The Foundation Fundlist

CHARLES STANLEY *Direct*

With over 3,000 funds available and many hundreds of investment trusts, selecting investments for your portfolio can be daunting. To help narrow down the field to a more digestible number of ideas, we have created **The Foundation Fundlist.**

How the Foundation Fundlist is chosen

The Foundation Fundlist highlights what we consider to be good-quality options for new investment in each of the major sectors.

Charles Stanley's Collectives Research Team carries out comprehensive and continuous coverage of a wide range of funds, incorporating detailed analysis of returns, as well and hundreds of face-to-face meeting with managers each year.

We seek to ensure chosen funds excel in our four "P's", People, Process, Performance and Price, by examining key characteristics such as risk, style, sustainability, governance, charges, operations, inflows/outflows and capacity constraints.

The resultant list combines actively managed unit trusts and investment trusts, which aim to add value against a certain benchmark, as well as a selection of passive funds or 'trackers' that aim to follow an index closely. All have been chosen on merit rather than for any commercial reason. We have our customers' best interest at heart, and our selection process is entirely independent.

Our approach is very much qualitative as well as quantitative. Looking at past performance only tells you so much. We aim to identify the key factor or 'edge' a fund. This might be that it does something differently or better, or in the case of passive funds – which aim to follow rather than beat an index – it might be that they offer the lowest charges available.

Funds and trusts on our Fundlist are:

- Designed to provide a helpful shortlist of options for investors to pick from
- Aimed at those doing their own research and seeking ideas for exposure to certain sectors or areas as part of a diversified portfolio
- Either 'actively' managed funds, aiming to perform better than their benchmark over the long term, or 'passively' managed funds aiming to track their index as closely as possible at low cost

Performance analysis

The actively managed funds and investment trusts on the Foundation Fundlist are all managed by individuals or teams who we believe can generate outperformance over the longer term. We look closely at the past perfor-mance record of a manager throughout their career, though that's only part of the story. It is important to gain a full understanding of how it is managed, why it has performed the way it has and what conditions it will likely perform best in going forward.

Often it is difficult to separate luck from skill over short periods. For instance, the approach of certain managers means they are more likely to outperform in rising markets. Others tend to protect capital better during less favourable conditions. Sometimes managers can end up being 'in the right place at the right time' rather than displaying genuine skill. Dissecting returns through attribution analysis (looking in detail at what has added to or detracted from returns) can help, over time, build a picture of fund manager differentiation and skill, and this can help put performance into perspective.

We are 'agnostic' on the active versus passive funds debate, and we usually view passive as the 'default' option in the absence of a genuinely strong reason to use an active fund. Many investors wish to use passive funds in their portfolios for reasons of simplicity or cost, and we include a range of these on the list. Covering the major investment areas, they are chosen to provide acceptable tracking error versus their benchmark, as well as their transparency and value for money.

Cost assessment

In a potentially lower return world, there is greater focus on cost. Funds we consider to be unreasonable value for money are excluded. The total ongoing charges figure, which includes underlying transaction costs, must be not significantly higher than its peer group average. Exceptions may be made for highly specialist funds or where a confluence of factors have increased the headline figure on a short-term basis. For passive investments cost is often the key factor when assessing a fund.

'Closet trackers' – active funds that command the higher cost of active management but offer little differentiation from a passive – represent the worst of both worlds. Charges erode returns at a higher rate than a tracker, yet there is limited prospect of the managers' portfolio positioning adding value to offset this.

Risk analysis

We like managers prepared to run high-conviction portfolios and a willingness to 'go against the grain', however we seek to rule out funds where managers are using excessive risk to generate returns. This could be either in terms of high concentration of stocks in the portfolio, or else through an unacceptably high level of volatility in the aggregate returns of the underlying constituents.

There is no single data point more important than another in our decision making. We consider a variety of performance and risk measures when forming a view on a fund with risk adjusted returns important, as well as performance versus a fund's relevant style benchmark. However, we try not to extrapolate historic trends when making our decisions and encourage investors to do the same. We are wary that, used in iso-lation, complex 'quant' screens inevitably end up pointing in the same direction – to what has performed well in the recent past.

Often risk is thought about as the volatility of asset price movements, but there are many other risks to bear in mind, and many factors that can influence performance. For instance, in open-ended funds strong returns often attract more assets from investors, which can in some cases erode future return potential.

This is particularly the case when a manager is operating in a niche area. A larger fund size can become a constraint in terms of accessing the best ideas generated, as well as inhibit buying or selling positions in a timely manner. For areas considered 'illiquid', i.e. where it is difficult, time consuming or costly, to transact, we consider a closed ended structure the appropriate vehicle i.e. an investment trust.

Regular Review

We maintain regular contact with the managers of all the investments on the list, to ensure each selection continues to be managed in line with our expectations. A detailed questionnaire covering all the areas of our due diligence is sent to the manager each year for completion, and we use this as the basis of our regular review meetings, all of which are carefully recorded.

As well as having a rolling timetable of formal reviews by sector, all investments on the list are continuously monitored for any significant events. For instance, personnel changes, closures, large changes in assets under management. We will remove a fund if we no longer consider it a best idea within its sector over a three to five-year time frame.

Meet the Team

The work of five specialist investment professionals goes into researching and compiling the Foundation Fundlist. The list is built on the same in-depth research from Charles Stanley's Collective Research Team that goes into providing fund ideas for Charles Stanley's other divisions including Private Client Investment Management and Asset Management.

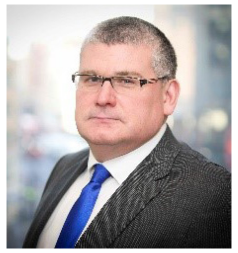
The list is compiled and maintained by Rob Morgan, Charles Stanley Direct's Investment Analyst, with proposals for additions and removals agreed with Ross Brookes, Head of Collectives Research, and other members of the Collectives Research Team in order that they reflect a consensus view. It is also subject to regular scrutiny and review by senior management and senior risk and compliance personnel within the firm.

Ross Brookes,
Head of Collectives Research

Rob Morgan,
Charles Stanley Direct Investment Analyst

Lynn Hutchinson,
Senior Investment Analyst, (Passives)

Ben Johnson,
Collectives Analyst



Adam Carruthers,
Collectives Analyst

charles-stanley-direct.co.uk

Contact us to find out how we can help you:

E | info@charles-stanley-direct.co.uk **T** | 0131 550 1234

W | charles-stanley-direct.co.uk

A | Charles Stanley Direct,
Freepost RTZT-HZLU-KZRA,
Nova House,
3 Ponton Street,
Edinburgh,
EH3 9QQ

This guide does not constitute personal advice based on your circumstances and the contents should not be considered as a personal recommendation to deal. Investment decisions in funds and other collective investments should only be made after reading the Key Investor Information Document, Supplemental Information Document and/or Prospectus. If you are unsure of the suitability of any investment please seek professional advice.
The Taxation of pensions is based on individual circumstances and may be subject to change in the future.
The information contained within this article is based on our understanding of current UK tax provisions, which is subject to change, and the benefits of which would depend on your personal circumstances.
Investors should be aware that past performance is not a reliable indicator of future results and that the price of shares and other investments, and the income derived from them, may fall as well as rise and the amount realised may be less than the original sum invested.

101.49 May 2020

CHARLES STANLEY *Direct*