Zen Wealth

Financial Freedom and Security

Financial Planners

Chartered

Fund Selection

January 2019

This does not constitute advice. Professional advice should be taken prior to acting on any part of it.

How do we blend funds

There are various modelling techniques commonly used in the wealth management industry. These can be used to project a range of possible outcomes for determining how assets will behave in relation to each other to determine an 'optimal' allocation. The most widely used modelling technique is based on Harry Markowitz's Modern Portfolio Theory (MPT), which seeks to maximise return from a portfolio for a given level of risk. Introduced in 1952 it is still widely used in the wealth management industry.

We used computer software to help us determine 'optimal' asset allocations for a given level of volatility (risk). This helps us to understand the relationship between risk and return and which funds in theory complement each other when blended together.

The past is not necessarily a guide to future performance

Initial Fund Screening

We start by taking the whole sector and applying a range of measures to reduce it to a short list of funds which display acceptable risk and performance characteristics. We then use quantitative and qualitative measures to ensure that the fund has a robust fund management process in place with a strong management team.

Whilst no guarantee, this can give us some indication of the platform which the fund is built on and how it might perform in the future.

We use fund analysis tools which combine and evaluate the data. The primary quantitative data is collected via Morningstar Adviser Workstation and we couple this with other data sources.

In all areas, funds were compared against their peers and benchmarks in the following areas:

- **Diversification**
- **TER/Ongoing Fund Charge**
- **Performance**
- **Volatility**
- **Fund Size**
- **Qualitative Screening**
- **Fund Manager Background**
- **Fund Philosophy**
- **Fund Management Process**
- **Risk Controls**
- **Manager Resources**

The past is not necessarily a guide to future performance

Diversification

We believe that diversification is essential, therefore when considering how the portfolio blends it was important that each fund “pays its way”. This means that we are spreading the risk within the portfolio across a wide range of underlying investments across the globe.

This reduces the reliance on the performance of a small number of stocks which is more traditional within a pure actively Managed Portfolio.

We adopt a core and satellite approach, which means at the core, we look for low cost passive investments, but where we believe value can be added by taking an active approach we divert resources accordingly.

TER/Ongoing Fund Charge

We believe that charges should be kept low. The charges taken by a fund manager can substantially impact on the performance of the fund. We have primarily selected funds with a TER or Ongoing Fund Charge of less than 1%.

Performance

Fund performance is a good indicator that the philosophy and management style of a fund manager is robust. Whilst this is important, it needs to be considered in the context of its peer group and benchmark. Performance of a fund is often relative to the risk that the individual manager is taking within the portfolio and therefore it needs to be considered carefully to ensure that sensible controls are in place and that undue risk is not taken.

We select funds which we believe will add value to a portfolio over the longer term, we look at the past track record of the fund in conjunction with the other quantitative and qualitative measures and not in isolation.

Volatility

Volatility is one of a number of measures we consider to help us understand the funds and how they operate. We consider the funds in relation to the benchmark and sector as well as their specific goal within the larger portfolio. There are a number of volatility measures which we consider when selecting a fund, the primary measure is the Standard Deviation of the fund.

We compare the funds against the average for the sector, but we also consider these measures in the context of the funds' investment aims and objectives. This may mean that funds that fail these measures may still be used if we feel this is understandable given the focus of the fund.

Fund Size

Fund size is considered, as we want to ensure that the funds we are suggesting have sufficient 'buying power'. For example, in the Corporate Bond market, some companies will only offer their Corporate Bonds to the key fund managers.

The minimum fund size depends on the sector, for established funds in the mainstream sectors (Balanced Managed, Cautious Managed, Corporate Bond, UK Equity Income, Europe, UK All Companies, Global Equities) we would generally look for a minimum size of £50m, however this would be reduced to £30m for sector funds (Specialist, Asia ex Japan, Japan, Global Emerging Markets, North America).

We are not restricted by this policy and will consider funds (new launches for example) that fail these criteria if they fulfil a majority of other requirements. Conversely, a fund can become too big, and too cumbersome to deliver strong returns against its initial objective, this is also something we would consider when recommending a fund.

Qualitative Screening

The qualitative screening allows us to look in more detail at the how the fund actually operates.

Fund Manager Background

We need to ensure that the fund management team has sufficient expertise in the area in which it is operating. This involves making a judgment on the relevant experience of the team and also the roles and responsibilities within the team. It is also important to understand these roles and responsibilities so that, if a fund manager leaves, we can make a reasonable assessment of how this will affect the fund management by knowing who will take over and their relevant experience. This is more prominent when looking at Actively Managed Funds rather than Passive, or Index Tracking Funds.

Fund Philosophy

This helps us to place the fund relative to their peers in terms of how the fund is managed in broad terms and what scope the managers have to deviate from the principles set. For example a fund may have a more flexible philosophy complementing a relatively strict process and we would need to understand which would have greater control in extreme market conditions. It also helps us to understand the general stance of the group as well as the individual funds characteristics.

Fund Management Processes

Much of the qualitative research is around how the fund operates, and how robust the fund management process is. This involves gaining a full understanding of how the fund is managed, what would trigger the manager to buy or sell a particular stock, what they are looking for in the stocks that they hold etc. We also look at how they monitor the fund holdings on an on-going basis and how decisions on the fund are made.

Risk Controls

The risk controls that are in place are also considered. It is essential that risk is managed according to a robust process and in line with any published risk tolerances.

Manager Resources

The resources that the fund manager has available to them can be important in the success of the fund. We therefore look at what research capabilities there are within the fund management team (clearly important in finding new investment opportunities) and also at whether or not any research is bought in (this can be good as it can provide an alternative view, however in some cases it can indicate a lack of resource within the team). We also look at the fund managers other responsibilities.

For example if the fund manager has to input heavily into other funds, then this can mean a lack of focus on the core fund, which may also affect future performance.

Fund Selection

Following the selection process the following funds have been identified for inclusion within the portfolio.

Sector	Fund
Liquidity	AXA Sterling Credit Short Duration
Liquidity	IShares 0-5 Years UK Gilt ETF
Fixed Interest	Fidelity Strategic Bond
Fixed Interest	Artemis Strategic Bond
Fixed Interest	Dimensional Global Short Dated Bond
Fixed Interest	Dimensional Global Short Term Investment Grade Bond
Fixed Interest	Dimensional Sterling Inflation Linked Intermediate Duration
Property	Henderson Janus Property Trust
Property	Legal and General Property Trust
UK Equities	Dimensional UK Core Equity
Japanese Equities	I-Shares Japan Equity Index
Pacific Equities ex Japan	I-Shares Pacific Equity Index Ex Japan
North American Equities	I-Shares North American Equity Index
European Equities ex UK	Vanguard FTSE Developed Equities Index ex UK
Global Small Cap	Vanguard Global Small Cap Index
Global Value Stocks	Vanguard Global Value ETF USD
Emerging Markets	Newton Global Emerging Markets Int W
Emerging Markets	Vanguard Global Emerging Markets Index

Benchmarking

As a committee, we believed that we should aim to broadly track the market, therefore we created a composite benchmark for each of the sectors which we believe offers a good representation of how our portfolio should behave.

Sector	Fund
Liquidity	BBGBarc Sterling NonGilts 1-3 Yr TR GBP
Liquidity	BBgBarc UK Gilt 1-3 Yr TR GBP
Fixed Interest	IA OE £ Strategic Bond
Fixed Interest	IA OE £ Strategic Bond
Fixed Interest	CITI WGBI 1-5 Yr Hdg GBP
Fixed Interest	CITI WGBI 1-5 Yr Hdg GBP
Fixed Interest	BBGBarc UK Gov Inf Linked 5-15y TR GBP
Property	IPD UK Property Index
Property	IPD UK Property Index
UK Equities	FTSE All Share TR GBP
Japanese Equities	FTSE Japan TR
Pacific Equities ex Japan	FTSE AW AP ex JPN TR GBP
North American Equities	MSCI North America NR USD
European Equities ex UK	FSTE AW Eur ex UK Tr GBP
Global Small Cap	MSCI World Small Cap NR USD
Global Value Stocks	MSCI World Value NR USD
Emerging Markets	MSCI Emerging Markets
Emerging Markets	MSCI Emerging Markets

The past is not necessarily a guide to future performance

A Blended Approach

Blended management is, as the name suggests, a blend of Active and Passive Management styles.

Blended portfolios bring together the potential benefits of both active and passive. The portfolios will be made up of a combination of actively and passively managed funds. There is no set allocation between the two styles; the selection is based on where we see the best opportunities for growth and how to gain access to them at the best price.

We recognize that, within certain sectors and assets classes (property for example), it is difficult to obtain coverage passively. In this instance we will look at how best to access the asset class whilst keeping costs low.

Quarterly Review Process

The committee will consider on a quarterly basis changes to asset allocation. Asset allocation changes will be dictated by any changes made in the Zen Wealth LLP Portfolios following a review by the Investment Committee. The changes will feed through to alterations to the weightings given to the funds listed above

The Committee will also consider the performance of the portfolios and will only make fund changes to react to corporate actions (where funds are closed, given a new objective, given a new benchmark or charges increased) or where it is considered that there has been continued divergence from the market return.

The past is not necessarily a guide to future performance

A Blended Approach

Blended management is, as the name suggests, a blend of Active and Passive Management styles.

Blended portfolios bring together the potential benefits of both active and passive. The portfolios will be made up of a combination of actively and passively managed funds. There is no set allocation between the two styles; the selection is based on where we see the best opportunities for growth and how to gain access to them at the best price.

We recognize that, within certain sectors and assets classes (property for example), it is difficult to obtain coverage passively. In this instance we will look at how best to access the asset class whilst keeping costs low.

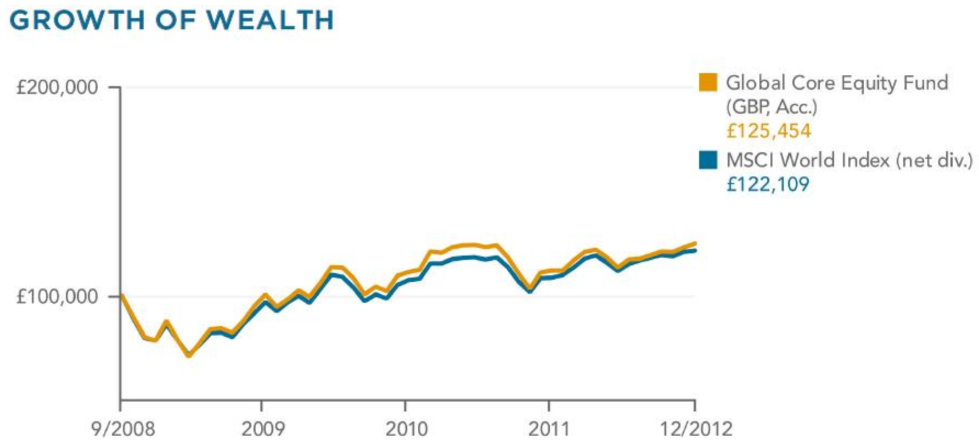
Quarterly Review Process

The committee will consider on a quarterly basis changes to asset allocation. Asset allocation changes will be dictated by any changes made in the Zen Wealth LLP Portfolios following a review by the Investment Committee. The changes will feed through to alterations to the weightings given to the funds listed above

The Committee will also consider the performance of the portfolios and will only make fund changes to react to corporate actions (where funds are closed, given a new objective, given a new benchmark or charges increased) or where it is considered that there has been continued divergence from the market return.

Monitoring Fund Performance vs. Benchmark Performance

We believe it is important for us to keep a close eye on the funds within your portfolio to make sure that they are capturing the risk and return characteristics of the asset class(es) that they are targeting. Part of this process involves us reviewing the fact sheets of the funds on a quarterly basis. On the fact sheets we can see live fund performance versus the benchmark performance as shown below:



It is likely that sometimes the fund will be performing better than the benchmark, whilst at other times the benchmark is performing better. This is what we would expect because the funds are not trying to exactly replicate the performance of the benchmark. Instead, the fund is trying to capture the asset class that the benchmark is interpreting. We monitor the relative performance of the fund and the benchmark to make sure that they are not looking too different. If we notice a significant difference between the two, then we will investigate further with the relevant fund manager to ensure that there is a logical and sensible explanation for this difference from the benchmark.

Portfolio Rebalancing

You will remember that we talked with you about your risk profile and the level of risk that you might need to take on in order to achieve your investment goals. This process was helpful in deciding which portfolio would be most appropriate for your specific needs and goals. It also helped to make sure that you were not put into a portfolio that would expose you to unnecessary or unwanted levels of risk.

The different asset classes in your portfolio should not all perform well or badly at the same time. The different timings of their types of performance is useful to the portfolio as a whole because it means that you are diversified.

Equities, for example, might perform better over a given time period than bonds. This would mean that the proportion of the total portfolio that is made up of equities increases from the initial proportion. At the same time, the proportion of bonds in the portfolio would, in this example, have reduced.

This is perfectly natural as the capital markets move up and down in relation to each other. However, the danger is that the portfolio may ‘drift’ so far away from the initial proportions of asset classes that the portfolio is exposed to more risk than we initially designed it to.

In order to safeguard against this, it is necessary for us to sell some of the asset class(es) that have performed relatively well, and also buy some of the asset class(es) that haven’t performed so well. We call this process ‘rebalancing’.

The past is not necessarily a guide to future performance

Advisory Management

We have reviewed a number of available rebalancing processes. We have decided to adopt a time-based rebalancing process. This means that every 12 months we sell and buy the necessary asset classes, so that the asset classes in your portfolio are returned to their initial proportions. In this instance we will seek prior approval from you before amendments to your portfolios are made.

Discretionary Management

Where assets are managed on a limited discretionary mandate, the portfolios will be rebalanced quarterly. Unlike Advisory Management, this process is automatic and we do not seek your approval before rebalancing the portfolio.

Investor Protection

Before we invest your money into any funds, we follow a process to ensure that there are the appropriate checks and balances in place to ensure your money is safe. This is a complicated but robust process that involves ‘custodians’, ‘transfer agents’ and ‘trustees’.

Platform and Tax Wrapper Availability

We believe that Platforms will play a major role in the delivery of a portfolio based solution. Clearly, there is little point in selecting funds that cannot be deployed in your preferred platform because you will have to replace these with alternatives which could alter asset allocation and risk.

We select funds which should, universally be accepted by a wide range of wrap platforms which allows us to source the best product for your specific needs.

Level 30
The Leadenhall Building
122 Leadenhall Street
London
EC3V 4AB
Tel: 020 3753 4638