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Charity Investment Training online for CFG

Understanding your Investment Responsibilities
July 2020

If you are a private investor, you should not act or rely on this document but should contact your professional advisor.

Sarasin & Partners LLP

Our speakers: Melanie Roberts, Ruadhri Duncan & Tom Lindsey

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Prior to joining Sarasin & Partners in 2011, Melanie spent 16 years at Newton Investment Management as a fund manager of charity, private client and pension fund portfolios. She qualified with a degree in Modern Languages from Durham University and is an Associate of the Chartered Institute for Securities and Investment. Melanie is primarily responsible for the management of charity and pension fund portfolios and is the current Editor of the House Report.

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Ruadhri Duncan, Partner, Charities

Ruadhri has over 20 years in the fund management industry where he has operated as both a fund manager and a charity trustee. After leaving the Army he started work with Leopold Joseph and Sons where he completed his fund management exams. In 1999 he moved to Newton Investment Management, where he worked within the charities department for over 12 years, managing charitable funds. Ruadhri is an associate of the Chartered Institute for Securities and Investment and holds a number of charity trusteeships.

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Thomas Lindsey, Associate Partner, Charities

Prior to joining Sarasin & Partners in 2017, Thomas worked for Standard Life Investments managing multi-asset and absolute return portfolios for corporate pension schemes and institutions. He graduated from the University of East Anglia in 2011 with a degree in English Literature & Philosophy. Thomas is a CFA Charterholder®, a holder of the Investment Management Certificate (IMC), the CISI Capital Markets Program and is a member of the Chartered Financial Analyst Society of the UK. Thomas is also a trustee of the Jeevika Trust, an Indian poverty relief charity seeking to implement smart technologies to address rural food scarcity & mitigate the impact of climate change.

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The aims of this course

- To understand the **fundamental drivers of the return** from the main asset classes

- To look at the **risk and performance characteristics** of the asset classes

- Understand how they work in **a multi asset portfolio**, looking at future returns and income levels to be applied to your own charity's circumstances

- To enable you to help design/enhance your charity's **Investment Policy Statement**

The 4 training sessions

Session One

- Investment Powers
- Introduction to the Compendium of Investment
- The Investment Universe:
  - Bonds

Session Two

- The Investment Universe:
  - Equities
  - Private Equity
  - Property
  - Alternatives

Session Three

- Charity Investment in Practice

Session Four

- Building an Investment Policy Statement

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02 The case for equities

The case for equities (shares/stocks)

- Represents part ownership (share) of a business for which you receive:
  - A **dividend** (variable)
  - Potential for capital appreciation over time
- Income and capital return dependent on performance of the business, which is closely linked to economic growth
- Decades of steady economic growth have resulted in equities providing returns in excess of inflation (real) and some of the highest returns within the asset universe
- But your investment time horizon needs to be sufficiently long to cope with the volatility!

See pages 12 – 13 & 27 – 48

We buy equities for capital growth and dividends

Why own equities?

- **For a real return**

  companies are generally able to absorb inflation by passing on higher costs to their customers as higher prices

- **Income and income growth**

  in most circumstances dividends grow ahead of inflation

- **Diversification within a multi asset portfolio**

  should be considered a long-term investment

- **Perform well when economies are doing well**

  if companies are in a position to preserve and grow the real value of their profits

- **When not to own equities?** Economic downturn

Strong link between real economic growth and profits and dividends

If **economies can grow in real terms** over the long term, companies have been able to grow their **profits** in real terms too, and this has led to real **dividend growth**

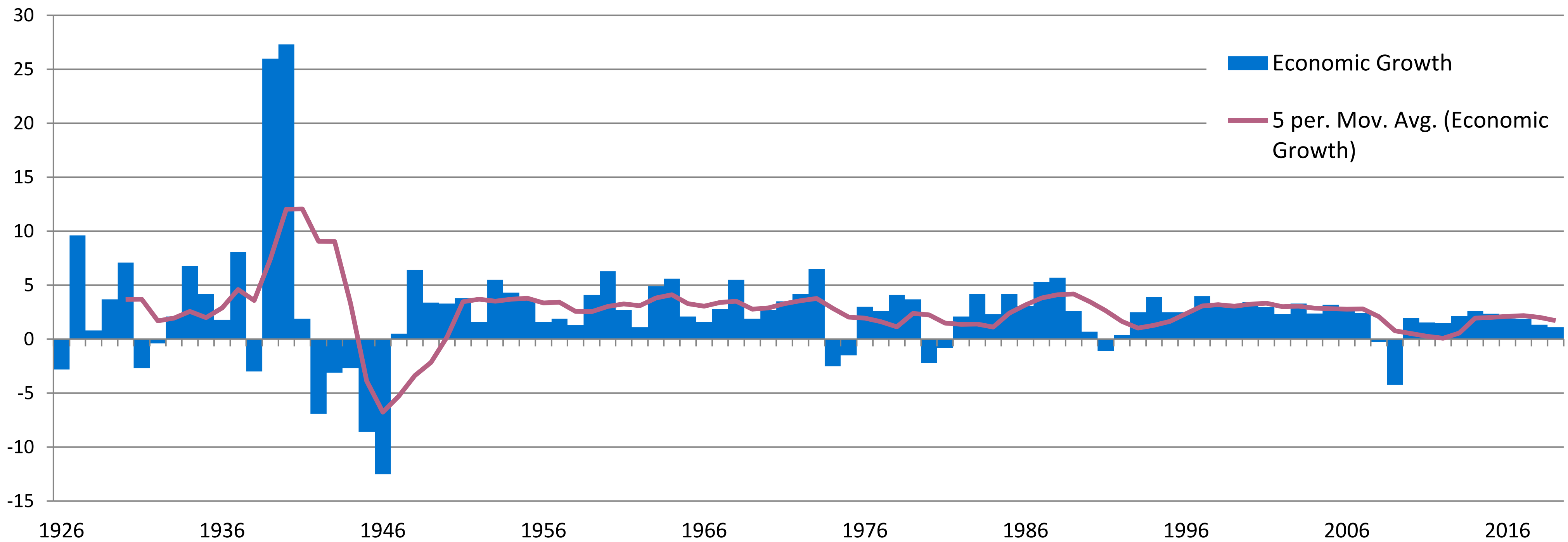
Average Annual Growth (%)	GDP Growth	Inflation	Profits	Dividends
Last 5 years	1.7	1.6	2.3	3.6
Last10 years	1.8	2.2	3.3	3.7
Last 25 years	2.1	2.4	3.5	6.4
Since 1926	**2.5**	**4.0**	**7.0**	**6.4**

Compendium Table 3.2

Source: Sarasin & Partners LLP, Sarasin Compendium of Investment 2020

Long-term UK economic growth

- Even with major setbacks, economic cycles self-correct with recessions always followed by recovery
- UK economic growth has **averaged 6.6%** per annum since 1926

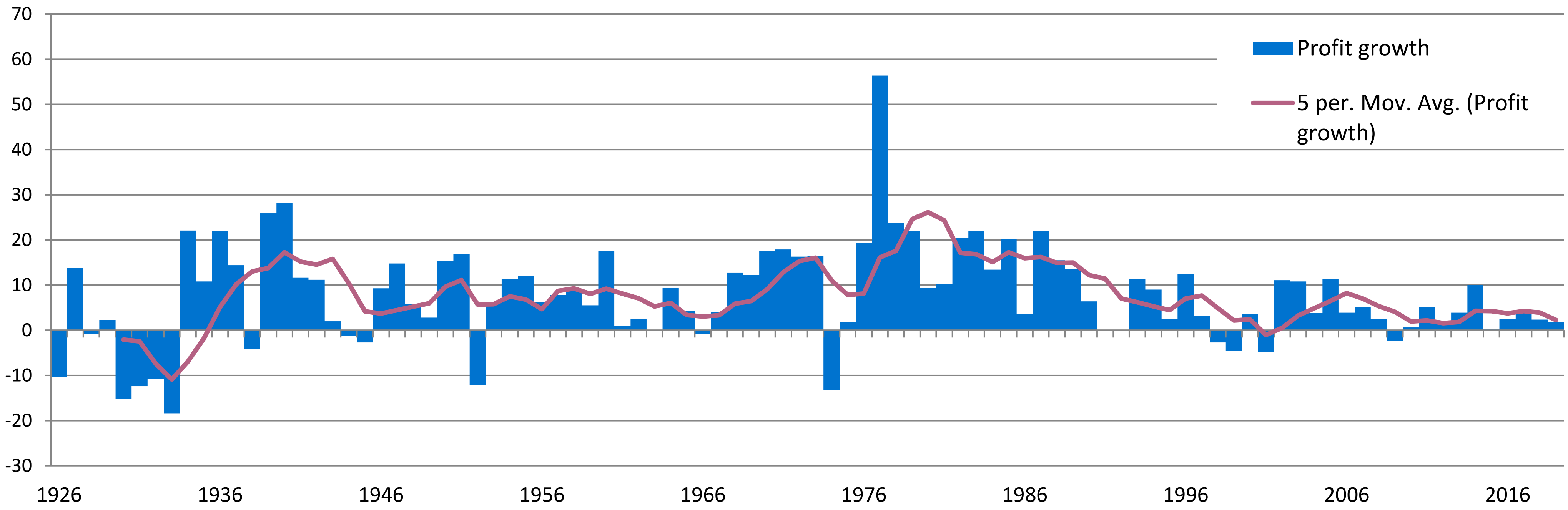


Compendium Table 3.4

Past performance does not guarantee future returns. Source: Sarasin & Partners LLP, Sarasin Compendium of Investment 2020

Long-term UK profits growth

- Profits have shown greater cyclicality – as you would expect because of leverage – but again, they have been restored.
- UK profits growth has **averaged 7.0%** per annum since 1926



Compendium Table 3.5

Past performance does not guarantee future returns. Source: Sarasin & Partners LLP, Sarasin Compendium of Investment 2020

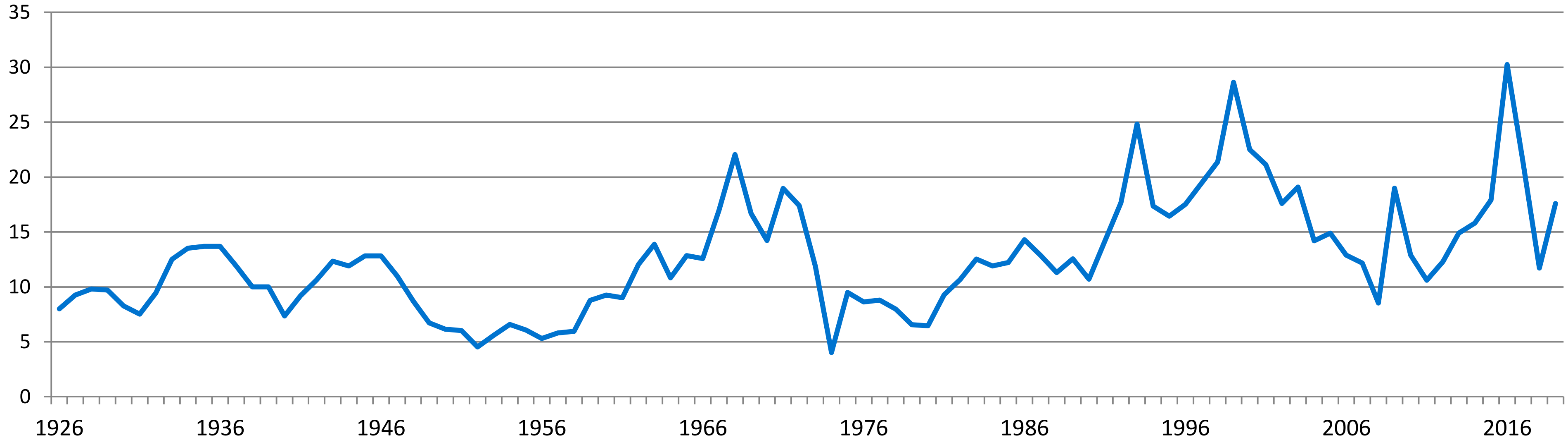
What about dividend growth?

- Need to use US data, because UK imposed controls and taxes on distribution between 1945 and 1979, so **UK dividends have lagged profits growth**
- US dividend growth has **averaged 3.0% per annum in real terms** and rare that they fall over 5 year rolling periods
- Important to have a view on **INFLATION**

Expected Return = Starting Yield X Inflation X Future real dividend growth

UK equity market Price/Earnings ratio

- When economies are growing strongly and confidence is high, investors are likely to pay higher multiples of profits and accept lower dividends, in the expectation that future growth in profits and dividends will restore multiples and yields to more normal levels
- **P/E ratio** is the multiple of a single year's profits that an investor is willing to pay to buy part or all of a company
- Below is the UK equity market's P/E ratio from 1926 to 2019



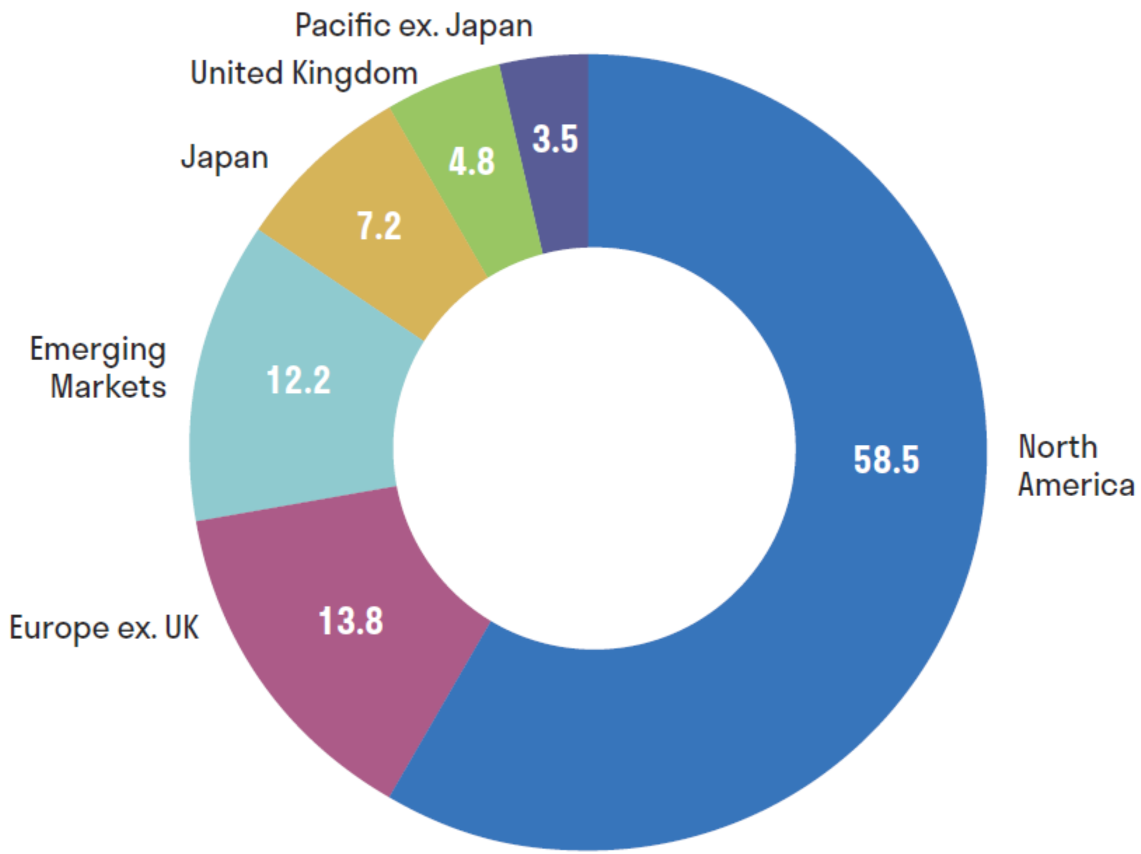
Compendium Table 3.9

Past performance does not guarantee future returns. Source: Sarasin & Partners LLP, Sarasin Compendium of Investment 2020

Equities

Where to invest?

Relative size of world equity markets (as a %)



Compendium Table 3.14

Source: Sarasin & Partners LLP, Sarasin Compendium of Investment 2020

Equities – where to invest?

Sector weights of different markets

	Global MSCI All Countries World Index	**UK** FTSE All-Share Index
Energy	**5.5**	**13.2**
Materials	**4.7**	**9.1**
Financials	**16.7**	**22.7**
Real Estate	3.3	2.7
Consumer Discretionary	10.8	8.1
Consumer Staples	8.6	13.6
Utilities	3.5	2.9
Healthcare	11.3	9.4
Industrials	10.5	11.5
Communication Services*	**8.8**	**5.1**
Information Technology	**16.3**	**1.8**

The Communication Services sector became effective 21 September 2018. It includes IT, Consumer Discretionary and Telecoms companies. Globally it include Alphabet (Google), Facebook, AT&T, Verizon, Tencent, Walt Disney, Comcast, Netflix, Charter and Softbank

Source: Bloomberg 30 September 2019

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Alternatives to equities and bonds

The case for Private Equity

- Represents part ownership (share) of a business but **generally not listed on a stock exchange**
  - Usually held through a partnership structure via a portfolio of investments
  - No income
  - Potential for spectacular capital returns

- Usually **highly geared** to magnify the return

- Usually **unquoted** and very **illiquid** often requiring funds to be invested for a minimum of five years

- Usually accessed via funds to spread risk

See pages 65 - 68

The different types of private equity

- Investors have three choices

  I. **Venture Capital** (angel investment)

  II. **Growth Capital**

  III. **Leveraged buy-out**

- … Venture and buy-out are the most well known

Risks and challenges with Private Equity

Liquidity

Leverage

Manager selection

Timing

Practical impacts of managing cash flows

Costs

The case for Commercial Property

- Ownership of ‘bricks and mortar’ for which you receive;
  - **Rent** (usually upward only reviews)
  - Potential for capital appreciation

- Income and capital return **dependent on performance of the economy**, thus providing the potential for ‘real’ return

- Has both **bond and equity characteristics**; rent provides investors with a high and stable income which should rise over time to keep pace with inflation

- Can be **illiquid** and requires large lot size; usually accessed through pooled funds (or via REITS which offer greater liquidity but more volatility)

See pages 48 - 57

Why invest in commercial property?

- **Multiple drivers of long-term return**

  driven by rental income, rental income growth and capital appreciation which, over time, has led to an attractive risk return profile

- **Higher income yield than equities and bonds**

  rental income makes up the majority of commercial real estate returns and rents are often linked to inflation

- **Diversification within a multi asset portfolio**

  has historically delivered lower volatility and higher returns than bonds and considerablylower volatility than equities

- **Stores of value**

  within the physical building and tenants can be replaced

Liquidity and leverage

- Property must be viewed as a long-term holding
  - **Liquidity** is a major issue for open-ended property funds investing in direct property
  - It is important that investors are aware of **potential delays in redemptions and initial investments**

- Investors need to be aware of **Leverage** or **Gearing**
  - Borrowing magnifies gains and losses
  - Is often the reason for the difference in performance between one property fund and another

How to invest in commercial property

- Four methods of property investment

  I. **Directly** in freehold or leasehold buildings

  II. **Pooled property funds**

  III. **Shares of listed property companies**

  IV. **REITs** Real Estate Investment Trusts

- UK investors need to be aware of additional cost of **Stamp Duty Land Tax**
  - relief applies on direct investment in property
  - possible to invest in specialist property funds

Asset allocation of core property funds

At 31.12.2019

	Office	Industrial	Retail	Other	Total	Net asset value (£ million)	Gross yield (%)
Common Investment Funds							
The Charities Property Fund	21.6	23.8	25.3	29.3	100	1,305.0	4.8
COIF Property Fund	34.1	31.2	16.7	18	100	636.0	5.5
Property Unit Trusts							
Hermes Property Unit Trust	35.9	29.0	18.1	17.0	100.0	1,510.6	3.0
BlackRock UK Property Fund	23.6	31.8	23.1	21.5	100.0	3,410.9	4.7
Lothbury Property Trust	25.2	21.6	38.0	15.2	100.0	1,722.7	3.1
Henderson UK Property Fund	17.4	23.0	26.7	32.9	100.0	2,130.0	3.1
The Local Authorities' Property Fund	35.4	35.0	14.5	15.1	100.0	1,173.0	4.4
Mayfair Capital Property Income Trust for Charities	35.7	35.5	17.5	11.3	100.0	581.2	5.5
Threadneedle Property Unit Trust	32.8	33.0	27.5	6.7	100.0	1,544.9	4.8
Managed Property Funds							
Aviva Investors Pensions Property Fund	35.9	26.5	23.2	14.4	100	563.3	5.5
L&G UK Property Fund	27.6	36.3	19.1	17.1	100.1	3,347.5	2.2
Standard Life Investments Pooled Pension Property Fund	22.7	36.6	30.9	9.8	100	2,642.3	4.5
Threadneedle Pensions Ltd	28.5	36.9	28.2	6.4	100	2,035.6	5.9
Property Partnerships							
UBS Triton Property Fund	14.5	44.0	25.1	16.4	100	923.8	4.9
					Total	**£23,526.8**	

Compendium Table 5.4

Source: Sarasin & Partners LLP, Sarasin Compendium of Investment 2020

The case for Alternative Assets

(Hedge Funds, Commodities, Infrastructure etc…)

- Investments that provide returns that are uncorrelated with conventional asset classes providing diversification and reducing risk
  - Hedge funds
  - Commodities
  - Infrastructure funds
  - Structured Products – returns linked to indices

- Accessed via a wide range of structures. Some complex. Some, such as listed vehicles can be liquid…..but many (Partnerships) can be very illiquid
- Some Alternatives can pay income stream but many do not
- Some seek consistent absolute returns (hedge funds), while others can be used to diversify risk as their returns can be uncorrelated with mainstream asset classes
- Costs can be (very) high

See pages 58 - 87

What do we mean by hedge funds?

And why own them?

Hedge funds are a legitimate asset class because in some cases, they have delivered **uncorrelated, lower volatile, absolute returns**

A broad range of funds from a wide range of well known houses

- Packaged in **more accessible structures**
- Increasingly sophisticated analysis of funds
- **Improving transparency**
- **Low correlation** with other asset categories
- Growing acceptance amongst all types of investor

"A wild, impossible idea?"

The argument against

- Indices of individual hedge funds suffer from **survivorship bias**
- Unusually **wide dispersion of returns** - some managers are better than others
- **No income**
- **Lacking in transparency** not easy to understand what you own (Madoff, MF Global)...
- **Lacking in liquidity**
- **Lacking in regulation**
- Comparatively expensive - double (triple?) charges for users of hedge funds of funds
- The jury is out after more recent performance...

Global Hedge Fund Performance in “Down” Years

Global Hedge Fund Performance In "Down" Years

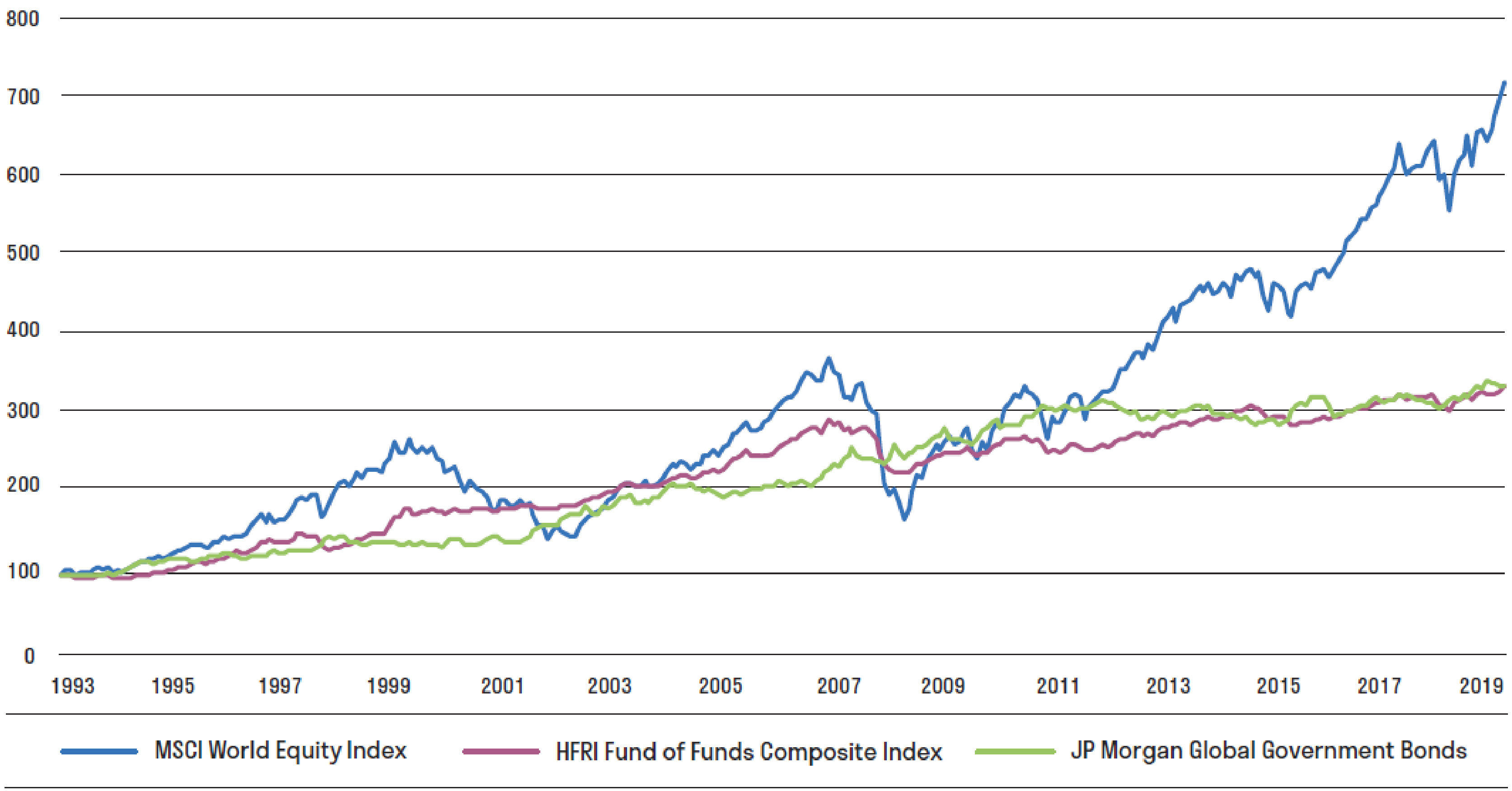
Global Hedge Fund Performance In "Down" Years	1990	1992	2000	2001	2002	2008	2011
Fund Type	%	%	%	%	%	%	%
Equity Market Neutral	15.5	8.7	14.6	6.7	1.0	-5.9	-1.3
Equity Quantitative Directional	-7.2	22.8	-9.0	1.4	-8.5	-22.9	-7.0
Equity Short Bias	36.2	10.1	34.6	9.0	29.2	28.4	1.0
Merger Arbitrage	0.4	7.9	18.0	2.8	-0.9	-5.4	1.6
Macro	12.6	27.2	2.0	6.9	7.4	4.8	-3.6
Fixed Income Asset Backed	-	-	-1.4	21.2	8.6	-3.4	6.7
Fixed Income Convertible Arbitrage	2.2	16.4	14.5	13.4	9.1	-33.7	-4.7
Fixed Income Corporate	-12.1	18.5	-3.0	5.4	5.8	-24.2	1.0
Emerging Markets	-3.4	24.4	-10.7	10.4	3.7	-37.3	-12.9
Fund of Funds - Diversified	17.0	10.3	2.5	2.8	1.2	-20.9	-4.9
HFRI Weighted Composite	**5.8**	**21.2**	**5.0**	**4.6**	**-1.5**	**-19.0**	**-4.8**
MSCI World Equity Index	-18.7	-7.1	-14.0	-17.8	-21.1	-40.8	-5.5
S&P 500 US Equity Index	-3.0	7.6	-9.1	-11.9	-22.1	-37.0	2.1
Citigroup World Bond Index	12.0	5.5	1.6	-1.0	19.5	10.9	6.4

Source: Hedge Fund Research © 2018 www.hedgefundresearch.com

Funds of Hedge Funds v Equities and Bonds

Compendium chart 6.5

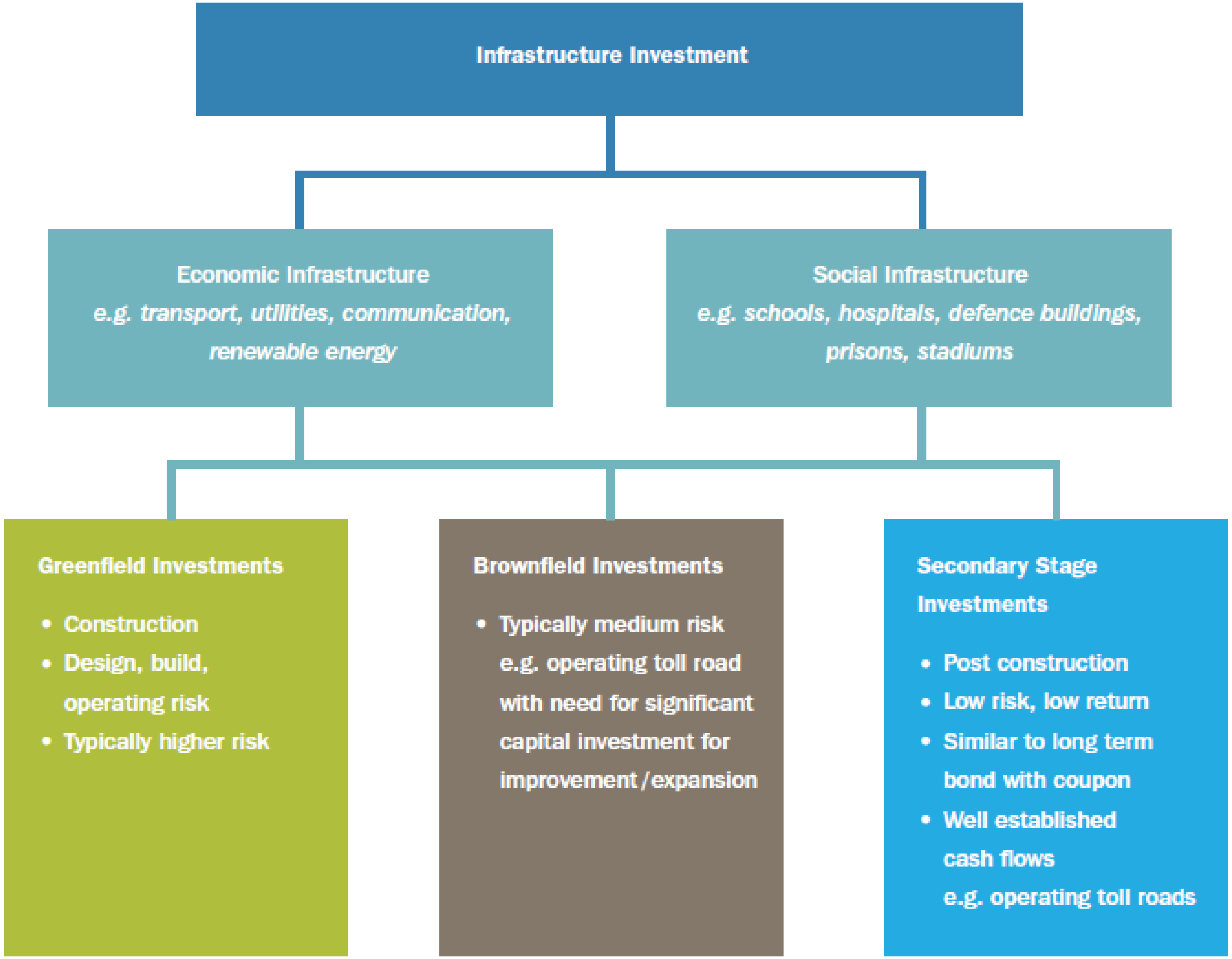
Funds of hedge funds vs global equities and bonds (USD)



Sources: HFR (Hedge Fund Research, Inc.), © 2018, www.hedgefundresearch.com and Sarasin & Partners LLP

Source: Sarasin & Partners LLP, Sarasin Compendium of Investment 2020

Infrastructure



Infrastructure Funds

What is **Net Asset Value (NAV)?**

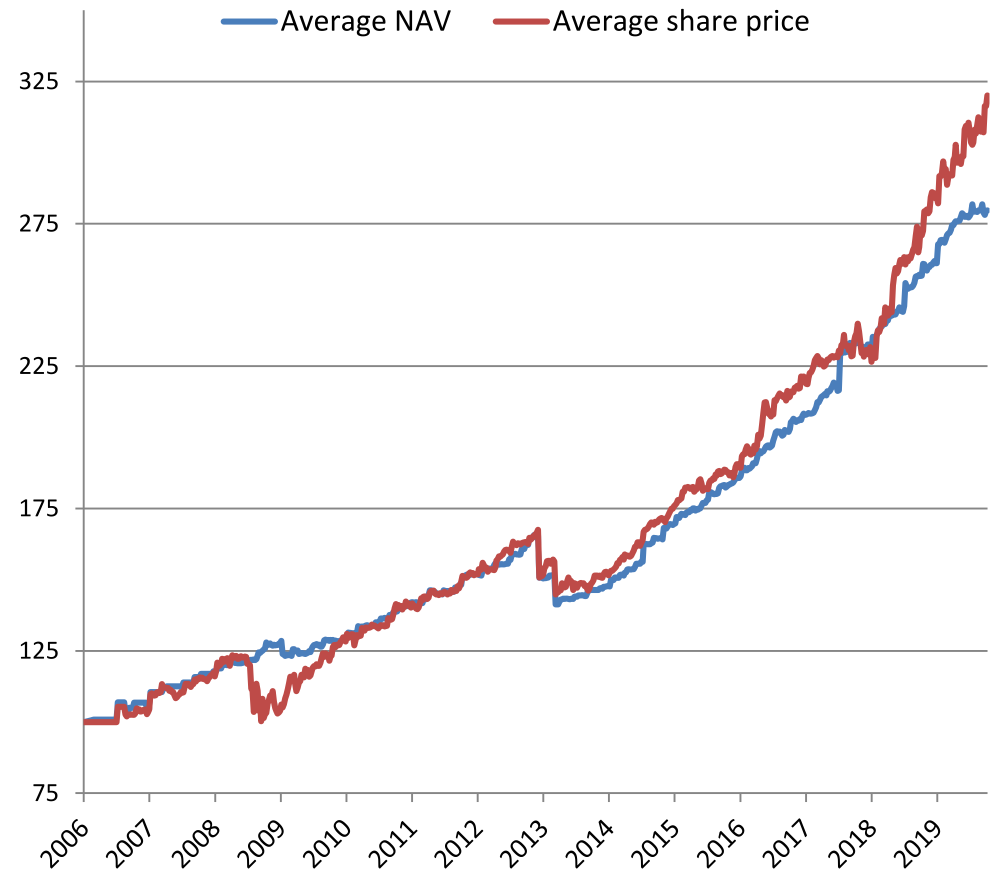
- For infrastructure funds: **NAV = current value of all future income streams less expenses and debt repayments discounted at an appropriate rate**
  - Assumptions are made for inflation, deposit rates, FX rates and tax rates
  - The discount rates used by funds vary: a higher discount rate means a lower NAV and vice versa
  - **Thus the NAV is a fundamentally different and less reliable calculation**

Source: Sarasin Compendium of Investment 31 December 2019

Infrastructure funds

- Infrastructure funds have traded at a **premium to Net Asset Value** for some time
- Historically, buying investment trusts at a premium has been unprofitable
- Infrastructure funds are attractive from an income and capital volatility perspective
- They also have **inflation linked income** backed by the public sector (in most cases)

Average share price vs NAV (total returns)



Source: Numis Securities Limited, 2019

Any other investments to consider?

- **Commodities** (Compendium pages 75-79)
- **Agriculture** (Compendium page 80)
- **Collectibles** – Wine, Art Classic Cars (Compendium pages (81-83)

Important information

Important Information

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