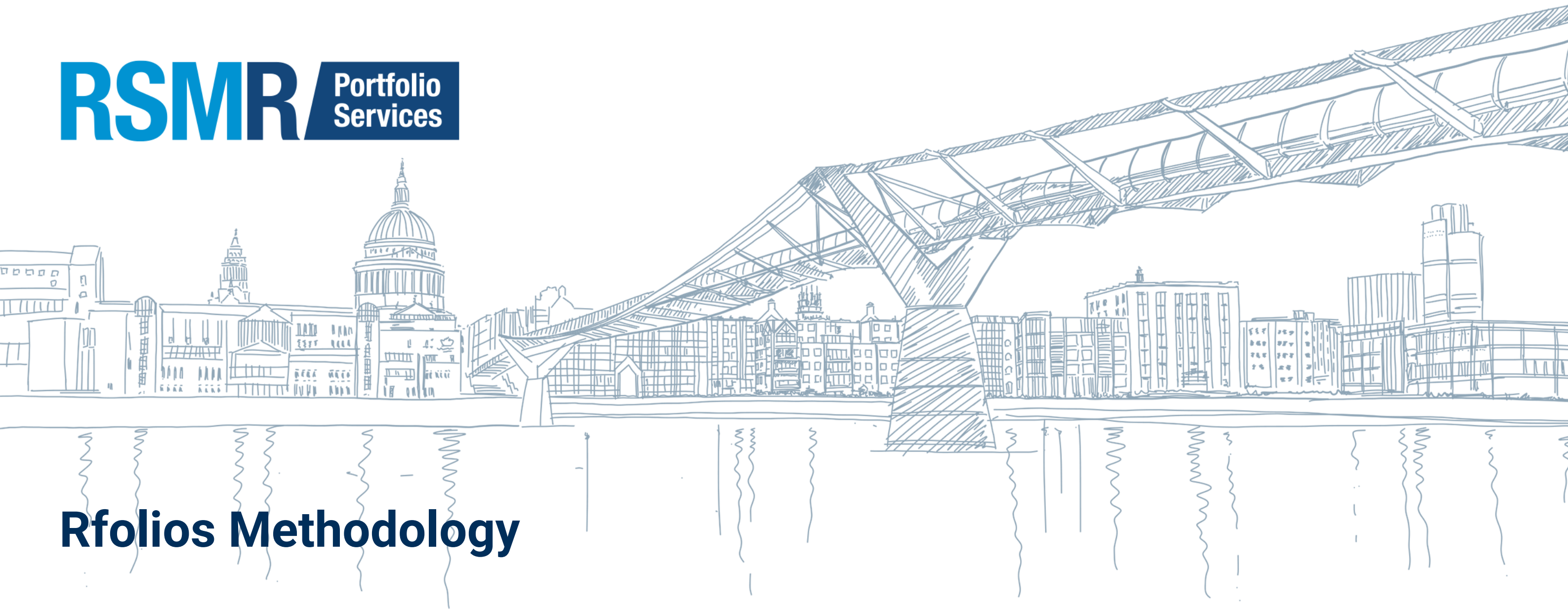
RSMR Portfolio Services



Rfolios Methodology

This document sets out our approach to asset allocation for the Rfolios portfolios, the thinking and research behind it, and also how, from a practical perspective, a set of asset allocations is put together.

Background

The aim of most portfolios is to achieve a consistent range of returns relative to the risk taken by investing in a range of assets with varying degrees of correlation. The foundation of most of the current asset allocation processes was set in the 1960s with the advent of modern portfolio theory. The theory is that a rational investor will want to diversify their assets to maximise their return. The basic concept in the theory uses what is termed the efficient frontier to illustrate how the assets can be combined to maximise risk and return; this is also often known as the Markowitz Efficient Frontier, after its founder.

Most of today's stochastic modelling tools take these principles and use historic data and some predictive modelling or scenario analysis to deliver portfolios that they predict will work along this efficient frontier. Modern Portfolio Theory has been adapted and challenged since its inception but the basic premise of combining assets to deliver the best risk-adjusted returns remains the goal of all subsequent alternatives.

We recognise that many stochastic modelling systems are based on historic data and therefore there is a need to add in forward-looking information and so our approach takes account of the academic theory as well as adding in information from managers, our own research and some practical understanding of how best to offer a solution that can be realistically maintained over time. We also consider qualitative data, which is discussed in more detail in a later section.

Our approach

Our approach to strategic asset allocation takes into account the historic, long-term risk and return of various asset classes which provides the base for portfolio construction. We intend this to be relatively simple and strategic in nature and are not looking to constantly change our positioning and/or time market changes. A tactical asset allocation is applied as a shorter-term overlay strategy. Our approach should be easily explained by the adviser and easily understood by the end investor.

The strategic asset allocations for the Rfolios portfolios are not aligned to any particular risk profiling tool with asset allocations determined internally, although the portfolios are risk profiled by Dynamic Planner, Defaqto and Synaptic on a quarterly basis.

There is an internal target of maintaining a consistent Dynamic Planner risk profile for seven of the eight portfolios over the medium to longer-term whilst being aware that short-term results may vary. These are:

- Rfolio Defensive – Dynamic Planner Risk Profile 3
- Rfolio Cautious – Dynamic Planner Risk Profile 4
- Rfolio Prudent – Dynamic Planner Risk Profile 5
- Rfolio Balanced – Dynamic Planner Risk Profile 6
- Rfolio Growth – Dynamic Planner Risk Profile 7
- Rfolio Dynamic - Dynamic Planner Risk Profile 8
- Rfolio Adventurous - Dynamic Planner Risk Profile 9

The exception is Rfolio Income, whose income/yield target is the primary objective and this may affect the portfolio's risk profile. The output from the quarterly Dynamic Planner risk profiling process is actively used as part of the asset allocation process. We are aware of the Dynamic Planner strategic asset allocations, but these are not formally used within the process.

Asset allocation

The methodology for building asset allocations is based around three core processes. The first is to establish our medium to long-term, strategic allocations to the major asset classes required within portfolios. Secondly, these allocations may be adjusted on a tactical basis to take account of shorter-term factors that are not reflected in longer-term performance, volatility and correlation figures. Finally, and of equal importance, we may adjust these allocations to account for specific client requirements.

Strategic Asset Allocation

The strategic asset allocations of the Rfolios portfolios provide incremental increases in volatility over the medium to long term primarily through an adjustment to the Equity and Fixed Income allocations. A key part of the process is to consider the various rates of return we expect from different asset classes over the long term based on a normal economic cycle, part of which is based on current valuation levels.

The positioning also takes into account economic and market data from various external sources in order that the view is not biased to internal information or influences. We typically consider the major asset classes to be split into five areas: Equities, Fixed Income (Bonds), Property (mainly UK direct commercial property but we also include property proxies), Alternatives (this encompasses a wide variety of underlying strategies) and Cash.

We may break down the asset classes further as follows:

- Equities – Region/ sector
- Fixed Income – Government/Index-Linked / Investment Grade Corporate / High Yield / Emerging Market Debt
- Property – UK direct commercial / equities, including REITs
- Alternatives – real assets, commodities, absolute return, thematic, etc.

For the Rfolios portfolios all five of the major asset class categories are used, but this may change over time, including additional categories.

The broad categories of Fixed Income, International Equities and Alternatives provide the portfolios with the flexibility to allocate to different sub-asset classes on both a strategic and tactical basis.

Tactical Asset Allocation

At a portfolio level, the ability to tactically allocate away from the central strategic asset allocations is based on a subjective judgement of the current position of asset classes relative to the medium to long-term. We consider three main factors within our analysis:

- **Valuations**
  Valuations are important because no matter how (un)attractive an asset class might appear based on fundamental factors (see below), if it is priced accordingly (i.e. those fundamental factors have been taken into account) then the outlook for future returns may well need to be challenged.
- **Fundamentals**
  Fundamentals are always important in evaluating an asset, as these provide the basis for investment decisions. Macroeconomic factors are often important in determining the longer term direction of an asset class, but fundamentals can also apply at a more granular level and on a shorter-term basis.
- **Sentiment**
  Sentiment is more of a short-term factor, but it is an important consideration within the context of our strategic, longer-term outlook. We may view current sentiment to be reflective of our longer term view, but we also have to consider that many investors will be investing new assets and therefore need to position portfolios with a forward-looking view.

Quarterly Meetings

The RSMR Research team meets formally on a quarterly basis to discuss both our medium to longer-term and shorter-term asset allocation views, with the output is geared towards the former. This output is then discussed by the MPS Investment Team in a separate quarterly meeting but with more of a focus on the shorter-term views, whether the team agrees or disagrees with these views and how these may affect our tactical positioning within portfolios. New information and how this may affect our asset class views is frequently discussed within the team and decisions can be made intra-quarter, if necessary, but this is likely to be rare and linked to wider, larger events (e.g. GFC, Covid outbreak etc.). In addition to specific tactical asset allocation positioning, fund selection can be another way of expressing a particular asset allocation view (e.g. value vs growth, large cap vs mid /small cap etc.).

Portfolio Construction

The Rfolios investment management process is leveraged off the detailed qualitative research undertaken by RSMR in building the fund ratings list, which covers all the IA sectors and asset classes. The funds used have been rated after a detailed analysis of both quantitative and qualitative factors. Our deep understanding of investment funds, including their behaviour in different market conditions and inherent style biases, means we can select and combine appropriate funds to represent our market and asset class views.

Portfolio construction combines the asset allocation process with our fund selection process. The aim is to provide a sensible combination of asset classes and funds for the given risk profile and the overall portfolio objectives.

Our investment managers have sole responsibility for fund selection and portfolio construction of the Rfolios portfolios. Fund selection aims to combine funds within asset classes to provide sufficient, but not too much, diversification in line with the risk profile. Fund selection can also be used to express our views of investment styles and market capitalisation exposures.

Review and Monitoring Process

The Rfolios portfolios are subject to ongoing performance and risk monitoring. We also review the constituent funds for any specific issues to make sure that funds are performing and behaving as we would expect, given the prevailing market and economic conditions. We continue to monitor and review our asset allocations under the auspices of the RSMR Investment committee.

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Important Information