TRUE

INSIGHT

True Potential Portfolios | Issue 9

PAGE 17

Investing Successfully in an Uncertain World

We take a look at our latest fund which launched in December in conjunction with Goldman Sachs Asset Management (GSAM)

true potential investments

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With investing, your capital is at risk. Investments can fluctuate in value and you may get back less than you invest. The contents of this magazine should not be interpreted as personalised financial advice.

A WORD FROM OUR CHIEF INVESTMENT OFFICER

Last year the returns from investing in our Portfolios ranged from 4.0% up to 13.5%. The return earned follows the risk appetite of our 5 client profiles. As expected Defensive came in at the lower end and Aggressive at the higher end. Thus, higher risk produced higher returns exactly as intended.

In our article on risk-adjusted returns on page 10, we explain how we produce efficient portfolios to deliver optimal returns. It is a tricky subject to explain but an important one to understand. At the end of the day we want clients with a specific risk profile to obtain the very best outcome for the levels of risk they are willing and able to take.

Having the confidence to invest, and, importantly, staying invested against a backdrop of uncertainty, paid off in 2017. By comparison, investors sticking with cash earned next to nothing from their bank. This year, like last year, we start with some uncertainties in front of us. Events not yet known will spring surprises just as they did in 2017. This is a realistic but uncomfortable truth if you intend to invest in a single stock or even single asset class like UK equities; which produced the lowest return out of all the major developed markets. However, in a multi asset portfolio, where you spread your risk, you confront the unpredictability of markets in a more measured and calculated way.

Multi-asset investing today is highly sophisticated. For example, if you want to invest in UK equities, would you prefer smaller companies or larger ones, would you prefer to obtain more dividend income than capital growth or should you just buy an index tracker and invest passively? All of these choices, and more, can be accommodated within multi-asset funds. Similarly, if you want to invest in a fund managed by an investment manager which one should you choose?

What style of investing do they have and how do you pick the right one ensuring they will keep doing what you expect them to do?

At True Potential Investments, our job is to take care of all this for you. We work with eight carefully selected investment managers who we believe are world class. Our relationship with them is based on a formal understanding between us that they will deliver what we expect.

They all have different approaches to investing money and the diversification they offer is enhanced when we blend them into True Potential Portfolios.

Our assets under management stand at £3.8bn which has more than doubled by 130% compared to a year ago. We believe we should not be satisfied with this achievement and we are aiming for better outcomes ahead. For the last six months we have been working with Goldman Sachs Asset Management looking at ways to launch our own version of their Dynamic fund. This fund is suited to clients with a Balanced client risk profile. After a lot of hard work from all sides we are delighted to be able to launch our new fund with them.

We explain more about the fund on page 17 and believe that launching this now will prove to be a good move. As explained later it is not over reliant on equities for return or bonds for diversification.

The relationship we have with our investment partners is extremely important and valuable. We spend a lot of our time with them, listening to what they say and we question them on a range of topics. Our job is to assess trends, looking at what is changing and why, and formulate a view before taking investment decisions across the ten portfolios that we manage.

On pages 14, 15 and 16 we share some of the opinions of our managers and we add our strong, interpretive voice to their considered views.

We begin 2018 with a sense of optimism which is shared by our investment partners across the globe. We will work tirelessly in the coming 12 months, guarding against complacency and acting with responsibility on your behalf.

Colin Beveridge, Chief Investment Officer.

PERFORMANCE UPDATE

The True Potential Portfolios are a suite of fully-diversified, discretionary-managed investment solutions.

With wide exposure to world-class investment managers, as well as diversifying their investment by asset class and geographic region, our clients benefit from having more potential to grow their money and manage volatility, all in one Portfolio.

And, as we're committed to helping our clients reach their financial goals, we continually monitor our Portfolios to make sure they perform as expected and remain within the chosen risk profile. We also rebalance for the future, rather than the past, taking an active approach to allocating your money where we see the greatest potential for growth.

We call this strategy 'Advanced Diversification'.

The results opposite show the performance of each Portfolio since we launched them in October 2015.

Portfolios	1st Jan 2017 to 31 Dec 2017	1st Jan 2016 to 31st Dec 2016	1st Jan 2016 to 31st Dec 2017	1st Oct 2015 to 31st Dec 2017
DEFENSIVE	4.0%	7.90%	12.21%	13.22%
CAUTIOUS	5.29%	11.03%	16.90%	19.30%
CAUTIOUS +	6.22%	10.09%	16.94%	19.52%
CAUTIOUS INCOME	6.33%	11.46%	18.52%	21.17%
BALANCED	8.31%	13.83%	23.29%	27.10%
BALANCED +	8.89%	14.22%	24.37%	28.76%
BALANCED INCOME	6.80%	13.41%	21.12%	24.37%
GROWTH	10.86%	16.39%	29.03%	34.90%
GROWTH +	12.86%	13.84%	28.49%	34.58%
AGGRESSIVE	13.54%	17.70%	33.64%	41.03%

With investing, your capital is at risk. Investments can fluctuate in value and you may get back less than you invest. Past performance is not a guide to future performance.

REVIEW OF THE MARKETS: Q4 2017

The closing quarter of 2017 was typical of the markets last year, pleasantly surprising. Equity markets once again produced strong positive returns and bond markets too performed well for investors during the three months to the end of December.

In general investors continue to benefit from investing in risk-based assets. Through the year they ignored the intemperate exchanges between the USA and North Korea, President Trump's potentially damaging protectionist "America First" trade policies, the perceived rise of "populism" across Europe, talk of historically high equity valuations and tighter monetary policy actions.

All of these uncertain factors threatened to undermine the bull market but were largely discounted. Global equity markets ended the year up 23% in local currency terms, gaining 6.3% over the final three months.

In terms of individual markets, Japanese equities provided the strongest returns, gaining 8.7% over the quarter.

The figures reflected robust corporate profit growth, healthy economic data and a likely continuation of relaxed monetary and fiscal policies following Prime Minister Shinzo Abe's re-election in October.

In the US, the S&P 500 reached a new all-time high, up 6.6% over the period, spurred on by gathering economic momentum and monetary policy being well sign posted.

Any caution investors may have felt about a gradual rise of interest rates was offset by the prospect of Donald Trump's much vaunted tax reforms finally coming to fruition.

Having lagged previously, the UK market rose by 5% during the last three months of the year. The FTSE 100 hit a new all time high with resources sectors driving the market higher as industrial commodity prices continued their recent strong run against a backdrop of stable global growth. European equities fell by 0.6% with investor sentiment dampened by Brexit negotiations and by political uncertainty in the wake of German elections with Angela Merkel unable to form a coalition government.

Emerging market equities were again strong, posting another positive quarter (up 7.3% in local terms) extending their year-to-date gains. Underpinned by a synchronised recovery in global growth, the region is also supported by an improving earnings outlook and relatively attractive valuations.

Bond markets enjoyed a much-improved final quarter of the year. Higher quality (less risky) parts of the bond market outperforming more high risk areas.

UK Gilts returned 1.8% for the quarter despite interest rates being raised 0.25% back to the pre-referendum level of 0.5%. In the US, the government bond yield curve has been 'flattening' i.e. the difference in yield between short dated and long dated maturities has narrowed.

There is a consensus that the Federal Reserve Bank wants rates to be higher, but not in a way that threatens growth.

High yield bonds have also been positive with demand for income and strong fundamentals driving returns. Over the year the asset class returned 10.4% in local terms. However, the lower yields on offer began to weigh in the final quarter, so over the last three months of the year gains were limited to 0.9%.

Inflation linked bonds, which underperformed for the first half of 2017, rebounded by 2.3% in the final quarter amid speculation that inflation may finally be responding to economic growth.

Commodities, generally, enjoyed a strong end to the year whether it be base metals, precious metals or agricultural "soft" commodities. In particular the price of oil continued to rise with Brent crude oil now above $60 per barrel as a result of production cuts, falling inventories and an improvement in global demand.

"Bond markets enjoyed a much-improved final quarter of the year. Higher quality (less risky) parts of the bond market outperforming more high risk areas."

INVESTMENT OUTLOOK

During 2017 we saw many events that felt unnerving; the results of the UK election, Brexit negotiations, geopolitical instability, the China Five Year Communist Conference and the Donald Trump presidency. What do all these events have in common? None of these events have managed to derail global markets. What we saw was stock markets becoming ever resilient and shrugging off any negativity.

How will this play out as we move through 2018?

Interest rates and central bank policy continue to dominate investor sentiment and will almost certainly be one of the biggest drivers of movement in markets this year. The theme of rising interest rates has prevailed during 2017 (in the UK and US) and a general move towards monetary tightening has been seen more recently in both Japan and Europe. Rate rises have been well signalled by Central Banks and the raising of interest rates is a signal that normalisation is taking place. Growth across the globe is broadening out.

There is a view that rising interest rates will hinder economic recovery and stymie any further advance in the equity markets. The progress made by economies since the dark days of the credit crisis and the upward move in asset prices continues to be distrusted. Those in the bearish camp have missed out on good returns. The fact that bearish views continue to be expressed is a sign that this current bull market remains a joyless one that can continue to advance and those sitting it out will have to wait longer to be proved right.

There is a general recognition that we are "late cycle" but this viewpoint is not particularly well defined or indeed quantified. The general opinion appears to be that economic growth will continue and with the implementation of tax cuts in the US growth may be higher than currently anticipated.

Inflation remains in focus. Though not a problem (indeed it has been frustratingly absent in recent years) there are signs of nascent price increases in the US. In the UK depreciation of the pound has pushed prices up in some areas but inflation is expected to recede as the pound strengthens.

Commodity prices across the board, including oil, industrial metals and agricultural products, have been rising since early summer and will be watched vigilantly for their effect on inflation generally.

The area where some softening is evident is in bond markets. As rates push upwards some areas of the high yield market will be particularly exposed because the yields offered are now lower than potential default rates through the cycle.

This means the risk reward ratio is poor. In areas where credit quality shows signs of deterioration interest spreads will widen. This area now requires far greater selectivity and our active managers are well placed to spot the duds.

As the cycle progresses, volatility (currently at historically low levels) will respond to bouts of heightened uncertainty. Market drawdowns, seen by many as a threat, can also present a better entry point for long term investors. Many of our managers hope for higher bond yields so they can once again buy sovereign debt to earn a decent return.

Our managers support the view that corrections, while not pleasant at the time, will ultimately be regarded as buying opportunities. They point out that liquidity levels remain high and with Europe and Japan continuing their programmes of quantitative easing (QE) there is ongoing support should set backs occur.

In Europe, economic growth is being maintained and the continuation of QE should ensure markets remain supported. So too in Japan where QE, together with measures encouraging companies to deploy large cash balances, should not only support financial markets but also encourage wage rises and consumer spending.

In the UK, sentiment remains clouded by Brexit negotiations with many overseas investors remaining underweight the market. However, relative to their international counterparts, many UK based companies appear cheap by comparison and with sterling still low there is increasing evidence of corporate activity as foreign buyers weigh up the uncertainty posed by Britain's exit from the European Union against the discount currently available on UK assets.

In conclusion...

2017 was an excellent year in the face of adverse conditions.

For 2018, there will be uncertainty and also the potential for unnerving events. However, the key for investors is diversification, not relying on just one area, asset class or manager style. It remains a proven way to reduce risk for investors and to help navigate unpredictable market conditions.

We all take risks. When it comes to investing money behavioural studies show that risk taking depends on our personal attitudes and our financial circumstances.

So, when we judge risk we use our sense of well-being to weigh up outcomes. This allows us to match what we desire against what we seek to avoid.

There is little doubt that a financial loss triggers an emotional reaction. Scientists say it is akin to physical pain. Understanding this goes a long way to explaining why some of us take too little risk and as a result potentially lose out in the process.

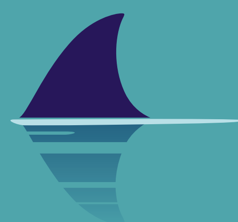
The level of risk a client is comfortable taking and the implications on their goal is a personal matter but when you delve into the relationship between risk and return, you quickly realise it is a complex matter.

The descriptions Defensive, Cautious, Balanced, Growth and Aggressive that True Potential uses are simple.

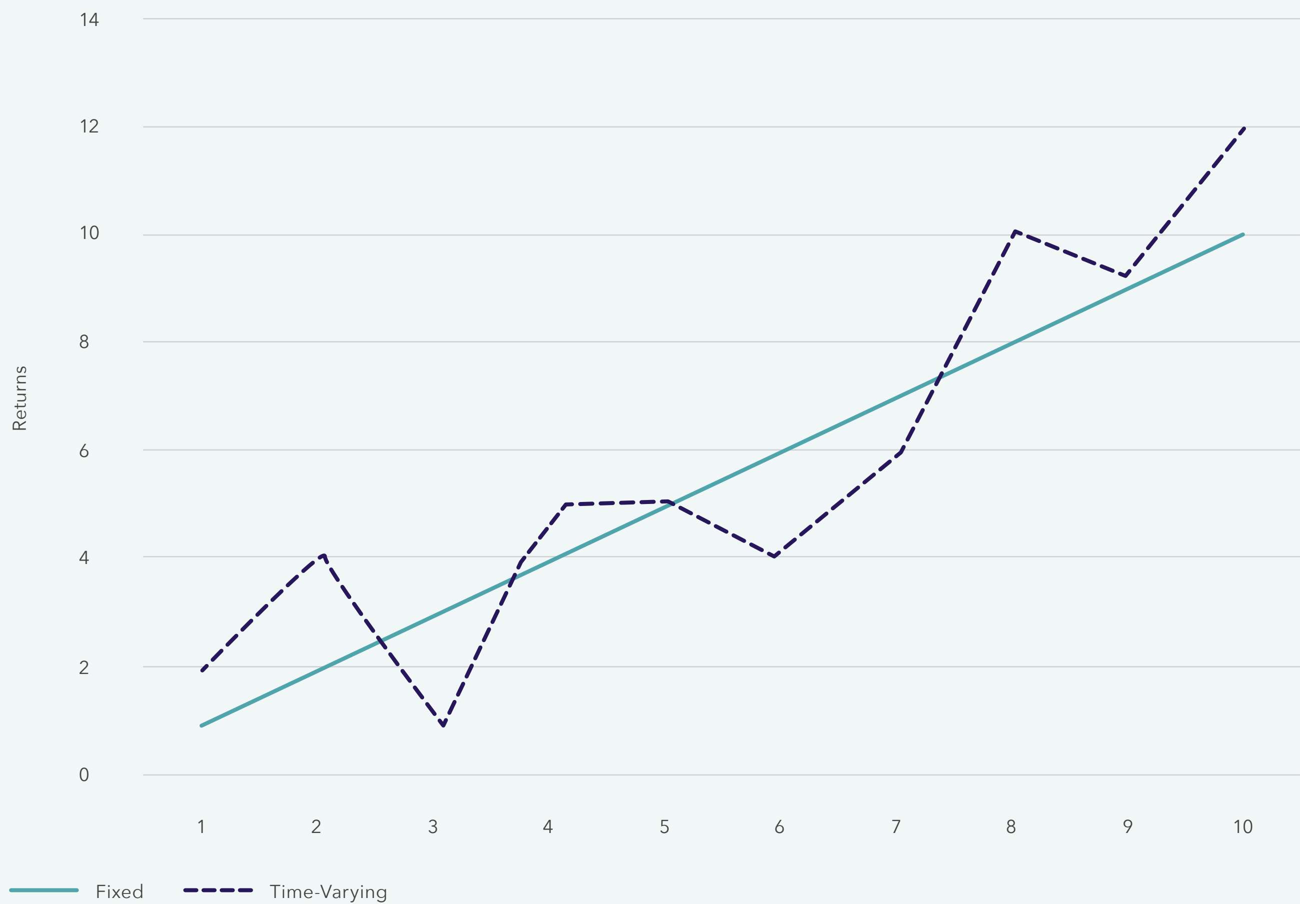
They convey the basic idea. However, behind the scenes we spend a great deal of time dealing with complexity. We need to understand how much risk is being taken by our investment partners and to use this knowledge as part of our decision making.

The ability to measure the relationship between risk and return really came from two academics, Sharpe and Lintner.

Back in the 1960s they gave us a theory called the Capital Asset Pricing Model (CAPM). The CAPM has many facets but essentially tells us that the higher the risk, the higher the potential return.



Risk and Return - Linear Relationship



Source: Bloomberg 2017

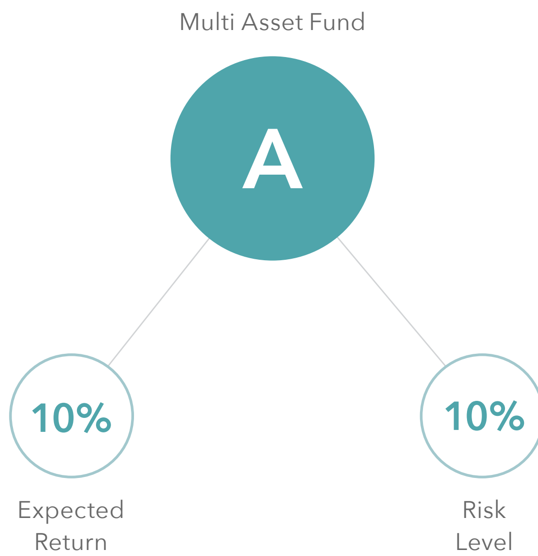
The linear ratio shown is nicely conforming. In the real-world risk is more difficult to gauge. In fact it is constantly shifting and evolving.

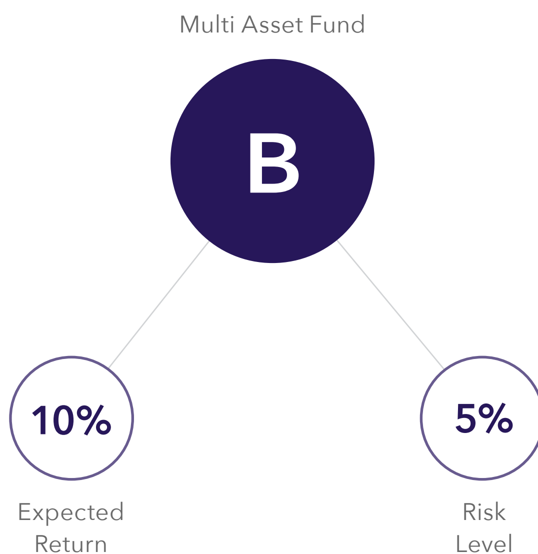
This means we need some way of levelling the playing field to help make selections between competing investments and funds.

We can illustrate this using an example:

Multi asset fund A has an expected return of 10% and a risk level (standard deviation) of 10%. Multi asset fund B has the same expected return, 10%, but a lower risk level (standard deviation) of 5%. If we divide each return by each level of risk we get the following ratios; 10%/10% = 1.0 and 10%/5% = 2.0.

** Note that we are using a simplified example of the Sharpe Ratio which incorporates the excess return above the risk-free rate.*





In our example fund B is expected to generate the same return. The implicit assumption is that fund B's superior (higher) risk-adjusted ratio of 2 is most likely achieved through selecting investments with better returns and lower risks and the investments are not correlated. Presented with a straight choice you would select Fund B over Fund A.

We observe that when managing our funds our investment partners produce risk-adjusted returns that shift over time. In the investment world this is normal.

However, we take the variations into consideration as part of our selection criteria and build this into the construction process.

From a client perspective, "efficient portfolios" deliver less volatile outcomes than portfolios requiring more risk to deliver the same given return.

This means they are less likely to throw up a curve ball that is difficult or unpleasant to deal with.

If you are a wealth-seeker rather than a thrill-seeker our Advanced Diversification strategies, combined with low costs and award-winning technology, will give you a shot at gradually higher returns without taking undue risk.

With investing, your capital is at risk. Investments can fluctuate in value and you may get back less than you invest.

FUND MANAGER PARTNERS SURVEY

We asked our fund manager partners to look forward and tell us what conditions they expect to encounter as the year progresses. As ever, there is a wide diversity of views. Therefore, our task is to understand the underlying driving forces informing their views and to find areas where opinions cluster around a compelling investment case.

Given the decisive move towards tighter monetary policy we note a strong tendency to favour equities over bonds. The case for this hinges on a continuation of positive economic growth accompanied by moderate inflation expectations.

This, in turn, should allow interest rates to increase and bond yields to move moderately higher without derailing growth. Of course, expectations can change and, as the year unfolds and data accrues, opinions will be reformatted and new strategies will evolve. **For this reason, the views expressed below represent current thoughts and should not be taken as advice.**

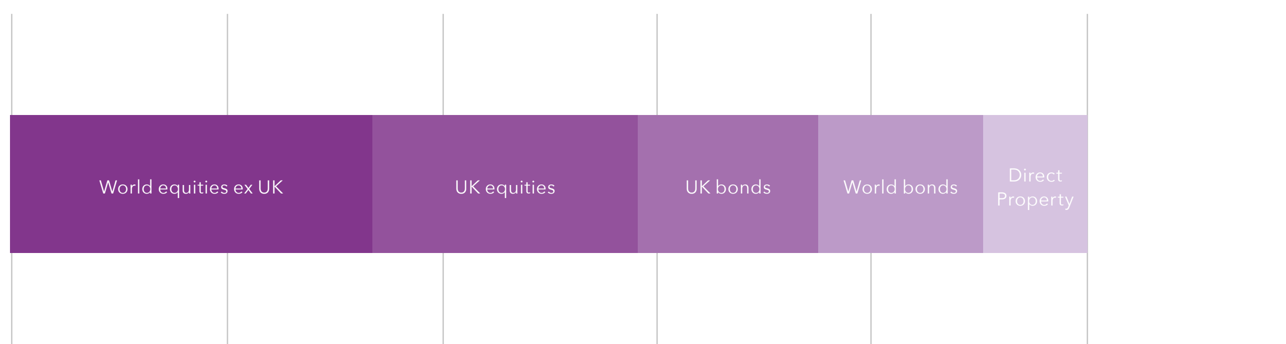
Our funds are managed to reflect changing conditions such as coping with a rise in volatility which means dealing with down markets as well as up markets. Our investment partners hold cash in the funds to help mitigate volatility and to buy assets during market set-backs.

Which asset class do you think will perform best in 2018?

As indicated, equity-based assets are favoured for their higher return characteristics. Government bonds, despite offering potentially lower returns, counteract threats associated with an unexpected slowing in growth or shocks to the system and are held for mainly defensive reasons. Direct Property investing is considered unattractive. Our investment partners believe that global equity markets, excluding the UK, still offer the best opportunities across asset classes. In their view, the UK equity market faces specific challenges from the Brexit process.

True Potential Investments view - Central banks will continue to act cautiously when unwinding loose monetary policy and are on alert for risks that could derail the current economic cycle. There is a generally negative view on the UK equity market. Our contrarian opinion says there is scope for a positive surprise should Brexit negotiations stay on track for an ultimately favourable trade agreement.

Expected best performing asset classes

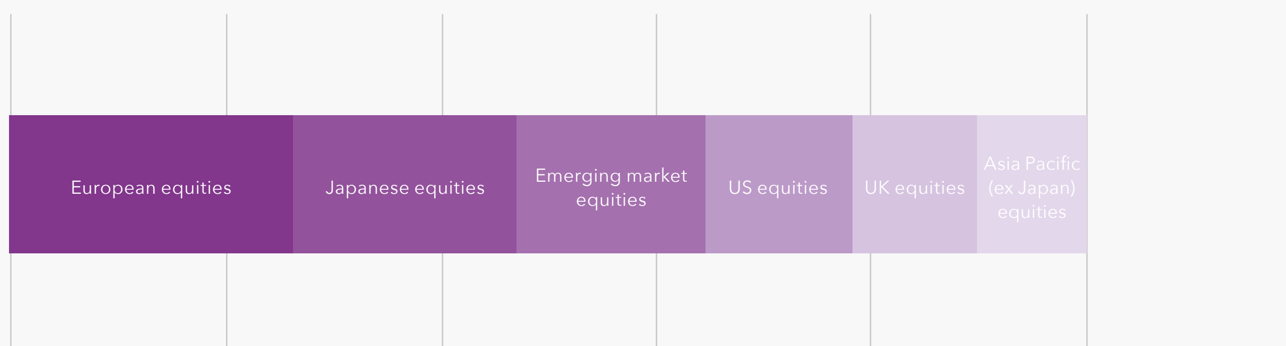


Which equity market will be most popular among investors in 2018?

Opinions differ but Europe, Japan and Emerging Markets (EM) appear to be more highly favoured than the US and the UK. Indicators suggest that the European economy is running above its potential, as it has for the last year or so, whereas Japan remains popular for ongoing corporate reform driving better shareholder returns. EM offer faster growth but with higher risks. China is a major EM constituent generating heated comment around its growth path which is underpinned by debt finance. Support for the US is based on hopes that President Trump's much heralded Tax reforms will provide a further leg to the bull market but many investors worry that valuations are extended relative to historic norms.

True Potential Investments view – Those of our partners who follow a stock picking strategy and invest in direct equities are well placed to navigate around extended valuations. Moreover, 'value' as a style of investing has lagged 'growth' and we expect the gap that has opened up between these two styles to close in favour of value.

Expected best performing equities



Which type of bond do you think will perform best in 2018?

With monetary policy tightening and interest rates likely to edge higher throughout 2018 fixed interest holdings are likely to remain subdued. Our funds favour short dated maturities as this helps lower sensitivity to interest rate rises but our partners are keen on corporate debt where higher yields accommodate higher risks. This can be accessed selectively across Emerging Market Debt and in international bond markets. If economic conditions remain healthy higher yielding corporate bonds should benefit from narrowing credit spreads.

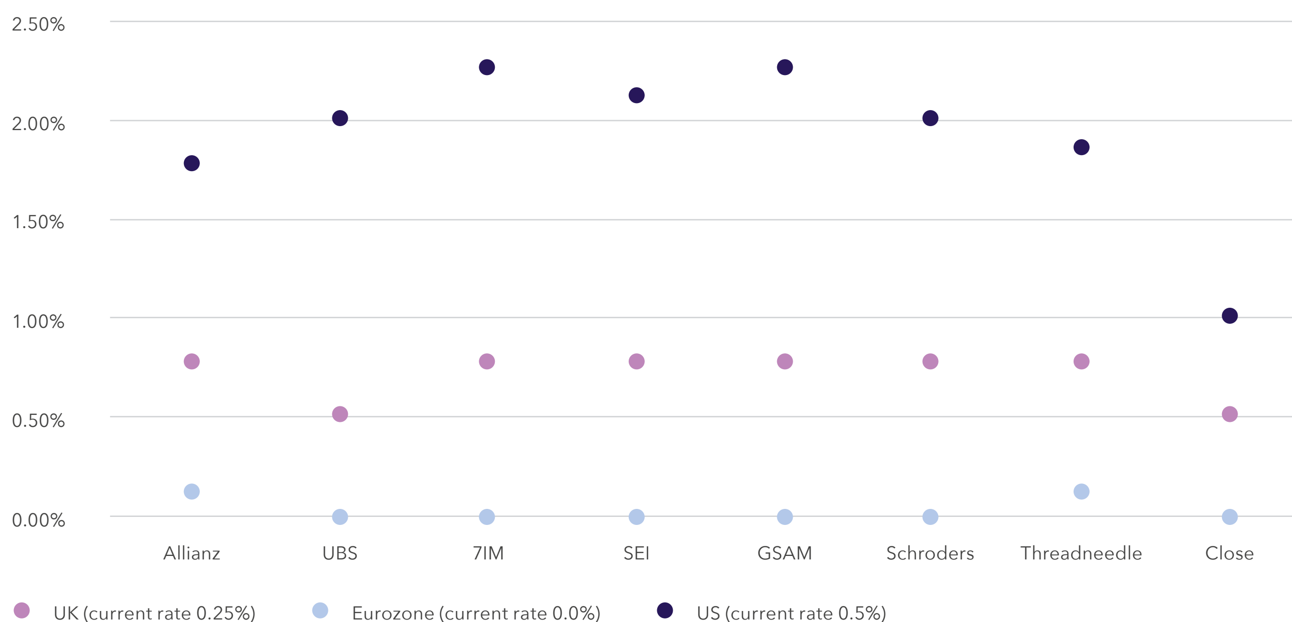
True Potential Investments view - We measure duration (interest rate sensitivity) within each of our funds and across our portfolios. We expect to retain a low bond duration stance but note that if bond yields spike higher unexpectedly we would change tack by recycling into securities offering longer duration. We also monitor the split between sovereign (government) debt and corporate debt and are steering away from lower quality credit at this stage of the economic cycle.

At what level do you think interest rates and inflation will be at the 2018 year end?

The global economy continues to enjoy an expansionary impulse that is broad-based by geography and by economic sector. Growth may moderate somewhat early in 2018 but is expected to remain above trend. Central Banks are expected to stay on a gradual and predictable path towards monetary tightening with inflation remaining the key metric for the markets to focus on.

True Potential Investments view - Interest rate rises are a signal of a return to monetary policy normality. Provided the signals from central banks are clear, all the noise generated can be put to one side. Of course, we will remain extra vigilant looking for signs of change emanating from our investment partners.

Expected interest rates

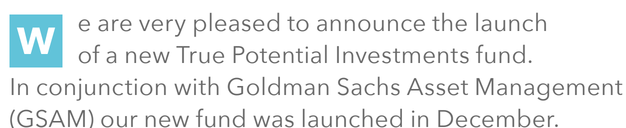


How do you think the following currencies will perform against sterling throughout the year?

Following its sharp fall in the aftermath of the Brexit referendum in June 2016, sterling has staged a partial recovery and is expected to grind its way higher. Much will depend on sentiment surrounding negotiations governing Britain's exit from the European Union and how both the Bank of England and foreign central banks' interest rate policy unfolds.

True Potential Investments view - Our funds operate a range of strategies associated with currency management. Income Builder uses a fully hedged strategy, our funds managed by Close Brothers operate with a half-hedging strategy. The remaining, globally-exposed, portfolios employ partial hedging dictated by circumstance. Our portfolios are skewed toward increased hedging of non-sterling exposure but we are keeping a watchful eye on developments.

INVESTING SUCCESSFULLY IN AN UNCERTAIN WORLD



We are very pleased to announce the launch of a new True Potential Investments fund. In conjunction with Goldman Sachs Asset Management (GSAM) our new fund was launched in December.

Our Balanced Fund is designed with similar objectives to Goldman Sachs, own Dynamic Fund.

The key objective is to deliver capital growth to clients and to do so in a risk controlled way.

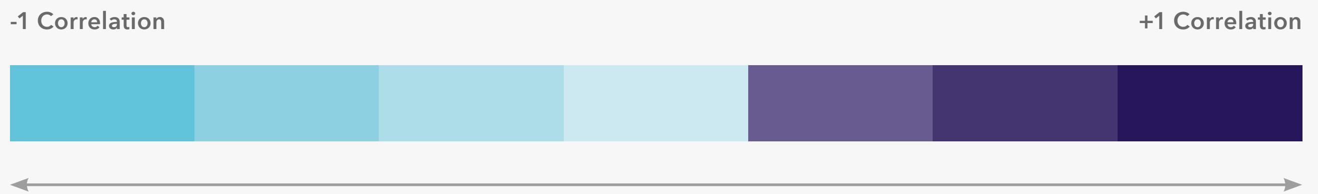
The structure is simpler and implemented through a mix of actively managed GSAM collective investment funds, low-cost exchange traded passive funds and forward currency derivative contracts to help manage currency exposure.

Another key change is the way asset allocation is handled. GSAM's preferred approach is to look at asset allocation through a factor-based lens. In doing so they are examining the drivers of return and risk.

This makes the whole process more dynamic and avoids undue concentration on equity risk, which is a feature of less sophisticated funds. GSAM express a concern that many asset classes, equity like in nature, have moved upwards together in this cycle. They want to avoid a situation where they might fall together should growth falter.

The way their approach differs is shown on the right. The first matrix shows a conventional approach. The second is GSAM's more innovative factor-based approach designed to optimise risk and return. In the tables, the relationship between each of the assets is shown. The correlations shaded purple have a value greater than 0.75 indicating a high chance they will move (correlate) similarly in both up and down markets.

Those assets shaded blue mostly have a low or negative correlation with one another. Having different assets that perform differently is what drives diversification.



(Traditional) Matrix: Asset Class Correlations

Asset Class	1	2	3	4	5	6	7
1. Fixed Income	1.00	0.03	0.31	0.25	-0.11	0.26	0.01
2. Public Equity	0.03	1.00	0.78	0.92	0.30	0.77	0.84
3. Hedge Funds	0.31	0.78	1.00	0.80	0.23	0.70	0.66
4. Public Equity	0.25	0.92	0.80	1.00	0.15	0.73	0.75
5. Commodities	-0.11	0.30	0.23	0.15	1.00	0.21	0.30
6. Real Estate	0.26	0.77	0.70	0.73	0.21	1.00	0.71
7. Infrastructure	0.01	0.84	0.66	0.76	0.30	0.71	1.00

Using the huge amount of resource and expertise at their disposal GSAM construct our portfolio using the factors listed on the next page.

(Innovation) Matrix: Factor Correlations

Factors	1	2	3	4	5	6	7
1. Market Cap Factor	1.00	-0.01	0.00	-0.01	-0.00	-0.00	0.00
2. Rates Factor	-0.01	1.00	-0.20	-0.38	0.51	0.10	-0.14
3. EM Factor	0.00	-0.20	1.00	0.20	-0.10	-0.08	0.17
4. Convexity Factor	-0.01	-0.38	0.20	1.00	-0.27	0.13	0.17
5. Momentum Factor	-0.00	0.51	-0.10	-0.27	1.00	0.19	-0.05
6. Equity Style Factor	-0.00	0.10	-0.08	0.13	0.19	1.00	-0.23
7. Commodities Factor	0.00	-0.14	0.17	0.17	-0.05	-0.23	1.00

Key Features

The fund has a myriad of key features. The first is the huge range of research and expertise available to GSAM. The division that looks after the True Potential Goldman Sachs Balanced Fund is called Global Portfolio Solutions, and has specialised in multi-asset investment for over 20 years with over $103bn assets under supervision. The partnership between True Potential and GSAM aims to bring institutional, advanced thinking, normally only used by large company defined benefit pension schemes and sovereign wealth funds, to all retail investors.

The fund has a rigorous investment process and selection policy, using longer term, top down, macroeconomic analysis but also taking short term, bottom up, fundamental views to add to return. This means it will be tactically proactive around the outlook for countries and regions of the world.

The fund managers are extremely business cycle aware and use a road map of the cycle to judge when to reduce and to add risk.

Cycle Aware

Modulating Long Term Risk Exposure Through A Cycle Aware Approach

GSAM use predominantly active strategies. The use of passive investments helps drive costs down in areas where there is less potential to obtain a return in excess of the market return. The fund invests in equities and bonds but also looks towards different types of investment such as absolute return, trend following strategies, quant-based factor funds and also using currency positioning, all as a way of diversifying the fund and helping to mitigate risk.

Our new fund is available to clients within the True Potential Balanced Portfolio. This consists of eight different investment partners, of which GSAM is one.

The key benefit of using the True Potential Portfolios is that you are not just relying on one single manager with one single style, you are using different managers all with different ways of thinking, be that around positioning or market view.

This allows for an even higher level of diversification, which we call Advanced Diversification. The True Potential GSAM Balanced fund is a great new addition into that mix.

The fund is competitively priced with an ongoing charges figure (OCF) of 0.95% and is available now.

With investing, your capital is at risk. Investments can fluctuate in value and you may get back less than you invest.

THE SCIENCE BEHIND OUR PORTFOLIOS

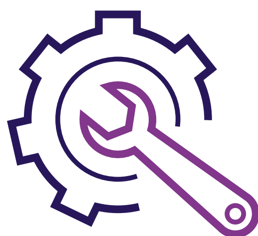
The construction of our Portfolios begins with a set of equally weighted models which correspond to the five Morningstar risk categories: Defensive, Cautious, Balanced, Growth and Aggressive.

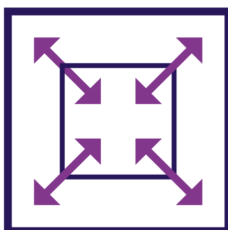
For example, we offer eight funds within the Balanced category, therefore if no preference was given to one fund over another, an equally-weighted allocation to each fund would be 12.5%.

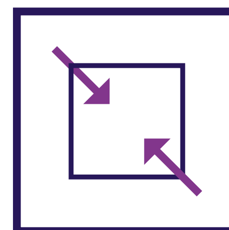
When we build our True Potential Portfolios, we tactically allocate away from the equally- weighted portfolios aiming for lower volatility, lower cost, higher expected returns and a better risk-adjusted return than could be expected from choosing an equal allocation.

	Defensive	Cautious	Balanced	Growth	Aggressive	Cautious +	Balanced +	Growth +	Cautious Income	Balanced Income
Risk (Volatility)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Risk (Mapped)	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Cost	✓	✓	✓	✓	✓	✓	✓		✓	✓
Long-Term Expected Return		✓	✓	✓	✓	✓	✓	✓	✓	
Risk-Adjusted Return	✓	✓	✓		✓	✓	✓			✓
Income									✓	✓

With investing your capital is at risk. Investments can fluctuate in value and you may get back less than you invest.







Risk (Baseline Portfolios)

Risk is estimated using the asset composition of each Portfolio. We use 'standard deviation', a measure to show how volatile the portfolios are. Where the measure of standard deviation is higher, the more volatile we judge the portfolio to be. We construct separate portfolios for each of the five risk categories containing all of the funds mapped to that risk category. When we optimise these Portfolios, we try to ensure they are lower risk than an equally-weighted Portfolio containing the same funds.

Risk (+ Portfolios)

Our three + Portfolios use funds outside the Portfolio's own risk category. For example, the Balanced + Portfolio does not include any Balanced funds but achieves the required risk profile by using funds from the Defensive, Cautious, Growth and Aggressive ranges. When we optimise for the + Portfolios, we are aiming for an improvement in the long term performance, accepting that volatility at times may be at the higher end of the risk bands applicable to each risk category.

Risk (Income Portfolios)

Our two Income Portfolios use all available income funds from the Cautious, Balanced and Growth risk categories. We then allocate accordingly to create one Portfolio mapped to the Cautious risk category and one mapped to the Balanced risk category.

Cost

This is an important factor as costs reduce future returns. This is why we build our Portfolios with the objective of being lower cost than an equally-weighted Portfolio. However, it should be noted that at times the choice may lie between lower cost and higher risk. Statistically/historically the impact from risk is disproportionate to the impact from cost. We are also proud to say that our funds are already amongst the lowest cost in the market.

Expected Return

When our Fund Managers change the underlying assets in our funds, the Portfolio compositions change. We analyse the expected returns for each of our funds and may rebalance the portfolios in order to help generate the best returns.

Risk-Adjusted Return

Risk-adjusted return is based on future expected returns for each Portfolio, minus the risk-free rate of return, divided by the level of expected volatility calculated for each portfolio. Our objective over time is to manage the portfolios to achieve the best risk-reward trade off.

TRUE POTENTIAL PORTFOLIOS

Each True Potential Portfolio contains all of the funds available within its risk category. The True Potential Portfolios have an enormous degree of diversification, meaning they are less prone to highs and lows relative to our + portfolios. We optimise the portfolios with the objective of being lower risk than an equally-weighted portfolio. In addition, the True Potential Portfolios do not have an income focus, which makes them very different to our Income Portfolios.

However, when investing in a True Potential Portfolio, some clients are happy to take an income by selling units. Below are the optimisation results for the True Potential Portfolios. We always aim to optimise across all factors where possible. However, sometimes we may place more emphasis on one factor over another.

Strategy Allocation

Defensive

- **Manager of Managers** - True Potential SEI Defensive 38.0%
- **Active Management with Passive Implementation** - True Potential 7IM Defensive 28.0%
- **Agile, Low-Cost Value Investing** - True Potential UBS Defensive 34.0%

Cautious

- **Direct Equity & Bond Investing -** True Potential Close Cautious 16.5%
- **Manager of Managers** - True Potential SEI Cautious 18.0%
- **Active Management with Passive Implementation -** True Potential 7IM Cautious 16.0%
- **Momentum with Volatility Control** - True Potential Allianz Cautious 15.5%
- **Fund of Funds -** True Potential Schroders Cautious 15.0%
- **Agile, Low-Cost Value Investing** - True Potential UBS Cautious 19.0%

Balanced

Momentum with Volatility Control - True Potential Allianz Balanced	15.0%
Direct Equity & Bond Investing - True Potential Close Balanced	15.0%
Alternative Dynamic - True Potential Goldman Sachs Balanced	4.0%
Income Funds - True Potential Goldman Sachs Global Income Builder	8.0%
Fund of Funds - True Potential Schroders Balanced	10.0%
Manager of Managers - True Potential SEI Balanced	19.5%
Active Management with Passive Implementation - True Potential 7IM Balanced	10.0%
Agile, Low-Cost Value Investing - True Potential UBS Balanced	18.5%

Growth

Momentum with Volatility Control - True Potential Allianz Growth	21.0%
Direct Equity & Bond Investing - True Potential Close Growth	21.0%
Manager of Managers - True Potential SEI Growth	20.0%
Active Management with Passive Implementation - True Potential 7IM Growth	16.0%
Agile, Low-Cost Value Investing - True Potential UBS Growth	22.0%

Aggressive

Manager of Managers - True Potential SEI Aggressive	32.5%
Active Management with Passive Implementation - True Potential 7IM Aggressive	31.0%
Agile, Low-Cost Value Investing - True Potential UBS Aggressive	36.5%

TRUE POTENTIAL PORTFOLIOS

Asset Allocation

Asset Class	Defensive	Cautious	Balanced	Growth	Aggressive
UK Equities	4.98%	13.20%	16.27%	21.36%	21.31%
North American Equities	15.45%	17.78%	22.75%	29.61%	37.41%
European Equities	5.02%	6.95%	10.08%	10.69%	13.20%
Japanese Equities	2.52%	4.05%	5.49%	5.49%	6.97%
Asia Pacific Equities	0.62%	1.07%	2.17%	2.36%	1.73%
Emerging Market Equities	1.64%	3.11%	5.89%	10.67%	12.60%
Global Bonds	13.20%	8.50%	6.19%	2.55%	0.53%
Global Inflation Linked Bonds	0.74%	0.78%	0.66%	0.61%	0.00%
Emerging Market Bonds	1.48%	2.18%	2.80%	2.51%	1.78%
Global High Yield Bonds	5.43%	4.09%	5.96%	3.10%	0.32%
UK Gilts	6.66%	5.70%	2.47%	1.24%	0.85%
UK Credit	6.06%	11.02%	8.60%	4.22%	1.81%
Property	0.27%	0.38%	0.42%	0.46%	0.00%
Commodities	1.10%	1.90%	1.18%	1.03%	0.79%
Cash	34.85%	19.30%	9.09%	4.11%	0.71%

Source: Smith & Williamson, 31 December 2017

+ PORTFOLIOS

The + group of portfolios are more concentrated in their fund selection, containing larger fund positions than their risk category equivalents in the True Potential Portfolios. The + portfolios are constructed using funds from right across the risk spectrum, while staying within the risk band for their risk category.

The + portfolios do not include funds from the same risk category to which the portfolio is mapped. In other words, the Balanced+ Portfolio does not select funds mapped to the Balanced risk category. To optimise the portfolios in the + category, we select from all of the funds outside of the portfolios' respective risk category. This approach enables us to optimise across all factors although sometimes we may place more emphasis on one factor over another.

Strategy Allocation

Cautious +

Strategy	Allocation
Direct Equity & Bond Investing - True Potential Close Balanced	14.5%
Fund of Funds - True Potential Schroders Balanced	12.0%
Manager of Managers - True Potential SEI Defensive	40.0%
Momentum with Volatility Control - True Potential Allianz Balanced	12.5%
Active Management with Passive Implementation - True Potential 7IM Growth	8.0%
Agile, Low-Cost Value Investing - True Potential UBS Growth	13.0%

Balanced +

Strategy	Allocation
Direct Equity & Bond Investing - True Potential Close Growth	19.0%
Manager of Managers - True Potential SEI Cautious	37.0%
Manager of Managers - True Potential SEI Defensive	2.5%
Momentum with Volatility Control - True Potential Allianz Growth	11.5%
Active Management with Passive Implementation - True Potential 7IM Aggressive	8.5%
Agile, Low-Cost Value Investing - True Potential UBS Aggressive	14.5%
Fund of Funds - True Potential Schroders Cautious	8.0%

Growth +

Strategy	Allocation
Direct Equity & Bond Investing - True Potential Close Balanced	24.0%
Manager of Managers - True Potential SEI Aggressive	28.0%
Active Management with Passive Implementation - True Potential 7IM Aggressive	16.0%
Agile, Low-Cost Value Investing - True Potential UBS Aggressive	26.0%
Momentum with Volatility Control - True Potential Allianz Balanced	6.0%

Asset Allocation

Asset Class	Cautious +	Balanced +	Growth +
UK Equities	13.2%	17.89%	22.61%
North American Equities	18.0%	25.45%	32.72%
European Equities	9.3%	10.06%	12.26%
Japanese Equities	5.2%	4.95%	5.81%
Asia Pacific Equities	1.6%	2.00%	2.29%
Emerging Market Equities	4.5%	6.53%	9.97%
Global Bonds	8.6%	6.57%	1.10%
Global Inflation Linked Bonds	0.8%	1.61%	0.00%
Emerging Market Bonds	0.8%	1.90%	1.15%
Global High Yield Bonds	4.8%	4.78%	0.54%
UK Gilts	3.8%	3.51%	0.80%
UK Credit	7.0%	3.35%	5.85%
Property	0.3%	0.42%	0.50%
Commodities	1.2%	1.35%	1.04%
Cash	21.1%	9.64%	3.37%

Source: Smith & Williamson, 31 December 2017

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INCOME PORTFOLIOS

Each Income Portfolio in the True Potential Portfolios range is focused on yield and income sustainability so we have income as an additional optimisation factor.

Given that investors in these portfolios are seeking income above capital growth, the income optimisation factor is our primary consideration. We have optimised on all factors for both portfolios; income, risk, cost, long-term expected return and risk-adjusted return.

Source: Goldman Sachs, Close Brothers, Threadneedle and Schroders, 31 December 2017

Strategy Allocation

Cautious Income

Direct Equity & Bond Investing - True Potential Close Cautious Income	32.5%
Income Focused - True Potential Threadneedle Monthly Income	15.0%
Income Funds - True Potential Goldman Sachs Income Builder	42.5%
Fund of Funds - True Potential Schroders Cautious Income	10.0%

Balanced Income

Direct Equity & Bond Investing - True Potential Close Cautious Income	6.0%
Income Focused - True Potential Threadneedle Monthly Income	35.0%
Income Funds - True Potential Goldman Sachs Income Builder	50.0%
Fund of Funds - True Potential Schroders Cautious Income	9.0%

Asset Allocation

Asset Class	Cautious Income	Balanced Income
UK Equities	22.5%	31.2%
North American Equities	11.9%	13.0%
European Equities	7.0%	6.9%
Japanese Equities	0.8%	0.4%
Asia Pacific Equities	1.3%	1.3%
Emerging Market Equities	0.0%	0.0%
Global Bonds	10.9%	11.3%
Global Inflation Linked Bonds	0.8%	0.2%
Emerging Market Bonds	0.6%	0.7%
Global High Yield Bonds	11.9%	14.1%
UK Gilts	1.4%	0.3%
UK Credit	15.4%	11.4%
Property	5.3%	1.4%
Commodities	2.5%	0.9%
Cash	7.6%	6.9%

Source: Smith & Williamson, 31 December 2017

tpllp.com/portfolios

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