HOW WE MANAGE MONEY

Tilney's investment philosophy and process

TILNEY
FOR PROFESSIONALS

About Tilney

Tilney is an award-winning investment company that builds on a heritage of more than 180 years.

We employ more than 1,000 staff through our extensive network of offices and are trusted to look after more than £24 billion of assets for clients around the world.

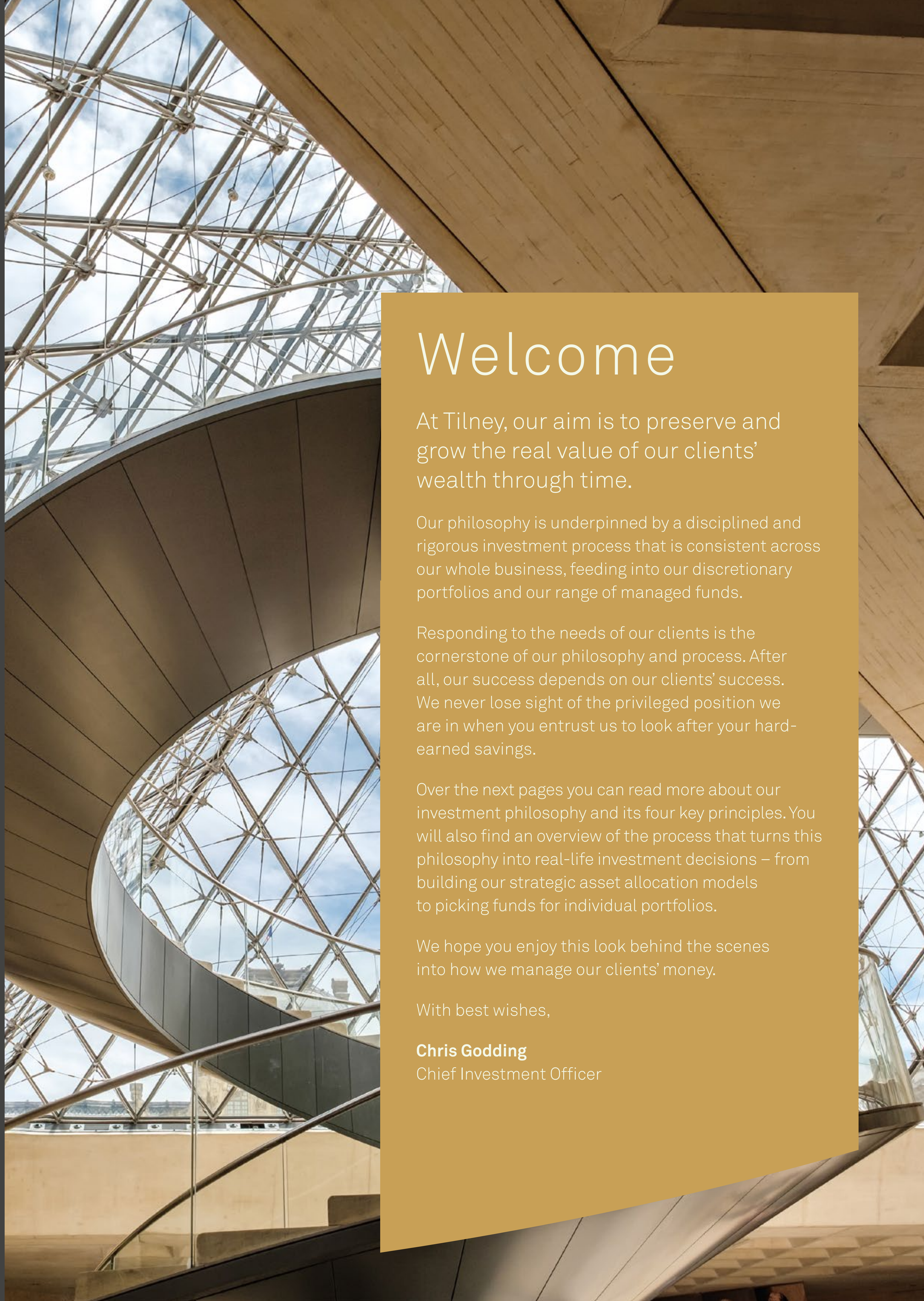
All of our services are underpinned by a disciplined investment process and delivered by some of the UK's most experienced and highly qualified investment professionals.

The foundation for Tilney's success is our focus on providing a high-quality, personal service to each of our clients, and we are proud of the recommendations of Tilney's service that many of our clients make to others.

At Tilney, your personal wealth is our personal responsibility.

Important information

The value of investments, and the income derived from them, can go down as well as up and you can get back less than you originally invested. Past performance is not an indication of future performance. This is not advice to invest, or to use any of our services. If you are in any doubt as to the suitability of an investment, please contact one of our advisers. Please note we do not provide tax advice.



Welcome

At Tilney, our aim is to preserve and grow the real value of our clients' wealth through time.

Our philosophy is underpinned by a disciplined and rigorous investment process that is consistent across our whole business, feeding into our discretionary portfolios and our range of managed funds.

Responding to the needs of our clients is the cornerstone of our philosophy and process. After all, our success depends on our clients' success. We never lose sight of the privileged position we are in when you entrust us to look after your hard-earned savings.

Over the next pages you can read more about our investment philosophy and its four key principles. You will also find an overview of the process that turns this philosophy into real-life investment decisions – from building our strategic asset allocation models to picking funds for individual portfolios.

We hope you enjoy this look behind the scenes into how we manage our clients' money.

With best wishes,

Chris Godding
Chief Investment Officer

Our investment philosophy

At Tilney we aim to **preserve** and **grow** the **real** value of our clients' capital through **time**. We do this by adhering to our investment philosophy and its four guiding principles.

Preserve wealth

We believe our clients are not necessarily averse to taking risks with their money, but they are sensitive to losses. After all, research suggests that the pain of losing money is twice as strong as the joy of gaining an equal amount*. This is why we focus on reducing the risk of loss as much as driving investment growth – even if this means avoiding particular types of investments at certain times.

We aim to preserve clients' wealth by constructing portfolios that should benefit from rising markets while limiting losses when markets fall. We also aim to give clients the best possible returns for their chosen level of risk and never take on more risk than has been agreed.

When investing in equities we look beyond prices and consider longer-term business risks as well. We prefer companies with good management quality, financial strength and a business model that is sustainable over the long term. We are also conscious not to overpay for these companies, since the price you pay for an investment can have a significant impact on the returns you get.

We aim to build portfolios that will benefit from the growing fundamental value of high-quality companies, rather than trying to second-guess short-term market movements, which is notoriously difficult.

Grow capital

We target the maximum returns for a given level of risk. To do this, we have a range of strategic asset models that serve as a framework for client portfolios – see page 6 for more information.

We believe equities will generally be the main source of investment growth over time, as they have the potential to provide higher returns than other investments (although they are also riskier). We do not try to time the market, but instead look for companies that can grow their profits and dividends over the long term. We expect non-equity investments such as bonds and property to also provide returns for clients, while reducing volatility to provide a smoother experience.

We primarily but not exclusively invest in funds. We identify a focused set of fund managers who own a concentrated portfolio of companies capable of growing over time. We aim to build long-term partnerships with those managers that we believe provide exceptional performance and value.

We look at real returns

We focus on real returns when evaluating our performance. Technically this means returns after the effects of inflation – if your savings have grown at a slower rate than prices have increased, you will have made a real loss as your money will buy you less than when you started.

At Tilney we also include all other expenses – such as management fees, dealing costs and tax. When investing for clients we aim to achieve a positive return after all of these have been taken into account.

The importance of time

At Tilney we believe investing is for the long term. We look for companies that have the potential to grow over time and let compounding of returns do the heavy lifting for us.

This involves being patient in our decision making and ensuring there is a robust argument supporting these decisions. We believe short-term returns are driven by investor sentiment and volatile market data, both of which are difficult to forecast. On the other hand, long-term returns are driven by changes to a company's fundamental worth and normalising valuations – which are possible to forecast with more confidence.

Find out more about the importance of time when investing on page 12.

*Kahneman and Tversky, 1992.

"Our investment philosophy encapsulates the key principles that we believe are essential for successful investing, while keeping us focused on delivering the best outcomes for our clients."

Ben Seager-Scott
Head of Multi-Asset Funds

Our investment process

We believe consistent investment performance requires a structured process that adds value for our clients at each stage. This process underpins all of our managed and advised investment services and our range of managed funds. Through this process we are able to filter the views and outlook of our Central Investment Team into our investment selections and individual client portfolios.

1. Asset allocation

The process begins with our range of strategic asset models, each suited to a different risk tolerance. These provide the long-term asset allocations we use as a framework for client portfolios. Our 'Efficient Frontier' system allows us to optimise these models using powerful statistical and mathematical techniques, with the aim of achieving the highest potential returns for a given level of risk while also preserving capital. See page 7 to find out more about Efficient Frontier.

We then apply a tactical overlay to these strategic allocations as opportunities or risks present themselves – investing more or less in certain asset classes, sectors or geographical areas.

These changes are based on the macroeconomic view of the global economy from our Central Investment Team, taking into account economic fundamentals, monetary policy, business fundamentals and political events.

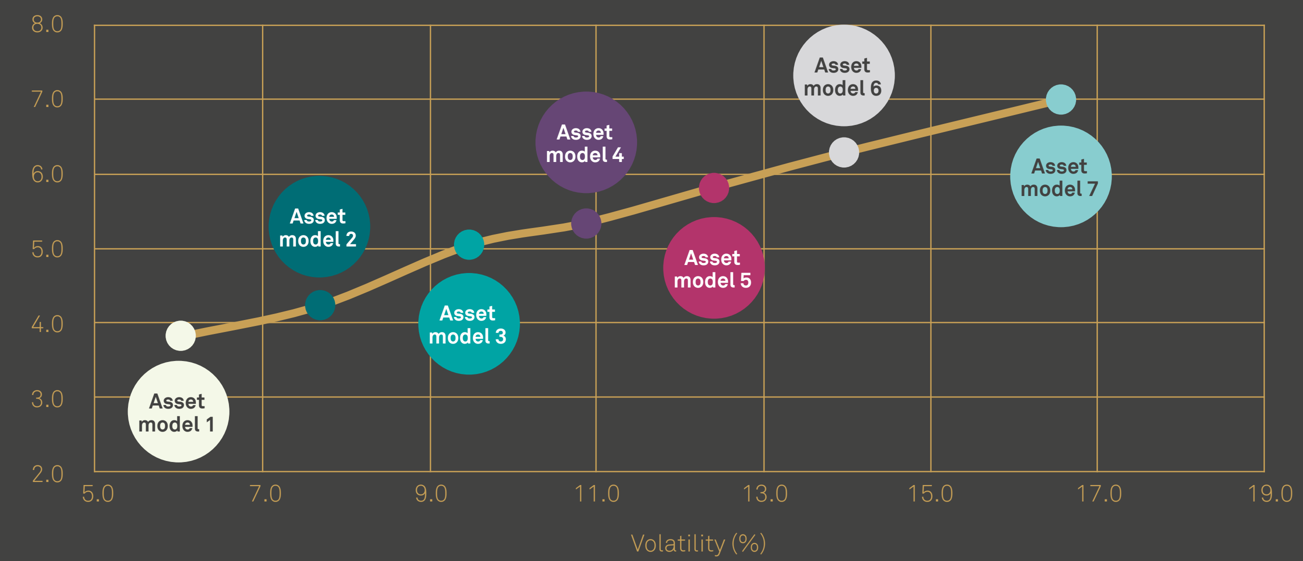
We have a dedicated Asset Allocation Committee that meets once every quarter. The committee is chaired by our Chief Investment Officer and consists of a group of senior investment professionals from across our business. All proposed changes to our asset models must be reviewed and approved by this committee.

Efficient Frontier

Efficient Frontier is what we call our proprietary system for creating long-term strategic asset allocations. It produces a number of asset models that are designed to give the best potential returns for different levels of investment risk.

To do this we input a range of market data, including current long-term return forecasts, and historical figures for both volatility and correlation between asset classes (as these can't be meaningfully forecast). The system then uses these data to calculate optimised asset models alongside their expected returns and volatility levels.

Efficient Frontier – example output



Source: Tilney, March 2019.

2. Investment selection

At Tilney we primarily but not exclusively invest in funds. Our Fund Selection Committee maintains and continually reviews a concentrated set of funds that we have high conviction in. These are used to populate client portfolios in line with their asset model.

We have developed a framework for identifying the best fund managers who are the most likely to deliver for their investors. We look at performance data, carrying out statistical analysis to see if a manager's success comes from skill or luck. However, these numbers don't give us the whole picture. Unlike many companies, at Tilney we also take an in-depth look at the people, process and philosophy behind each fund.

We focus on managers with a clear investment objective and consistent investment approach, who align their interests with those of their investors (usually by investing their own money). We look for managers who focus on growing wealth rather than just beating their benchmark – like us, they look at absolute returns rather than relative returns.

To do this, they don't follow the herd or hug their benchmark. They pick high-conviction stocks in line with their investment philosophy, and usually have a low turnover – which means reduced dealing fees. These managers strike a good balance between holding a concentrated number of funds and diversifying to reduce risk.

We may also use low-cost passive funds if we feel that this approach is the best way to gain exposure to a particular market or index.

3. Portfolio construction

When building client portfolios we diversify across individual investments, asset classes, sectors, geographical areas and investment styles. We aim to find the best risk and reward balance – making the most of the available opportunities while reducing volatility. We do this by choosing investments that have a low or negative correlation – so they don't all move in the same direction at the same time.

On the other hand, we only diversify portfolios to the extent that we are making the most of the risk and reward balance. We don't spread our investments to the point that returns from good managers become diluted.

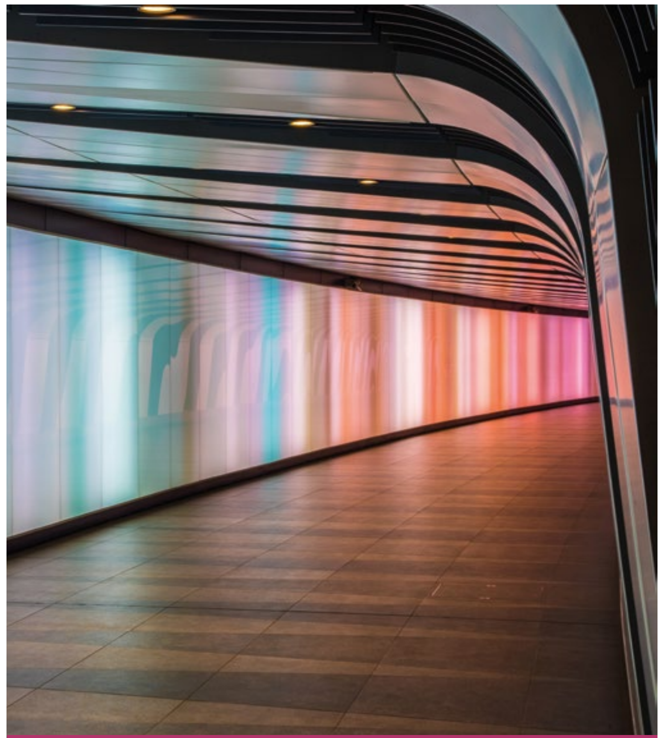
We explain more about the importance of diversification on page 10.

4. Continuous monitoring

The world of investments is unpredictable and ever-changing. This is why we monitor our top-level asset models, set of chosen funds and individual client portfolios continuously.

We formally review our asset models every quarter – this is where we may make tactical changes to our asset allocations. A meeting can be called more often by a member of our Asset Allocation Committee, for example if there is a major change in our assumptions or a big market event.

We actively monitor our full list of funds and meet with hundreds of fund managers each year. We question the managers on their recent investment decisions and performance, as well as finding out about any changes in investment style or approach. We will formally reassess a fund's place on the list whenever there is a significant change – for example, if a manager leaves the company or there is a change in the fund's investment mandate.



"We have developed a unique framework for identifying the best fund managers who are the most likely to deliver for their investors. We call this framework our '10 Principles for Manager Selection'."

Ben Seager-Scott
Head of Multi-Asset Funds

The importance of diversification

At Tilney our in-house asset models are diversified – they contain a mix of different asset classes and geographical areas. Our individual client portfolios are also diversified across individual investments, asset classes, sectors, geographical areas and investment styles. By diversifying portfolios we aim to find the mix of investments that has the potential to give the highest returns for a given level of risk.

We don't put all our eggs in one basket

Different types of investments tend to behave differently. By choosing a diverse mix of investments, the returns from our client portfolios don't rely on the performance of any single company, sector or stock market.

After a certain point, diversification stops reducing risk and simply dilutes returns from good managers. We find the optimum point where volatility is reduced without affecting potential returns.

Investment risk: a definition

There are many different ways to measure risk. At Tilney we focus on volatility and drawdown.

Volatility is the range of possible returns on an investment – a more volatile portfolio has the potential to give investors greater profits or losses. For this reason it can also be interpreted as uncertainty.

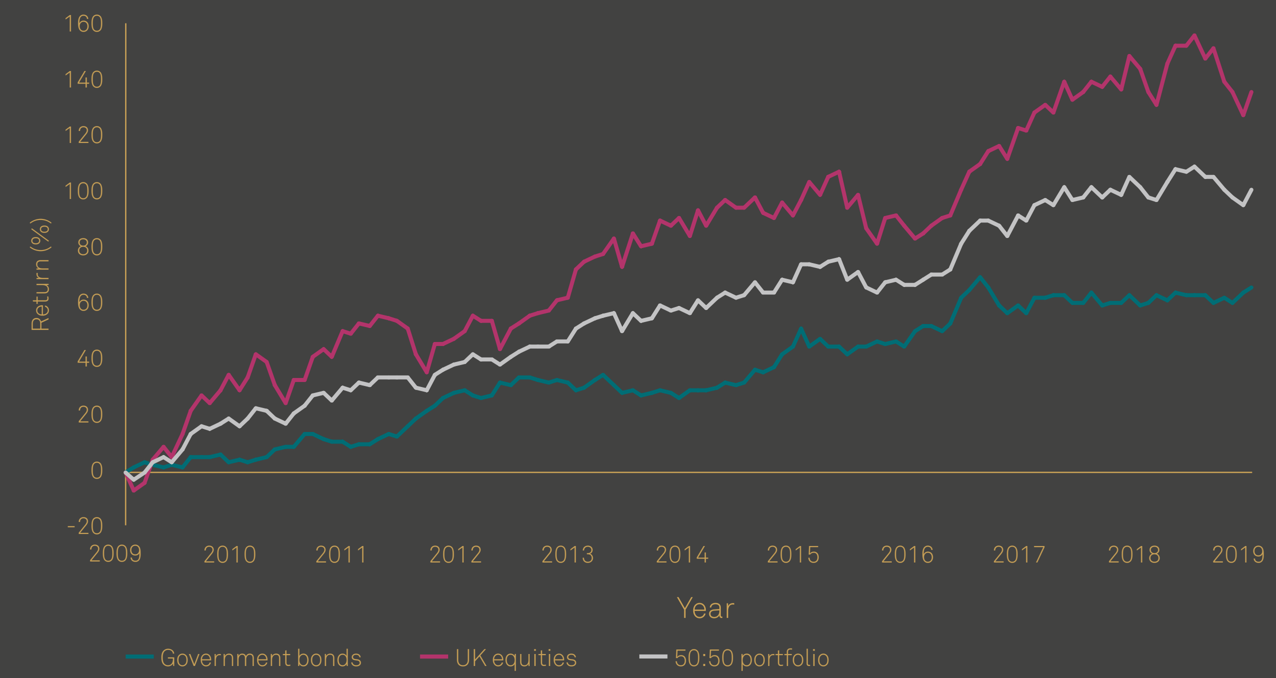
Drawdown is a measure of the maximum potential loss that a portfolio could be expected to sustain at a certain level of confidence. For example, we could be 95% confident that a portfolio will not lose more than 10% of its value in a year. A portfolio with a higher potential maximum loss is riskier.

A smoother ride

We combine investments that have a low or inverse correlation with one another – meaning when one investment rises in value, the other tends to fall. This reduces the overall volatility of our client portfolios. Our aim is to provide a smoother ride with fewer ups and downs along the way, whilst preserving the portfolio's long-term potential for growth.

The graph below gives a simple example of how diversification can reduce volatility. It shows the historical returns from portfolios of UK government bonds and UK equities, alongside a diversified portfolio that is split evenly between the two. We can see that the return from the combined portfolio was less volatile as a result of the offsetting effects of the two asset classes:

Growth of an equal-weight bond and equity portfolio versus individual indices



Source: Lipper for Investment Management, March 2019.

Taking a long-term view

We believe that investing should be for the long term. Over shorter periods of time market movements can be unpredictable, but historically stock markets have risen in value and economies have grown over time. Investing for the long term boosts your chances of making a good return on your investment while reducing the probability of sustaining an overall loss.

We don't try to time the markets

While we do make tactical changes to our asset allocations, we don't try to trade or second-guess movements over a short period of time. We believe short-term returns can't be accurately forecasted, whereas long-term returns can.

We very much align with the view of Benjamin Graham, who is regarded as the father of value investing. He once explained that in the short term the stock market is a voting machine that measures the popularity of companies, whereas in the long term it is a weighing machine that measures each company's substance and value.

The effects of compounding

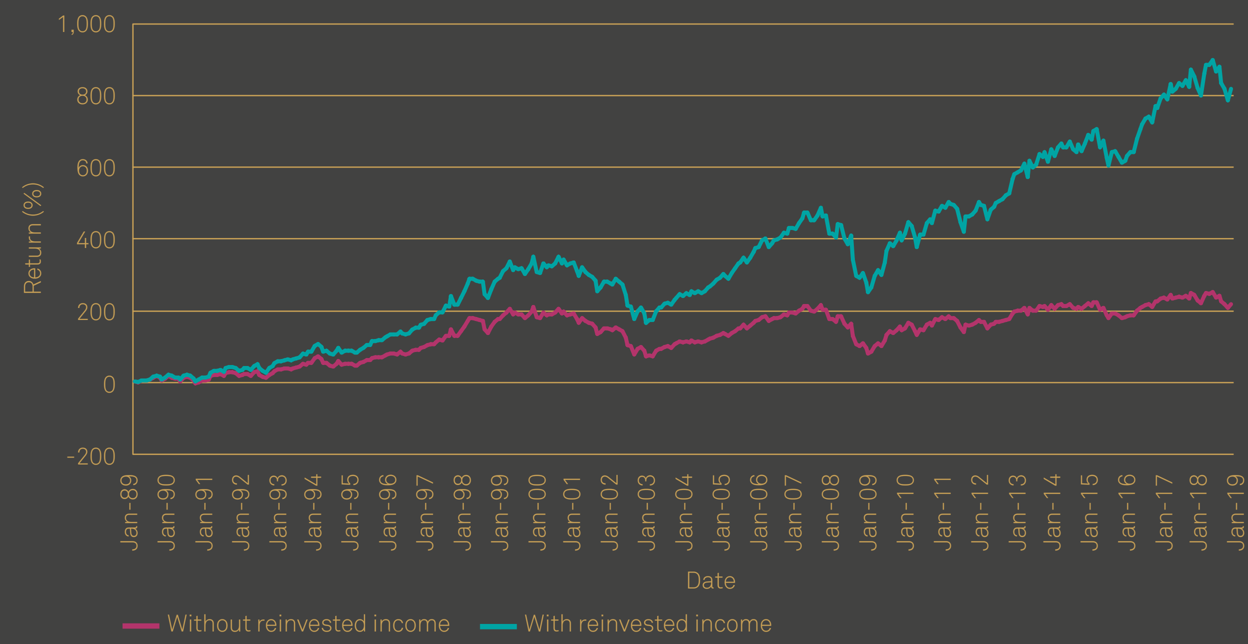
Albert Einstein reportedly called compounding "the eighth wonder of the world." At Tilney we see it as the main driver of investment returns over the long term – through companies growing in value over time, and through investors reinvesting the dividend payments they pay.

As companies generate profits each year, they will reinvest some of this money into the business. This could be to hire more staff, increase their advertising or develop new products. These investments are expected to generate more profits for the company over the long term, increasing its value and ultimately providing its shareholders with a better return.

Many companies also pay a portion of their profits out to their shareholders through a regular dividend. Dividend-paying shares are a staple for income-seeking investors, but reinvesting dividend income into more shares or units can also produce great total returns when investing for growth.

The effects of reinvesting income can be seen in the graph on page 13. This shows the final value of a 30-year investment in the UK stock market, both with and without reinvested income.

Major UK asset class returns



Source: Lipper for Investment Management, March 2019.
Measured by the MSCI United Kingdom index.

Our investment services

Successful investing takes time and dedication which is why increasing numbers of people are choosing to have an expert manage their investments. At Tilney we have a range of investment services, each based on our investment philosophy and process, and delivered by some of the UK's most experienced and highly qualified investment professionals.

We will manage your investments

We have a range of services where our experts will invest for you. They decide which investments to buy (or sell), how much to invest and when to do so. They review your portfolio and make any changes to ensure it remains suitable to your personal objectives. This gives you more time to do what you enjoy in life, with the peace of mind that your investments always reflect our latest views and best ideas.

Services for charities and US-connected clients

At Tilney we have a specialist team that helps charities to achieve their investment objectives. We also offer a service designed to meet the differing tax, currency and investment needs of US-connected clients.

Please get in touch to find out more about Tilney's investment philosophy and process or our range of investment services.

You can call us on **020 7189 9918**, email **info@tilneyforprofessionals.co.uk** or visit **professionals.tilney.co.uk** Alternatively, speak to your financial adviser.

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