SOLOMON'S
FINANCIAL PLANNING FOR LIFE

OUR APPROACH TO INVESTING

Becoming A Successful Investor
Successful investing is a combination of art and science. There are thousands of investment philosophies, perhaps hundreds of thousands. None are perfect. Someone else will also "do better". As financial planners, our role is to help you to make better decisions and to reduce the number of poor decisions that most investors make whilst keeping you true to your goals. It may seem surprising, but our role is not to "beat the market" - those who attempt to do so invariably become deeply disillusioned and frantically chase events that have already been consigned to history. Instead, our aim is to provide the market return (less the investment charges); to reduce and remove unnecessary risk, to remove emotion from investing, and to have a disciplined approach which over time will yield favourable results.

Conscious of the need to strike a balance between sufficient information and keeping things easy to follow, this document is a very brief overview of our investment approach, which we hope you will find helpful.

Time For Money
Like a fine wine, investments need to be given time to mature. Whilst it may appear that little is actually going on, the rewards of patience are evident when the time is right. The right time to drink wine has a degree of trial and error, which is often not a luxury that most people have when it comes to investment, especially if they have a fixed date when they require funds. Those that have more flexibility over this are likely to be at a considerable advantage.

The Pied Piper Effect
The most damaging aspect of investing is the investor. It is human nature to want to participate in good fortune; we are all expert investors with hindsight. Yet in reality, these "golden opportunities" are rare, and indeed successful ones are rarer still. Few professional investors have the time or resources to find the next Microsoft. Those that chase high level investment performance do so at their peril, invariably buying holdings from those that have already seen the fruit, only to experience disappointment and decidedly average (or worse) returns thereafter. If the good news has happened, don't assume that there will be more. Research by Dalbar was conducted a few years ago which revealed that investors tend to suffer a 3% below-market return as they move from one "sure thing" to another. Research by Barber and Odean found even worse results with investors achieving 7% below the market.

Adjust Your Thinking
Having and holding an investment strategy is vital. Investment success and failure need to be met in the same way – both will pass. The important thing to be mindful of is that your goals are achieved, not that you become the next Warren Buffett. A strategy should be time-based – the less time available, the greater the need for certainty. This truth will affect everyone who lives to see their goals. Absolute certainty cannot be achieved in life. The investment world suggests that using less volatile (not necessarily less "risky") investments will help to achieve a higher degree of certainty. In simple terms, this might be to hold fewer equities (shares) and more cash as you approach your goal date. We would generally suggest that investors with 10 years or more to achieve a goal take a long-term approach and therefore use a suitable long-term portfolio. Novice investors, indeed experienced ones too, need to remove emotion from their investment strategy. This is more difficult to achieve than you may realise.

The Dance Of The Market
Market timing is another aspect of investing that yields little that is favourable. Spotting when to get out of a market is considerably easier than spotting when to get back in, though neither is easy. Research has shown that missing just 10 of the best days of stockmarket gains reduced performance by nearly 3% - missing the best 20 days resulted in a return that was 4.6% lower. Market timing is really a game only to be played by those that have money to lose and can react very quickly to market conditions. This is not a game that we are prepared to play with your money. John Bogle (founder of Vanguard) says of market timing:

"A lifetime of experience in this business makes me profoundly sceptical of market timing. I don't know anyone who can do it successfully, nor anyone who has done so in the past. Heck, I don't even know anyone who knows anyone who has timed the market with consistent, successful, replicable results."

A long-term mindset is vital for successful investing. There will be occasions for doubt, and times of crisis that force investors to question themselves. So whatever the future brings it is worthwhile to remember some facts which might help you to cope with the peculiarities of investing.

Tel: 020 8542 8084
Fax: 020 8542 8083
email: info@solomonsifa.co.uk

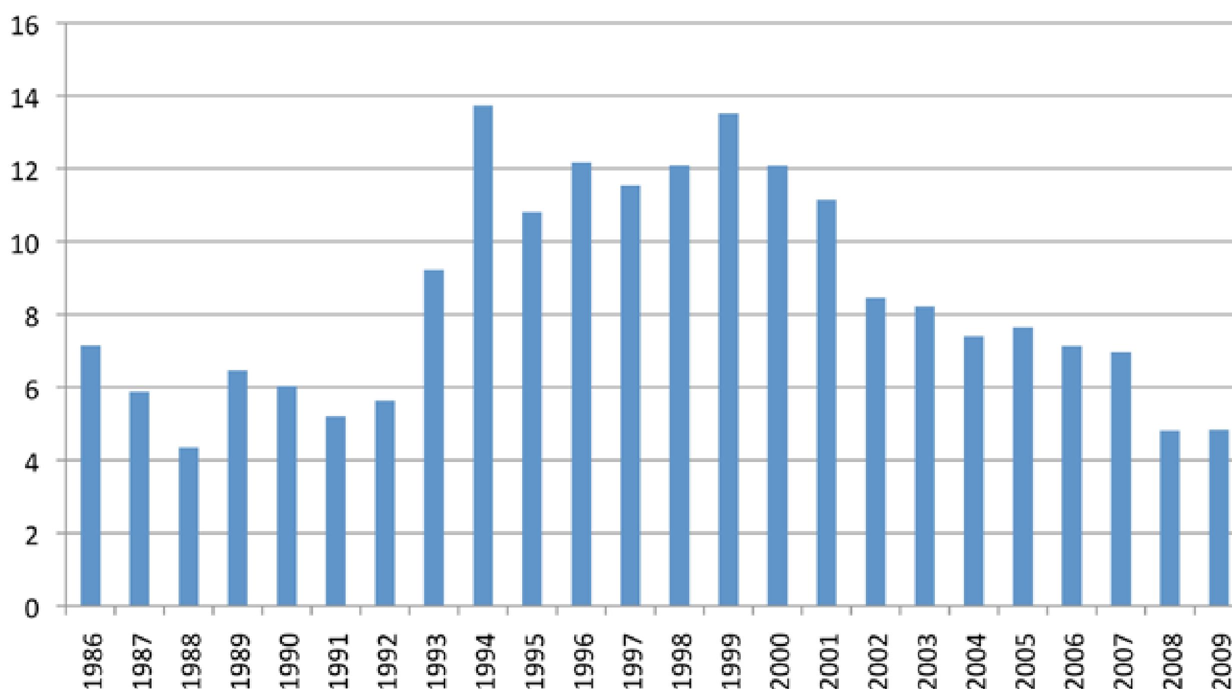
Lessons From History

Looking back over a 24 year period to 1986, of the 24 calendar years concerned six were negative years (1990, 1994, 2000, 2001, 2002 and 2008). Years like these will test your patience. Despite this, the obvious point to make is that 75% (18) of the years concerned

Time period	Positive	Negative	Occasions
12 months	18	6	24
5 year	20	4	24
10 year	22	2	24
20 year	24	0	24

The table above reflects the real (after inflation) average returns from UK equities up to 2009 (the latest data). The time periods other than the 12 months are an average. For example, the most recent 5-year data is 2004-2009 which had a positive return to investors. The 20 year averages effectively begin from 1966-1986 to the present day (data that is over a period of 43 years).

In other words, since 1966 there has not been a 20-year investment period where overall returns were negative, (allowing for inflation). This information is vital to investors as it reminds us that whilst "bad years" and even bad periods of time will come, the longer term trends have been favourable to investors. Indeed, if you were to consider a 5-year plan that had an 83% chance of success, for most people this would be reason enough to implement the plan. In practice however, successful financial planning is for periods that are usually far greater than five years, thereby yielding more favourable chances of success.



Tel: 020 8542 8084
Fax: 020 8542 8083
email: info@solomonsifa.co.uk

The Long Term Reality Check

It is also important to keep in mind a healthy sense of reality with regard to investment returns. The table below is the long term UK economic data. It is the average of 20-year averages (quite a mouthful) but in essence it is data since 1966.

Asset Class (UK)	After Inflation Average (last 20 years)	Our Expectation after inflation (the next 20 years?)
Cash Deposits	3.06%	2.50%
Property	5.10%*	4.00%
Equities	8.43%	6.50%
Gilts	5.17%	3.50%
Wage Inflation	1.73%	1.50%

*all figures collated since 1966 with the exception of property with data from 1972 to end 2009.

The "After Inflation Average" figures in the middle column are the actual "real" (inflation adjusted) figures for 20 year investment periods since 1966. What are your thoughts as you observe this information? This reveals that equities provided a real return (after inflation) averaging 8.43% a year since 1966, significantly outperforming other types of saving or investment. Using this data, I have compiled an outlook for the next 20 years. I am prepared to say with a high degree of certainty that my expectations are highly likely to be wrong in practice! However, they are conservative for a 20-year time frame.

Asset Allocation

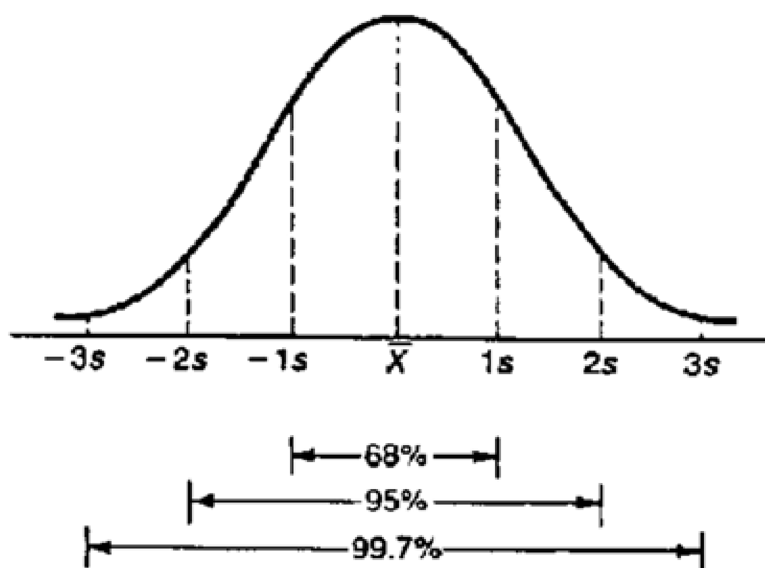
When considering the best places (asset classes) to invest, human nature is once again unhelpful. In any year, equities might be the best or worst performing investment (or anywhere in between). Whilst many look for patterns in the numbers, the only pattern is that there is no pattern. We therefore decided a few years ago to adopt asset allocation modelling techniques. Harry Markowitz is regarded as the founder of Modern Portfolio Theory, and his work in the 1950's earned him a Nobel economics prize in 1990. In simple terms, he did the maths to prove why you shouldn't keep all your eggs in one basket and that there is a mathematical "efficient frontier" for achieving the best mix of assets for different levels of investment "risk".

We take information from Towers Watson, one of the worlds leading economic consultancy firms, who apply forecasted data on top of historical data to help provide the basis for allocation of different asset classes to each portfolio. Each year, we rebalance the portfolio to keep it within the original "risk range" which really means "volatility range". We may also adjust a portfolio if data assumptions from Towers Watson suggest that this is appropriate.

Tel: 020 8542 8084
Fax: 020 8542 8083
email: info@solomonsifa.co.uk

Portfolio Modelling

You may remember from your schooldays, the bell curve or "normal distribution" curve, an example of which is below. To remind you, the middle point is the median/mean or average of results, and within one "standard deviation" (above or below the middle) is where roughly 68% of results will lie. A further "standard deviation" (so two in all) will include 95% of all possible outcomes. This means that in approximately 5% of occasions the results will be at one end or the other, in an "extreme".



In practice, if we assume a 10-year period for investing, and observe the average return after inflation as 7% and one standard deviation was say 10% (for the sake of the example) we would expect 68% of returns to range from -3% to +17%. In 95% of occasions we would expect to observe (from our example) that returns ranged from -13% to +27%. In about 2.5% of occasions, returns would be expected to be more than +27%, similarly in 2.5% of occasions they would be worse than -13%. One way to view this might be to consider 2.5% of 3,650 days as 92 days.

Portfolio modelling widens or narrows the range of possible normally expected returns. The "higher risk" the portfolio is, the greater the range (positively and negatively) of expected returns. The extra risk is compensated for by a higher than expected average return.

Portfolio Construction

When we construct portfolios for our clients, they are based upon using a mix of different asset classes (not all equities) – we have often described this as rather like making a cake: the same basic ingredients, but in different quantities can produce very different results. Hence even a "low-risk" investor could hold some "high-risk" investments, which within the overall context of the portfolio render the overall risk to be low.

Fund Selection

We have gradually altered our fund selection techniques based upon research and experience over many years. In essence, we seek to use funds that will provide investors with value for money, that consistently deliver market returns, and increasingly this has meant that we use index-tracking funds. These are typically cheaper (annual management charges at 0.10% to 0.50%) than "actively-managed" funds run by Fund Managers which typically have an annual management charge of 1.50% or more.

Tel: 020 8542 8084
Fax: 020 8542 8083
email: info@solomonsifa.co.uk

Fund Selection
We have gradually altered our fund selection techniques based upon research and experience over many years. In essence, we seek to use funds that will provide investors with value for money, that consistently deliver market returns, and increasingly this has meant that we use index-tracking funds. These are typically cheaper (annual management charges at 0.10% to 0.50%) than "actively-managed" funds run by Fund Managers which typically have an annual management charge of 1.50% or more.

Fund Managers
Whilst there are many successful Fund Managers few have a long-term track record, with most having full responsibility for a fund for less than 5 years. Fund Managers seek to exploit market advantage where they find it. We believe that this becomes increasingly difficult due to the level playing-field open to professional investors, created by available data and information about companies and markets. It is also difficult to tell whether or not a successful Fund Manager has merely been "lucky" due to market conditions. According to Tim Hale in his book, "Smarter Investing" only a track record of more than 15 years is required to prove anything other than luck. There are some notable exceptions, but very few have a long-term, same-fund track record.

As a result, we favour using index-tracking funds where possible. They are cheaper, easier to understand and deliver the market return less inexpensive investment costs. This does not mean that we do not respect Fund Managers - some of them are highly gifted, most of them have achieved considerable academic success, virtually all those that I have met have a high degree of conviction in their investment process. However, this is your money and the additional risk that is being taken with it, for the hoped-for additional return, is rarely worthwhile. As charming as they may be, respectfully we will tend to decline to use actively managed funds.

Investment Management
Investment administration can be very burdensome. Investors tend to get mountains of paper directly from the organisations with which they hold investments. Our main objective with regard to the administration of your investments is to be able to provide accurate valuations on any working day, to make this easy to read and understand. In practice, this should integrate with our own IT systems and enable us to deliver the service you choose.

Check, Update, Review, Check, Update, Review..
We prefer to use tools that help us to create, monitor and review portfolios easily, whilst being able to apply logical forecasted approaches to asset allocation selections from organisations such as Towers Watson. We also believe that it is important for your costs to be minimised where possible, so that there are no additional charges for switching and rebalancing – which ideally will be free of charge. As we are looking after your money, it is important that the organisation providing such tools is financially robust and has adequate experience in providing such services. In recent years, we have seen new entrants come and go. Those that fail tend to do so as a result of poor IT and failure to understand the needs of both advisers and clients.

I hope that I have given you a sense of what it is that we are trying to achieve from investments for our clients. I have been advising on investing for nearly 20 years and I know for certain that the next 20 will be full of challenges and plenty of change. Equally, I believe that there is much that will not change – investing is uncertain, but timeless principles hold true over the long term.

If you feel like doing some further reading on this subject, may I suggest that you begin with two books. The first is called "Winning The Loser's Game", by Charles Ellis. The other is "Smarter Investing", by Tim Hale. In many respects, my approach has been influenced by the research and findings derived from these two books, together with plenty of real life experience.

Dominic

Dominic Thomas, July 2010.
Solomons IFA

Tel: 020 8542 8084
Fax: 020 8542 8083
email: info@solomonsifa.co.uk

SOLOMON'S

FINANCIAL PLANNING FOR LIFE

Tel: 020 8542 8084
Fax: 020 8542 8083
email: info@solomonsifa.co.uk