Grey Parrot
FINANCIAL PLANNING

Our investment principles:

How we obtain the best return for our clients

02033 68595

info@grey-parrot.co.uk

Introduction

We decided upon these seven principles following a great deal of research to answer the question, "how can you get the best return on your money?". What followed was a clear, logical set of ideas that provided the answer and guided how we select and manage investments on behalf of our clients. These principles are explained in turn within this summary, along with the relevant evidence to support.

"To understand the world as it is, not as we should wish it to be, is the beginning of wisdom" – Bertrand Russell

The purpose of researching the question, "how can you get the best return on your money?" meant putting perceptions and experience to one side and focussing on finding out what was true based on the best evidence available. Our clients have chosen to delegate work to us that they don't have the time or expertise to do themselves. We are trusted to act in their best interests, and by ensuring our advice is based on the best evidence available, we make sure that trust is not misplaced.

The value of investments and any income from them can fall as well as rise and you may not get back the original amount invested.

The principles

1. Evidence shows diversification works, and we will seek to diversify our clients' investments according to the principles of modern portfolio theory

In summary, modern portfolio theory explains that you can construct a portfolio that maximises the potential return for a given level of risk. As investors differ in their preference for risk and have different investment objectives, a range of portfolios at different risk and return levels can be built to meet varying needs. In a 1986 study by Gary Brinson, L. Randolph Hood and Gilbert Beebower, portfolio construction alone accounted for 93.6% of the total return investors achieved over time (Source: Financial Analysts Journal Vol.42 No.4). Diversification and portfolio construction are where most of your efforts need to be concentrated if you are looking to get the best return on your money. Not in stock picking or trying to time when to invest, as these add very little to the overall return.

2. We will outsource portfolio construction to portfolio managers, portfolio funds or use portfolio construction technology where we cannot ensure our clients hold optimised portfolios at a level of risk they are comfortable with

Portfolio construction is a specialist skill, requiring post-graduate qualifications, access to the right technology and the correct permissions from the Financial Conduct Authority, the UK financial services regulator. The UK regulator mandates specific licenses to carry out "investment management" activities, and many financial advisers have neither the qualifications nor permissions to build portfolios for their clients. Some firms and their advisers attempt to construct portfolios for their clients without the skill or expertise. Their clients are at risk of being provided with sub-optimal investment strategies, which can mean unnecessarily missing out on returns and exposure to higher risks.

As independent financial advisers, we believe that our role here is to ensure that we select investments where we can be sure that portfolio construction theory is applied correctly to give our clients the best chance of return. As we are not investment managers, nor do we pretend to be, we outsource this to experts who work on behalf of our clients. Our time is best spent helping our clients establish their investment objectives and implementing the strategy that will provide the best potential for return on their money.

3. We will use the best risk profiling technology we can obtain to help our clients understand their risk profile

Most of us have never had to justify our thoughts and feelings about taking risks to another person. What makes us believe that we would articulate this easily at the first attempt? As selecting investments at a risk level you are comfortable with is a crucial part of your investment journey, we believe that a discussion with an adviser about risk should be more than a discussion about your initial understanding and experience.

Risk profiling technology can capture your investment preferences and help you understand something about your behavioural tendencies when it comes to investment risk. We work with Dynamic Planner, who, based on our research, provide the most suitable tool for us to use to discuss your investment strategy.

4. We will seek to reduce overall costs for clients by obtaining platform savings where we can

The costs you pay significantly influence the investment returns you achieve. If you were to save £6,000 a year over 30 years at a 7% return, the difference between paying 2.1% and 0.8% a year is £120,278.* Investment platforms serve the purpose of providing an administration service for investors and their advisers. Where multiple tax wrappers are needed, or an investor has more complex needs, a platform can be helpful. However, we feel that it is best for our clients to find the option that meets their needs at the lowest cost to preserve investment returns. A platform isn't always needed, so we only use one where we need to and carefully consider the costs. As independent advisers, we are not restricted in our choice in this respect, making this one reason why you should choose an independent adviser over a restricted adviser.

5. Our fees will be fixed; we will not charge a percentage of our client's funds for any work we do

As most financial advisers are not qualified to manage investments, nor are they responsible for their performance, they shouldn't be rewarded for it. If £250,000 was invested for 20 years at a 7% growth rate, and an adviser charged 1% for their services, the investor would have paid a total of £165,625. If the same service were provided at a fixed fee of £2,400, increasing 2% a year with inflation, the total cost would be £58,313.88. There is no difference in work required, only a difference in charging structures. In the fixed fee example, you would be £107,331 better off.*

With percentage-based charges, the adviser's fee increases with the investment balance; however, there is no evidence to suggest that the adviser has any more work to do. All that happens is you pay more for the same service, and there is no logical reason for this.

calculations were made using Candid Money's Fund Charges Impact Calculator, assuming a 7% growth rate and no initial charge.* **http://www.candidmoney.com/calculators/investment-charges-impact-calculator

6. We will only select portfolio managers and portfolio funds who avoid using active managers. Where we construct portfolios using technology, we will only use low-cost funds which provide the market return

Research by Standard & Poors Indices versus Active (SPIVA) showed that in December 2015, there were 1121 actively managed funds investing domestically in the US whose returns were higher than the market. A year later, only 317 of those remained. After two years, that number fell to 109, and by four years, only 43 of 1121 at the start remained. A mere 3.8% of the total could replicate their outperformance over four years. What level of success would an investor or adviser have if they selected funds based on their performance the previous year?

Nobel prize winner, William Sharpe, stated in a 1991 paper, "properly measured, the average actively managed dollar must underperform the average passively managed dollar, net of costs. Empirical analyses that appear to refute this principle are guilty of improper measurement". There is no credible method of finding the very few fund managers who can outperform the market year on year. Very few replicate their outperformance, making it incredibly difficult, if not impossible, to select good fund managers. If they are chosen, the cost of monitoring, the losses incurred through poor performing periods before deciding to change managers and the cost of change carry more risk to investors than buying a passive fund and obtaining the market return.

The most logical choice is for investors, given the evidence, is to avoid active fund managers altogether. We only recommend low-cost portfolios which provide the market return.

7. We will add value to our clients through financial planning alongside financial advice, helping them make plans and decisions, invest wisely and avoid costly mistakes

Financial planning is different from financial advice, and terms like financial planner, wealth manager and financial adviser are all used interchangeably, making it difficult for investors to understand the difference. Financial consultancy Ernst & Young, in their 2021 global wealth research report, found that 51% of those surveyed wanted their adviser to tell them whether they had adequate income and financial security. 49% wanted to know to what degree their wealth is protected from risks, investment loss, inflation etc. Financial planning is the process that provides the answers.

As financial planners, we believe that getting the best return on your money must be considered within the context of what it is you are trying to achieve. Whether it is financial independence, saving for a comfortable retirement, fulfilling work/life balance or using your wealth to help younger generations of your family, a financial planner can help you structure your wealth to meet your objectives.

The best return an investor can achieve is the one that helps them reach their financial plans while remaining protected from risks. Our fees for this service are fixed, not based on percentages, to give you the best possible chance of a return and financial security for you and your family.

Summary

If you would like to understand more about our thinking and how we reached these seven principles, you can read more in our brochure titled, "The £64,000 question: How can you get the best return on your money?".

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Get in touch

Find out how we can help you.

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info@grey-parrot.co.uk
www.grey-parrot.co.uk

Grey Parrot Financial Planning
71 Bradbourne Park Rd,
Sevenoaks, TN13 3LH