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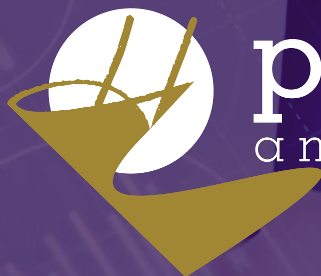

portfoliosense®

a more dependable way to invest

0121 313 1370

info@henwoodcourt.co.uk

IN THE GRAND SCHEME OF THINGS, MONEY ITSELF IS NOT IMPORTANT: IT IS SIGNIFICANT ONLY TO THE EXTENT THAT IT ALLOWS YOU TO ENJOY WHAT IS IMPORTANT TO YOU.

Nick Platt,
Managing
Director,
Henwood Court

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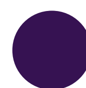


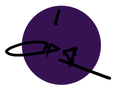
TO INVEST SUCCESSFULLY OVER A LIFETIME DOES NOT REQUIRE A STRATOSPHERIC IQ, UNUSUAL BUSINESS INSIGHTS OR INSIDE INFORMATION. WHAT'S NEEDED IS A SOUND INTELLECTUAL FRAMEWORK FOR MAKING DECISIONS AND THE ABILITY TO KEEP EMOTIONS FROM CORRODING THAT FRAMEWORK.

Warren Buffet

PUTTING THE THEORY INTO PRACTISE

Portfoliosense® was born out of the scientific study of how capital markets work, it is intellectually robust, with all decision-making based on Nobel-Prize winning academic theory and strong empirical evidence. Quite simply, it is evidence-based investing.

Investment theory has been turned into reality with the advances in technology allowing for much testing and planning, resulting in the construction of risk calibrated portfolios each with an expected return and an expected risk (downside) allowing us to match people with portfolios.



Portfoliosense® allows our clients to invest with their eyes wide open and with confidence and provides ‘a more dependable way of investing’, all at a low cost.

WHAT IS EVIDENCE BASED INVESTING?

Evidence based investing is an approach that is based on research, observing markets and how they work, and using data to make considered investment decisions.

The evidence employed is the product of many decades of independent, peer-reviewed research and analysis by some of the world's leading academics, including numerous Nobel laureates.

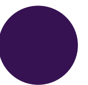
Evidence based investing is in contrast to an active strategy, where fund managers look to 'beat the market' through predicting which companies or bonds will be successful in the future.

Markets are notoriously hard to beat in the long term and this is why an evidence-based philosophy sits at the heart of Portfoliosense®.

An evidence-based approach uses systematic investment management, replicating an index of market returns. Systematic investing seeks to minimise costs by limiting the number of trades performed. This is known as strategic asset allocation, where investors set target allocations for various asset classes based on criteria such as the investor's risk tolerance and investment objectives.

This contrasts with an active management approach where the manager undertakes specific investment with the goal of out-performing a target return, or "beating the market". This is known as tactical asset allocation, and as already established, the beating of a benchmark (or market) is not achieved on a consistent basis by active managers.

We believe that it makes good sense to base our portfolio construction process on the academic theory and empirical evidence that exists and to think deeply about each of the key decisions that need to be made, on your behalf.



BUILDING PORTFOLIOS FOR ALL SEASONS

The first thing to remember is that there is no absolute best way to construct a portfolio, but there are certainly some portfolio structures that are more sensible and more robust than others.

The following are the steps we take when constructing our portfolios.

B The world is full of opportunity, don't turn a blind eye, be globally diversified

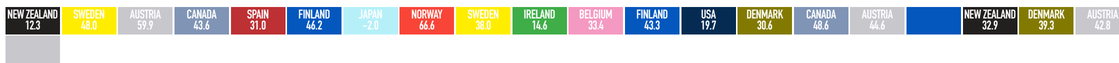
Not putting all of your eggs in one basket is an intuitive and valuable concept. No-one knows what the future holds and owning a highly diversified portfolio spread widely across asset classes (bonds, equities and property, for example) and across global markets, industry sectors and by company, helps make sure that we are prepared for whatever the markets throw at us over time, whether that be going up or down; a portfolio for all seasons, if you like.

Think of a portfolio like everyone's general approach to day-to-day life; you might start the day with a coffee which originated in South America, use your mobile phone which was designed and developed in America and manufactured in Taiwan, before you drive your German made car.

Every day, without thought, we enjoy the benefits of accessing products from around the globe. However, when it comes to investing, many focus their portfolios on their home market and therefore reduce their exposure to the benefits the globe offers. This approach is what is commonly known as "home bias".

A "home bias" can increase investment risks and decrease the investment opportunities for a portfolio. Portfoliosense® therefore adopts a globally diversified approach, it does not sacrifice exposure to all the developed markets for an overweight position to one particular country.

As the table opposite highlights, 13 different developed countries (out of 22) had the best-performing equity market in a given calendar year for the 20 years ended in December 2022, and no country had the best-performing market for the following year.



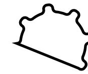
Source: Dimensional Fund Advisors

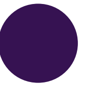
Clearly, attempting to pick only winning markets in any given period is a challenging proposition, some may even say impossible without a good dose of luck. By pursuing a globally diversified approach to investing, Portfoliosense® doesn't have to attempt to pick winners to achieve a rewarding investment experience. By expanding the investment opportunity set beyond the UK stock market, Portfoliosense® can help increase the reliability of outcomes. Thus, investors in Portfoliosense® can be confident that a globally diversified portfolio will hold the best (and worst) performing countries each year.

C The cogs - growth and defensive assets

Portfoliosense® comprises of two components; the first is what we call growth assets, which are higher returning, equity-like assets. To own an entire portfolio made up of these higher risk investments, however well-diversified, would take some staying power when markets are in turmoil. So, most investors require a balancing allocation to assets that perform a strongly defensive role, which tends to be predominantly high-quality bonds (loans from investors to a borrower, typically a government or company). The figure below explores this relationship, by looking at how different types of bonds performed during the equity market crash from 2007 to 2009.

It is evident that the riskier bonds tend to act more like equities at times of market trauma, particularly if this is accompanied by an economic downturn.





Portfoliosense® holds fund managers who exploit these drivers of return in an attempt to generate returns in excess of the market over the long-term. There are currently 2 factors adopted across the Portfoliosense® suite:

Stock prices closer to their book value have higher

We also seek out other asset classes that can diversify some of this equity risk, but without giving up too much return, as in the case of bonds. Global commercial property, being offices, retail and industrial buildings, is one such asset class considered.

Environmental	Social	Governance
'Producing more output with less natural resources, energy, water, waste pollution.'	'Improving relations with key stakeholder; employees, customer, suppliers.'	'Reducing risk through board oversight and risk controls.'
Air & Water Pollution	Community Relations	Audit Committee Structure
Biodiversity & Deforestation	Customer Satisfaction	Board Composition
Climate Change	Employee Engagement	Bribery & Corruption
Energy Efficiency	Gender & Diversity	Executive Compensation
Waste Management	Human Rights	Lobbying Activities
Water Scarcity	Labour Standards	Political Contributions

Due to increased demand, and ensuring Portfoliosense caters for all investor's needs, the Earth portfolio range allows investors to use the growth assets within the portfolio to support ESG investing. For those clients who do not wish to invest with an ESG screen, the Global portfolio range provides a broader investment approach.

A common question raised is "are ESG characteristics tied to stock performance?" Many researchers have studied the relationship between companies with strong ESG characteristics and corporate financial performance. Whilst there is currently a major challenge to show that positive correlations exist, it does not appear to be detrimental to investors. Therefore, it really is a question of as an investor, do you wish to follow an ESG investment approach or not?

As a result of the above, the growth assets component of Portfoliosense® is highly diversified at the asset class, geographic, sector and company levels, and contains exposure to several thousand companies in over 40 markets.

This part of the portfolio will be volatile, with negative returns likely in around one-in-three annual periods; that is fine, as it is the nature of markets. Large falls in value may well be experienced at times of market turmoil, such as during the credit crisis and COVID-19 pandemic. Remember that a fall only becomes a loss if you sell, which is something that patient and disciplined investors should avoid. Remember, too, that your holding in defensive assets should help to reduce any fall in the value of your portfolio at these times.

ii)
Defensive assets – cushioning the falls

We believe in the equity premium risk, and, as evidenced within the long-term performance of our portfolios, the higher the exposure to growth assets, the higher the long-term return.

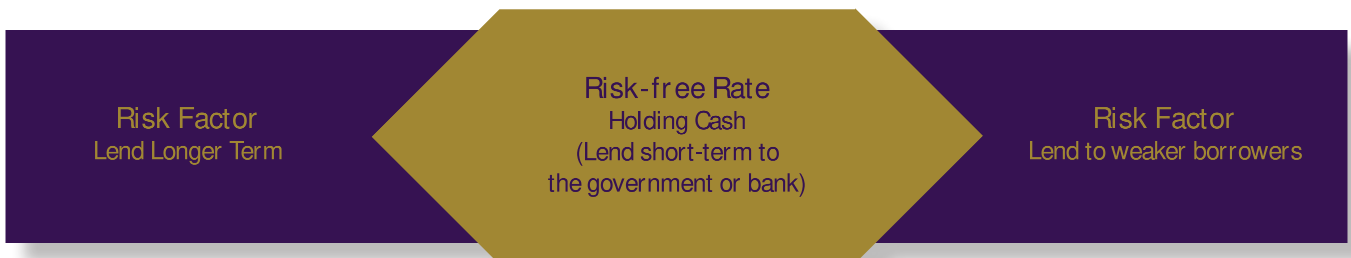
So, why do we hold defensive assets?

Not all investors have the emotional or financial capacity to cope with the associated risks and volatility of investing entirely in growth assets. Defensive assets have generally, but not always, had lower or negative correlation (e.g. moving differently) to growth assets.

For more cautious investors, defensive assets provide downside protection by delivering lower levels of potential falls than equity markets and should preserve purchasing power over the long term, although this is not guaranteed.

A simple approach could be to just hold cash. However, defensive assets, such as global bonds, have a higher expected return than cash, which is simply part of the fixed income spectrum. Both approaches are essentially lending money to a government or company (a bank in the case of holding cash). The yields associated with defensive assets is often higher than cash, but as we know, this is not guaranteed. There is no way of knowing when cash yields are going to be higher than defensive asset yields, therefore, it could be detrimental over the long-term to hold cash in place of defensive assets.

Due to higher expected return of defensive assets, there are of course investment related risks associated, with the two key risks being as follows:



The table below illustrates that these defensive qualities have been highly beneficial when equities have fallen. Although cash is deemed to be a defensive asset, it does not do as good a job as short-dated, high-quality bonds (in this case short-dated UK gilts). The time frames covered are the worst five equity market falls since January 1999 to January 2021, and the returns are after inflation:

Peak Date	Trough Date	Global Equities	Cash	Short-Dated Gilts
September 2000	September 2002	-49%	7%	13%
November 2007	February 2009	-35%	2%	9%
July 2011	September 2011	-15%	-1%	0%
April 2015	September 2015	-11%	0%	1%
August 2019	March 2020	-16%	0%	0%

Whilst short-dated bonds provide some protection against inflation, as their yield reflects the market's forward-looking view on inflation, periods of unanticipated and sustained inflation leave bond assets vulnerable to poor returns and possibly the erosion of capital by inflation. Inflation linked bonds, such as the UK index-linked gilts, can provide an insurance policy against this risk, and whilst currently not adopted, may be included in our Portfoliosense® suite.

It is important to remember that despite being included for their defensive characteristics, short-dated bonds still carry investment related risks. There is no guarantee that they will cushion

iii)
‘Best in Class’ Funds

Choosing which funds to recommend to our clients is a big responsibility that we take very seriously. We employ a detailed and insightful due diligence process to ensure that we fully understand the funds we recommend.

At first glance, debacles such as the Madoff ‘Ponzi’ scheme and the ability of professional fund managers and advisers to be taken in, are hard to believe. On closer examination though, it is perhaps not surprising. If you run a business model that promises great market-beating performance and promise high returns with low risk, you will always be susceptible to being drawn into every ‘exceptional’ investment opportunity, where the rush for performance dominates and blinds the need for careful and insightful due diligence.

Our focus is always on risk management that starts with eliminating fraud, explores operational risks, then focuses on product structure risks and finally looks at the ability of the fund firm to deliver market returns effectively.

There are over 600,000 individual funds available to invest in, our due diligence process is focussed on achieving our investment principles and asset allocations.

The diagram below provides a high-level overview of our screening process:

Some examples of the screens adopted include total investment related charges, availability to UK investors and insufficient data sets.

It is entirely possible, and likely, that our portfolios will look much the same between one time period and the next with little activity, except for rebalancing. That most definitely does not mean that nothing is happening.

We hold regular Investment Committee meetings. If we were an active management firm, these meetings would be taken up with economic analysis, forecasts for markets, tactical short-term market timing decisions and fund picking choices. Our meetings are far less exciting, focusing on any new evidence

As the portfolios increased in number, the exposure to growth assets, and therefore associated investment risks also increases.

So, to help you work out which portfolio is most suitable to you, we first of consider three things:

Risk Tolerance – Your Response to Market Fluctuations

Over the course of your investment life, the value of your portfolio will rise and fall. While we would always rather see our portfolio value rise, a prudent investor knows that any investment will have some periods in which the value will fall. Equity markets in particular are very volatile and investors must expect that there will be regular periods of rising prices and regular periods of falling prices.

Your risk tolerance defines your level of comfort in coping with the market downturns and your ability to 'stay the course'. If the risk you take is within your risk tolerance, then you will be able to maintain your investment strategy through the weak markets as well as the strong, giving you the best chance of investment success.

Risk Capacity – Your Financial Vulnerability to Losses

Designing an appropriate investment strategy requires a clear understanding and the ability to weigh up the factors that can be in conflict. Your tolerance for risk may be high, but a wise investor should still consider their ability to withstand financial losses. Because market downturns are unpredictable, you need to assess the real economic harm that you would face if your portfolio seriously declined in value.

It is therefore essential to assess your level of reliance upon your portfolio

Risk Required – What Risk do you Need to Take to Achieve your 'Target Return'?

What other capital or income resources do you have, and consequently how important is your portfolio to your overall position?

Total reliance on your investment portfolio to provide for your current and/or future needs may introduce more caution into your approach, whilst in contrast having alternative means may allow you to comfortably introduce more risk to your position.

If you need your portfolio to grow by a greater amount over your time horizon, you will require a higher rate of return. An increase in your target return objective, however, will involve taking more risk. If your target return objective is higher than your risk tolerance (your willingness to take risk) or your risk capacity (your financial vulnerability to losses), then you must compromise one or more of these parameters.

It is essential that you consider this and make the right choice(s). Sleepless nights avoided by owning a portfolio with an investment journey that you can tolerate may ultimately be replaced by sleepless nights due to owning a portfolio that does not provide enough on which to retire comfortably, or which leaves you with the very real prospect of outliving the retirement pot. A resolution that is understood, agreed and owned by the client is essential.

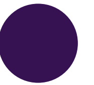
On the other hand, if your target return objective can be lowered because your assets and income can support your goals with less growth, then your need to take risk is reduced and your portfolio should be determined accordingly.

As your portfolio grows over time, your need to take risk should be reassessed and your investment strategy adjusted in view of that. For instance, at the outset you may be in a wealth accumulation phase, where the potential for investment growth is the main objective of your investment strategy. Over time you then may move in to a wealth preservation stage, where the protection of your accumulated wealth is more important, and therefore, a lower exposure to growth assets is a key objective of your investment strategy.

REVIEW, REBALANCE, RELAX

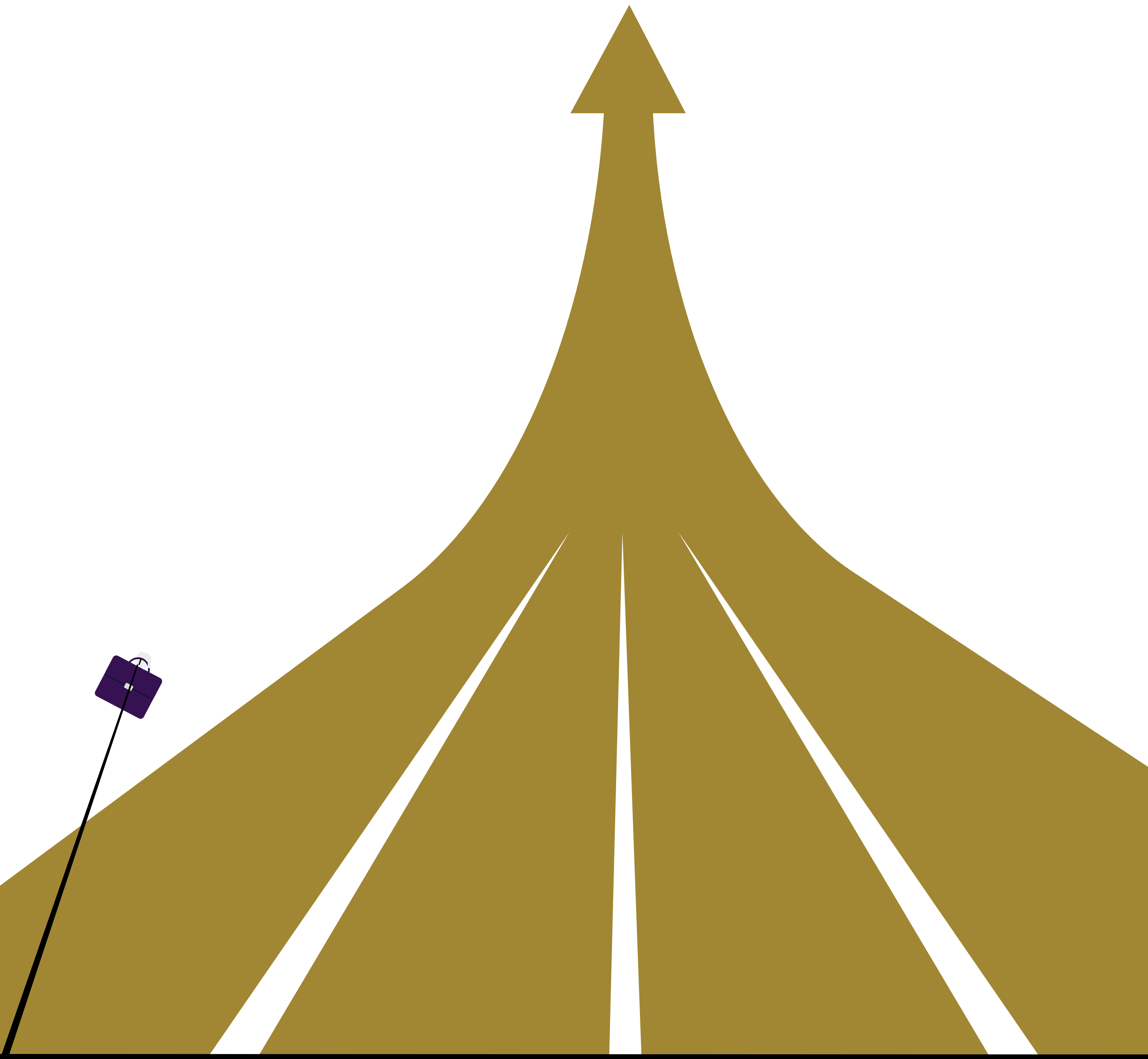
Having spent considerable time and effort ensuring your portfolio is both suitable for you and robustly structured, it is important to keep it that way.

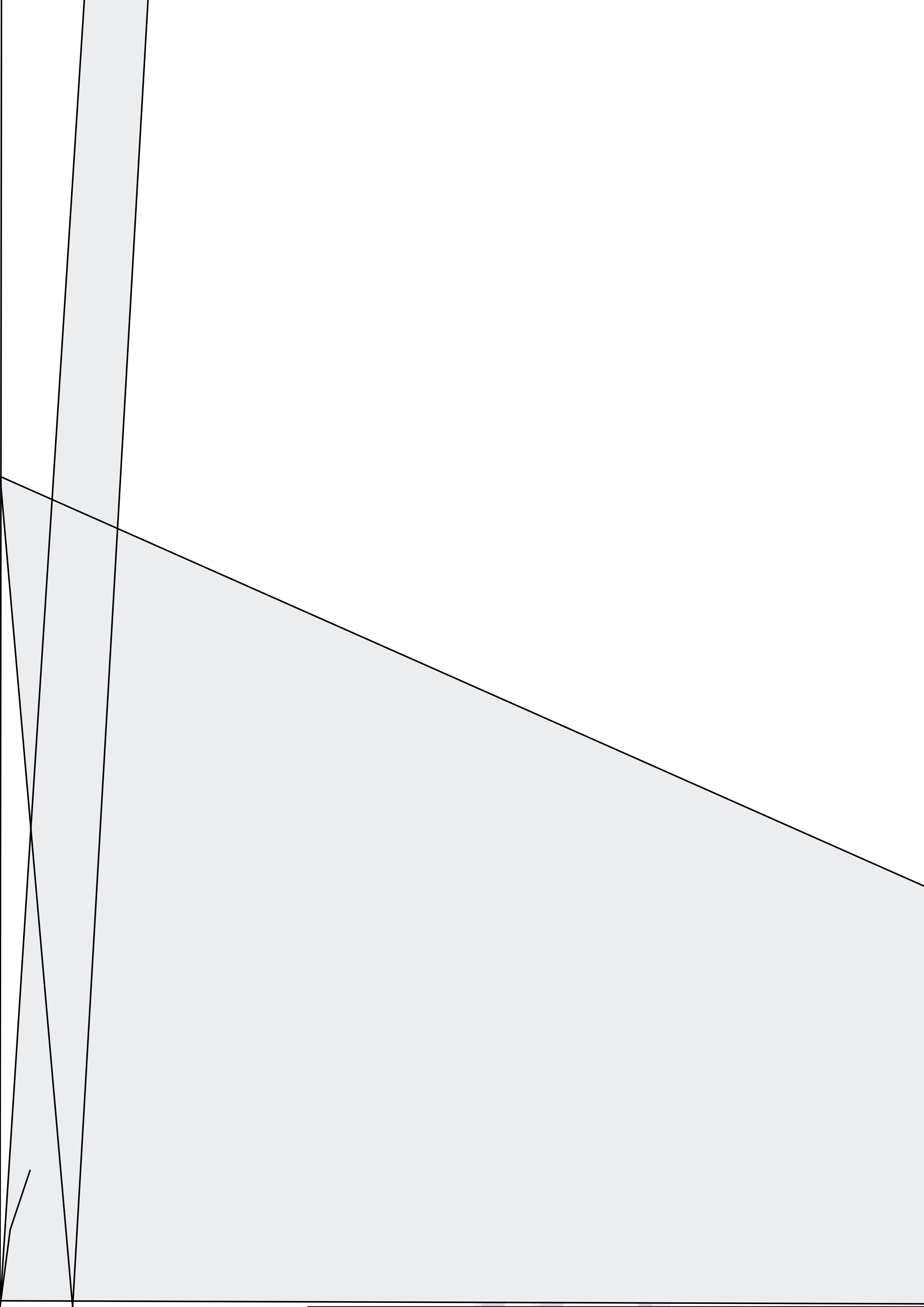
Over time, the portfolio will drift away from the original asset allocation as different asset classes perform differently. If left unattended, the portfolio's exposure to riskier assets may increase and therefore the associated risks be outside your risk capacity.

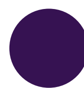


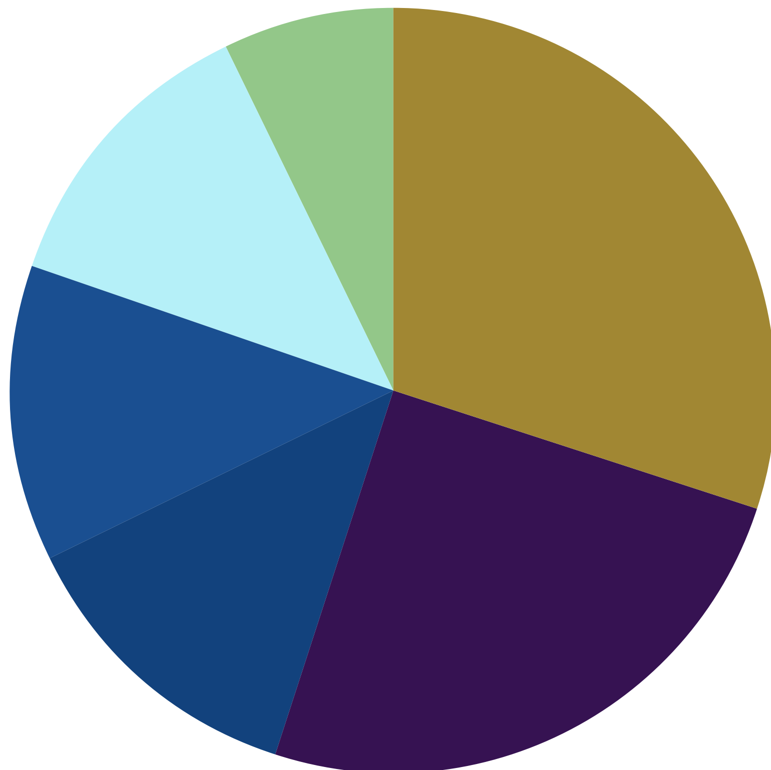
PORTFOLIOSENSE® SUITE

In investing there is no 'one size fits all', and due to this, Portfoliosense® has three different offerings, Global, Earth and Multi Asset. Whilst the investment principles are the same across the different ranges, each offering varies slightly offering investors a full range of investment solutions.







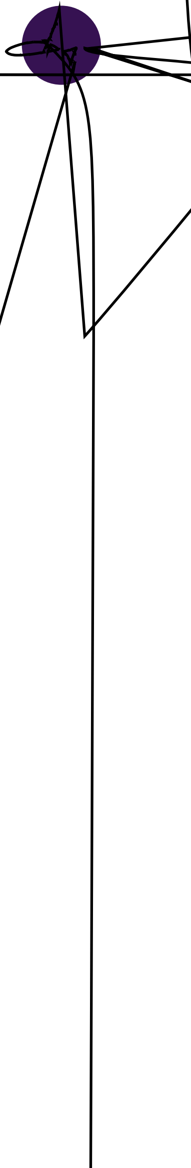


PERFORMANCE

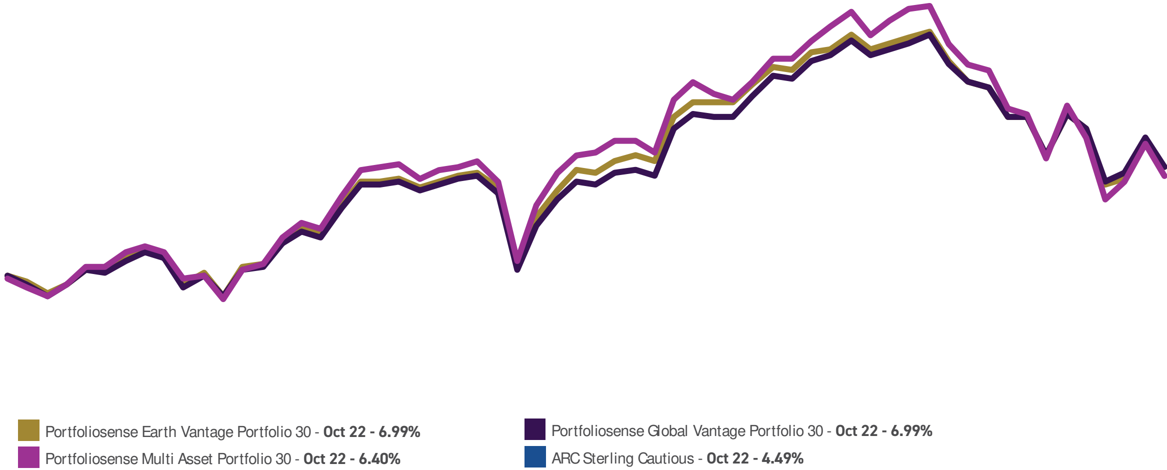
Rather than solely highlighting the performance of the portfolios, and overloading with the performance of 31 portfolios, we have provided the performance of Portfolios 30,70 and 100 to provide a spectrum of the portfolio and risk ranges and compared them to the relevant ARC Private Client Indices (PCI) benchmark.

ARC's PCI series allow performance to be assessed against a realistic and sizable peer group. With over 100 investment houses contributing performance data, all the major investment styles, approaches and philosophies are represented making the ARC Private Client Indices unique in coverage and scope.

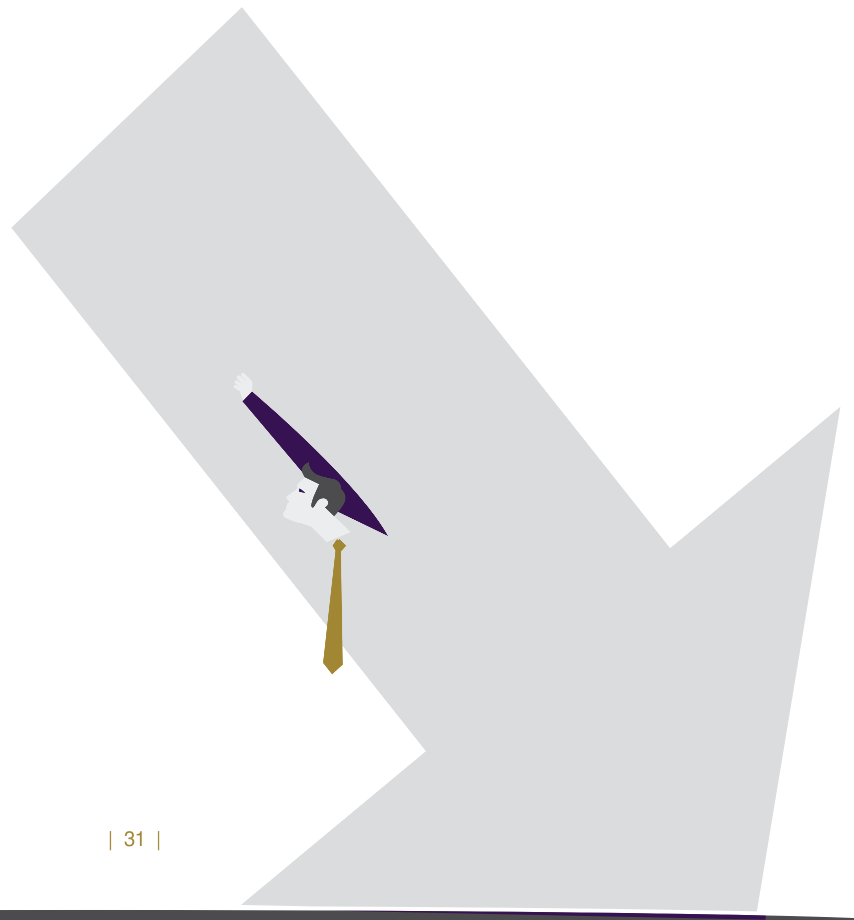
All of the performance charts are run for 5 years to the end of 2022 and do not take account of any additional fees and charges which may apply.



Portfoliosense® 30 v ARC Sterling Cautious



Portfoliosense® 70 v ARC Sterling Steady Growth



CONCLUSION

Portfoliosense® really does add value over the long-term. This is not just a statement, it is a matter of fact, and the following proves this.

The following bar chart shows the annualised returns over the last 20 years (to 30 June 2022) of the following portfolios and asset classes:

- The average investor
- Cash
- Average market returns for Bonds, Portfolio 50 and 100 equivalents
- Combined average returns for Portfoliosense® Bond, 50 and 100 portfolios

From the above, we can see the average investor achieved an annual return of 3.60%. The average return of our lowest risk portfolios, Portfoliosense® Bond, achieved a return of 3.37% over the same period. This return was 0.37% higher than the average market return for the same investment approach.

When increasing the risk, the average returns of Portfoliosense® 50 and 100 has been well in excess of the average investor at 6.65% and 8.97% respectively, but also in excess of the market returns over the same periods.

These figures highlight that over the 20-year timeframe reviewed, the approach adopted by Portfoliosense® has added value and achieved a premium return for investors, all at a low cost!

Key Risks

Past performance cannot be used as a guide to future performance and the value of your investment will fall as well as rise in value. You may not get back all of your investment and the final value of your investment will depend on the performance of your portfolio. The information contained in this document is for information purposes only. It does not constitute advice or a recommendation or an offer or solicitation for investment. Changes in exchange rates could affect the value of overseas investments. The effect of inflation could reduce the future purchasing power of your investments, whilst any exposure to property funds could face difficulty in being redeemed in the future.

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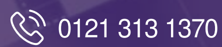
Gaye Morris,
Business Owner



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