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Fiscal Engineers held its latest Investment & Risk Committee meeting (IRC) on 30 November 2021. These notes provide an insight into some of the areas of discussion held and decisions taken.

A message to our clients

The November meeting of the IRC was a notable one. towards retirement after many years of service to Fiscal Engineers and our clients. In his time as Chair of the IRC, he ran a tight ship with both energy and humour, ensuring that discussion was always robust and balanced, and that the quality of the governance process continued to push forwards. We thank him for his material contribution across the years. Into his shoes steps David Jones as Chair.

It is always good to be able to report back on yet another despite the lingering challenges of Covid and the growing impact of inflation. We even saw value stocks making a comeback and delivering a positive premium above the market!

News in the latter part of 2021 (Omicron notwithstanding) was, at least for a few weeks, dominated by climate change and COP-26. Although some progress was made, the absence of firm commitments from China, Russia and others was disappointing. For many, it was a time to reflect on the impact that we are having on our planet and question what we can each do to play a part in the solution. There are no easy or cost-free (in the broadest sense) choices. Investing in a sustainable manner may be one part of the solution, but there are challenges to how, and to what degree, it can make a difference, which was discussed at length in the meeting. Our thoughts are summarised in this note.

We hope that 2022 represents the start of getting back to some sort of normality.

As ever, if you have any questions or comments, please do not hesitate to call us.

The Team at Fiscal Engineers

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1. The purpose of the IRC

The IRC is the formal body that is responsible for the governance of the investment process at Fiscal Engineers. Meetings are currently held at a minimum twice a year. Meetings can be called on an ad hoc basis if circumstances warrant it, such as a material market fall. To recap, the purpose of the IRC is to:

- Define and implement a risk-focused approach to investing.
- Continually test, refine and reaffirm its investm philosophy; the structure of client portfolios; the asset classes (e.g. equities, bonds, commercial property) that [illegible] provide access to the rewards of desired asset classes.
- Employ best-practice fiduciary standards in overseeing the investment program.
- Help educate clients about what they own and why they own it.

2. IRC meeting proceedings

2.1. Introduction

The formal IRC meeting took place on 30th November 2021 and a quorum was present.

Attending the meeting were: John Clarke (CIO), Shane Mullins (Executive Chairman), Ian Rodger, Dave Till, David Jones (Chair) and Frazer Edwards of Fiscal Engineers, Tim Hale of Albion Strategic Consulting and Neil Wright (guest member).

Changes to Committee: David Jones takes over as Chair. Ian Rodger was thanked for his many years in the role.

The minutes of the previous meeting were reviewed, previous follow-up actions were discussed, and the minutes were duly signed off by the Chair. A number of regular agenda items were raised, and the following decisions/conclusions were made/drawn:

2.2. Key decisions summary

- Systematic vs. judgemental approaches: the evidence still supports utilising a low cost, diversified systematic, buy-hold-rebalance approach. A regular, well-structured analysis of the percentage of active managers delivering on their promise to beat the market revealed that around 9 out of 10 US funds failed to do so over a 20-year period[1]. Capturing the market return, for the risks taken, continues to sit at the centre of our approach.
- Product due diligence: the funds used in the model portfolios were reviewed and all products are performing in line with expectations. It is worth noting that for the year to 30 September 2021 all funds in the Model Portfolios were in the top quartile (25%) of funds in their Morningstar peer group[2].
- Portfolio review: 2021 saw another very strong year of returns, particularly in growth assets. Fiscal Engineers Portfolio 60 model delivered a return of just under 13% in 2021 and a cumulative return over the past ten years of 106%. Markets have been kind in that time with only 2018 delivering a down year. As a rule of thumb equity markets would be expected, on average, to fall around once in every three years. Trying to guess when the next downturn may come is an impossible game and one can be wrong for a long time, as the last decade has proven.

1 S&P Index vs. Active (SPIVA) US mid-year report to 30 June 2021 http://us.spindices.com/resource-center/thought-leadership/spiva/

2 The Dimensional Global Short Dated Bond Fund has not been included as it has no directly comparable peer group category on Morningstar, which results in apples-to-oranges comparisons.

- Asset class research: the IRC confirmed that it remains comfortable with all the asset classes in the portfolios at present.
- Asset class assumptions: the IRC has decided that the long-term asset class assumptions used in its cash flow planning process remain sensible at this point.
- Strategy affirmation: in view of the higher level of inflation, the current allocation of the defensive assets, split 70% to high quality, global short-dated bonds hedged to GBP and 30% to intermediate index-linked gilts was discussed. It was agreed that it will remain in place. It was also agreed that a screen of the product market would be made to establish if any suitable shorter-dated index-linked gilt funds are available yet. This will be reported back on and discussed in the next IRC meeting.
- Sustainable investing: a long discussion on the challenges, misunderstandings and misrepresentations as to what ‘sustainable’ inves
reference to the deep analysis cov October 2021, n Albion’
which the Committee had reviewed. It was agreed that clients interested in more sustainable investing approaches deserve a transparent and balanced view on what such an approach can, and cannot, achieve.

3. Market overview

As usual, the IRC reviewed the market returns delivered to portfolios. Longer-term data provide greater insight into the characteristics of asset classes. Shorter-term data contain considerable noise. That said, growth assets delivered spectacular returns with the exception of emerging market stocks (however, emerging market value and smaller companies performed well). Inflation-linked gilts performed well in the face of unexpected rises in inflation.

Table 1: Nominal returns on asset classes to 31 December 2021[3]

Date	World equity (dev.)	UK equity	Emerging market equity	Global large value	Global small	Global REIT	Short-dated bonds	Index-linked gilts
Asset role	Return drivers					Diversifier	Defensive	
10 years	14.3%	6.5%	6.9%	12.3%	13.9%	11.7%	1.2%	3.8%
5 years	12.9%	4.2%	7.9%	6.8%	9.7%	7.4%	0.9%	3.1%
3 years	19.2%	6.5%	8.7%	11.9%	16.7%	12.5%	1.3%	3.9%
2021	22.9%	19.6%	-1.6%	27.0%	21.8%	33.7%	-1.0%	3.9%

Data source: Dimensional Returns Web

3.1. Outlook for the economy and inflation

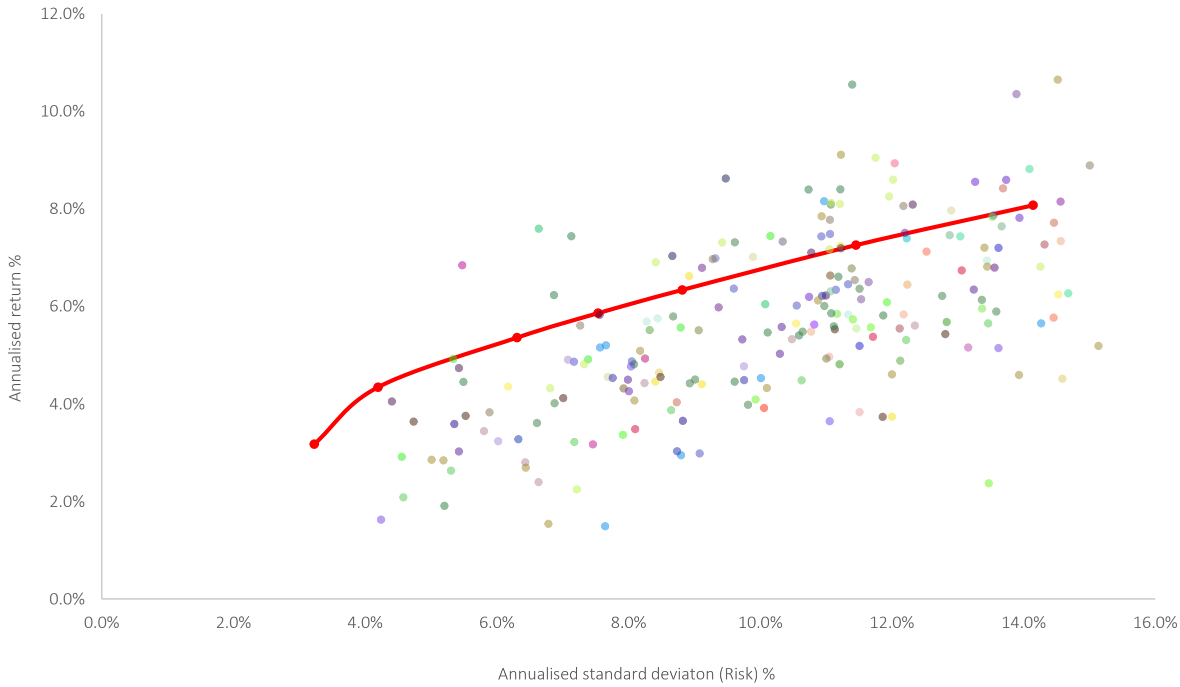
Led by CIO John Clarke, the Committee discussed the current economic situation, focusing on the rapid rise in inflation that was flagged some time ago as a possible scenario and risk. Monetary supply and purchasing index data suggest that inflation is likely to be high throughout 2022 and 2023, noting that interest rate increases are likely to be the main tool used to address the issue rather than monetary destruction via unwinding quantitative easing. The Committee note that the split between short-dated bonds and index-linked gilts should be kept under watch, but caution that index-linked gilt exposure is designed to protect against unexpected inflation, rather than expected inflation. There is inevitably a risk to making tactical decisions based on either current conditions or an expected scenario which may not come to pass. We typically avoid such risks and the Committee ultimately concluded that the short-dated bond/index linked gilt mix at 70/30 remains reasonable.

[3] Note that the data was updated to year-end after the IRC meeting. Data sources: UK equity – MSCI UK Index (net div.); developed market equity – MSCI World Index (net div.); emerging market equity – MSCI Emerging Markets Index (net div.); global commercial property – S&P Global REIT; global large value - Dimensional Global Large Value Index; global small - Dimensional Global Small Index; short-dated bonds – FTSE World Government Bond Index 1-5 Years (hedged to GBP); index linked gilts - Bloomberg Barclays Govt. Inflation Linked 5-15 Year bond Index. All in GBP.

4. Peer group (multi-asset manager comparison)[4]

Fiscal Engineers tracks the performance of its model portfolio range since inception in 2005, incorporating all asset-class and fund level decisions made by the IRC. In the chart below, the Fiscal Engineers model portfolio range - from low risk to higher risk - are plotted against the universe of professionally managed multi-asset funds available to UK investors. Multi-asset funds are those that, for example, include allocations to developed markets, emerging markets, property and possibly other assets or strategies such as commodities, hedge funds or absolute return funds. These managers have the discretion to ‘play’ where and how they want to.
Charges Figures (OCFs) but prior to other charges. Fiscal Engineers portfolios are rebalanced annually. Individual client portfolio performance may vary due to the timing of cash flows, the date on which portfolios are rebalanced and planning and platform costs.

Figure 1: Multi-asset fund manager comparison. Data from Dec-05 to Dec-21.



 Source: Albion Strategic Consulting. Full methodology available on request.

4.1. Rebalancing – managing tolerance limits

Rebalancing is an integral part of the investment discipline implemented at Fiscal Engineers. A regularly updated ‘rebalancing heat map’ is produced and revie
different model portfolios have moved away from their long-term strategic neutral split between growth and defensive assets, dependent upon which month they were last rebalanced. All models remain within bounds. As noted in previous minutes, a large project is ongoing within the firm to automate the monitoring of ‘portfolio drift’ at a client level and IRC meeting.

As a firm, Fiscal Engineers will inevitably nudge clients back towards their ideal models each time work is undertaken in the portfolio; for example, making use of ISA allowances and CGT exemptions each year, or raising liquidity to support spending. This system of rebalancing
allocation to the agreed risk profile, but without taking assets out of the market unnecessarily. With this method, we rarely find our client portfolios in the position of having drifted beyond our tolerances. However, this does not protect clients from sudden movements in the markets such as those seen in early 2020 when Covid was first placing its roots into our world. In black swan scenarios, it is not uncommon that some portfolios will drift 10% or more from their ideal weighting in equities. This is all part and parcel of investing and as such, in these circumstances, the IRC will closely monitor and

[4] Note that this was updated post-meeting to take the data to December 2021.

consider the options available, which include ad hoc rebalancing or doing nothing. Remember, market timing is extremely difficult to get right and if clients are mid-rebalancing, and therefore have money out of the market for a few days, when the rebound hits this could easily become counter-productive for the value of portfolios. Remember, it is time in the market that counts and gives us a chance of a successful investment experience; this is very different to timing the market.

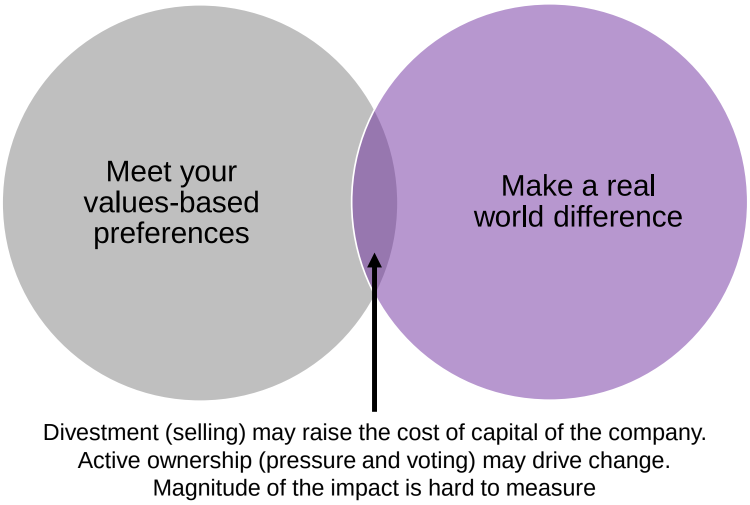
5. Sustainable investing

A large part of the meeting was spent discussing sustainable investing.

A definition might be a good starting point. In short, sustainable investing is investing with a view to making a difference and attempting to improve the sustainability credentials of the firms owned in a portfolio, in line with one's values-based preferences. 'ESG investing', i.e. where process in some way considers the environmental, social and governance risks associated with a company, has become the market term that generally subsumes other descriptions of preference and values-based investing such as socially responsible, green, and ethical investing. It can, however, mean many things to many people, both in terms of the values reflected, as well as the method by which portfolios are constructed. Sustainable investing and ESG investing are generally considered to be interchangeable terms.

The major challenge faced by sustainable investors is that there is a big difference between satisfying one's pers-based preferences by, say, emissions by 50% (by not a portf owning highly polluting companies) and actually reducing CO_2 emissions in the real world. It is important to remember that every sale in the seconda someone else to own the shares for the trade to settle. Simply changing ownership of those shares has no direct tangible impact on the company or its emissions.

Figure 2: The challenges of sustainable investing



The mechanism for driving real-world change - as opposed to portfolio characteristics change – is multi-pronged, indirect, nuanced and largely unmeasurable. That is the harsh reality. In summary, by owning a values-based preference portfolio, e.g. focused on climate change, investors send a loud message to the fund management world that this matters. This puts pressure on fund management firms to improve the stewardship of portfolio companies by adding more resources to the team, developing sound and focused engagement strategies with portfolio companies, and using investor to effect change.

Divestment can send a powerful message if it comes from a powerful and high-profile investor. More likely, the aggregated sales by a large number of i impact negatively on the companies' share prices and raise expensive to raise extra funds, if required, and increases the hurdle rate for internal projects, reducing the number of them that go ahead. It is very hard to specifically measure the impact of investing sustainably, but the logic of how it might help provides some comfort that it is worthwhile pursuing for some.

We want our clients to be able to be able make a fully formed choice when deciding how to invest, particularly around climate change and other sustainability issues. Understanding the mechanisms through which investing sustainably may make a real-world difference and the challenges and timeframes of such mechanisms is important. At its highest level, making a choice to invest sustainably – alongside many other investors – raises investors’ voices to fund mar message that these issues are important. Sustainable investing is not a panacea, but is it a small step in the right direction. Thinking more broadly about the impacts on sustainability of lifestyle choices can also help to identify opportunities to improve our footprints more broadly.

These are all personal choices and the team at Fiscal Engineers is always on hand to talk through your options and decisions where that would be helpful.

6. In conclusion

Investing is not easy and with the benefit of hindsight there will always be some part of the markets (e.g. Tesla, US tech stocks) that may have performed better than the broad portfolios Fiscal Engineers recommends to its clients. The IRC provides the ongoing challenge, in depth discussion and discipline to focus on building robust *‘all weather’* portfolios for the future and not to suffer from FOMO (the fear of missing out). Focusing on doing a few ordinary things exceptionally well (building robust, diversified structures; identifying high quality, lower cost products; regular review and rebalancing; and helping clients to stay the course) can result in strong and competitive longer-term returns for clients, as we have seen since 2005.

Please feel free to contact your adviser if you have any questions or comments arising from this document.

Let us hope that in 2022 returns to normal as the days lengthen.

Fiscal Engineers’ Investment & Risk Committe

January 2022

Endnote: use of Morningstar Direct© data