



Glamorgan Financial Services Investment Process

This document details the full investment process for Glamorgan Financial Services Ltd. The process has been set out by the Investment Group and is reviewed on a regular basis.

Members of the Investment Group

- Gary Prewett - Director and Independent Financial Adviser
- Matthew Harris - Director and Independent Financial Adviser
- Martin Kelland - Director and Independent Financial Adviser

The five key parts to the Investment Process

1. Risk Profiling
2. Asset Allocation
3. Fund Selection Process
4. Ongoing Monitoring and Reviewing of Funds
5. Client Reviews

Risk Profiling and Asset Allocation Tool

It is inevitable that clients and advisers will have widely varying interpretations of investment risk. It is vital from the perspective of consistency that the business and all advisers within the business adopt the same interpretation of investment risk.

Furthermore it is a key obligation under the Financial Services Authority's requirement for 'treating customers fairly' that all our clients assessed to be of equal risk should receive the same investment choices.

The only way to satisfy these requirements is to establish a consistent measure across the business for establishing attitude to risk.

The basis we have adopted for the consistent assessment of attitude to risk is to encourage all clients to complete an 'attitude to risk' questionnaire. To ensure a consistent basis for assessing our clients' attitude to risk we will use the same tool for each client.

We recognise that perception of risk is a relative measure and it is therefore important we educate clients about the relationship between risk and return. We demonstrate that for any given potential upside to a portfolio there is a potential downside. We establish that in order to achieve the potential for higher upside the client must also accept the potential for a larger downside.

To this end the questionnaire helps clients to focus on what they can afford to lose rather than what they hope to gain.

Finally, risk is a relative measure and therefore an individual's attitude to risk will vary according to that person's expectation of the likelihood of a negative outcome. It is therefore imperative that as a business we re-assess each client's attitude to risk according to their client service agreement.



The completion of a new attitude to risk questionnaire will be the first function of each annual client review.

Asset Allocation Theory

We recognise that efficient asset allocation is the key determinant in the variation of returns in a client portfolio.

In 1952 professor Harry Markowitz published his doctoral thesis “Portfolio Selection”, marking the introduction of what is now known as Modern Portfolio Theory.

Professor Markowitz established that for any given level of risk it was possible to construct an investment portfolio that mathematically delivers the maximum possible investment returns. That portfolio is said to sit on the ‘efficient frontier’.

Modern Portfolio Theory states that any portfolio that does not sit on the efficient frontier is inefficient as the portfolio is not maximising the returns for that given level of risk.

Thus we use the attitude to risk questionnaire to first establish a clients’ acceptance of risk before we then find the portfolio on the efficient frontier for that level of risk.

More recent research* indicates that asset allocation is by far the dominant determinant, at 91.5% in the variability of returns in a portfolio. Market timing represents 1.8% and Stock selection 4.6%.

Further more the Myners report of 2001 clearly states the significance of asset allocation and goes so far as to state that clients should pay more in order to receive advice on asset allocation.

Choice of Asset Allocation Tool

Having carried out a thorough review of the risk profiling and asset allocation tools on the market we have selected the asset allocation tool provided by Selestia/Watson Wyatt to build our clients portfolios. Additionally, we have concluded that it is important to use the same company’s attitude to risk questionnaire as the output of this feed directly into the asset allocation models.

One of the key reasons for choosing this tool is that it does not amend the economic output in any way. We believe providers who bias the output of their models are creating a conflict of interest. In addition our research indicates that it is the only model that takes into account the impact of the different tax wrappers i.e. the impact of a gross or net yielding environment on the performance of the underlying assets.

**Brinson, Singer and Beebower “Determinants of Portfolio Performance II: An Update” 1991.*



Modelling Asset Classes

The asset allocation tool models the following asset classes:

- Cash / Money Markets
- UK Fixed Interest
- International Fixed Interest
- Property
- UK Equity
- International Equity

Although international equity is modelled together it is further sub-divided into North America, Japan, Europe, Far East, Emerging Markets and Global Specialist. The proportions for each of these sectors are determined by Watson Wyatt and are based primarily on the size of each market and their respective economies.

Gross Versus Net Yielding Wrappers

The asset allocation tool takes account of the tax status of the investment wrapper.

Gross Yielding – Pension ISA and PEP

Net Yielding – Investment Bond and Unwrapped Collectives

For any given attitude to risk there may be a difference in the asset allocation recommended for an investment into a gross yielding wrapper and a net yielding wrapper. Specifically the differences arise because of the different tax treatment of the underlying asset classes within the different wrappers.

UK Equity Dividends suffer the 10% tax credit regardless of the tax status of the Wrapper in which they are held. Similarly the yields on UK property are taxed regardless of the tax status of the Wrapper within which it is held. UK fixed interest suffers saving tax within a net yielding wrapper, but is untaxed within a gross yielding wrapper.

The tax advantaged position of fixed interest over property within Pensions, ISA and PEP increases the assumed return for the fixed interest within these wrappers. Within a gross yielding environment fixed interest is assumed to produce similar returns to property, but do so for a lower assumed rate of volatility. It may, therefore, become preferable to hold fixed interest over property in a gross yielding environment. However we consider the advantage is likely to be marginal compared to the benefit of spreading assets across all sectors and have therefore chosen to include an element of property within pension portfolios.



Asset allocation within Sectors

The asset allocation tool provides us with the recommended asset allocations into the following sectors.

- Cash/Money markets
- UK Fixed Interest
- International Fixed Interest
- Property
- UK Equity
- European Equity
- US Equity
- Global Specialist
- Global Emerging Markets
- Far East (excluding Japan)
- Japan

Fund Selection Process

Although asset allocation is core to our investment process we don't believe markets are 100% efficient. There are likely to be inefficiencies in the distribution of information in any market.

That said, we believe a number of fund managers and fund houses have the ability to outperform the market over the longer term. Our fund selection process aims to select those managers who have the ability to exploit these differences and deliver long term outperformance of a given sector.

In short, we are aiming for an active style of management.

Criteria for Selection

The investment group recognises that past performance is not a guide to future performance and as such performance only plays a small role in our selection. We pay much more attention to the following five criteria:

1. Ratings agencies
2. Risk adjusted returns
3. Relative risks
4. Consistency of performance (rather than specific performance)
5. Representatives of the asset class (ensuring it fits our model)



The following paragraphs provide information on each of these criteria.

1. Ratings Agencies – as a small IFA practise we recognise that we are limited in our ability to perform a detailed due diligence appraisal on the whole market of investment funds. A key part of our investment process is, therefore, to study the output of the ratings agencies. These organisations have huge resources and high levels of access to fund groups and fund managers. (See Appendices A & B)
2. Risk adjusted returns – we use a measure called the Information Ratio. The Information Ratio is use to help put the returns generated by a fund manager into context given the level of risk they take on.
3. Relative Risk – Volatility is a statistical measure of how often a series of values move up and down around its average. The higher the volatility number the less consistent historical performance has been. We are therefore looking for funds that have performed with as little volatility as possible.
4. Consistency of Performance – As we have already established past performance is not a guide to future performance. What is useful however is to establish which funds have generated consistent performance. To assess this we look at discrete quartile rankings over the following time periods:

- 1 year from 36 months ago
- 1 year from 60 months ago

Rankings of 1 and 2 are above average and rankings 3 and 4 are below average.

5. Representativeness of the asset class – For the asset allocation to maintain its validity its important we choose funds that fit the sector reasonably closely. If they fit the sector exactly they effectively track the performance of the sector and are in passive funds. It is possible to calculate an estimate of the potential to outperform the sector from the extent and consistency by which a fund is above or below average. Clearly we are not looking for funds that vary widely from the sector for this would upset the asset allocation principles; however a little variance provides the opportunity to outperform the sector.



Client Reviews

Every client will be offered a review at least annually.

Every client will, from their discussion with their financial adviser, already be aware of whether Glamorgan Financial are providing them with an Active or Reactive level of service (see below). All clients, irrespective of the level of service chosen, need to contact their Financial Adviser at the earliest possible opportunity if their circumstances change in any way that might affect their investment objectives. Such circumstances may include an inheritance, opting for earlier or later retirement, redundancy, change of employment, arrival of new children/grandchildren, separation, illness or bereavement. (This list is not exhaustive and your Financial Adviser should be notified of any material changes to your circumstances or objectives)

Actively Managed Clients

For actively managed clients the first part of the review will be focused on re-assessing the client's attitude to risk. Where this results in a change the clients portfolio will need to be amended in line with the correct asset allocation for the new risk level. Active clients will also benefit from our annual portfolio monitoring and rebalancing service and at each annual review receive an investment report and portfolio valuation summary.

Ongoing Monitoring of Portfolios and Review of Recommended Funds

The investment group meets every January to perform 3 functions

- 1 Decide whether to apply any changes made necessary by a shift in the underlying asset allocation recommendations provide by Watson Wyatt.
- 2 Review the recommended fund selection.
- 3 Re-align client portfolios to match the new portfolio recommendations.

The outcome of the review meeting and any portfolio recommendations will be published and we will write to our active clients with our new recommendations inviting them to consider, and notify us, if they *wish* to accept our recommendations and make the appropriate changes to their portfolios. We do not currently hold discretionary adviser status and therefore any changes to a client's portfolio must first be authorised by our clients' individual signed authority.

All of these functions will be performed by the end of February each year.

The group will of course continually monitor the funds for any extraordinary events (e.g. a high profile manager leaving or retiring) and, if necessary, call an extraordinary meeting of the investment group to consider and matter that has arisen.

Reactively Managed Clients

Reactively managed clients will be invested in an Investment Group approved multi-asset or multi-manager fund where asset allocation and portfolio rebalancing is done automatically within the underlying investment fund. When we review our choice of investment funds all reactively managed clients will remain in the original fund recommended unless, and until, a change is specifically requested by the client or is recommended by Glamorgan Financial as a result of a review meeting. Reactively



managed clients should therefore contact their financial adviser if they want a review because their circumstances, objectives or attitude to risk have changed.

Appendices

Appendix A

Old Broad Street Research (OBSR) detail

OBSR AAA rating

This is the highest rating awarded by OBSR. This rating is awarded to funds which demonstrate very powerful investment processes and disciplines which are believed will translate into exceptional long term performance. It is an indication of excellence.

OBSR AA rating

This is determined using the same methodology as for the AA rating; it is an indication of highly superior quality, based on process and track record.

OBSR A rating

This is again determined with methodology consistent with the AAA and AA ratings; a fund receiving the A rating is a highly commended fund.

Ratings are formally reviewed on a quarterly basis but may be changed during the quarter should the judgement alter about the future prospects for a fund. Changes of this type are likely to occur following a significant event such as a change in fund manager or a fundamental change in the investment process applied in the management of a fund.

The OBSR Fund Ratings Service aims to identify funds which will achieve their objectives. The award of an OBSR rating does not imply, however, that a fund will achieve positive return, nor is the award an indication of the prospective returns from any particular asset class or asset allocation strategy.

OBSR ratings are intended to be 'predictive' in nature; their aim is to identify the in-coming funds of tomorrow.

How ratings are determined

OBSR Fund Ratings are determined on the premise that the fund selection process should, whilst taking past performance into consideration, ascribe greater weight to identifying the factors which will affect future performance.

There are several factors that lead to the final OBSR rating determination, these are:

- Strength of investment process and length of time it has been in place
- Continuity of investment personnel
- Investment style that has proven durable over time
- Clearly defined investment objectives
- Strong and consistent past performance record
- Favourable risk adjusted returns

The OBSR ratings are determined following an in-depth qualitative and quantitative analysis with the emphasis more focused towards qualitative appraisals. Clearly defined routines are followed for consistency.



Discreet Time Period Analysis

The OBSR Fund Ratings Service analyses historical fund performance and places greater emphasis on short to medium term trends in performance than on long term trends. Examination of performance over long time horizons can severely distort and disguise more recent movements. As the focus is to define the winners of tomorrow it is believed that placing the emphasis on the short to medium term provides a more valid guide. This contention is supported by the many fund management company takeovers and mergers and fund manager moves which are a feature of the global financial services industry today. Changes to investment processes and/or the appointment of new fund managers can clearly, in many instances, bring into question the relevance of long term historical performance.

Proprietary Classification System

The OBSR Fund Ratings Service uses a proprietary classification system across all regions and asset classes to group funds together by style. This ensures the 'like for like' comparison of funds that, in turn, enables OBSR to remain agnostic about the type of fund chosen and to focus purely on the best managers. The extensive knowledge of funds, achieved through the rigorous qualitative analysis that is undertaken, allows OBSR to build up a sample group of funds representative of different investment styles. From this quantitative models are constructed that describe the behaviour of particular styles over specific time periods. The aim is to clearly identify groups of funds that exhibit similar characteristics.

Funds are ranked over discrete time periods according to their performance relative to what are termed their true peer group – *the OBSR defined universe*. Funds can be moved between these universes at any time, as and when changes in style are identified through qualitative analysis. The process also takes into account fund manager changes. Those funds that achieve the highest rankings in terms of consistency within the OBSR defined universe are then analysed under the Capital Asset Pricing Model to assess their risk/return characteristics.

The objective is to determine whether a fund is justifying its fees relative to its systematic risk. This sounds rather technical but in simple terms the aim is to measure the added value from any given fund. This process highlights funds worthy of further analysis and, thus, the possible consideration of an OBSR rating.

Qualitative Analysis

There are certain key areas that are focused upon, including an analysis of the strength of the investment team, the quality of its individuals and their experience, the level of research undertaken by the fund manager or the reliance placed on third party information. Also considered are the merits and demerits of funds being managed locally or at head office. The reliance on individual or so-called 'star' fund managers, as opposed to the adoption of a team approach is also considered. OBSR needs to assess how vulnerable an organisation is to the departure of a specific fund manager which may result in an OBSR rating being revised.

OBSR attempts to identify particular strengths which enable it to assess whether an organisation is likely to be better than its competitors at managing specific types of funds. For example strong asset allocation disciplines are more important in a fund management company which is heavily involved in the management of global or regional funds. To give a further instance, when examining bond funds, consideration is given to the quality of the organisations' skills in the interpretation of macroeconomic data as well as its ability and resource in the evaluation of credit risk.



Fund Manager Interviews

In depth interviewing of fund managers is the cornerstone of this aspect of the process. The aim is to gain a thorough understanding of the investment process applied in the management of a fund. This part of the analysis is ongoing. OBSR carry out around 5000 fund manager interviews each year for the OBSR Funds Rating Service and other research services.

There are a number of areas that are examined as part of the due diligence. OBSR has deliberately avoided the production and completion of questionnaires for fund managers. It recognises that there are great differences in style and OBSR does not wish to be constrained by the need to 'straight jacket' fund managers with its own definitions and questions. Anyone can fill in boxes but there is more required to gain real insight into a fund. Assessment is made based on detailed discussion and, whilst knowing what questions need to be answered, fund managers are encouraged to describe their (and their teams) investment process in their own way.

Ongoing Monitoring

The OBSR rated funds are monitored continuously and their managers may be contacted or re-interviewed as frequently as quarterly. The objective of regular follow up is to enable the research teams to revalidate the understanding of a fund. Managers of other funds which may aspire to the OBSR rated status are also interviewed regularly.

Considerable time is spent developing understanding of how different investment management houses operate. Real insight is gained into investment style and to identify areas of expertise; and possibly, weakness.

Contrasting Investment Approaches

Analyses of different groups, fund managers and individual funds points to the fact that, at times, very different approaches are taken in managing money in similar areas. Once the strengths of a particular management group have been defined, focus is turned to specifics. A clear picture needs to be gained as to how an individual fund is to be managed and how a company's overall methodology translates into practical day to day management.

The most important issue here is to obtain a clear definition of a funds objective. The examination of attitudes towards managing an investment portfolio actively or passively is undertaken. Growth and value are looked at. The degree of aggression and attitudes towards trading are assessed, including the blend of these in the portfolio. The degree of diversification or concentration in the portfolio is understood. Followed closely is the pursuit or otherwise of the sector themes. Portfolio commitment is looked at in relation to individual sectors and stocks either as core holdings or as temporary features

Summary

As noted earlier the award of an OBSR rating to a fund is intended to be a predictive indication of its quality. While past performance can be an important factor, the essence of the approach is to emphasise this qualitative aspect and the judgement and experience of the teams is critical in the OBSR rating determination. This is the real added value of the OBSR Funds Rating Service.



Appendix B

Citywire Ratings detail

Citywire tracks the individual fund managers, the people, rather than the funds. The problem is that fund managers switch jobs so frequently, they might move from one firm to another, or they may simply take on new funds and drop others. Therefore it becomes very important, as these people move around so much, to produce regular and reliable information which highlights how they perform.

Rankings

Fund managers are ranked compared to their peers. The assessment of how well, or how badly, they have done is published in league tables.

Ratings

Also assessed is how much risk managers have taken to produce their returns. A manager who takes lots of risk to produce good returns would be in great danger of failing to deliver those results in future. Conversely, a manager who is able to deliver good results without taking too much risk is, perhaps, more reliable for the future.

Analysis of the risks taken by a manager considers their performance in comparison with the benchmark index of the markets in which they invest. For example a UK fund manager who invests in large and mid-cap shares should be judged against the FTSE 350 index; a fund manager investing in the US could be judged against the S & P 500 index.

The Citywire rating combines analysis of risk taking with how well the fund manager does in comparison with their relevant benchmark over a three year period.

The very best – fewer than 5% of all UK fund managers – achieve an AAA rating from Citywire. If they do it means that they have performed very well and are the elite.

Managers who achieve an A or AA rating are still well above average performers. Less than one in five fund managers get any rating at all from Citywire.

Other fund managers will get no rating at all either because they are not good enough or have not been running funds long enough to qualify.

One important point is that all this is a mathematical process which is approved by outside experts; AKG Actuaries.

Who comes out on top is entirely down to how they perform, not whether they spin a good story, are charismatic or forceful personalities or pay a fee.



Appendix C

Investment Managers Association, Sectors and Definitions

Sector Definitions and Classification

There are about 2000 investment funds to choose from but to help identify funds with similar characteristics they are categorised within a fund classification system of over 30 sectors. The sector categories are broadly divided into funds that aim to provide an 'income' and those designed to produce 'growth'. Each sector is made up of funds investing in similar assets, or the same stock market sectors, or in the same geographical region.

Funds are classified in this way to make it easier to find those that meet the investment objectives. This ensures that when comparing one fund with another we are comparing funds with similar objectives or with similar underlying assets.

Funds principally targeting income

UK Gilts

Funds that invest at least 95% of their assets in Sterling denominated (or hedged back to Sterling). Triple AAA rated government backed securities with at least 75% invested in UK government securities (Gilts).

UK Indexed Linked Gilts

Funds that invest at least 90% of their assets in UK Index Linked Government securities (Gilts).

UK Corporate Bond

Funds that invest at least 80% of their assets in Sterling denominated (or hedged back to Sterling) BBB minus or above bonds (as measured by Standard and Poors or an equivalent external rating agency – (Moody's Baa or above)). This excludes convertibles.

UK Other Bond

Funds investing at least 80% of their assets in Sterling denominated (or hedged back to Sterling), and at least 20% of their assets in below BBB minus bonds (as measured by Standard and Poors or an equivalent external rating agency), convertibles and income producing preference shares.

Global Bonds

Funds investing at least 80% of their assets in fixed interest stocks. All funds which contain more than 80% fixed interest investments are to be classified under this heading regardless of the fact that they may have more than 80% in a particular geographical sector, unless that geographical area is the UK when the fund should be classified under the relevant UK heading.

UK Equity & Bond Income

Funds which invest at least 80% of their assets in the UK, between 20% and 80% in UK fixed interest securities and between 20% and 80% in UK equities. These funds aim to have a yield in excess of 120% of the FTSE All Share Index.

UK Equity Income

Funds which invest at least 80% in UK equities and which aim to achieve a yield on the distributable income in excess of 110% of the FTSE All Share yield.



Funds principally targeting capital

UK Zeros

Funds investing at least 80% of their assets in Sterling denominated (or hedged back to Sterling),
And at least 80% of their assets in zero dividend preference shares or equivalent instruments (i.e. not income producing). This excludes preference shares that produce an income.

UK All Companies

Funds investing at least 80% of their assets in UK equities which have a primary objective of achieving capital growth.

UK Smaller Companies

Funds investing at least 80% of their assets in UK equities of companies which from the bottom 10% by market capitalisation.

Japan

Funds investing at least 80% of their assets in Japanese equities

Japanese Smaller Companies

Funds investing at least 80% of their assets in Japanese equities of companies which from the bottom 30% by market capitalisation.

Asia Pacific including Japan

Funds investing at least 80% of their assets in Asia Pacific equities including a Japanese content. The Japanese content must make up less than 80% of the equities.

Asia Pacific excluding Japan

Funds investing at least 80% of their assets in Asia Pacific equities and exclude Japanese securities.

North America

Funds investing at least 80% of their assets in North American equities.

North American Smaller Companies

Funds investing at least 80% of their assets in North American equities of companies which form the bottom 20% by market capitalisation.

Europe including UK

Funds investing at least 80% of their assets in European equities. They may include UK equities, but these must not exceed 80% of the fund.

Europe excluding UK

Funds investing at least 80% of their assets in European equities and exclude UK securities.



European Smaller Companies

Funds investing at least 80% of their assets in European equities of companies which form the bottom 20% by market capitalisation in the European market. They may include UK equities but these must not exceed 80% of the funds assets. ('Europe' includes all countries in the MSCI/FTE pan European indices)

Cautious Managed

Funds investing in a range of assets with the maximum equity exposure restricted to 60% of the fund and with at least 30% invested in fixed interest and cash. There is no specific requirement to hold a minimum percentage of non-UK equity within the equity limits. Assets must be at least 50% in Sterling/Euro and equities are deemed to include convertibles.

Balanced Managed

Funds would offer investment in a range of assets with the maximum exposure restricted to 85% of the fund. Assets must be at least 50% in Sterling/Euro and equities are deemed to include convertibles.

Active Managed

Funds would offer investment in a range of assets with the manager being able to invest up to 100% in equities at their discretion. At least 10% must be held in non UK equities. There is no minimum Sterling/Euro balance and equities are deemed to include convertibles. At any one time the asset allocation of these funds may hold a high proportion of non-equity assets such that the asset allocation would by default place the fund in either the Balanced or Cautious sector. These funds would remain in this sector on these occasions since it is the managers stated intention to retain the right to invest up to 100% in equities.

Global Growth

Funds investing at least 80% of their assets in equities, but not more than 80% in UK assets and which have the prime objective of achieving capital growth.

Global Emerging Markets

Funds investing at least 80% or more of their assets directly or indirectly in emerging markets, as defined by the World Bank, without geographical restriction; indirect investment e.g. China shares listed in Hong Kong should not exceed 50% of the portfolio.

The above sectors also require funds to be broadly diversified within the relevant country/region/asset class. Funds that concentrate solely on a specialist theme, sector or single market size (or a single country in a multi currency region) would be incorporated in the Specialist Sector (see below), or in the case of tech funds in the Technology and Telecommunications Sector.



Funds principally targeting capital protection

Money Market

Funds that invest at least 95% of their assets in money market instruments (i.e. cash and near cash such as bank deposits, certificates of deposit, very short term fixed interest securities or floating rate notes)

Protected/Guaranteed Funds

Funds, other than money market funds that principally aim to provide a return of a set amount of capital back to the investor (either explicitly guaranteed or via an investment strategy highly likely to achieve this objective) plus some market upside.

Specialist Sectors

Specialist

Funds that have an investment universe which is not accommodated by the mainstream sectors. Performance ranking of the funds within this sector is inappropriate given the diverse nature of its constituents.

Technology and Telecommunications

Funds that invest at least 80% of their assets in Technology and Telecommunications sectors as defined by the major index providers.

Appendix D

Sources of Information

- Bloomberg Financial Glossary (www.bloomberg.com)
- FTSE The Index Company
- Gartmore
- Skandia
- Investment Managers Association