BLACK SWAN
FINANCIAL MANAGEMENT

PORTFOLIO CONSTRUCTION

OUR PHILOSOPHY

For an investor with cash on deposit there can be more risk in doing nothing than doing something. This is because if an investment has only grown in line with inflation (as cash held on deposit commonly does) the returns are an illusion. If the cost of all the things an investor wants to purchase have gone up by more than their investment, the reality is that they have lost money, to obtain real (more than inflation) returns investors need to accept risk. We believe a good investment is one that delivers real returns with a level of risk that our clients are comfortable with.

Historically, equities (shares) have been a good investment and with patience, they have delivered real returns. But equities have also been a risky investment. There have been a number of long periods when equity returns have not kept up with inflation and many shorter periods when they have lost a lot of real money.

Two other types of investment can protect savings against inflation: property and index-linked gilts. An investment in property, like equities, has risks attached; there have been periods when returns have been disappointing and it can be an expensive and difficult investment to buy and sell quickly. Furthermore many people have much of their wealth already invested in property, so it can be risky to put too much spare cash into investment property as well. Index-linked gilts are risk free and being backed by the Government, are secure. The amount of money returned is protected against inflation, as is the income paid every year. They are one of the safest things one can invest in.

Gilts, corporate bonds and savings accounts at banks are other possible investments. They are certainly less volatile and have less risk than equities or property, but they are most suitable for shorter holding periods or as a means of diversifying equity exposure to reduce portfolio risk. For patient investors, who can afford to leave their investment alone for at least ten years, the inflation risk of gilts, bonds and cash rises whilst the inflation risk of equities falls. This is because gilts, bonds and cash offer no protection against inflation, whereas equities do. For longer terms our favoured investment asset is equity and is thus a key component in the portfolios we create.

OUR APPROACH

Investment risk is the chance investors take on making or losing money and with investment there is a strong relationship between risk and return. Unless an investor has very strong views about the investment approach they wish to adopt, we will establish an appropriate risk/reward profile for each of their investment objectives. In finding the right strategy we look to understand a range of aspects that could influence investment decisions and portfolio makeup; these include risk perception, inherent and effective risk and the trade off between risk and return. The resulting asset allocation strategies we use will be based upon one of five risk/reward definitions, each of which govern maximum equity exposure and potential for loss.

For portfolios with higher return mandates, equity is the predominant asset class with exposure to both developed and emerging markets. For clients willing to exchange some investment return for a reduction in risk, we cut the amount of equity exposure and introduce a range of different assets. Because different assets react differently to changes in the economy, spreading exposure across a range of different assets reduces risk.

OUR METHODS

Our investment portfolio recommendations pull together the talents of professional investment managers that we access

White Hart House Silwood Road. Ascot SL5 0PY t.01344 873254 e.info@blackswanfinancialmanagement.co.uk www.blackswanfinancialmanagement.co.uk

through collective investment vehicles. Collective investments allow individuals to participate in a large portfolio of stocks and shares by pooling their money with other investors. The spread of holdings within a collective investment provides a broad degree of diversification, the scope for which is extended by investing in a variety of collective investments with different investment objectives.

As stated within our Investment Manager Selection guide, we have a preference for investment managers who are free to pursue absolute investment returns and are not tied to a benchmark. As a result of this investment flexibility, the underlying asset allocations of our investment portfolios are not static and will change in accordance with the views of the investment managers. Please refer to the portfolio factsheets on our website to see the current asset allocation of our example portfolios.

Because collective investments are individually well diversified, for growth objectives we typically recommend clients take six holdings within a portfolio, with an even allocation of capital to each. This spread enables each holding to have an impact on performance whilst limiting over dependence on an individual manager. Due to the characteristics of income generative investments, an income portfolio will typically have twelve holdings.

When reviewing, setting up a portfolio or adding to an existing one, prevailing market conditions and asset prices will influence the investments we select and the advice we give. For example at times of market volatility we may recommend phasing capital into assets or if , however because we are unable to predict the future, we believe that time in the market is more important than timing the market, being invested for the long term is important as it provides time to ride out market downturns.