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Investment and Risk Committee Update

June 2024

Fiscal Engineers held its latest Investment & Risk Committee meeting (IRC) on 4th June 2024. These notes provide an insight into some of the areas of discussion held and decisions taken.

A message to our clients

Portfolio returns this year so far have been strong. Long may it continue. Global yield curves have remained inverted – meaning shorter term borrowers are being rewarded with higher yields than longer term borrowers – which has led to better returns in the shorter dated bond space. Investors continue to enjoy the higher yields on offer, relative to where things were before 2022, and the historically low yield environment is becoming an increasingly distant memory. Market returns are covered in more detail in the minutes.

It feels like 2024 is the year of the election with over 64 happening in various countries around the world covering around 50% of the world's population! These range from the re-election of Putin, to that in the UK which has recently seen a Labour landslide victory. The important thing to remember is that these and other events are already baked into today's market prices. As ever, our best defence against uncertainty is to remain well diversified and to own high-quality defensive bonds to the extent that they allow us to stay invested in tough times.

It requires fortitude and discipline to weather any market storms. It requires fortitude and discipline to stay calm at times of market crisis, to remain invested and to rebalance the portfolio, if necessary. It also requires fortitude and discipline not to chase 'hot' parts of the markets (BitCoin, gold, tech stocks etc.) or 'hot' managers, or to restructure the portfolio to take advantage of perceived short-term opportunities and challenges or giving up on certain parts of the diversified portfolio that happen to be suffering at any point in time.

The key to successful investing is to get the balance between bond and equities right, given your circumstances. Thereafter we want to pick up as much of the return on offer by investing in low-cost, systematic funds seeking to deliver market returns. The rewards of capitalism are there for those who can wait.

As ever, please get in touch if you have any questions, comments or concerns.

The Team at Fiscal Engineers

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Contents

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 four times 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 investment process including: the firm's investment philosophy; the structure of client portfolios; the asset classes (e.g. equities, bonds, commercial property) that it uses or excludes; and the 'pure-asset-class' lower cost funds that 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

Introduction

The formal IRC meeting took place on 4th June 2024 and a quorum was present.

Attending the meeting were: David Jones (Chair), John Clarke (CIO), Frazer Edwards, Hazel Manlove, Tom Sadler and Dave Till of Fiscal Engineers, and Ben Edwards of Albion Strategic Consulting (Albion). Apologies from Neil Wright.

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

Key decisions summary

- Systematic vs. judgemental approaches: the data available to us continue to support avoiding making judgemental tactical market timing and stock selection decisions. The Committee agrees there is no change to the underlying philosophy, namely that active management outcomes are inconsistent over time and no new data suggest a reliable way to pick winners in advance. It continues to believe that a systematic approach offers investors the best likelihood of a successful investment outcome. The Committee reviewed the Albion Global Active Manager Evaluation (GAME™) report which, along with the regularly reviewed SPIVA studies supports the incumbent philosophical approach to investing.
- Product due diligence: the Committee concluded that the current range of funds are capturing the markets and asset class characteristics intended and, subject to the ongoing roll out of the changes we launched in November 2023, no other fund changes are required. The next full product screen and due diligence review is due at the end of Q3 2024. All current funds and portfolios will be monitored in the interim on a regular basis.
- Portfolio review: the new global portfolios, which were available from 8th November 2023, were reviewed and it was agreed by the Committee that the portfolio structures were robust and that they are capturing the market exposures – and thus expected returns - sought.
- Asset class research: the IRC confirmed that it remains comfortable with all the asset classes in the portfolios at present. The value premium was discussed. The premium is noisy in nature but remains positive on average and the Committee concluded that in absence of any ability to correctly time exposure, maintaining a consistent exposure to value stocks through time provides the most effective way to capture the returns on offer. The Committee also reviewed a new strategy launched by the fund management firm Dimensional which seeks to provide exposure to short-dated UK inflation-linked bond returns – an area currently devoid of investable products. The Committee concluded that the fund is too new for inclusion at this

time and will wait until such a time that it progresses through the firm's comprehensive whole of market screening process before considering it further.

- Asset class assumptions: the Committee agreed that the current asset class assumptions, which generate our overall portfolio assumptions, remain reasonable starting points for investment discussions with clients.
- Regulatory points: the Committee discussed the Anti-Greenwashing rules as set out by the FCA, which came into effect in 31st May 2024. The committee remain confident our current "*steps in the right direction*" approach is clear, fair and not misleading, but it is important to remind clients of the limitations that exist when it comes to investing in ESG-screened solutions. Investing in secondary markets – as Fiscal's clients do – means that the impact of such exposures are unmeasurable and perhaps slight at best.
- Strategy affirmation: After detailed discussions and reviewing the available research and due diligence, subject to the planned changes, the Committee concluded that there is no reason to change the evidence-based, long-term systematic strategy.

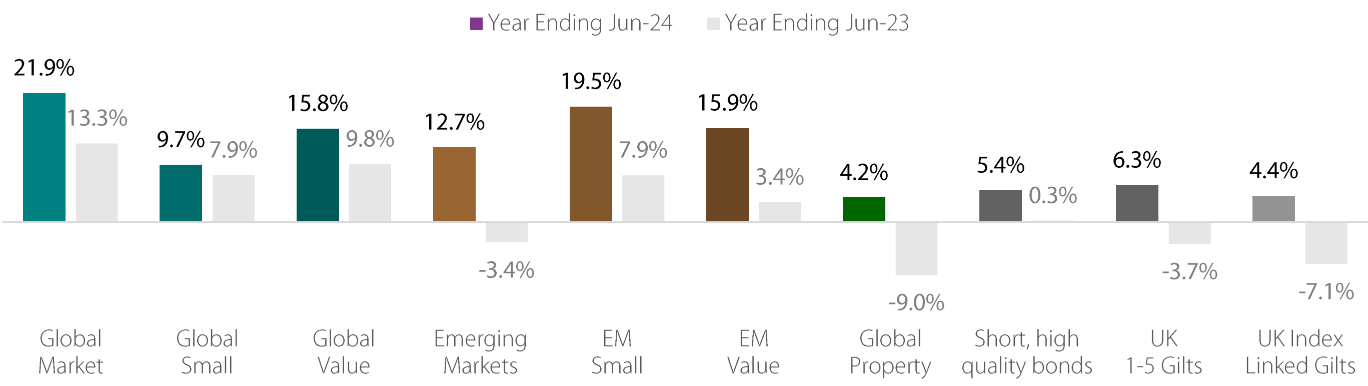
3. Market overview – 2024 so far (to 30 June)

Most major asset classes have seen positive absolute returns so far this year. Investors in diversified portfolios would likely be pleased with the strong returns YTD and over the past 12 months, as these returns should lend well to the success of long-term financial plans. Global developed markets have continued to perform well in the first half of 2024. US growth continues to be a major contributor to this. Large cap growth's dominance is further illustrated by the relative underperformance – though strong absolute returns - of value and small companies compared to the broad developed market. Profitability has been a strong relative performer in the first half of the year. In emerging markets, value and profitability have outperformed the broad market, while small caps have slightly underperformed.

On the defensive side of portfolios, returns have been steady overall. Global yield curves generally remain inverted. Cash has generally outperformed bonds with any amount of duration so far in 2024, but the variable maturity mandate inherent in the Dimensional Global Short Dated Bond fund has led to more 'cash-like' returns. This has been positive for portfolios.

Year-on-year inflation in the UK has continued trending downwards, coming in at the bank of England's target rate of 2% in May.

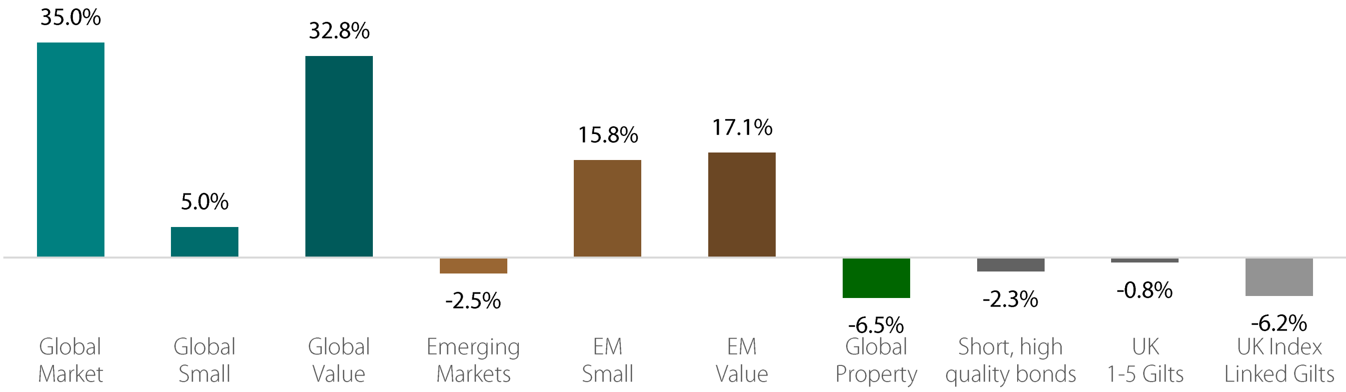
Figure 1: Global investment returns – asset class returns



Data: Funds used to represent asset classes, in GBP. See endnote for details

Looking at three-year cumulative returns helps to illustrate the benefit of remaining invested through tough years such as 2022. Bond returns have been poor due to yields of around 0% at the start of the period followed by subsequent yield rises (and thus bond price falls) in 2022. Broad developed market returns have been very strong over the time period.

Figure 2: Cumulative global investment returns – three years to Jun-24

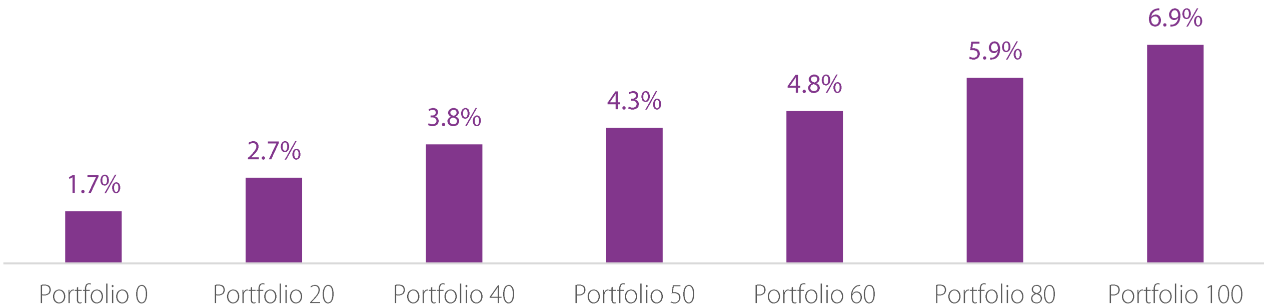


Data: Funds used to represent asset classes, in GBP. See endnote for details.

4. Fiscal model portfolio returns

At the model portfolio level, portfolios have delivered positive returns across the risk spectrum (YTD to 30 June 2024), as the figure below reveals.

Figure 3: Fiscal Engineers Model Portfolio – Jun-24[1]



Source: Fiscal Engineers. June 2024

The table below provides cumulative performance data to the end of June 2024 from inception.

Table 1: Fiscal Engineers Model Portfolio – cumulative performance Dec-2005 to Jun-2024

Cumulative	P0	P20	P40	P50	P60	P80	P100
1 Year	5%	7%	9%	10%	11%	13%	15%
3 Years	-3%	1%	6%	8%	11%	16%	21%
5 Years	-2%	7%	17%	22%	26%	37%	47%
10 Years	11%	31%	51%	62%	74%	100%	128%
15 Years	43%	84%	132%	160%	191%	262%	345%
Since inception	59%	97%	138%	161%	185%	238%	293%

[1] These represent fund level model portfolios (after fund OCFs and trading costs) but before any other costs for the year to 30 June 2024. They reflect all portfolio changes made over the period including the new global asset portfolio structures from November 2023. Note that individual client 'live' portfolio performance may vary due to actual holdings, last rebalance date, interim cash flows and adviser and platform costs.

5. Outlook for the economy and inflation

Led by CIO, John Clarke, the IRC reviewed the Economic Risk Matrix.

Based on the trends in the quantity of money and the spare capacity in the economy, a significant rise in inflation in the UK, the US, or the eurozone, would seem less likely. Inflation in the UK is expected to ease and could possibly fall below zero in the UK next year. This may lead to falling interest rates, as set by the Bank of England.

With the recent election of a Labour government, it looks as though it will stick to the public expenditure envelope for the first five years which we hope will not result in unwelcome market volatility. As ever, the IRC makes its best effort to continue to monitor economic risks on a regular basis.

6. Judgmental active managers failing to meet their market beating promises.

Albion's Global Active Manager Evaluation 2024 (GAME™)

Two central tenets of a systematic, evidence-based approach to investing are understanding that trading in the markets is a zero-sum-less-costs game and that markets work pretty well at incorporating information into prices thus making it hard to find mispriced securities. The combination of the two suggest that few actively managed, judgmental funds would be predicted to be able to deliver market-beating returns across time.

One regular series of studies assessed in IRC meetings that looks at the empirical evidence on this is the SPIVA® reports from the US, Europe and elsewhere in the world. The overwhelming take-away is that the vast majority of active managers fail to deliver to their investors the market beating promises they make. Other studies tell the same story including Dimensional's *The Fund Landscape 2023*, and Vanguard Research: *The case for low-cost index-fund investing 2022*.

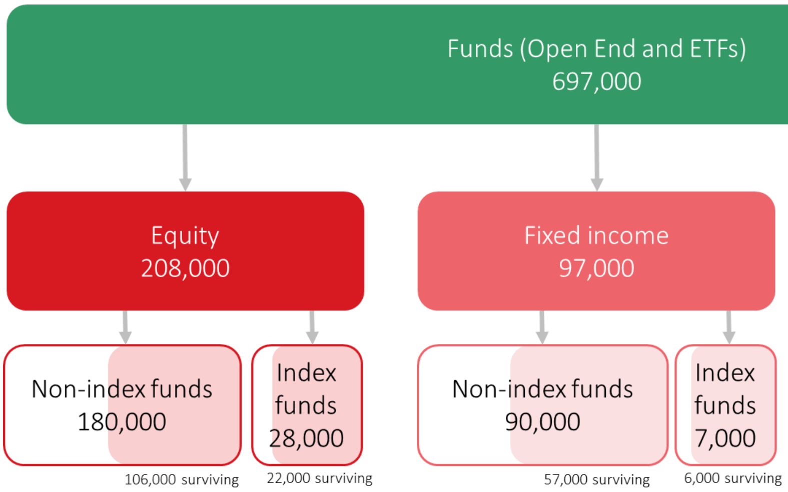
Albion – a guest member on our IRC - has built a deep and detailed, evidence-based research tool to further enhance the insight that can currently be gleaned from the SPIVA® and other similar studies. Preliminary, high-level findings – and an insight into how the study has been developed - are provided below.

Defining a starting universe

The first challenge is to define a suitable starting universe for further analysis. Morningstar Direct's 'all managed investments' category currently contains just under 1.4 million instruments of which 764,000 are currently available for investment, whereas 636,000 (45%) have merged or liquidated to date, which tells its own story! Categories included are open and closed end funds, hedge funds, separately managed accounts (SMAs), restricted investments and pension wrapped products, amongst others.

The starting universe for this study will be to focus on those product vehicles available and suitable for most retail investors, namely open ended and exchange-traded funds (ETFs). The diagram below highlights this opportunity set at the time of writing.

Figure 4: Open-end fund opportunity set

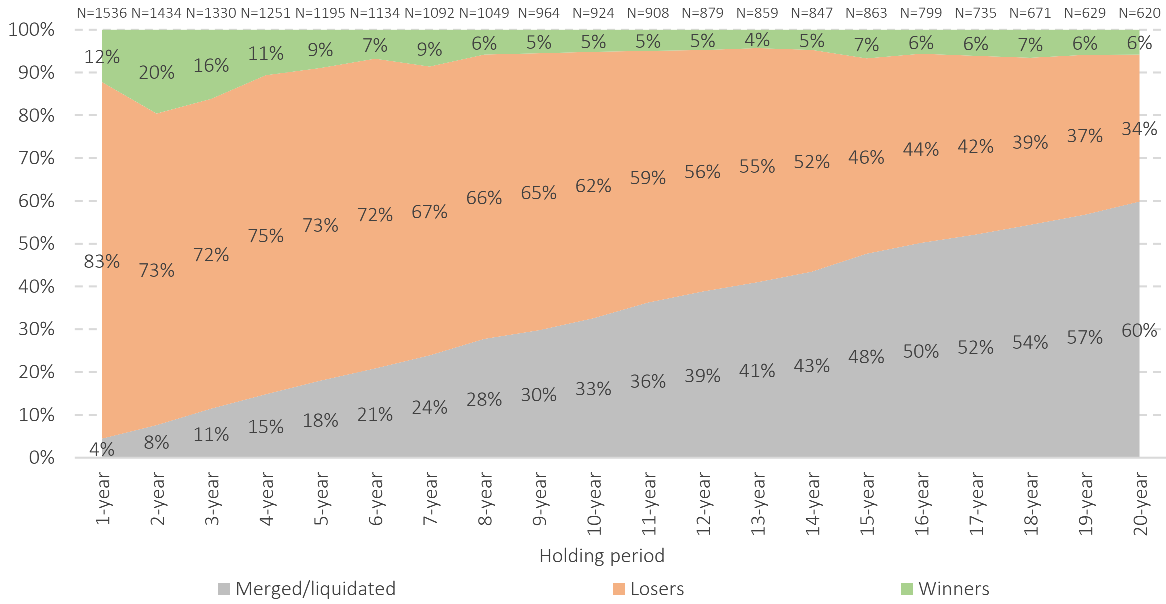


Source: Morningstar Direct © All rights reserved.

As the primary return driver in Fiscal Engineers' portfolios, global developed equities make for a sensible starting asset class. Wide screening criteria were implemented in order to arrive at a sensible cohort of judgmental (active) developed equity fund managers. The goal is to return a comprehensive list of unique judgmental funds that are broadly allocated across developed nations, do not implement any currency hedging strategies, and are not overly concentrated in any one sector.

The chart below demonstrates that the cohort of judgmental managers in this dataset have overall struggled to compete with the MSCI World Index on an absolute performance basis. Managers with live funds, but no performance data available were excluded from the study, but this only constituted a handful of funds. The horizontal axis displays the holding period i.e. the 1-year point represents the percentage of judgmental managers that outperformed or were beaten by the MSCI World Index from 1st January 2023 to 31st December 2023 as well as those who merged or liquidated. The 2-year point is between 1st January 2022 and 31st December 2023 and so on.

Figure 5: Global equity (market): judgmental manager evaluation vs. MSCI World Index



Source: Morningstar Direct © All rights reserved. Albion. Index: MSCI World NR USD. Data to Dec-23.

Even in the short-term, the index approach fared extremely well in 2023 outperforming 88% of 1,536 judgmental managers, of which 4% merged or liquidated throughout the year. At the 20-year horizon, only 40% of the 620 funds available at that time survived the period, with 34% being beaten by the MSCI World Index and 6% surviving and outperforming.

The longer-term numbers are unsurprising given markets are a zero-sum-less costs game and, for the most part, highly efficient at pricing in new information. The shorter-term numbers are higher than one might expect given that a sensible rule of thumb is that in most calendar years around 2/3 managers get beaten by a fair index. In 2023, some of the largest US tech stocks that make up many of the top holdings in the MSCI World Index performed extremely well, with the likes of NVIDIA, Meta and Amazon returning 220%, 178% and 71% respectively in GBP terms. This might go some way to explain the disappointing short-term performance of the judgmental management cohort. When just a handful of names drive all of market returns, one must be holding them to do well or risk being left behind, Jack Bogle said it best:

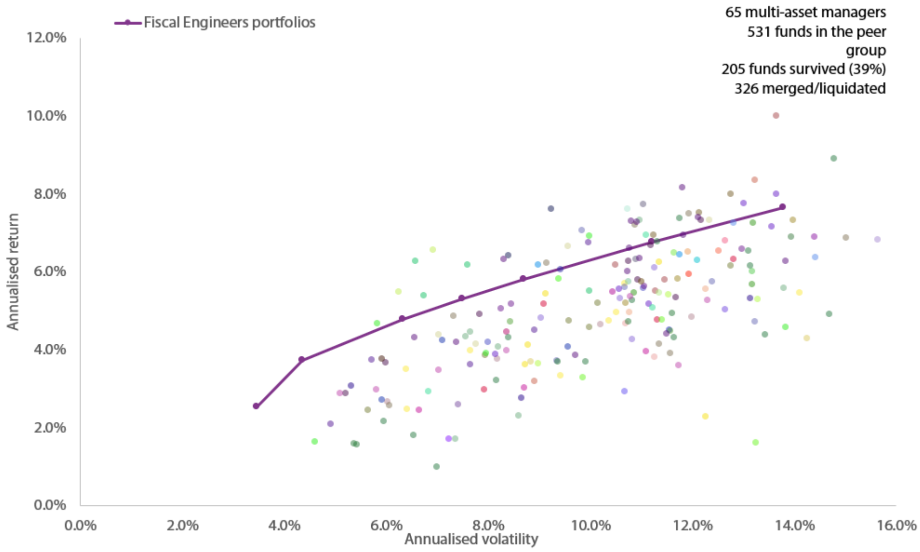
'Don't look for the needle in the haystack. Just buy the haystack!'

Results of the study are comparable with the likes of SPIVA®, which reinforces the conclusions. In the future, the study will be expanded to a wider range of markets. The IRC will continue to assess SPIVA® and other studies alongside so as to gather as to make informed decisions around its investment philosophy.

The chart below shows how Fiscal Engineers' systematic model portfolios have performed against a peer group of professional fund management firms offering multi-asset funds to UK investors along the risk spectrum, since Fiscal's model portfolios were first offered in December 2005. It reflects changes that have been made to model portfolios over time. The Fiscal performance track record is net of fund OCFs for suitable comparison purposes to this third party professional peer group of multi-asset funds. Client financial planning fees and platform charges are excluded to allow for an apples-to-apples comparison.

Figure 6: Multi-manager peer group comparison Dec 2005 – Jun 2024

Portfolio	% Beaten (Risk Adjusted)
Portfolio 0	73%
Portfolio 20	95%
Portfolio 40	96%
Portfolio 50	95%
Portfolio 60	95%
Portfolio 80	93%
Portfolio 100	92%



Note: Risk-adjusted performance calculated using Sharpe ratio. Data source: Morningstar Direct © All rights reserved.

7. In conclusion

The IRC continues to remain supportive of the systematic approach adopted to managing client portfolios, the asset allocations of the portfolios and the funds used to implement them.

Process rigour and discipline contribute to delivering sensible market returns for the risks taken on in client portfolios. Diversification, rebalancing, low costs and the fundamental belief that markets – not people – deliver returns.

Please feel free to get in touch if you have any questions or concerns.

Fiscal Engineers' Investment & Risk Committee – July 2024

Endnote: use of Morningstar Direct© data

Data series used:

Asset class	Fund proxy used for
Gbl market	Fidelity Index World P Acc
Gbl value	Dimensional Global Value GBP Acc
Gbl small cap	Vanguard Glb Small-Cp Idx £ Acc
EM	iShares Emerging Mkts Eq Idx (UK) D Acc
EM value	Dimensional Emerging Mkts Val GBP Acc
EM small cap	iShares MSCI EM Small Cap ETF USD Dist
Gbl property	L&G Global Real Estate Div Index I Acc
Short, high qual bonds	Dimensional Global Short Dated Bd Acc
UK 1-5 gilts	iShares UK Gilts 0-5yr ETF GBP Dist
UK IL gilts	Dimensional £InflLnkdIntermDurFI GBP Acc