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INVESTMENT COMMITTEE PACK

23<sup>rd</sup> October 2018

BLACKWOOD  
ASSET MANAGEMENT

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Attendees: MTR / RWF / SCG / SMG / TS / AR / AJ

PURPOSE:

This meeting performs part of BLACKWOOD's due diligence in ensuring the model portfolios continue to meet their investment objectives.

The aim of the meeting is to enable BLACKWOOD to:

- discuss the main drivers of the markets and our sentiment on the different asset classes
- to review the model portfolios
- to discuss and decide on a course of action based on the preceding discussions detailing what needs to be done, by whom and by when

DATA SOURCE: Blackwood Asset Management, Bloomberg (unless otherwise stated).

## MACRO OVERVIEW

The period leading up to the financial crisis saw an artificial boost to global productivity as western technology met the excess labour and resources of the developing world. This has now ended. A combination of aging demographics, and a lack of transformative innovations mean that productivity growth is below historic levels and will remain that way.

Given that, in the long run, productivity growth is the driver of economic growth (nominal GDP) this means that we are not going to be seeing interest rates rising to historic levels. Central bankers will be constrained in raising interest rates as any movement upwards in rates will act to stymie the low levels of GDP growth present. As a result interest rates will remain at 'zero' forever with low levels of inflation persisting.

This has important implications for the allocation of capital within the global economy. Interest rates are the pricing mechanism for an economy's capital stock. Low levels of interest rates keep so called "zombie" companies, which offer negative returns on capital, alive. This prevents the capitalist process of creative destruction that allows capital to be re-allocated to those tasks that generate the highest returns, in turn creating a self-reinforcing cycle of diminished productivity growth.

From the point of view of investors this means we cannot expect future returns to match those witnessed historically, and must remain aware of the increased risk, and opportunities, generated from the market inefficiencies caused by the misallocation of capital.

## TACTICAL POSITIONING AT TIME OF LAST MEETING

At the time of the last investment committee meeting in July we had:

- acquired an exposure to emerging markets by investing 1% of portfolio in model 4 into Vanguard Emerging Markets Stock Index fund; rising to 4% in model 7 (with an increase of 1% for each increase in risk category in between)
- reduced cash exposure by corresponding amounts
- reduced UK equity exposure by 1%
- increased US equity exposure by 1%.

The Tactical Asset Allocations at this time, and their variance from the Strategic Asset Allocation, can be seen in the tables on the right hand side.

SAA	3	4	5	6	7
cash	3.0%	3.0%	3.0%	3.0%	3.0%
debt	70.0%	50.0%	31.0%	13.0%	
equity	18.0%	33.0%	48.0%	65.0%	97.0%
property	4.0%	4.0%	4.0%	4.0%	
alternatives	5.0%	10.0%	14.0%	15.0%	

TAA	3	4	5	6	7
cash	12.0%	11.0%	10.0%	9.0%	9.0%
debt	67.0%	50.0%	33.0%	20.0%	
equity	15.0%	30.0%	46.0%	59.0%	91.0%
property	4.0%	4.0%	4.0%	4.0%	
alternatives	2.0%	5.0%	7.0%	8.0%	

VARIANCE	3	4	5	6	7
cash	9.0%	8.0%	7.0%	6.0%	6.0%
debt	(3.0%)	0.0%	2.0%	7.0%	0.0%
equity	(3.0%)	(3.0%)	(2.0%)	(6.0%)	(6.0%)
property	0.0%	0.0%	0.0%	0.0%	0.0%
alternatives	(3.0%)	(5.0%)	(7.0%)	(7.0%)	0.0%

note: the variance from the SAAs is capped at  $\pm 10\%$



## CHANGES TO THE TACTICAL ASSET ALLOCATION

We made alterations to the Tactical Asset Allocation on 7<sup>th</sup> September, the 28<sup>th</sup> September and the 11<sup>th</sup> October.

Market declines provided us with the opportunity to deploy some more cash in the areas where we see particularly good value, namely the U.K. and Emerging market equities. As previously noted, Emerging equity markets have fared very badly this year due mainly to the perceived impact of trade tariffs on Chinese stock markets, the largest constituent of the emerging markets sector, and a stronger dollar whilst the U.K. has been performing poorly for the obvious reason of Brexit uncertainty.

Global asset managers are generally very underweight both areas and we believe that, as is usually the case, this consensus view will prove to be wrong and “value will out” in the end as it invariably does.

Overall we have:

- increased UK equity exposure by around 5%
- increased emerging market equity exposure by 1%-2%
- sold the model portfolios’ exposure to high yield debt
- reduced the cash position by 3% on model 3, rising to a 6% reduction on model 7.

The new Tactical Asset Allocations, and their variance from the Strategic Asset Allocation can be seen in the tables on the right hand side.

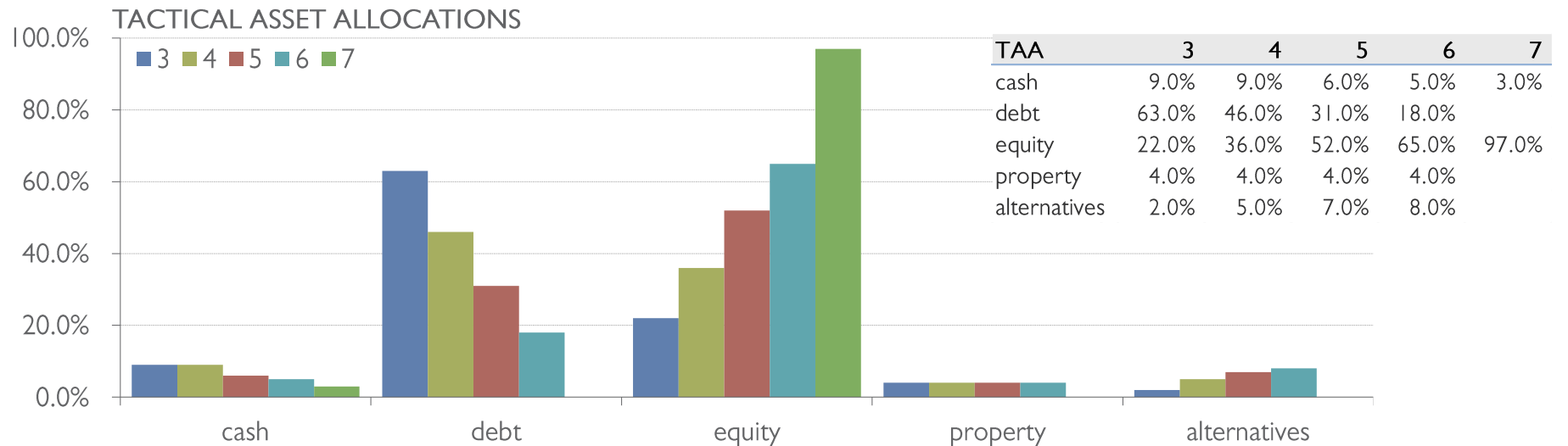
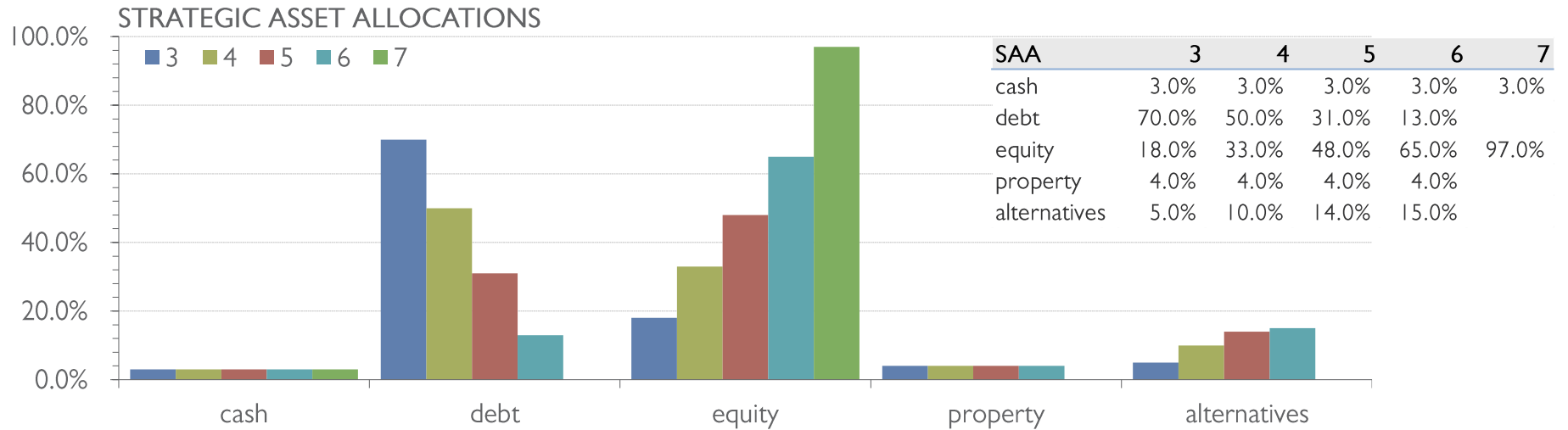
SAA	3	4	5	6	7
cash	3.0%	3.0%	3.0%	3.0%	3.0%
debt	70.0%	50.0%	31.0%	13.0%	
equity	18.0%	33.0%	48.0%	65.0%	97.0%
property	4.0%	4.0%	4.0%	4.0%	
alternatives	5.0%	10.0%	14.0%	15.0%	

TAA	3	4	5	6	7
cash	9.0%	9.0%	6.0%	5.0%	3.0%
debt	63.0%	46.0%	31.0%	18.0%	
equity	22.0%	36.0%	52.0%	65.0%	97.0%
property	4.0%	4.0%	4.0%	4.0%	
alternatives	2.0%	5.0%	7.0%	8.0%	

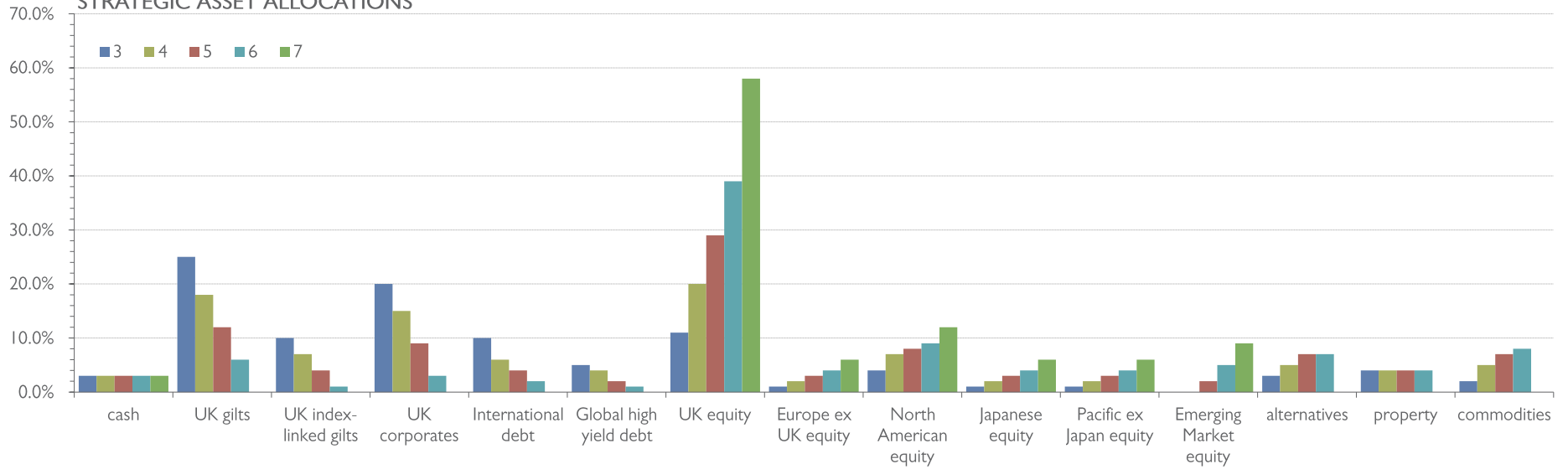
VARIANCE	3	4	5	6	7
cash	6.0%	6.0%	3.0%	2.0%	0.0%
debt	(7.0%)	(4.0%)	0.0%	5.0%	0.0%
equity	4.0%	3.0%	4.0%	0.0%	0.0%
property	0.0%	0.0%	0.0%	0.0%	0.0%
alternatives	(3.0%)	(5.0%)	(7.0%)	(7.0%)	0.0%

note: the variance from the SAAs is capped at ± 10%

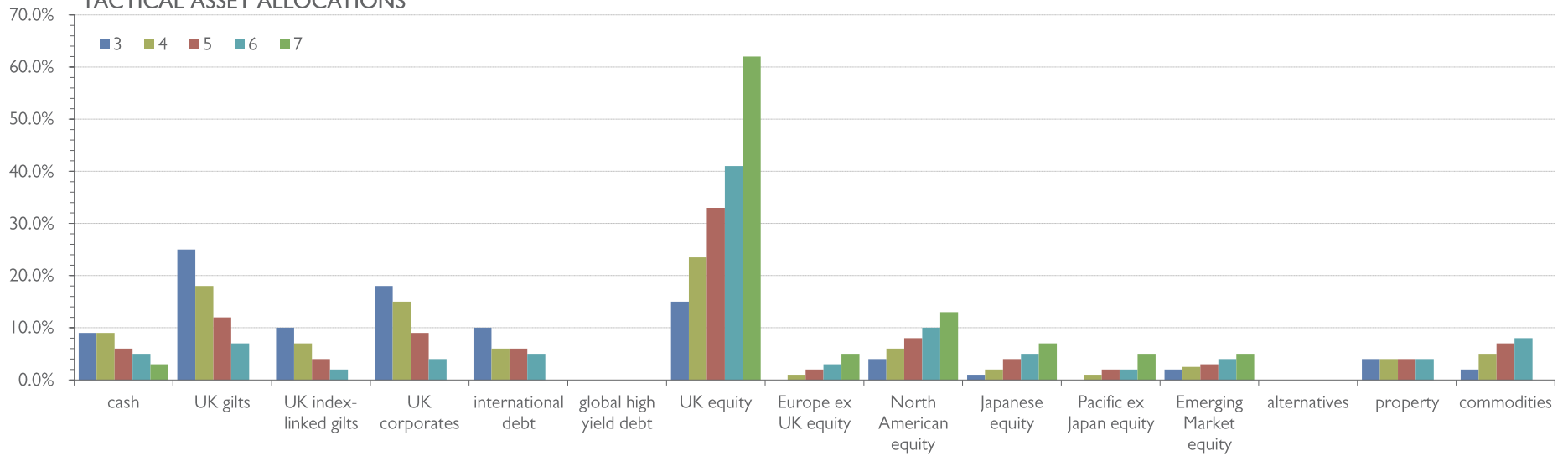
# BLACKWOOD MODELS



### STRATEGIC ASSET ALLOCATIONS

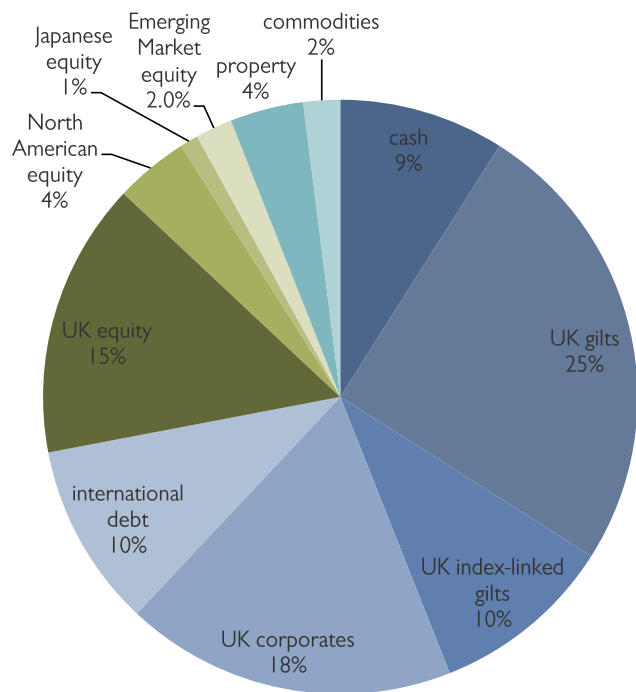


### TACTICAL ASSET ALLOCATIONS

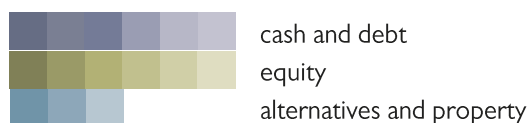


# BLACKWOOD MODEL 3 TACTICAL ASSET ALLOCATION

number of holdings 12  
total cost of investment 0.74%



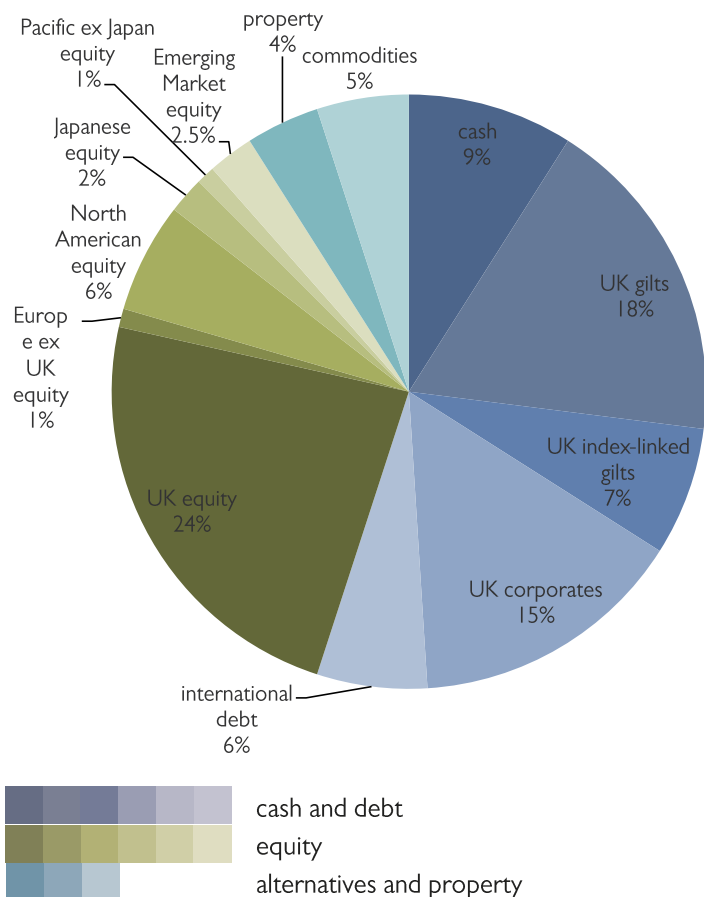
asset class	fund holding	% total
<b>cash</b>		<b>9.0%</b>
cash	sterling	9.0%
<b>bonds</b>		<b>63.0%</b>
UK gilts	Vanguard U.K. Government Bond	25.0%
UK gilts	L&G All Stocks Index-Linked Gilt	10.0%
UK corporates	Vanguard UK Investment Grade Bond	18.0%
international bonds	TwentyFour Dynamic Bond	5.0%
international bonds	TwentyFour Monument Bond	5.0%
<b>equity</b>		<b>22.0%</b>
UK equity	iShares 100 UK Equity	10.5%
UK equity	SORBUS VECTOR	4.5%
North American equity	Vanguard U.S. Equity	4.0%
Japanese equity	iShares Japan Equity	1.0%
Emerging Market equity	Vanguard Emerging Markets	2.0%
<b>alternatives</b>		<b>2.0%</b>
commodities	Investec Global Gold	2.0%
<b>property</b>		<b>4.0%</b>
property	iShares Global Property Securities Equity	4.0%





# BLACKWOOD MODEL 4 TACTICAL ASSET ALLOCATION

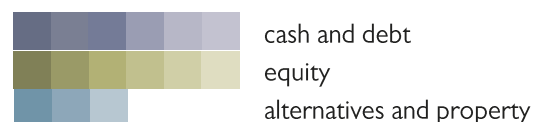
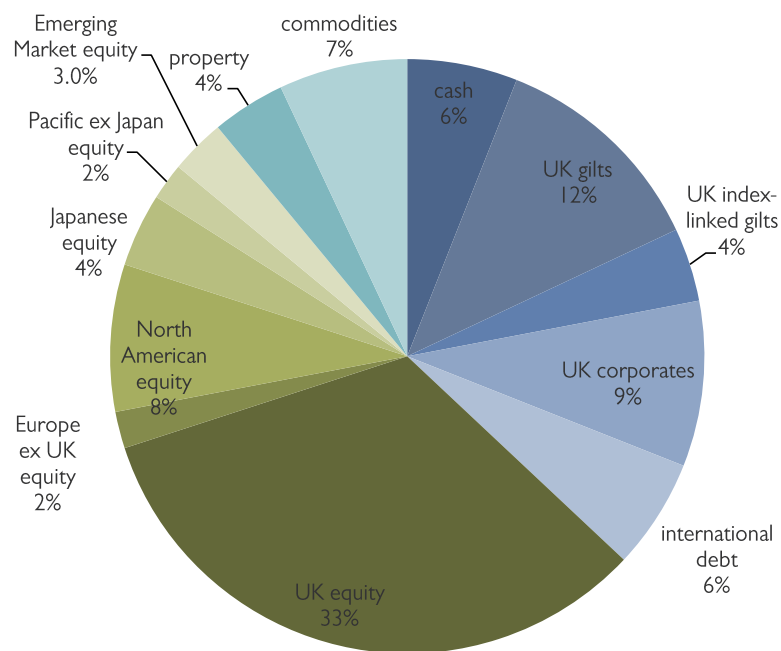
number of holdings 15  
total cost of investment 0.85%



asset class	fund holding	% total
cash		9.0%
cash	sterling	9.0%
<b>bonds</b>		<b>46.0%</b>
UK gilts	Vanguard U.K. Government Bond	18.0%
UK gilts	L&G All Stocks Index-Linked Gilt	7.0%
UK corporates	Vanguard UK Investment Grade Bond	15.0%
international bonds	TwentyFour Dynamic Bond	3.0%
international bonds	TwentyFour Monument Bond	3.0%
<b>equity</b>		<b>36.0%</b>
UK equity	iShares 100 UK Equity	16.5%
UK equity	SORBUS VECTOR	7.1%
Europe ex UK equity	Vanguard FTSE Developed Europe ex UK Equity	1.0%
North American equity	Vanguard U.S. Equity	6.0%
Japanese equity	iShares Japan Equity	2.0%
Pacific ex Japan equity	Invesco Perpetual Asian Z	0.5%
Pacific ex Japan equity	Stewart Investors Asia Pacific Leaders B	0.5%
Emerging Market equity	Vanguard Emerging Markets	2.5%
<b>alternatives</b>		<b>5.0%</b>
commodities	Investec Global Gold	5.0%
<b>property</b>		<b>4.0%</b>
property	iShares Global Property Securities Equity	4.0%

# BLACKWOOD MODEL 5 TACTICAL ASSET ALLOCATION

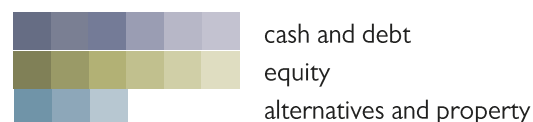
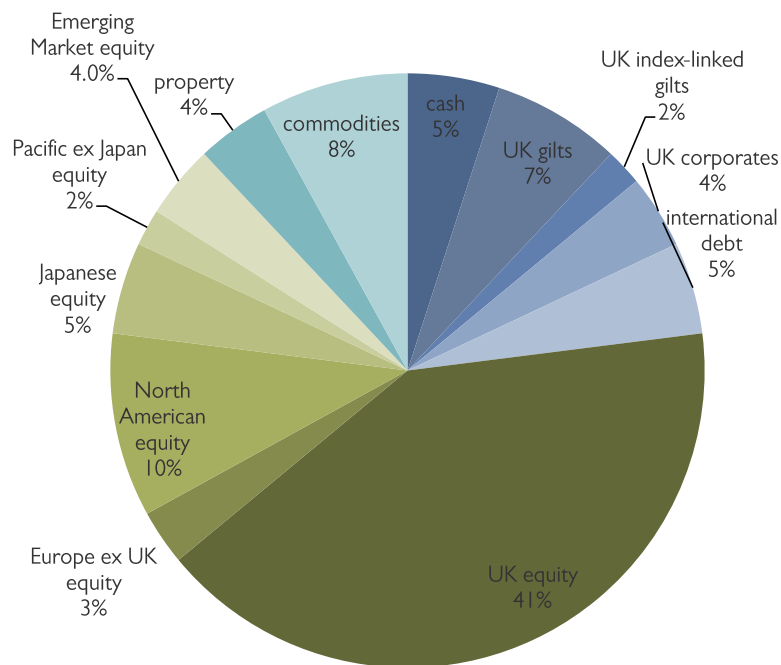
number of holdings 15  
total cost of investment 1.00%



asset class	fund holding	% total
<b>cash</b>		<b>6.0%</b>
cash	sterling	6.0%
<b>bonds</b>		<b>31.0%</b>
UK gilts	Vanguard U.K. Government Bond	12.0%
UK gilts	L&G All Stocks Index-Linked Gilt	4.0%
UK corporates	Vanguard UK Investment Grade Bond	9.0%
international bonds	TwentyFour Dynamic Bond	3.0%
international bonds	TwentyFour Monument Bond	3.0%
<b>equity</b>		<b>52.0%</b>
UK equity	iShares 100 UK Equity	23.1%
UK equity	SORBUS VECTOR	9.9%
Europe ex UK equity	Vanguard FTSE Developed Europe ex UK Equity	2.0%
North American equity	Vanguard U.S. Equity	8.0%
Japanese equity	iShares Japan Equity	4.0%
Pacific ex Japan equity	Invesco Perpetual Asian Z	1.0%
Pacific ex Japan equity	Stewart Investors Asia Pacific Leaders B	1.0%
Emerging Market equity	Vanguard Emerging Markets	3.0%
<b>alternatives</b>		<b>7.0%</b>
commodities	Investec Global Gold	7.0%
<b>property</b>		<b>4.0%</b>
property	iShares Global Property Securities Equity	4.0%

# BLACKWOOD MODEL 6 TACTICAL ASSET ALLOCATION

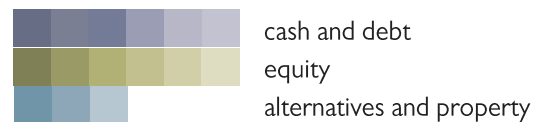
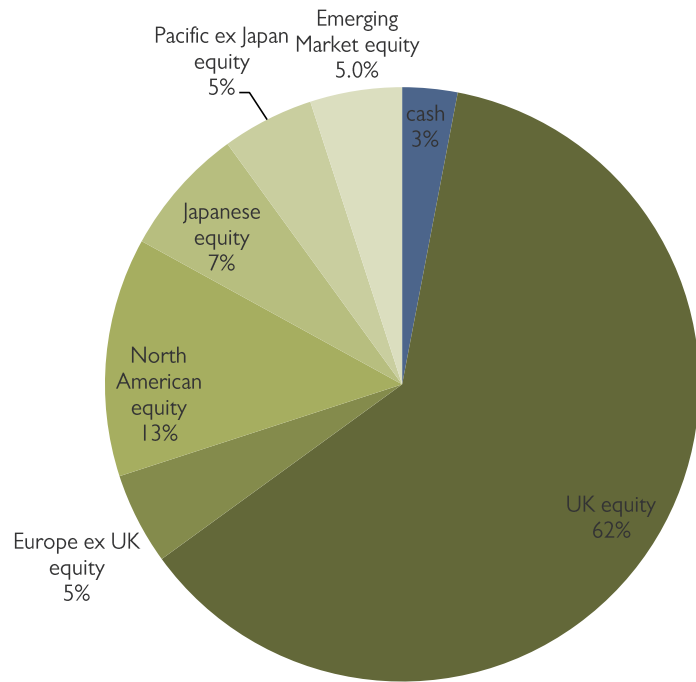
number of holdings 15  
total cost of investment 1.01%



asset class	fund holding	% total
<b>cash</b>		<b>5.0%</b>
cash	sterling	5.0%
<b>bonds</b>		<b>18.0%</b>
UK gilts	Vanguard U.K. Government Bond	7.0%
UK gilts	L&G All Stocks Index-Linked Gilt	2.0%
UK corporates	Vanguard UK Investment Grade Bond	4.0%
international bonds	TwentyFour Dynamic Bond	2.5%
international bonds	TwentyFour Monument Bond	2.5%
<b>equity</b>		<b>65.0%</b>
UK equity	iShares 100 UK Equity	31.0%
UK equity	SORBUS VECTOR	10.0%
Europe ex UK equity	Vanguard FTSE Developed Europe ex UK Equity	3.0%
North American equity	Vanguard U.S. Equity	10.0%
Japanese equity	iShares Japan Equity	5.0%
Pacific ex Japan equity	Invesco Perpetual Asian Z	1.0%
Pacific ex Japan equity	Stewart Investors Asia Pacific Leaders B	1.0%
Emerging Market equity	Vanguard Emerging Markets	4.0%
<b>alternatives</b>		<b>8.0%</b>
commodities	Investec Global Gold	8.0%
<b>property</b>		<b>4.0%</b>
property	iShares Global Property Securities Equity	4.0%

# BLACKWOOD MODEL 7 TACTICAL ASSET ALLOCATION

number of holdings 8  
total cost of investment 0.83%

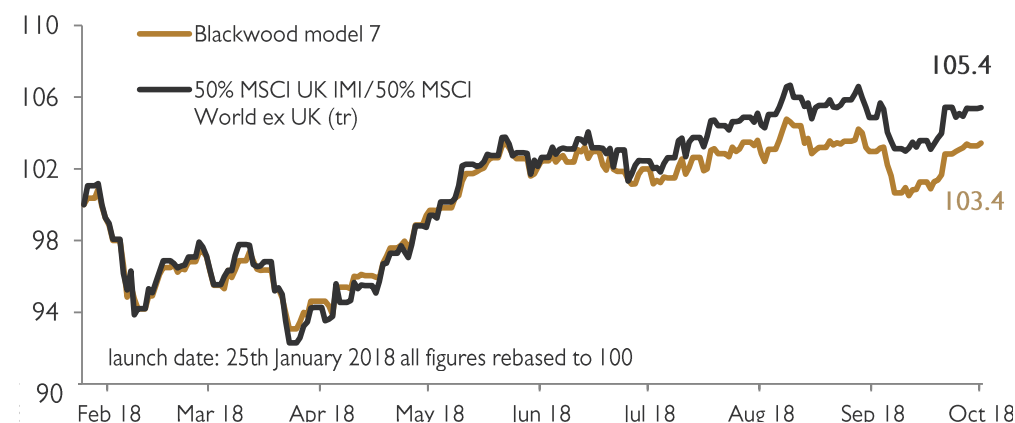
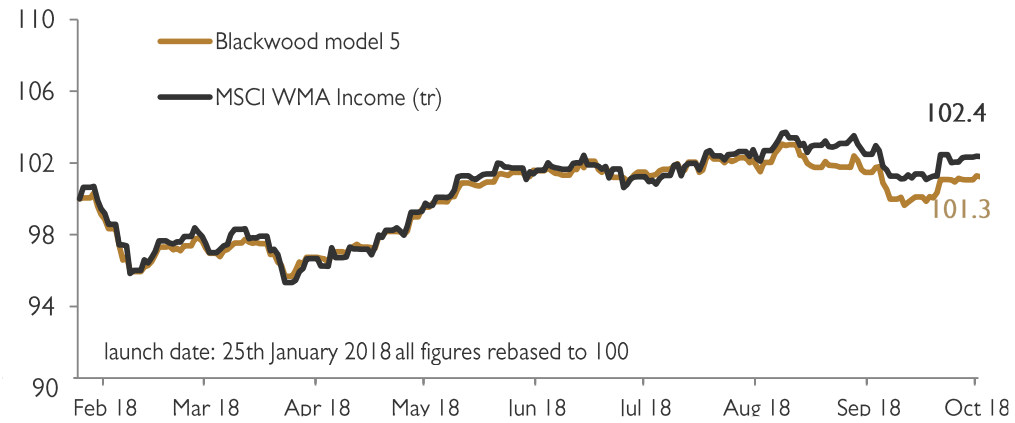
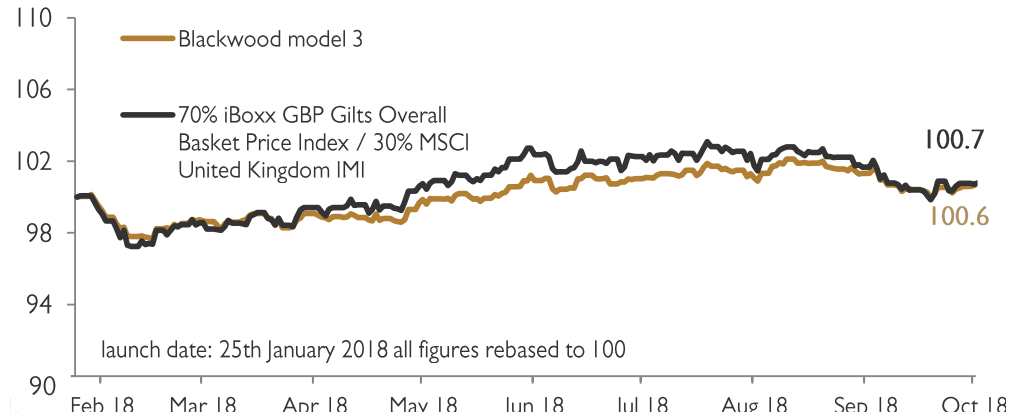
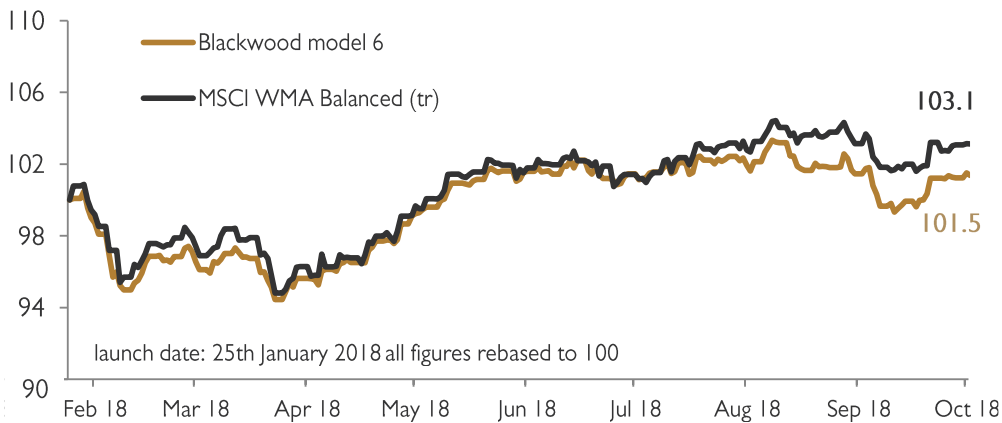
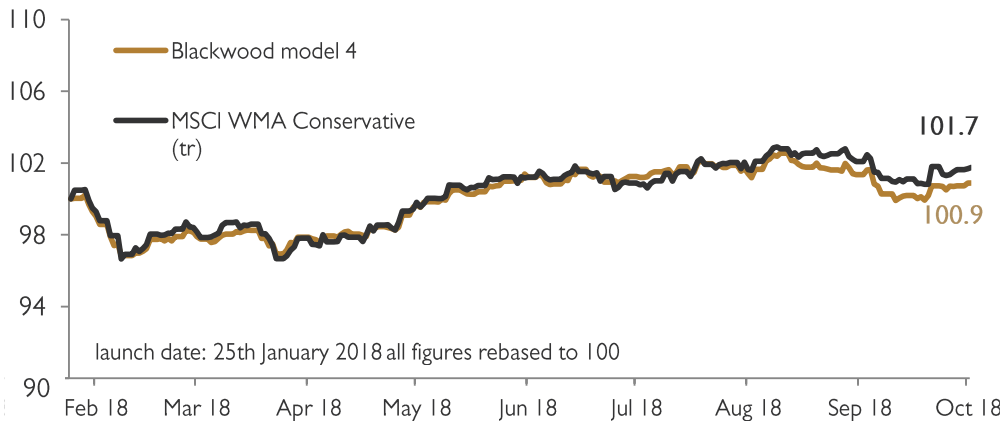


asset class	fund holding	% total
cash		3.0%
cash	sterling	3.0%
<b>equity</b>		<b>97.0%</b>
UK equity	iShares 100 UK Equity	52.0%
UK equity	SORBUS VECTOR	10.0%
Europe ex UK equity	Vanguard FTSE Developed Europe ex UK Equity	5.0%
North American equity	Vanguard U.S. Equity	13.0%
Japanese equity	iShares Japan Equity	7.0%
Pacific ex Japan equity	Invesco Perpetual Asian Z	2.5%
Pacific ex Japan equity	Stewart Investors Asia Pacific Leaders B	2.5%
Emerging Market equity	Vanguard Emerging Markets	5.0%

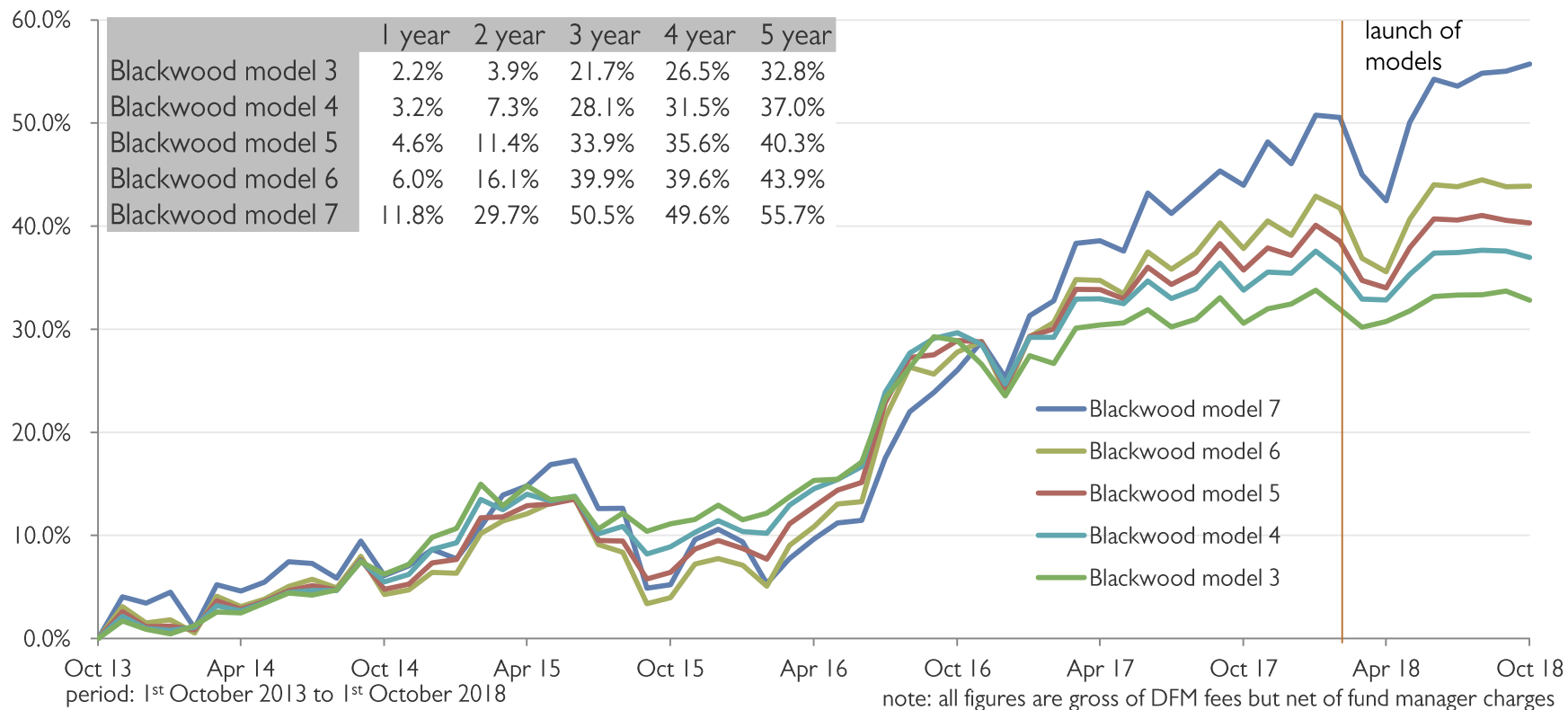
# PERFORMANCE SINCE LAUNCH

model performance			
model	1 month	3 months	inception
3	(0.7%)	(0.4%)	0.6%
4	(0.5%)	(0.4%)	0.9%
5	(0.2%)	(0.2%)	1.3%
6	0.0%	0.0%	1.5%
7	0.5%	1.4%	3.4%

performance shown until 01/10/2018



## 5 YEAR PERFORMANCE OF BLACKWOOD MODELS (BACKDATED)



Performance figures prior to the launch of the models on the 25/01/2018 have been derived based on the underlying index returns of the funds currently constituting the models and the strategic (long term) asset allocation for each model. Past returns are not a guide to future performance and this graph is not intended to set expectations of the potential future returns on the models. It is intended solely to provide information on the historic variance in the returns of the models. The actual asset allocation of the models at any time and for an extended period of time may differ significantly from the strategic asset allocations, reflecting the dynamic investment and market conditions.

This is provided for information purposes only at your request and does not constitute a formal valuation. While we have used all best endeavours to ensure that the performance figures and/or the values in this report are correct, it has been produced manually and has not been independently validated and we take no responsibility for any loss you may suffer as a consequence of your relying upon the information in this document.



## BAM MODELS VS CURRENT BENCHMARKS

BAM SAA	3	4	5	6	7
cash	3.0%	3.0%	3.0%	3.0%	3.0%
debt	70.0%	50.0%	31.0%	13.0%	0.0%
UK equity	11.0%	20.0%	29.0%	39.0%	58.0%
overseas equity	7.0%	13.0%	19.0%	26.0%	39.0%
property	4.0%	4.0%	4.0%	4.0%	0.0%
alternatives	5.0%	10.0%	14.0%	15.0%	0.0%

BAM TAA	3	4	5	6	7
cash	9.0%	9.0%	6.0%	5.0%	3.0%
debt	63.0%	46.0%	31.0%	18.0%	0.0%
UK equity	15.0%	23.5%	33.0%	41.0%	62.0%
overseas equity	7.0%	12.5%	19.0%	24.0%	35.0%
property	4.0%	4.0%	4.0%	4.0%	0.0%
alternatives	2.0%	5.0%	7.0%	8.0%	0.0%

benchmark AA	70% iBoxx GBP Gilts / 30% MSCI UK IMI	WMA conservative	WMA income	WMA balanced	50% MSCI UK IMI / 50% MSCI world ex UK
cash	0.0%	5.0%	5.0%	5.0%	0.0%
debt	70.0%	40.0%	25.0%	17.5%	0.0%
UK equity	30.0%	17.5%	30.0%	30.0%	48.9%
overseas equity	0.0%	15.0%	22.5%	32.5%	48.0%
property	0.0%	5.0%	5.0%	5.0%	3.1%
alternatives	0.0%	17.5%	12.5%	10.0%	0.0%

## CHANGE OF MODEL 7 BENCHMARK

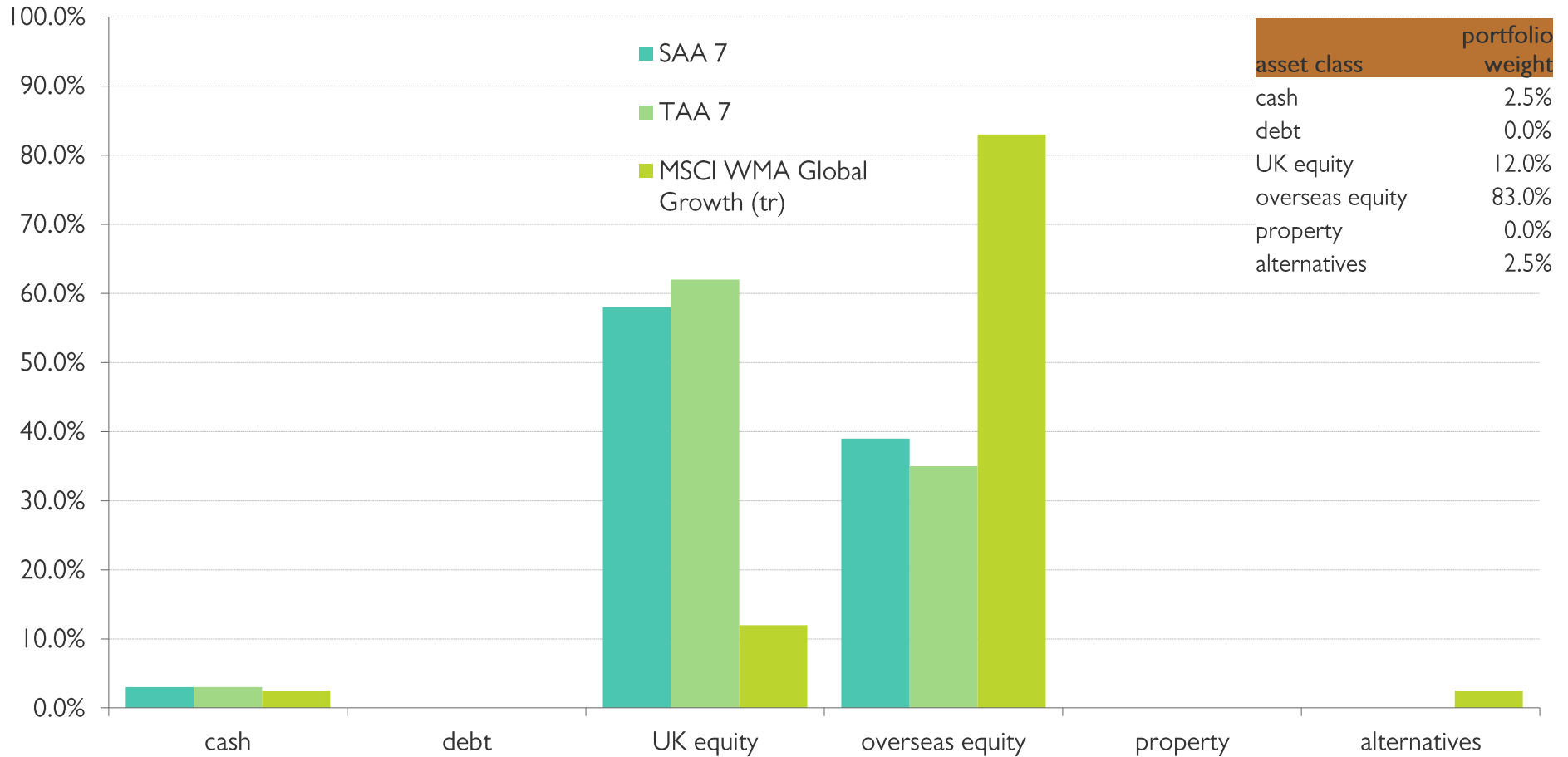
Upon reviewing the benchmarks for the BAM Model portfolios, we determined that the benchmark for Model 7 was unsuitable.

We were using the MSCI WMA Global Growth Index, of which the UK Equity market represents just approximately 12%. Given the predominantly UK location of BAM clients, and thus need to retain a reasonably significant proportion of their assets invested here, this benchmark does not accurately reflect the desired asset allocation.

We therefore changed the benchmark to one consisting of 50% 'MSCI World ex UK' and 50% 'MSCI UK IMI', which provides a much fairer guide.

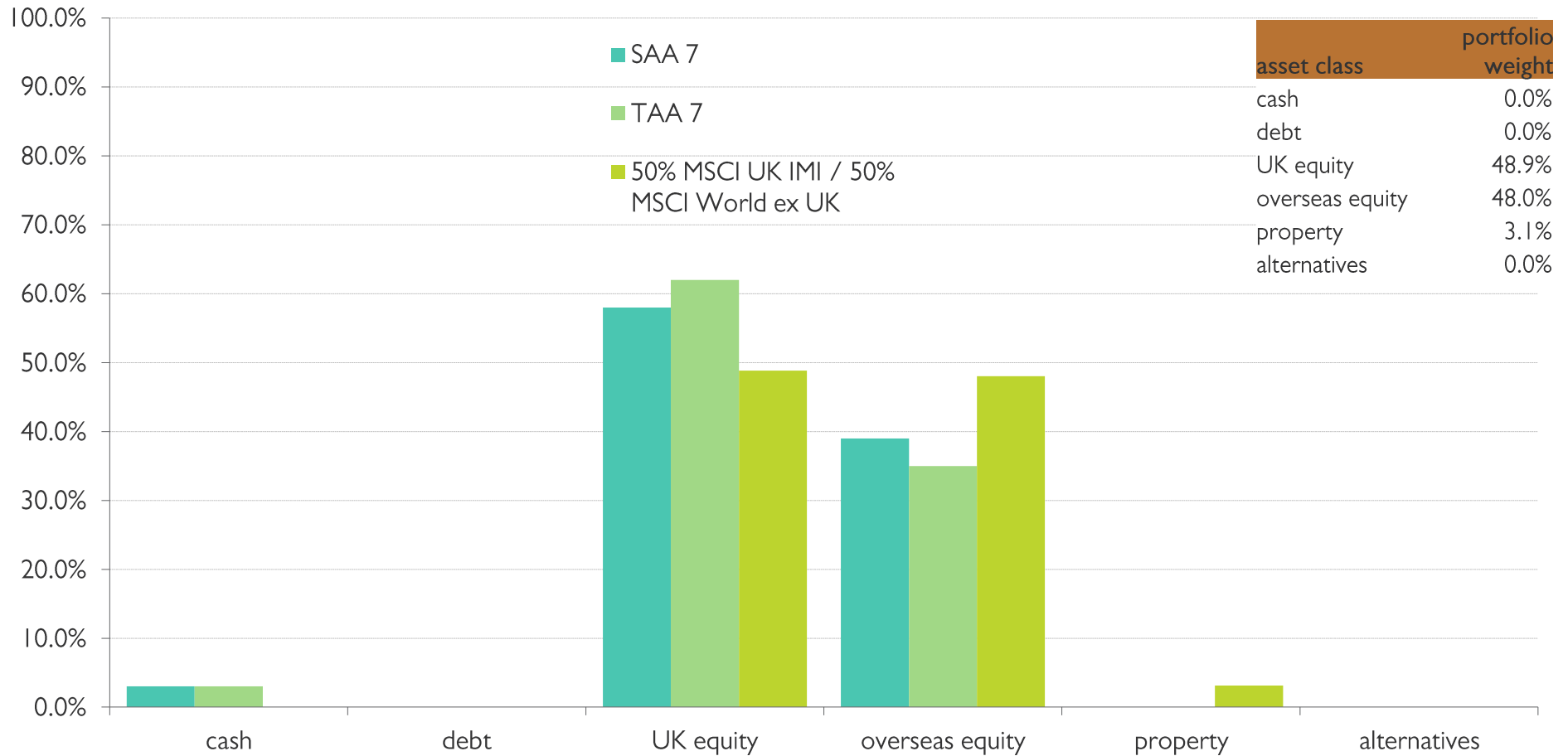
A more detailed breakdown of the asset allocation of both benchmarks is shown over the next two pages.

# MODEL 7 BENCHMARK COMPARISON (PREVIOUS)

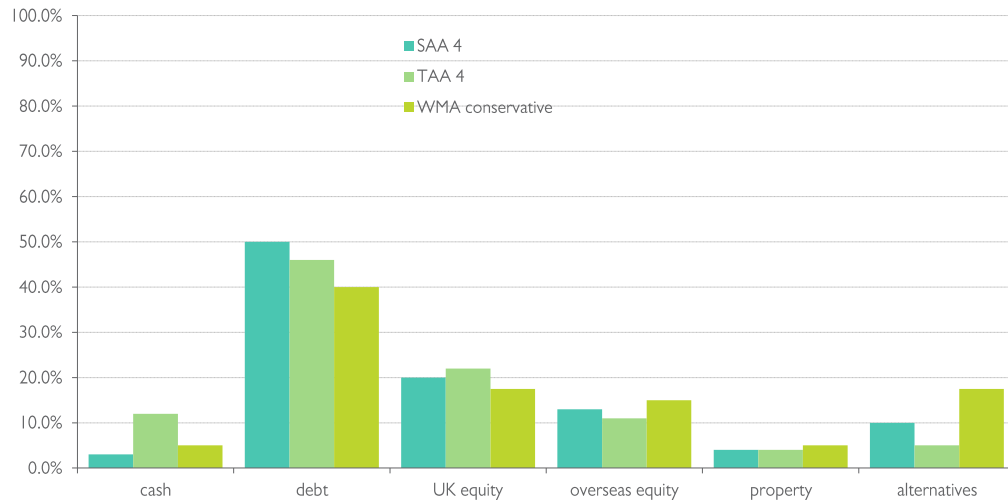
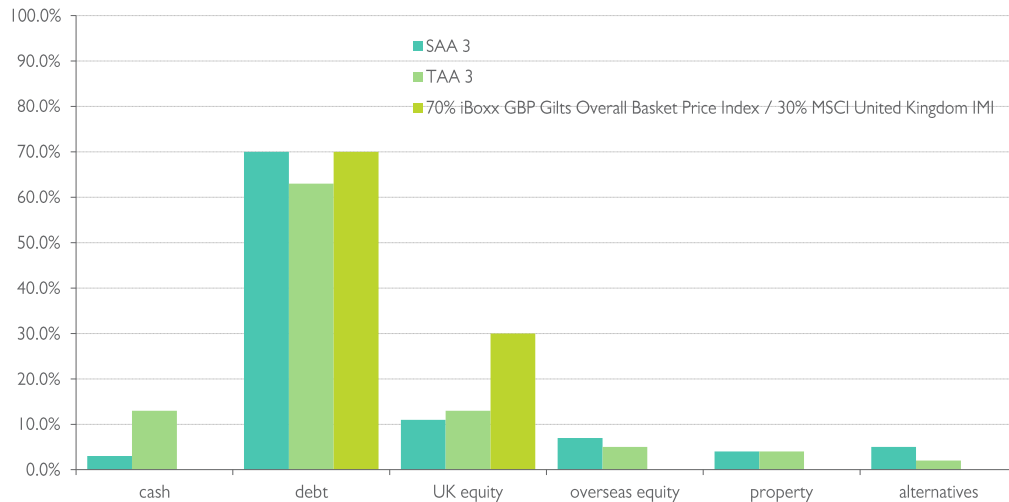


asset class	portfolio weight
cash	2.5%
debt	0.0%
UK equity	12.0%
overseas equity	83.0%
property	0.0%
alternatives	2.5%

# MODEL 7 BENCHMARK COMPARISON (NEW)



# OTHER BAM MODELS VS CURRENT BENCHMARKS



# APPENDIX



# FUND SELECTION

We structure our model portfolios almost entirely from passive funds. This reflects the evidence that actively managed funds cannot consistently beat the market (Cremers et al. 2014, Blake et al. 2015, S&P, 2014). This allows SORBUS to keep the underlying investment costs low and thus boosting the portfolio returns.

The occasions where SORBUS PARTNERS uses active funds represents a specialist market where markets are not efficient and an investment house is able to add value through their deeper understanding of market conditions.

## **active fund choices**

### *bond funds*

- TwentyFour Asset Management Monument bond fund
- TwentyFour Asset Management Dynamic bond fund

### *Asia pacific equity funds*

- Invesco Perpetual Asian
- Stewart Investors Asia Pacific Leaders

# ACTIVELY MANAGED FUNDS

## TWENTYFOUR ASSET MANAGEMENT

TwentyFour asset management is a fixed income specialist that provides two of the externally active managed funds that the model portfolios invest in. They operate in niche market areas that offer benefits of diversification to client portfolios.

### **Monument Bond Fund**

This is a low risk bond fund that invests in a selection of floating rate asset backed securities (largely mortgage backed). The investments are plain vanilla (not a repeat of the subprime versions from 2008). As the fund invests in floating rate securities it naturally provides a degree of protection from rising interest rates.

### **Dynamic Bond Fund**

This fund is higher risk than the Monument fund. It operates on an unconstrained basis. It aims to provide an attractive level of income along with the opportunity for capital growth, by investing in a broad range of bonds and fixed income assets, including investment grade bonds, high yield bonds, government bonds and asset-backed securities.

## ASIA PACIFIC EQUITY FUNDS

The Asia Pacific region (ex. Japan) is an example of an inefficient market. Both fund selection choices have a strong track record of outperformance against their peer group and against the FTSE Asia Pacific ex Japan indices.

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Past performance of an investment is not a guide to its future performance. Some investments may not be readily realisable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. Futures and options trading is considered risky and past performance of an investment is not a guide to its future performance. Some investments may be subject to sudden and large falls in value and on realisation you may receive back less than you invested or may be required to pay more.

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