Investment Philosophy
&
Investment Management Process

Introduction

If you are looking for a financial strategy and investment approach that is right and meaningful for you personally, it is imperative that it is approached rationally and objectively. After reading this guide you should have a clear understanding of how Magenta Financial Planning (Magenta) can help you achieve that goal.

This guide explains Magenta's Investment Management Process, our core beliefs and our strategies. Quite simply, it explains how we help you to look after your money in what we believe to be the most effective way for you and those dearest to you.

We know that each of our clients is different, which is why we provide a bespoke Planning service. However, there is a distinct advantage in working within some common guidelines and controls to ensure that our advice is given in a consistent, controlled and efficient manner.

It is part of our philosophy that clients need to go through our Financial Planning Process before we can prepare a personal investment plan entirely developed for your specific purposes.

Once, the ***Financial Planning Process*** has helped to determine the type of investments or plans that are the most suitable for your personal requirements, then the ***Investment Management Process*** enables us to put together investment portfolios specifically designed for you, tailored to your investment risk profile and the goals we have agreed to help you achieve.

The way in which your money is invested then becomes an integral part of your personal, lifetime Financial Plan.

Our Investment Philosophy

Most people, when they set off on a journey, know what sort of car they are in, where they want to go and how they plan to get there. Not everybody uses the same approach when it comes to arranging their investments. Sometimes this can mean that they end up making investments without considering what the purpose is, whether the investment 'vehicle' is right or even having sufficient understanding of the underlying investment.

Magenta's fundamental philosophy towards selecting the right investments for clients is to ensure that we provide the right advice for your entire situation, not just isolating different elements of your current circumstances or random financial objectives.

To do this, we use a tried and tested ***Financial Planning Process.*** One of the results of this process is that it provides you with a Lifetime Cashflow Forecast which shows you the importance of ensuring that the right money is invested in the appropriate investments and is always available in the right hands at the right time. This way, we can help you to create and enjoy your desired lifestyle now and in the future without worrying whether, or not, your financial affairs are in order. You will receive an objective analysis of your current plans, with an assessment of their suitability and if necessary suggestions where improvements might be made. We can then ensure that we recommend an investment strategy suitable for meeting your objectives.

Our investment philosophy when selecting specific investments comes from a wealth of experience accumulated over many years working with private clients, stock brokers, fund managers, economists and various financial pundits. We have seen many investment strategies come in and out of favour. As a result we are very sceptical of any investment approach that suggests it can be all things to all men.

There are a number of different and successful approaches to investment management. It is wrong to say that any one approach is better than another; it depends on the circumstances. An approach which might be highly suitable for one client may well be entirely unsuitable for another. Our belief is that good Financial Planning firms should be sufficiently broad minded to recognise this and not just adhere rigidly to one investment management style. Thus it is our philosophy that we should consider each client's needs independently and then recommend an investment approach we believe will be the most suitable for those specific needs.

For years there has been an ongoing debate about whether investment management is an art or a science. We believe this to be a fruitless debate. Whilst mathematical theories and formulae can be of great assistance to investment managers, they should not be regarded as dogmatic rules. As the old proverb says, "*Rules are for the guidance of wise men and the blind obedience of fools."*

In investment management there are too many unknowns to create scientific formulae by which to run portfolios. You might as well try to create a mathematical formula to describe the growth of a tree.

Another key element to our investment philosophy is that of ‘investment’ rather than ‘speculation’. Any investment portfolio should be constructed with a view to maximizing your lifetime purchasing power and not chasing short term speculative gains. We want to try to reduce risks, not increase them.

In this context we accept that for each asset class (for example, UK Equities, Commodities, or Global Bonds) there is an implied trade off between risk and return. Magenta cannot influence what market returns on investments may be, but we can use a combination of asset classes to provide a diversified mix of assets with differing characteristics that, both individually and combined, play an important role in balancing your portfolio.

Our standard approach is to use lower cost, index-tracking or passive strategies at the core of client portfolios. This ultimately helps your portfolio to grow at a lower cost and reduces the risks implied by trying to time market decisions and selecting the right stocks, whilst still capturing the market returns for each asset class.

Our research indicates that many active fund managers add volatility, and therefore risk, but do not outperform the market index on a consistant basis. They charge a fee for their ‘expertise’ regardless of their performance. However, we also believe that in some situations and for some clients, there may be arguments for selecting investments with an added risk and return dimension, in which case we will also use actively managed funds,

It is this overall strategy that we believe will help you better achieve your goals. By updating your long term Financial Plan each year at your annual planning meeting, we can monitor your circumstances over time in relation to your objectives and take any action that may be necessary.

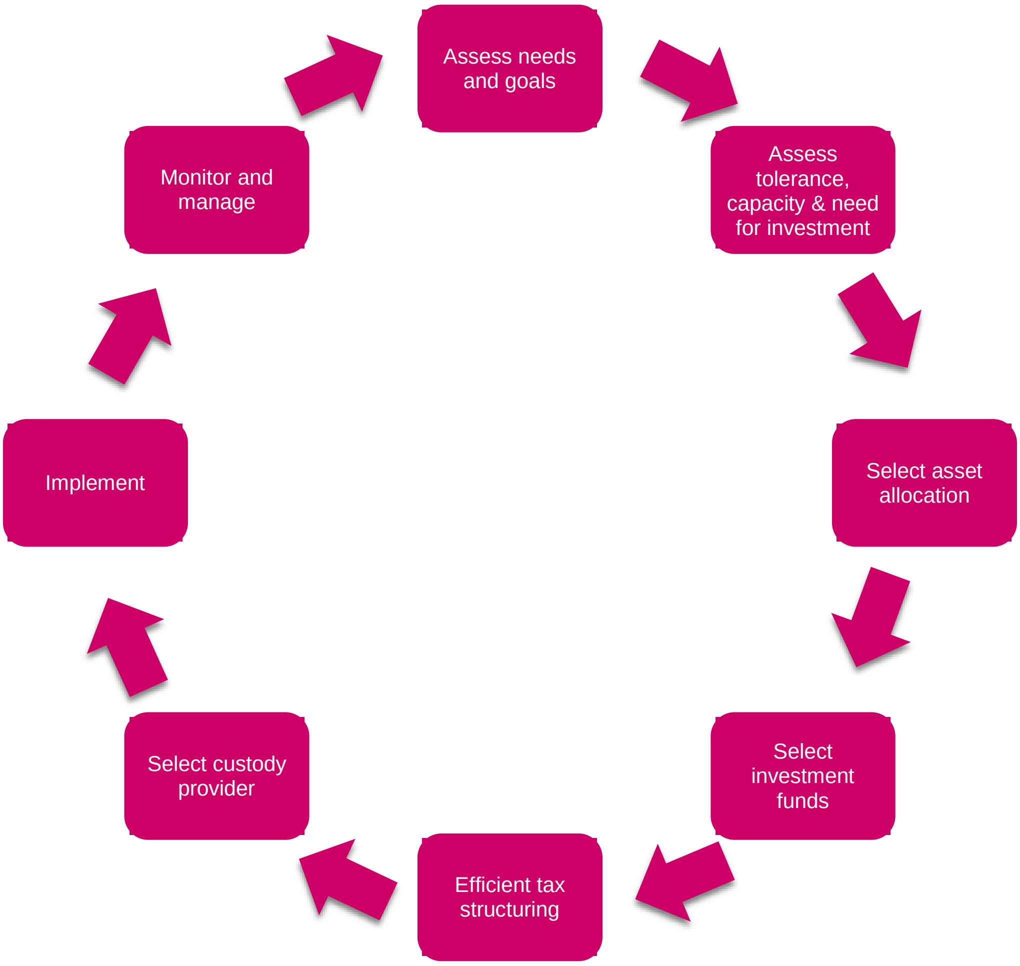
We provide independent advice

Magenta is not an investment manager. Once we have agreed a personal investment strategy for our clients we then recommend the investment companies and managers that we feel will be the most suitable for their purposes.

We have chosen to remain independent because we believe that it is important that our advice is not restricted in any way if we need to recommend a solution to clients. There are certain types of investments which we believe are highly unlikely to be suitable for some clients, due to their structure or inherent risks. However, it is important that we are fully aware of them and understand the circumstances where they *may* be relevant, so that we are able to advise appropriately if a client already holds such investments. We are committed to maintaining our knowledge in all product areas and this forms part of our Continuing Professional Development (CPD) Programme.

Investment Management Process

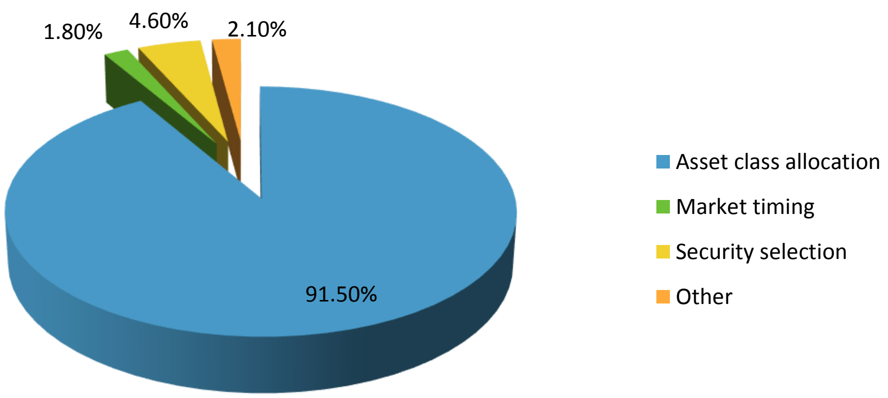
At Magenta we believe in the consistent application of the Investment Management Process to determine what type of portfolio and investment style will be the most suitable for you.



After we have assessed your goals and dreams, your current circumstances and your attitude to risk, we can then determine how your money will be invested to get the best possible returns, at a reasonable cost and with the least amount of acceptable risk.

Asset Allocation

How important is asset allocation? Historic studies have shown that over 90% of the variation in a portfolio's performance can be attributed to asset allocation.



Source: Financial Analysts Journal, BGP, Brinson, BD Singer & GL Beebower, June 1991.

When designing the asset allocation of your portfolio, there are three key elements to the portfolio that need to be considered. These are:

1. Short term liquidity
2. Capital expenditure requirements in next 3-5 years
3. Long term portfolio

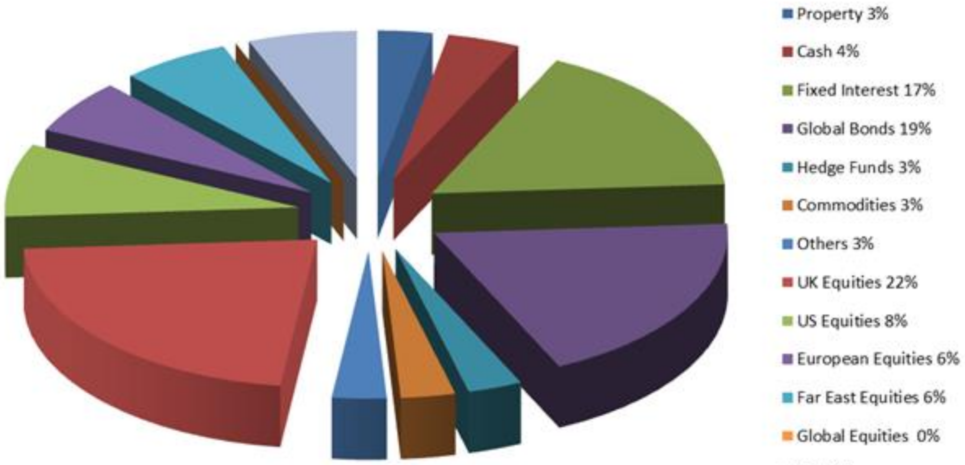
As part of the preparation of your long term Financial Plan we will discuss your liquidity and capital expenditure needs. The long term portfolio will then comprise the assets remaining after we have allocated monies required for these needs, with which you can take an element of investment risk, in order to achieve a reward / return over the longer term.

The portfolio we recommend will have a combination of equity, property, fixed interest securities and cash as a starting point, and depending on personal circumstances, may include other asset classes as required in order to achieve the long term return required from your portfolio.

By spreading money into different investments and different *types* of investment, we can reduce the risk within your portfolio. Some investments will be positively correlated (i.e. they all go the same way at the same time) whilst others may be negatively correlated (like two ends of a seesaw).

In the longer term, investments such as shares and property have shown that they increase more in value than bonds and cash, but they have also been shown to be more volatile. It is the relationship between these four main investment asset classes and their subsets that determines the level of risk, volatility and performance of a portfolio.

This is an example asset allocation of a 'Balanced' portfolio



Selecting Investment Funds

Once we have determined a suitable asset allocation, we start to look for the most suitable investment solution. As independent planners we believe that we can serve our clients best by not being aligned with any one investment company, but having licence to research the 'whole of market' to select those that in our opinion offer the best solutions to each individual client's needs.

Consistent investment research shows that trying to manage money on a 'buy low, sell high' basis is fraught with danger and potential volatility. Taking the example of equity allocation, if you select the shares of only a handful of companies and the equity market as a whole rises, you could still lose money if one or more of your shares performs badly.

Other than for speculative money, our view is that a portfolio of well diversified assets, allocated to your personal risk and requirements and tilted on occasion, provides the most suitable long term solution. Once we have agreed on a balance for your portfolio across your asset classes, it is equally important to diversify within those asset classes.

To diversify within asset classes, we research managers who will provide a portfolio of collective investment funds, such as unit trusts, OEICs (open-ended investment companies) and ETFs (exchange traded funds).

Collective investment funds pool your money with that of many other investors. This shared arrangement allows individuals to invest in a wider selection of assets, spreading their investment and reducing their exposure to risk. When investing in a unit trust or OEIC, money invested buys shares / units. Each unit trust or OEIC has thousands of people holding units/shares in the fund. The fund managers then have substantial sums to invest widely within asset classes. The price of the units is determined by the value of the underlying assets.

Units trusts and OEICS cover a wide variety of funds. The funds are grouped together in sectors, covering general principles of style, area and risk level in which the fund has chosen to invest. They are flexible and have no lock-in period, allowing for withdrawals at any time.

The gains made on shares within the funds are free of capital gains tax until such time as the funds are encashed, which helps you to make the most of your investment. Collective funds offer a cost- effective and tax-efficient way to diversify across and within asset classes. They also offer a convenient way to invest in overseas markets. This all helps to manage risk and volatility.

Magenta has an ***Investment Committee*** that meets quarterly to discuss the investment strategy, review the fund managers whom we recommend and consider whether any changes should be made.

Active and Passive Investment Management

What is active management?

Actively managed investment funds are run by professional fund managers or investment research teams who make all the investment decisions, such as which companies to invest in or when to buy and sell different assets, on your behalf. They have extensive access to research in different markets and sectors and often meet with companies to analyse and assess their prospects before making a decision to invest.

The aim with active management is to deliver a return that is superior to the market as a whole or, for funds with more conservative investment strategies, to protect capital and lose less value if markets fall. An actively managed fund can offer you the potential for much higher returns than the market average, providing your fund manager makes the right decisions.

It also means that you have somebody tactically managing your money, so when a particular sector looks as if it might be on the up, or one region starts to suffer, the fund manager can move your money accordingly to expose you to growth or shield you from potential losses.

How does this differ from passive management?

Passive investment funds will simply track a market, and charge far less in comparison. The funds are essentially run by computer and will buy all of the assets in a particular market, or the majority, to give you a return that reflects how the market is performing. The idea is to minimise investing fees and to avoid the adverse consequences of failing to anticipate the future correctly.

By tracking an index, an investment portfolio typically gets good diversification, low turnover (good for keeping down internal transaction costs) and low management fees. With low fees, an investor in such a fund could expect to see higher returns than a similar fund with similar investments but higher management fees and/or turnover/transaction costs when actively managed.

Passive core, active satellite, portfolios

We are happy to advise and assist clients to select managers with a number of different styles, but **our default preference is for portfolios made up of a core of passive investments with a satellite of more active and client specific investments – so a blend of the two approaches**. We believe that reducing cost is important to the performance of a fund, but that there are situations where an Active Manager can bring added value.

As a result we believe in using a low cost, typically passive investment which keeps down the total cost of the portfolio for assets where we believe there is limited opportunity to improve on market returns and therefore little value in paying a premium for active fund management.

Conversely, for certain assets, we believe there is value in using an active fund manager to create returns which aim to beat the market return. By using a predominantly low cost passive investment approach, the total cost of the portfolio can be kept relatively low, even when the small amount of more expensive active management is included.

There are advantages and disadvantages to both active and passive investing and there is an increasing number of ways in which funds are constructed.

Magenta's Investment Management Committee regularly reviews the investment managers who construct portfolios using this approach to determine who are the most suitable for our clients.

These are some of the areas we review:

- In selecting active or passive funds, managers can make bad judgements, make bad investment choices or follow an unsound theory in managing the portfolio.

- Fees for portfolio management can vary significantly and we are conscious that it is our role to keep ensuring that our clients are getting value for money.

We select funds and fund managers that meet all of the following criteria:-

- They maintain well-diversified exposure to the target asset classes so that investors can reliably capture the asset class returns.

- They maintain low investment turnover to reduce trading costs.

- They maintain low fund operating expenses and fund management fees.

Tax Structuring

While asset allocation and fund selection are the most important considerations in building a portfolio, it is also important to minimise the effect of tax on your returns where possible.

We will also help you to decide within which tax wrappers (for example pensions and ISAs) you should build up your investment portfolio. Each wrapper offers distinct tax benefits but there are also limitations on their use. We will select what is likely to be the most effective combination of wrappers for you, given your situation and objectives.

If there are opportunities to reduce tax, such as transferring assets between spouses, we will discuss these with you and can also advise on investments which have inheritance tax advantages.

Selecting a Custody Provider

Custody providers (also known as wrap platforms) provide an administrative service that can consolidate all of your investments onto a single manageable platform that you can access directly whenever you wish.

We have used wrap platforms with our clients for many years. They provide a convenient, cost-effective and secure setting within which we can help you to build and manage your investment portfolio.
There are many general advantages for you of holding your investments on a platform and these are listed below:

- Simplicity – one place to access your portfolio and arrange transactions.
- Charges - a clear and transparent view of charges.
- Value for money – being able to access funds at institutional annual rates not available when dealing direct with fund providers.
- Reduced administration – consolidated Income and Capital Gains tax statements from one source to help you complete your tax return; consolidated valuations and transaction reporting.
- Service – we can report, arrange transactions and monitor your portfolio on one platform.
- Access – online access to your portfolio to obtain up to date valuations.

Discretionary Fund Management Service

For clients with upwards of £300,000 investable assets, we may consider introducing the services of a Discretionary Fund Manager (DFM). For clients with less than that, we do not feel that it is possible for the DFM to offer a truly bespoke solution and therefore the premium charges are not warranted.

Discretionary fund managers provide a tailored service, targeting the client's goals and accommodating specific requirements around legacy assets. We are able to arrange an introduction to a suitable DFM if we feel they would provide a tailored investment solution within the overall financial plans we have created.

Implementation

Once a plan of action has been determined, Magenta will assist you in making all the necessary arrangements for its implementation.

Where our recommendations include non-investment solutions, for example protecting against risks like ill-heath or premature death etc, we will guide you through the necessary actions and confirm on completion.

We may agree that it is in your interests to transfer your existing investments to a new custody provider. The custody provider will then arrange the transfers following our instruction.

Establishing your investment portfolio will involve buying the funds that we recommend as the building blocks of your portfolio. We will instruct your selected custody provider to carry out the fund purchases for you and they will hold a record of your fund purchases (and sales) available to you.

'A strategy is nothing but good intentions unless it is effectively implemented'.

Monitoring and management

Once your investment portfolio is established, we will help you to monitor and manage it. We carry out several management tasks.

Your portfolio will be composed of a range of different asset classes. The amount that you hold in each one will depend on your financial position, your goals, the return that you need and your tolerance of risk.

Over time, your asset allocation will drift from your optimum target. This is because the different asset classes will have different rates of return. Your portfolio will therefore acquire different risk and return characteristics over time that may no longer match your goals, risk preference and tax position. This is commonly known as asset drift and will be addressed each year by rebalancing your portfolio where necessary.

When reviewing your portfolio, our Investment Management Committee will check whether the portfolio managers are doing what we expect of them. If we feel changes are required we will suggest suitable alternatives.

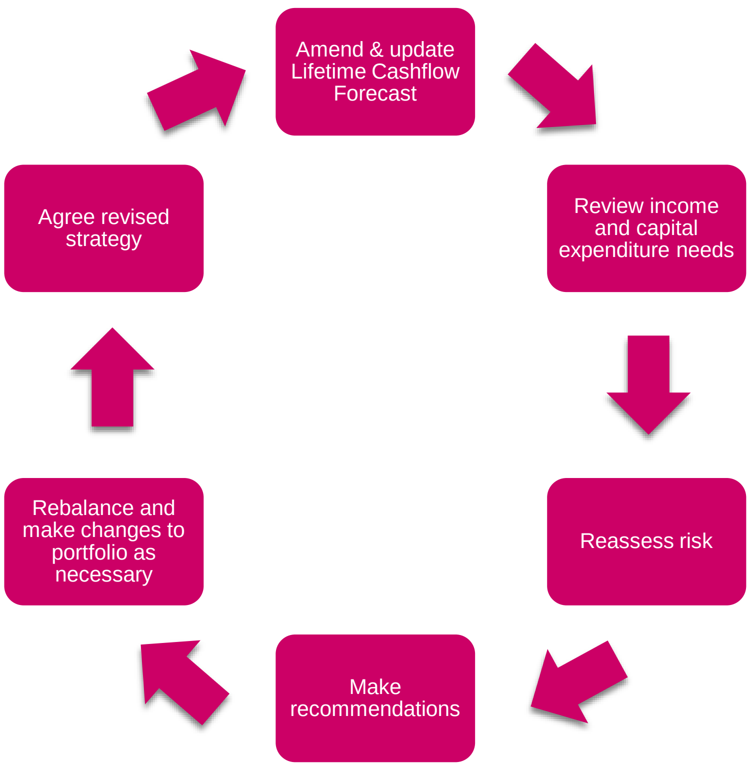
Portfolio rebalancing normally involves selling off part of the funds that have performed relatively well and become ‘overweight’ and redistributing the profits so that a more balanced allocation is maintained.

Client portfolios are monitored and rebalanced, taking into consideration risk exposure consistency, transaction costs, and tax ramifications to maintain target asset allocations.

Fund management is a competitive arena and, from time to time, it may be possible to gain more relevant and/or cost-effective access to an asset class elsewhere. If this is the case, we may recommend a fund switch to you.

In addition to these tasks, we will continue to review the service and offerings of custody providers to ensure that you get good value.

The annual planning service looks like this:



And repeat...

Financial Planning is an ongoing process and must be reviewed regularly. Investment portfolios also need regular review, not only to check investment performance but also because your investment portfolio will need to be adjusted to respond to your changing circumstances and needs, as well as changes in financial markets and taxation.

Holding regular meetings with us at Magenta and following the processes set out above, will ensure that you always have a robust framework within which to make the right decisions at the right time.