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IS PERFORMANCE THE ONLY MEASURE?

FACTORING IN MIFID II

WHEN CAUTIOUS MEANS SOMETHING ELSE

FINDING THE RIGHT FIT; LOOKING FOR THE RIGHT DFM

In association with:

beaufort INVESTMENT

BLANKSTONE SINGTON Investment Managers & Stockbrokers

Smith & Williamson

THE BIG DEBATE

THE ROAD AHEAD FOR DFMs

Discretionary fund managers (DFMs) now play an important part in advice firms' propositions. Take our annual Top 100 list: out of all the firms featured in 2017, 45 said they outsourced to a DFM to some extent.

Even when a firm does not outsource investment decisions, DFMs are likely to come into its thinking because they have to justify why they choose to make investment decisions in house.

So at this roundtable we wanted to get to the bottom of why so many advisers are picking DFMs for their clients' investment needs. This meant looking at what they offer to advisers: do they offer bespoke services to certain firms? How do they set out key information such as charges and investment strategy? And what impact have the EU's MiFID II rules had since they were introduced at the start of 2018?

Our enquiry also involved asking advisers what they want from a DFM. Service always ranks highly when we ask advisers why they pick a particular DFM. In fact, it seems to be more important than charges or performance. But in this discussion we looked a bit further at what good service entails. We also discussed some of the challenges facing DFMs and advisers when markets crash.

Hopefully you enjoy reading the results of our discussion.

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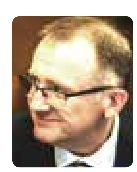
PARTICIPANTS

CAROLINE ANSTEE
MANAGING DIRECTOR, ANSTEE & CO

Caroline Anstee is managing director at Anstee & Co, overseeing the operations and advising clients. She has been in the role since January 2012. Anstee has over 35 years' experience in the financial services industry, working in retail banking for 21 years before switching to independent advisory – a decision she has been more than happy with, finding it very rewarding. Before building Anstee & Co, Anstee was a director at a number of firms. In her spare time, Anstee tutors at Sheffield University, covering money planning as a life skill.

ANDREW BENNETT
GROUP CHIEF EXECUTIVE OFFICER, BEAUFORT GROUP

Andrew Bennett has worked in financial services throughout his career and comes predominately from a financial planning background. Bennett is responsible for the management and direction of Beaufort Group and is focused on growing the number of advisory firms, together with growing assets under management by offering a high-quality service which is valued by clients and firms alike.

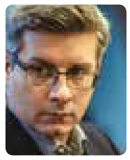


CHRIS BIBB
CHARTERED FINANCIAL PLANNER, INDEPENDENT FINANCIAL ADVICE

Chris Bibb is a chartered financial planner at Chris Bibb Independent Financial Advice, which is an appointed representative of Strategic Solutions Financial Services and has been since December 2013. Before joining the profession, Bibb served as a constable in the Metropolitan Police in the 1980s before becoming a financial adviser in July 1988. Since then, Bibb has worked for various retail banks, joining the independent financial advisory market in 2004. Bibb is a fellow of the PFS and is a retirement planning and later life specialist. Bibb is a family man with a keen interest in rugby.

NEIL BLANKSTONE
BUSINESS DEVELOPMENT DIRECTOR, BLANKSTONE SINGTON

Neil Blankstone is the firm's business development director. He has worked at Blankstone Sington for over 30 years and is the second generation to the company's original founders. Starting in June 1987 as a trainee in the dealing room, Neil initially became an investment adviser before gaining authorisation for investment management. He joined the main board in 1999. His main responsibilities are business development and marketing, in particular relationships with other professional intermediaries.



SIMON BULLOCK
CHARTERED FINANCIAL PLANNER & PARTNER, MULBERRY BOW

After gaining a BA Hons 2:1 and an MA from Bristol Business School in 1997, Simon Bullock joined Chase de Vere's graduate training programme and has been advising private clients for more than 20 years. His role at Mulberry Bow is focused on advising clients and leading the practice. He specialises in acting as a 'Personal FD' for entrepreneurs, and he wrote the white paper 'Pre-exit planning for entrepreneurs in the UK' released by Barclays in January 2015. Bullock has also worked for Schroders and Barclays Private Bank, where he led the wealth structuring team in London.

CHRIS HOLMES
DIRECTOR, ALMUS WEALTH

Chris Holmes is the director at Almus Wealth Management, which he set up in 2015. Holmes is a chartered financial planner and holds the titles of chartered wealth manager and certified financial planner. Holmes runs a generalist, London-based practice but holds a particular interest in advising on social impact investment (SII). Holmes has been involved with the Personal Finance Society and has acted as regional chair for the London professional body. In 2015, Holmes joined the Money Plan Scheme, in which he volunteers time each month to assist the work carried out by Citizens Advice.

PAUL LINDFIELD
CONSULTANT, STRATAGEM WEALTH

Until very recently, Paul Lindfield was the founding partner of Sedulo Wealth Management. But now Lindfield is about to embark on a new adventure with Stratagem Wealth and is looking forward to building a unique brand and reputation amongst the professional services sectors. An avid Manchester United fan and regular visitor to the 'Theatre of Dreams', he is often at war with the Manchester City half of the office. Outside of his dedication to football, he is also a keen chef and enjoys cooking up most things Italian.

MICKEY MORRISSEY
HEAD OF DISTRIBUTION, SMITH & WILLIAMSON

Mickey Morrissey joined Smith & Williamson in December 2012 as head of UK IFA sales and was appointed head of distribution in July 2014. He is responsible for growing intermediated sales into the DFM, managed portfolio service and multi-manager business lines. Previously Morrissey was head of distribution at Liontrust Asset Management for 10 years and prior to that worked at Merrill Lynch Investment Managers for 12 years.

DAVID PHILIPS
DIRECTOR, WEALTH DESIGN

Having worked in financial services since 1987 with a particular specialism in advice about pensions, David Philips has a wealth of experience under his belt. He spent many years working with major names in the sector too and prides himself with 'knowing his stuff' and making solutions clear and client friendly. Philips has also been regional chairman for the Personal Finance Society for Staffordshire and Shropshire for over 13 years, chairing quarterly meetings and attending national conferences. Outside of work Philips loves art and drawing, has his own studio at home, enjoys summer workshops and has been successful in competitions.

NICK TOWNSEND
DIRECTOR, DEVONSHIRE WEALTH MANAGEMENT

Nick Townsend's career began with a major UK insurer in 2000 where he gained an intensive understanding of the financial services universe. Townsend was a mortgage broker when he was initially recruited into Devonshire Wealth Management in 2008 and was enlisted onto a trainee programme to become a fully qualified IFA. Since then, he has become a director and part owner of Devonshire Wealth Management and has played a key role in modernising the firm's business through the integration of the latest financial planning systems and technology.

CHARLES WALMSLEY
NEWS EDITOR, CITYWIRE

Charles Walmsley is news editor at New Model Adviser® magazine. He joined Citywire in 2014 as a reporter after graduating from Oxford with a degree in English.

HOW DO YOU SELECT A DFM BASED ON PERFORMANCE?

NICK TOWNSEND: We look at data from DFMs, and from Asset Risk Consultants (ARC) and FE Analytics. We use FE Transmission, especially for managed portfolio services (MPS). We also have regular face-to-face meetings with the DFM to look at their research and capabilities. It takes time for a DFM to get on our panel as we want to build a relationship with the individuals we deal with as will our clients. We encourage that our clients have a relationship with the DFM on the bespoke DFM services.

CAROLINE ANSTEE: I've used DFMs for 20-odd years and it's more about relationships – I even follow managers around different companies. Performance comparisons are important and part of due diligence, but it is not always the most important to clients. It is more about trust in advisers and the DFM. I have followed one manager through four firms over 20 years because of the way he deals with clients and myself. I trust him 100%. But I also do due diligence on the company.

With advisers who don't use DFMs, it's often because of performance. As a DFM, how do you put out information about performance and speak to advisers about it?

ANDREW BENNETT: It's not easy, however, we try and be as transparent as we can. Our factsheets are on our website, updated monthly, with a live feed. All our numbers are shown and audited by FE. All our performance numbers are net of charges, even the MiFID II [revised markets in financial instruments directive] additional charges. We also compare our performance against ARC's recognised benchmark.

HOW DO YOU MEASURE RELATIONSHIPS?

CHRIS HOLMES: I'd like to separate bespoke discretionary management and model portfolios because there is a massive difference. The relationship for a bespoke service is crucial for the client. We occasionally do beauty parades and it's important that the investment manager gets to articulate what they do and how, so they know the client understands.

With MPS, our relationship with the manager is more important because the client doesn't get to touch the manager. If we're getting transparent answers, we feel more comfortable. Where there's opacity – and there's plenty of that around – we have concerns. So performance is a filter. Then we look at other things.

WHAT WOULD YOU CONSIDER TO BE POOR PERFORMANCE?

CHRIS HOLMES: One of our preferred model portfolio providers is underperforming. We know why and we endorse what they're doing. So there can be reasons, often to do with market stresses. But we are duty bound to consider [factors] beyond performance.

ANDREW BENNETT: Do your assets sit on platforms because of the ability to sack or appoint a different DFM? Does that give the client confidence that you're reviewing your panel?

CHRIS HOLMES: Yes, I do value the independence and that we can move around, and we do though it's rare.

NEIL BLANKSTONE: Regarding MPS, we think it is important to allow the client to interact with the manager, if they and the IFA want. So although it can be templated, we would still get involved. We're in a service business.

On performance, clients want to know 'What's the value gained or lost and what does it cost me? How do I compare?' More of that will become apparent. We also have to provide [information] showing what it will cost through the life of your investment. This is an important move as clients and IFAs say they're looking for that.

ANDREW BENNETT: Coming from an IFA background myself, you don't want any unnecessary surprises. You've got to see consistency of performance and understand what the conviction is, and how that model portfolio is being run. But you want to keep the client comfortable in a long-term relationship. You can easily lose that by making a massive market call.

CAN DFMs DO ANY MORE TO AID UNDERSTANDING OF PERFORMANCE AND UNDERSTANDING OF SERVICE IN HOW THEY DEAL WITH IFAs?

PAUL LINDFIELD: We've also seen some of our DFMs and MPS lag performance due to a tactical decision. So we look at all the factors, but most importantly we look under the skin. What is their investment philosophy – active, passive or blended? Is it direct versus collectives? Do they use alternatives? So we have to understand before we put that to the client and then be a critical friend. Do they have convictions? Are they contrarian? If so, when?

MICKEY MORRISSEY: We're on FE Transmission and we're a founding partner of ARC. For five years, we've been talking to them about what they could do in the MPS world and we introduced them to a major platform. They're working closely with the platform, looking at the [thousands of] MPS portfolios on there. Hopefully, by the end of this year, ARC will come out with an MPS system of transparency.

> 'Performance is more a box you have to tick. It's a minimum expectation from any DFM service'
> —Simon Bullock, Mulberry Bow

SIMON BULLOCK: Performance is more a box you have to tick. It's a minimum expectation from any DFM service. Once that is met, we move on to other factors. For me it's about how do they communicate with me, my team and the client? Does our brand fit with theirs or would the client feel a disconnect?

Responsiveness is important at certain moments, such as the Volkswagen emissions crisis – the smart DFMs contacted their key clients and communicated what they'd done about it. It was a good opportunity to show where active management might add value, but most missed that opportunity.

We only go bespoke over, typically, £3 million. Under that, the client doesn't meet the DFM. So we don't need many partners, just two or three. Do you consider charges as part of performance and how important are they?

CHRIS BIBB: You want a net return for the client to meet their objectives, within their attitude to risk. And they need to be comfortable with a good service. So, it's a combination of factors. Charges are key and on MiFID II we've said to DFMs, 'what will this do to your proposals? Are we talking 10 basis points, 30 basis points or more? What's it for? What will we say to the existing client who, when they get their ex-post [after the event] information, thinks charges have gone up since the proposal?' I

agree there has been a lot of opacity. There is still opacity with [some] DFMs, [on charges and] strategy. You need to do the due diligence, not just to cover your back, but to do the right thing by the client. So charging is key, but it's not the sole factor.

ANDREW BENNETT: You also have to compare services. IFAs might have five or 10 portfolios. There's a disconnect if the DFM has four or seven. A seven out of 10 needs to look and remain like a seven out of 10.

Also, IFAs want a certain amount of control of communication, and to agree what the communication is and what it looks like.

PAUL LINDFIELD: With modern technology, clients are much more aware of charges and value. So charges are important, but what are you getting for it? Before MiFID II, people were aware, but I have seen costs jump up suddenly – another extra 0.3% – where has that come from?

HAS MIFID II CHANGED YOUR DFMs IN ANY WAY?

CHRIS BIBB: There are different stances taken by different houses. Some declare what they can and err on the not so high side. Others, in the attempt to be honest, err on the upside and look uncompetitive.

ANDREW BENNETT: Is it a total expense ratio (TER) or an ongoing charges figure (OCF) or, now, a MiFID II compliant number?

How do you position that with your client? The client might say 'Those charges you disclosed before are now different. I'm starting to distrust what you're saying.' We haven't provided any more clarity than before because even if you disclose what the charges are for last year on a fund, they won't necessarily be the same next year.

> 'With modern technology, clients are much more aware of charges and value. So charges are important, but what are you getting for it?'
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> —Paul Lindfield, Stratagem Wealth

NEIL BLANKSTONE: The FCA said to us that they will give more formal guidance on charging in 12 months. For the ex-ante, some firms will do 12 months of costs. Some will do five years. The difficulty is what was the turnover in between.

So we need clarification. Do you take a three-year average? The FCA has provided annualised projected returns that everyone should use, but I'm not sure everyone has cottoned on to that yet. You can then break down elements of your asset allocation and link that to your costs to provide an even playing field.

CAROLINE ANSTEE: I want to be able to tell the client, 'this is how much it will cost a year'. We might pay more because we want a manager to see the client, but the value from that is X. So it's all about value, not about being cheap. If I don't know what it will cost, how can I convey that to the client? So I am keen on DFMs, just as I do with my client, saying 'It's going to cost you X. This is what you're getting for it, and this is the value.'

CHRIS HOLMES: There is a trend of moving towards trackers and ETFs and I'm not sure if it's worrying. It started a while ago, but partly with MiFID II in sight. It seems an easy way to reduce cost is to just buy indices. But in the current climate, that may not be the right thing to do.

ANDREW BENNETT: Some IFAs have gone down the passive route to justify what they charge without explaining the overall structure. Passive, active, blended – you should explain all the options.

CHRIS BIBBS: It will affect behaviour because people will start looking at costs and saying, 'that looks steep' rather than 'what are we getting for that?'

SIMON BULLOCK: ...which is one of the intended outcomes from MiFID II – to drive costs down.

MICKEY MORRISSEY: You can see why the sales of passive providers such as iShares and Vanguard have rocketed.

CAROLINE ANSTEE: Yes, but clients don't understand [that].

MICKEY MORRISSEY: The last five years have seen good returns. The projected returns from the regulator [now] look high. I've seen numbers of 9% annualised. We can't show that because it's too good.

ANDREW BENNETT: The IFA is good at managing expectations. If you make too much money or markets are down, they [adjust expectations] accordingly.

HOW DO ADVISERS KEEP TRACK OF DEALING COSTS AND TRADES?

SIMON BULLOCK: They're hard to track properly. The transaction friction on a portfolio can be much higher than clients or advisers anticipate. There also doesn't seem to be much information saying 'We don't know what our turnover will be, but in the last few years it's been X.'

I agree, the answer isn't just to throw it all into Vanguard. But discretionary passive portfolios – passive execution, but with discretion, rebalancing and diversification – have moved the bar. On platform, we can access such a comprehensive solution for a total cost of about 0.35%.

Ten years ago, there's no way I could access that. I'm not saying all my clients should go into that, but that's a starting point. If my clients pay more, they need an understanding of the additional value. Is it risk management, diversification, handholding, which is more valuable than many people credit? There might be many good reasons, or it might be half and half. If the client is talking to private banks, the private bank portfolios come out much higher than that. They could have a TER of 2%, it's not uncommon.

Anecdotally I've heard of projected costs being much lower than actual dealings. Have you had any experience of that and heard any explanation?

NICK TOWNSEND: You hope that the DFM is dealing for the right reasons and costs get outweighed by the performance. But it is difficult – how do you project costs for future dealings? One way is to look at the previous year's trades on a similar risk graded portfolio. Some DFMs bundle the costs together with dealings included in the overall cost. For the right client, that works well. MiFID II may bring the information out in more detail.

DAVID PHILIPS: The bulk of the market is moving to clean costs, without dealing. I've seen, and it's been pitched to me that, one or two DFMs have spoken with clients about using direct equities to reduce portfolio costs. But clients generally squirm at direct equities. It's perhaps the way I position it, but they see more comfort in the collective balance of risk. Clients with bigger portfolios may be more investment savvy and see the benefits of holding direct equities.

SIMON BULLOCK: We find smaller clients prefer a more diversified approach. The private banks or larger clients we deal with tend to use more direct equities. So rather than it being the 2% TER that you might associate with a private bank, the ones we work with [come in] just over 1%.

ANDREW BENNETT: This will take a few months to play out because the platforms have had to react quickly and make assumptions ready for January. They wrote to every fund management group and asked, what's the overall charge now? I don't think that is fully transparent yet. There's still much confusion.

SIMON BULLOCK: There's some research on how many stocks you have to hold, globally, to be diversified. It's a lot fewer than most clients think. There's not much benefit in holding thousands of stocks. Research suggests that [it is more like] 100 carefully selected companies.

That's interesting in relation to DFMs and dealing.

WOULD YOU EVER EXPECT TO PAY MORE FOR DIFFERENT STRATEGIES OR SERVICES?

DAVID PHILIPS: We bought into the FE risk-rating process. FE have introduced their hybrid portfolios, which we are finding fantastic success with. Through that we can risk rate clients, and it's the same charge across. So I'd be opposed to additional charges for additional risk.

DOES IT MATTER HOW CHARGES ARE PRESENTED? HOW CAN DFMs IMPROVE THAT?

PAUL LINDFIELD: It's important to drill down so you understand it. I always try and keep total charges below 2%. I always used to be active. We have had a good bull run, which won't last forever. So costs become more important. Now I'm happy to blend and use passives for the lower end.

DAVID PHILIPS: Eighteen months ago, we bought another adviser practice. The owner saw his role as fund picker. We started to introduce clients to [DFMs], particularly the higher net worth clients. The clients were open to the ideas and have been happy with the results. The process is smooth and the worry is removed.

ANDREW BENNETT: I'm surprised that many IFAs are still running centralised investment propositions, looking backwards to see what they should be doing in their models while still holding all the risk in their business. Face-to-face visits with the managers and the qualitative research is where the value is.

WHEN YOU INTRODUCED THEM TO DFMs, WHAT DID THAT DO FOR THEIR COSTS AND PERFORMANCE?

DAVID PHILIPS: It wasn't all about cost. It was peace of mind in changing markets; seeing clouds on the horizon making moves to protect a portfolio. Likewise, when the sun is shining, taking advantage. Saying it with conviction and some experience from my original business won them over. I yearn to find another business like his to do the same again.

PAUL LINDFIELD: I've come across a few fund pickers recently. They were saying, 'I need to move my investment proposition forward, how do I do it? This client expects me to pick funds as I have done for 20 years.' The quickest way is to say 'This is a volatile and rapidly changing political and economic environment and you cannot react [quickly enough].' So it was all the adviser's perception, not the client's. The adviser [realised that and agreed with me].

DAVID PHILIPS: You did well to get him to admit it. On our purchase the owner saw it as his role to select funds and letting that third person in the room ... It is so much about personalities, because that DFM becomes part of your team, your family. You present him as a seamless part of your business. I can't remember when I last did a beauty parade, because the client usually says, 'If that's what you think, then go with it, you're the adviser.'

HAS OUTSOURCING TO DFMS GIVEN YOU TIME TO DO OTHER THINGS IN YOUR BUSINESS? WHAT BENEFITS HAVE YOU SEEN?

CAROLINE ANSTEE: I've always used DFMs, so I haven't changed. As I've grown the business, I've tried to mentor and change people's views on DFMs. I've found that tough and had to release two people who weren't converted.

I'm a financial planner – 90% of my time is with clients and that's what they want. If I was doing investment management I wouldn't be able to sleep at night. I explain to clients that [market events] happen in nanoseconds. So I'm going to introduce you to somebody who's looking after your money 24/7. They say, 'That's fantastic'. I don't know how fund pickers sleep.

> 'I'm a financial planner – 90% of my time is with clients and that's what they want. If I was doing investment management I wouldn't be able to sleep at night'
>
> —Caroline Anstee, Anstee & Co

PAUL LINDFIELD: Through ignorance!

CAROLINE ANSTEE: Yes. I wouldn't have that liability in my company. I want to know for every single client – and I have more than 4,000 – that all their investments are where they should be, are in the right risk profile and are being looked after by somebody else. No more sleepless nights.

HAS ANYONE HERE BEEN A FUND PICKER?

CHRIS HOLMES: 1994, I think it was. Then the lightbulb moment came and [we realised we] didn't have the resources or the skillsets. Instead, we can challenge and understand what someone else does. Sleeping at night is a big deal and you can't put a price on it.

PAUL LINDFIELD: When you tell a fund picker that he'll get higher multiples for his business if he outsources and streamlines his business, that lightbulb moment has to happen.

DAVID PHILIPS: We had an email this week suggesting that more IFAs are looking to sell because of the pressures of MiFID II. It laid out the strategy for increasing the value of your business by [outsourcing and] streamlining it, which you can't do if you're picking funds.

CHRIS BIBB: I've worked in firms with dedicated fund pickers. The lower-end portfolios would always be in-house and we'd outsource anything over about £250,000.

PAUL LINDFIELD: I bet Caroline's fund-picking adviser couldn't justify what she was doing. It's about the financial planning, cashflow and regular client contact throughout the journey.

CAROLINE ANSTEE: The investment is the last bit. You start with cash flow modelling, then all the planning. Then we have a lump sum and it's about going from there. That's the least interesting bit. They pay me to bring all that together and to be a critical friend. I rarely put my clients with one DFM. If they have a lot, I might have three or four. My job is to make sure they're all doing their jobs. I interview them with the client, ask them questions that perhaps the client hasn't thought about and keep them on their toes. That's what they're paying me for.

ANDREW BENNETT: Let alone qualitative research and all those various bits, just operationally you're trying to do portfolio switches without discretionary permissions. You have to write to all your clients to agree those switches. Now an additional layer to that is MiFID II saying this is a suitability issue. You have to produce a suitability letter for each client about the changes. That's a massive risk to IFAs, let alone whether they have the expertise to do it in the first place. So it's adding more pressure to the decision to outsource for many still running centralised investment propositions.

NICK TOWNSEND: Hasn't there been an increase of IFAs trying to get discretionary permissions? I understand that there are still some small IFAs looking into this, which for us as a business carries a big risk – do you have the resources to run discretionary portfolios? You only have to look at the size of any DFM's research team, plus the tools they use [to see that we and others haven't].

PAUL LINDFIELD: I spoke to somebody who went for DFM permissions and I asked him why. He said, 'So we don't have to produce suitability reports all the time.' I was amazed: it was a two- or three-adviser practice.

NEIL BLANKSTONE: We understand the suitability issues and all those other issues, so we can support you in that and provide you with additional information. We have to understand the financial planning, the tax advice and everything else. But we're investment managers – we concentrate on that.

CHRIS HOLMES: One thing that we struggle to find is a genuinely risk-averse portfolio for clients who don't want to lose money but want inflation plus returns. That's the only space where we may look at doing something ourselves.

PAUL LINDFIELD: I have looked after several charities and entrepreneurs that take risks in the business. They don't want the extra risk. We've looked at a major insurer based in Edinburgh doing that and it has been OK, but in a bull market it had a loss last year.

There are two other DFMs that are doing defensive funds and many more MPS including absolute return aspects. But there isn't anything that ticks the box and sometimes, if you look at an absolute return fund, you're thinking, 'I don't understand some aspects myself, such as the Mexican peso versus the Turkish lira. How can I explain it to a client?'

NEIL BLANKSTONE: It's about managing expectation. We're a cautious house and all you can do is measure yourself against your peers. What is being CAUTIOUS about? Dampening volatility, reducing drawdowns, and then still trying to produce a positive return. That is how we manage it. It still allows people to have a broad spread of assets.

CHRIS HOLMES: Articulating that to clients who have cash to invest and who want inflation plus returns – it's going back to the sleepless nights. I'm anxious about meeting them again in six months' time with a negative return to explain. We can justify it, but that's not the mandate the client has given us. Drawdown is the big issue, not volatility.

NEIL BLANKSTONE: This is where client education and managing expectation is so important. Sitting on cash forever will do them a longer-term disservice.

The other important bit is to look at teams and managers that have been together and have managed through the crashes and difficult periods because they understand it. That's as much comfort as you can give to a client.

CHRIS HOLMES: We can educate the client, and many do understand it. I had a new client who articulated her risk definition better than anybody I've spoken to, which is fantastic. But generally, clients can't do that and their behaviour, irrespective of the educational process, is different when their portfolio has fallen by 30%.

ANDREW BENNETT: It's dangerous for any DFM to call the market. If you get it wrong, it could finish your business.

SIMON BULLOCK: There is one solution. There is an investment management firm from South Africa, and an ex-derivatives guy there runs capital-protected structured product portfolios. So subject to counterparty risk, you are 100% capital protected if you hold to maturity. He targets 4% and he has got a record to show that that's feasible. The main downside, as long as the counterparties hold up, is that you might get nothing, but clients are getting almost nothing in cash anyway.

CHRIS HOLMES: The investment risk is replaced by something else. So it could be liquidity, and you want liquid capital available when markets fall so you can buy back in.

SIMON BULLOCK: Selling absolute return as if it's the same as cash is dangerous.

NEIL BLANKSTONE: Structured products can have a place in a portfolio, and are part of what we do. The attitude to risk statements is just one element. You've got to link that to the soft facts, their financial position and everything else and then challenge them on their actual attitude to risk. What can you afford? Possibly segregate it for different pots. Then the manager must create portfolios to meet those challenges.

CITYWIRE DID SOME WORK LOOKING AT MPS RECENTLY. ONE ISSUE WAS THAT SOME PORTFOLIOS MARKETED AS CAUTIOUS WERE NOT CAUTIOUS – THEY WERE ACTUALLY TAKING MUCH MORE RISK. HOW DO ADVISERS ENSURE THAT CLIENTS ARE GETTING WHAT IS ADVERTISED? HOW DO DFMs ENSURE THAT YOUR OFFERING MATCHES THE LABEL?

PAUL LINDFIELD: What risk profiling tools and analytics you use are in your investment proposition. Is it risk mapped against Distribution Technology (DT), for example? But it's common sense. If it has 50% in equities but marketed as cautious, that doesn't work. DT works off volatility, so that's what you look at. Also, is it benchmarked? What is its maximum drawdown?

MICKEY MORRISSEY: On our MPS, which is aligned to DT, we submit quarterly all the stocks and sector allocations to DT and they [test it] and report back to us with a traffic light system. If for some reason a portfolio becomes higher risk, it will flag up.

ANDREW BENNETT: What if you have a big outlier?

MICKEY MORRISSEY: The first thing is to find out why. It depends what you mean by outlier...

ANDREW BENNETT: Your eight looks like a six or your five looks like a ten...

MICKEY MORRISSEY: That has never happened in six years, but it did happen to one firm with £300 million under management and they shut the whole service down. They took a big call on markets, [putting] 30% in cash – not a great idea with markets going up.

ANDREW BENNETT: There's a massive problem defining cautious, balanced and adventurous. The liability comes back to the IFA. They must define what cautious looks like.

NEIL BLANKSTONE: Volatility is only one measure. It is a poor one because it is backward-looking. All the other risk measures need to be built into your calculations to give a reasonable understanding of risk in that

portfolio – Sharpe ratio and so on, then drawdown. So you can see the difference between your investment objectives and how they're mapping.

The investment process is most important. It can't just be quantitative because markets act on sentiment as well. People act irrationally.

HOW DO YOU SEGMENT YOUR CLIENTS?

NICK TOWNSEND: We will talk to clients about both MPS and bespoke propositions. One key element when looking at MPS is how active they are compared with their bespoke offering. There are still many MPS portfolios stating that they will proactively make amendments to the portfolios when required. However, when looking at historical data and looking at when the changes actually take effect, they are making changes on a set date – quarterly or six-monthly – rather than proactively adjusting to the market.

We're using FE Transmission to see how often those changes are taking effect.

PAUL LINDFIELD: Artificial intelligence has caused volatility recently – it is thinking 'bonds look cheap so sell out of equities. Now equities look cheap and we bounce back within a day.' I am concerned about how technology will increase volatility. It's not the sole part, but clients see that volatility. What do the true MPS do about that? Are they reacting as quickly?

NEIL BLANKSTONE: We have a daily morning meeting, plus throughout the day. So yes, we have a set day for the model portfolio for ease of administration. But dealing can occur at any time as markets adjust.

The FCA has picked up on these supposed active funds and said 'No, actually, they're closet trackers.' That will cause everyone to view their propositions and push back, and you should get a true model portfolio, templated but active, with daily changes.

> 'The best thing about discretionary management is the ability to do something straight away. So in 2008, if you could get out of commercial property at the right time you could do it'
>
> —Andrew Bennett, Beaufort Group

ANDREW BENNETT: It's a difficult balance because if you tinker with a portfolio too much, is that what the IFA wants? Sometimes making no changes is good. The bigger difficulty with volatility is the DFM that says 'We're prescribed to make changes because volatility has reached a certain barrier.' That's ridiculous. There's good and bad volatility. We know that the biggest downside was in 2008. At that point, even a cautious portfolio would have lost a significant amount.

PAUL LINDFIELD: Yes, there were not many percentage points between a cautious fund at 28% average drawdown and a more adventurous fund at 37%. So it's good to quote that, because if Armageddon comes, this is what you can expect. If you're a year away from retirement then you won't be in there. That's where the planning comes in.

ANDREW BENNETT: Clients who have lived through it understand now to stick with a downturn. The time horizon is more important.

CAROLINE ANSTEE: That's also where cash flow modelling comes in, because you can stress test it.

ANDREW BENNETT: The best thing about discretionary management is the ability to do something straight away. So in 2008, if you could get out of commercial property at the right time you could do it. IFAs at that time would have had different products all over the place. How could they do that at one point in 2008? It was also a no-brainer to go overweight in fixed interest in 2009. It's a push of a button. But the proposition, processes and the structure behind it is more important than trying to change something day-to-day.

NICK TOWNSEND: I'm not suggesting changes need to be made every day. But take commercial property. Compare those MPS portfolios that stayed in commercial property 'because the next quarterly review wasn't for another month' with the bespoke offering that proactively amended the portfolio accordingly.

NEIL BLANKSTONE: Yes, that was a failing.

NICK TOWNSEND: It's easier now, with technology available, to be able to highlight these previous failings and ask the relevant questions to those offering MPS propositions.

ANDREW BENNETT: As a DFM, you have to prove that you did make changes in the past within quarters.

NICK TOWNSEND: Correct. That's the biggest flaw with many MPS offerings.

THANK YOU FOR THE DISCUSSION.

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