six month and reinvested into lower growth holdings. The desired asset allocation is thus maintained as close to the recommended proportions as possible.

Investment Recommendations

The financial planner and investment adviser add value by:

- managing your portfolio in accordance with their investment policy and philosophy
- avoiding market fads and market timing
- recommending and reviewing asset allocation and asset location
- rebalancing portfolios periodically to target allocations
- minimising costs and taxation
- maintaining discipline and the ability to stand against human impulses and marketing strategies

Investment Mandate

Our advice will be provided in a separate financial planning report which will contain detailed recommendations and other information about the specific holdings that we recommend. We will advise you on the basis that our financial planning analysis indicates that in order to meet your objectives, your invested assets need to achieve a typical compound annual return (net of tax and charges).

Your assets are intended to remain invested for the medium to long term, by which we mean a minimum of 5-7 years. Requirements for additional income and capital within that period will be met from a Cash Reserve.

Where income is generated from your holdings this will be held in your Cash Reserve. As part of your Annual Review we will consider whether the amount available for investment should be reinvested within the portfolio, or remain in cash to continue to fund your Cash Reserve.

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Background

Our firm is **independent and whole of market**. This means that when we prepare our recommendations which we consider are most likely to enable you to meet your lifestyle and financial planning objectives, we consider the widest possible range of investment and insurance funds and products from all available product providers. We have no links, obligations or commitments, formal or informal, that constrain our freedom to advise you in any way.

Your adviser is qualified significantly beyond the minimum benchmark qualifications for the financial services sector. We have specialist financial planning and investment qualifications which enable us to be confident that we are well placed to advise clients on meeting their objectives.

We aim to provide a service which is tailored to your very personal lifestyle and financial objectives. However, we also know that costs of advice and transaction charges take a heavy toll on investment returns, thus increasing the challenge of meeting your objectives. We therefore apply our knowledge and experience to create a service which offers the benefits of personal service and investment strategies whilst seeking to control our (and therefore your) costs.

Every year, we will report on your investments and assess progress towards your objectives. Our Annual Review strategy enables us to keep up to date with your plans and ensure that your financial arrangements remain appropriate to their purposes and sufficient for your needs. However, your financial planner will be available to answer your questions or deal with your concerns at any time.