Managing risk

BREAKFAST BRIEFING

DIVERSIFYING YOUR INVESTMENT PORTFOLIO

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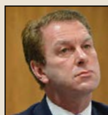
Diversification

Panel:

Arun Shetty
Shetty is portfolio director at asset management group GAM Investments.

Vicky Rooke
Senior analyst at consultancy firm Asset Risk Consultants (ARC).

Jenny Williams
Williams is a trustee for sight-loss charity Fight for Sight.



Guy Davies
Charity trustee and director of charity advisory firm Yoke & Co.

Chris Oxland
Oxland is chief executive at benevolent fund IET Connect.

Nicola Gilham
Gilham is a board trustee at Child Bereavement UK.

With a consistent need for income, it's often easy for charities to remain invested in the assets that are consistently performing well. After all, why fix something that isn't broken? But although many investments appear to be yielding strong returns, there's always room for improvement.

However, knowing when it's the right time to refresh your investment portfolio can be difficult, particularly when costs and risks are involved. Diversification can cost more in the shorter term, but there are many rewards to reap in the longer term.

Together with GAM, Charity Times gathered an expert panel of trustees, chief executives and financial officers from charities across the UK to discuss the issues leading the investment agenda. Markets have changed drastically over the years and volatility has dropped, but the need to diversify has still remained the same.

The 'new normal'

Kicking off the discussion, Larry Hatheway, chief economist and head of investment solutions at GAM, explains how markets are currently exiting the 'new normal'. The 'new normal', he describes, characterised the global economy and markets after the financial crisis, when conditions were characterised by "sluggish growth, low inflation and low interests rates, accompanied by extraordinary monetary policies".

He also describes the 'new normal' as a time of a "historic maldistribution of income", which was not just prominent in terms of household income, but also in terms of elevated levels of profitability in the corporate sector. High returns accrued to the few while most saw their real incomes stagnate or decline.

However, Hatheway explains we are now beginning to exit the 'new normal'. "Growth is accelerating, which is probably a departure in itself," he says. "In fact, we now live in a world where we have the most synchronised global expansion in more than a quarter of a century."

"In exiting the 'new normal', the relatively easy performance that investment managers could achieve is, I think, over. Investment strategy must adjust."

The right time to review

Against this backdrop, it is important charities look to mitigate risks and secure a broad portfolio of strong investments. But when is it the right time to review and refresh your existing portfolio?

Guy Davies, charity trustee and director of Charity Investments, explains how there's a lot of "debate and uncertainty" among trustee boards about the timing of investment reviews. "There's a debate as to what is considered to be 'periodic', but I think the general opinion is three to five years."

"Of course an annual review is important, but it's also important not to review it too intensely and too quickly," he says. "Boards should take a step back and look to review every few years, particularly as they don't have the expertise to monitor it too regularly."

Arun Shetty, portfolio director at GAM agrees, explaining how for those who aren't in the industry on a day-to-day basis, getting quarterly reports can be "worrying", whereas a business cycle of three to five years will enable a board to fully assess how a manager performs over a longer period.

Finding the right balance

So when the right time has come, how do you look to ensure your portfolio is well-balanced? And what does 'balanced' actually look like?

Of course the classic portfolio consists of 60 per cent equities and 40 per cent bonds. "That portfolio has performed brilliantly since the financial crisis," GAM's Hatheway explains. "But I think it gave people a false sense of security. It performed well, but people may have felt that's a diversification and it isn't."

"If one is looking at portfolios and seeing there is some non-negligible risk, then the bond sell-off will continue and all of a sudden and it can erode the value of that part of

the portfolio."

But, if the traditional 60/40 portfolio isn't fit for purpose, then what is? Hatheway explains it's an "extraordinary challenge" trying to identify the right balance. But Chris Oxland, chief executive at IET Connect, highlights how pension funds have proven the need for a better split. She explains how pension funds are "heavy in bonds and gilts, which is arguably why the likes of Carillion were so drastically underperforming".

Antonia Coad, head of investor relations and external affairs at Oxford University Endowment Management, agrees, highlighting how charities are the "ultimate long-term investor". Nevertheless, she argues that creating a more diverse portfolio doesn't happen overnight. "It takes time to build a fully diversified portfolio."

Ethical investments

While charities should be looking to diversify portfolios beyond the traditional 60/40 split, investments also need to be kept in-line with a charity's overall objectives to avoid any reputational damage.

But Coad stresses that charities "deserve the highest level of investment management", and thus ESG should form part of the investment process as a whole, and not be a separate element.

"All of our investments should go through rigorous environmental and social risk management before they go into the portfolio," she says. "Of course we have the scale to do that at OU Endowment Management, but ESG shouldn't be separate to the investment process. It should just be wholly integrated throughout the portfolio."

For many smaller charities however, ethical investments need to be carefully balanced with the best returns. In some cases, this means smaller charities have opted for a pooled fund.

However, Davies argues that even for charities that have chosen pooled funds, ESG isn't off limits. "Almost every pooled fund available in the UK works to ethical standards," he says. "Whether that's excluding tobacco or armaments or pornography, most pooled funds for charities have an ethical slant to them."

Reviewing your investment manager

Another way to ensure investments are kept in-line with the charity's overall objectives, whilst performing consistently well, is to review the investment manager responsible for making it happen.

"It's important to find a manager with the right ethos," Vicky Rooke, senior investment analyst at ARC says. "It's important to discuss an ethical investment policy, and then find a manager who will help you to refine and implement the policy."

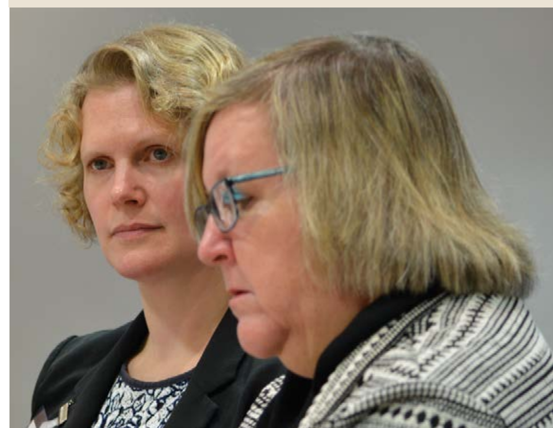
Nancy Jachec
Jachec is an administrator at the Sir Richard Stapley Educational Trust.

Dr Karen Brewer
Dr Brewer is secretary of the CMJA Endowment Fund.

Antonia Coad
Head of investor relations and external affairs at OU Endowment Management.

Marie Magimay
Magimay is the secretary for not-for-profit organisation Carers UK.

Larry Hatheway
Chief economist and head of investment solutions at GAM Investments.



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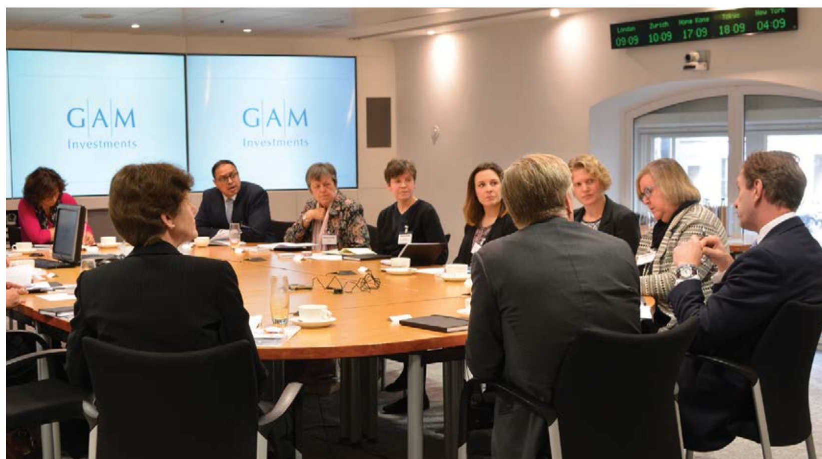

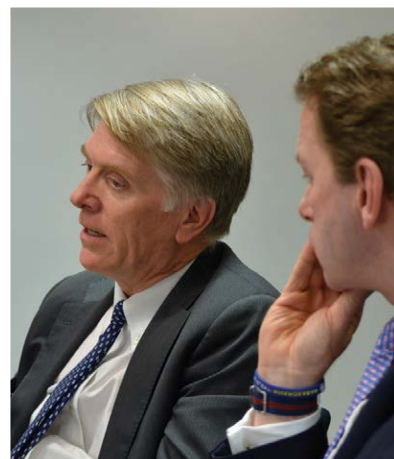

Reviewing your investment manager also has monetary value, too. Rooke explains the main reasons charities would look to review their investment is two-fold: performance and service. "On the service side, charities need to look at whether the manager is providing them with what they need in terms of understanding their portfolio. On the performance side, charities should be looking at performance on a long-term basis against a targeted return, and on a medium-term basis against a benchmark as well as an appropriate peer group.

"If your manager is not performing in-line with each of these comparators, then can they explain why that is? If you're not happy with the level of service or the performance – or of course, a combination of the two – then it's time to review," she says.

Assessing and mitigating risks

While beneficial, reviewing the performance of investments and the firms employed to manage them can be a major undertaking. Boards risk wasting considerable time and resource if they are too quick to change manager.

"As a small charity, you really need to be very cautious about embarking on this process because the downsides can be so much worse than the upsides," Jenny Williams, trustee at Fight for Sight says. "As a small charity, you've got to trade off against risk. And that's actually quite difficult to do when you have a target return to meet."

For smaller charities, it's not just reviewing investment managers that can be costly, diversification as a whole can be, too. Dr Karen Brewer, secretary at CMJA Endowment Fund highlights this, explaining how small charities don't always have the appropriate resources to branch out.

"It's nice to have a big resource to be able to diversify our investments, but it is much more difficult to do that as a smaller charity," she says. "It's a debate we have in our trustee meetings. We have invested in bonds and in equities, but diversifying the different investment funds can be very difficult, because we have very little money. "

With this in mind, Nicola Gilham, board trustee at Child Bereavement UK notes how there is by no means a 'one size fits all' approach. "Diversification entirely depends on the investment policies set by the individual charities," she explains. "It depends on how that particular charity chooses to invest – whether it be through a low-risk portfolio, high-risk or medium-risk."

A price worth paying

Diversifying investment portfolios may not seem like the easiest, or cheapest of tasks for many charities, but with the right help, it can be seamless and incredibly rewarding in the long-run.

The panel emphasises the struggles surrounding paying investment fees, noting how high fees can make it almost impossible for charities with minimal resources to broaden portfolios. However, the group concludes that the fees in the short-term do pay off in the long-term.

"Charities can choose to go down the passive investment route," Rooke explains. "It's cheap and charities can buy these investments themselves. But by not employing an investment manager, charities are not getting any of the portfolio construction, or strategic asset allocation that is needed. Charities must also bear in mind that the fees they're paying to their investment manager are paying for them to explain when markets go down and to make difficult decisions on a charity's behalf.

"This is something that's incredibly worthwhile and as long as they're providing a decent service for the money, it's always going to be a good investment to make." ■