TRAILS

January 2021

Rationale for recommendations

& Frequently Asked Questions

tandem.

tandem financial / planning your adventure

TRAILS™ 2021 Portfolio Review

Foreword:

2020 was quite a year! It is hard not to mention the obvious, but read on, there is good news below!

The pandemic started in December 2019, and in late January the director general of the WHO (world health organisation) declared it a PHEIC (public health emergency international concern). We saw global stock markets tank between early February and early April 2020, almost solely due to the fear and economic uncertainty associated with Coronavirus.

We had the first lock down in late March, the second was in November and now we are in our third National lockdown which started 4th Jan 2021. Besides the health impact of COVID-19, we have had largely grounded airplanes and suffering airline companies, US-Iranian tensions, US-China tensions, the lowest BOE base rate in history at 0.1% in early March 2020, negative oil prices in April for the first time ever, job losses, the furlough scheme, massive UK, EU and US stimulus packages unveiled, various vaccines created in unprecedented timescales, Black Lives Matter protests, an impeached president (twice), a raid on the Capitol, a new Democratic president, BREXIT and now home schooling…phew!

Better not to look back though and instead look to the future! Being positive is a state of mind. The world is always in a mess, there is always something stealing the headlines and it is largely bad news. You have to *look* for the good news. Here is some: -

Looking back, you might have expected stock markets to be down on the year. They have been volatile but the importance of keeping one's resolve and believing that remaining investing is best has proven correct. Our TRAILS™ portfolios have ALL achieved positive returns since 1st Jan 2020 to date (1 year and 3 weeks), *despite* the issues mentioned above!

Defensive, our lowest risk profile portfolio has achieved a NET return of **3.87%** over the last 12 months (and 3 weeks) and Speculative, the highest risk profile portfolio has achieved a NET return of **7.96%.** Even though the latter has been more volatile and fell more in late March 2020, it has bounced back massively. All other portfolios were somewhere in between.

We constantly review our TRAILS™ funds and all of our model portfolios, to make sure we have what we consider to be the 'best' funds and the most efficient portfolios. This means sourcing and selecting funds that give us exposure to the asset class we require, the right sector, geographical region, style and investment type, all at the lowest cost, with the greatest efficiency.

There is no pattern regarding market returns. They go up, they do down, but over time, they go up. Staying invested is the key, adding regular premiums and lump sums and keeping the right mindset are crucial.

We do *not* advocate the idea of timing markets, knee jerk reactions, predicting what might happen etc. And we certainly do not consider crypto currency as investing!

At Tandem, we believe in diversification, asset allocation and using low-cost, risk-based investment portfolios. This strategy works. One's mindset should focus on the medium to long term which means a minimum of 7-10 years plus.

Our TRAILS™ model portfolios use index and passive funds where the weighted OCF (ongoing charges figure) is just 0.22% per annum. There are 10 funds comprising 4 bond funds and 6 equity funds. We advocate the mix of growth assets (holding the market) together with tilts to small cap and value assets.

In January 2020, we made several recommended fund switches. This year, having reviewed all funds thoroughly we are only recommending one fund switch, and that this should be done at the same time as re-balancing which we advocate doing annually.

Therefore, we propose the following changes to TRAILS:

Fund switches: Global Bonds:

Proposed Action:

- Sell Dimensional Global Short Dated Bond Acc
- Buy Dimensional Global Core Fixed Income Acc

Reasons:

- Both funds are global bond funds, investing in both Government (Sovereign) and Corporate Bonds.
- The Global Short Dated Bond Fund invests only in high quality bonds (rated as A up to AAA only) with a maturity of up to 5 years but the average maturity is less than 1 years. This means that the risks associated with default will be low, and volatility will be low, but return is compromised and will consequently also be very modest.
- The Global Core Fixed Income fund invests in longer dated bonds with some between 10-20 years. The average maturity is 8.35 years.
- Given how low interest rates are globally, the expected return of the Dimensional Short Dated Bond fund is low. Inflation may rise in the next few years and we are concerned that this fund will not give sufficient returns.
- The Global Core Fixed Income has achieved annualised returns in excess of 7.5% over the last 2 years (since its inception) compared to c. 1.5% per annum returns in the Dimensional Short Dated Bond fund over the same period. The long-term annualised return of the latter is 2.91% (since 14/01/2004). Click **HERE*** to view a comparison graph and chart comparing returns.
  *** https://bit.ly/39m4IDa**
- The Global Core Fixed Income fund can invest in Bonds rated from BBB up to AAA, which gives it more choice and a higher potential for return. It can also invest more in more diverse set of bonds.
- Whilst this increases the risk, if they are held in a balanced portfolio which includes equities, this risk is substantially lower.
- The Global Core Fixed Income fund comprises 454 holdings compared to 300 in the Dimensional Global Short Dated Bond fund.
- The OCF (ongoing charges figure) is the same between the two funds, at 0.28% p.a. so the overall weighted average OCF of all TRAILS™ portfolios remains the same, at just 0.22% p.a.

N.B. Investing in Global bonds carries the following risks:

- Term risk (length of time to maturity)
- Credit risk (the risk that the issuer defaults)
- Duration risk (sensitivity to interest rate changes-the longer the duration the greater the change in bond prices)
- Currency risk (cash flows losing value when exchanged for a different currency)

- Risk and reward are related. If you take more risk, you should expect to be rewarded for it. We believe the Dimensional Global Core Fixed Income fund will serve all clients better as it has a greater scope for return, whilst not taking excessive risks.

Frequently Asked Questions:

Q: Is there is a cost/fee to action (agree to) these changes?

A: The answer is hardly any! Tandem do not charge to make fund changes or re-balance. There are no fees or costs to sell a fund. There are negligible costs to buy (max 0.05%) via platform costs, stamp duty and dilution levies. If your portfolio (or combined portfolios) is greater than £400,000 there is no initial fee of 0.05% via Transact as it is waived. See the Re-balancing guide also for more details.

Q: Can I change risk profiles?

A: Yes, just let us know which you prefer. Please speak to us, should you wish to discuss this. You can increase or reduce risk profile and the best time to do this is at the point that we are suggesting some fund changes and a re-balance of your portfolio. One should not generally chop and change their risk profile as a result of topical news events. More logically it could be due to age, health, attitude and feeling towards volatility, or whether you 'need' to take more risk, or whether you do 'not' really need to take risk. Click **HERE*** to view All 7 x TRAILS™ portfolios in more details in our National Parks document. ***https://bit.ly/3iSntkB**

Q: Do I have to agree to the suggested fund changes?

A: No, but this means you won't be in the latest 2021 TRAILS™ models and consequently you won't then benefit from our latest thinking and research, as we develop our 7 x risk profiles to give what we believe will be the best potential for return given each of their respective asset allocations.

Q: Why do you only use OEICs and Unit trusts?

A: OEICs (open-ended investment companies) and Unit Trusts are both types of open-ended collectives, 'pooled investments' or 'funds.' 'Open-ended' means they can create new units as the fund grows.

The OEICs and Unit Trusts within TRAILS™ can be divided into a 10,000th of a unit (unlike ETFs (Exchange Traded Funds) or direct shares, for which you have to buy at least one unit or share. This is far better for regular premium investing as you can pay just £20 per month and still have the contribution spread between all 10 funds as per the asset allocation of the TRAILS™ portfolio you select.

Unlike OEICs and Unit Trusts, Investment Trusts are closed-ended funds. This means they cannot create new units. Investment trusts can also trade at a premium or discount which means they can utilise gearing, which can incur risk and volatility. ETFs can have dealing fees/ brokerages fees and 'spreads,' which is the difference between the offer and the bid price.

All of the above collectives have their pros and cons, but we prefer to use OEICs and Unit Trusts within all 7 x TRAILS™ portfolios. All of our TRAILS™ funds have a 0% initial charge to the fund house, nor do they have an exit fee. They are incredibly transparent, low-cost index and passive funds with extremely strong companies like Vanguard, iShares (Blackrock) and Dimensional. All of our selected funds can be used inside all the tax wrappers (ISAs, GIA, Pension, Onshore and Offshore bond) and they are suitable for lump sum investing and regular premiums.

Q: Why do you only use ACC (Accumulation) funds?

A: With accumulation units the income generated by the assets within the fund (e.g. dividends distributed by company shares and interest generated from bonds) is reinvested automatically back into the fund. The effect of this is either an increase to the price of the fund represented by the 'unit price' or by buying more units within the fund. It is almost always the former these days. Holding accumulation units gives the investor discipline because it eradicates the need to manually buy more units in the fund, which can prove to be hugely uplifting in the long-term, since reinvesting dividends and income from bonds, is a major factor in generating long term returns.

Q: Why do you use Institutional funds?

A: Investopedia defines an institutional fund as, "A fund that targets high value investors with low management fees, but very high minimum investing requirements." Using the Transact and Nucleus wrap platforms, we have access to over 7000 funds comprising both retail and institutional funds. Both platforms can only be accessed directly through an intermediary (e.g. Tandem). Collectively, Tandem now manage more than £100 million of client monies and consequently, through economies of scale, we are able to negotiate the use of institutional funds which benefit all of our clients largely because they have lower costs.

Q: Why do you use Vanguard?

A: Vanguard makes up the majority of the 'index' funds within TRAILS™ giving you exposure to market equity returns in a very cost-effective way. For example, the Vanguard FTSE Developed World ex-UK Equity Index Fund gives you exposure to global equities at a cost of just 0.14% per annum.

We also use Vanguard to give exposure to both Government bonds and Corporate Bonds as well as to small companies. Vanguard has massive financial strength and is extremely reputable. They are the second largest investment house in the world after Blackrock with over $6 trillion of funds under direction. They are a mutual firm (not a PLC), so their profits go back into the funds to reduce charges further. They are extremely transparent and low cost.

Q: Why do you use Dimensional?

A: At Tandem, we fundamentally agree with and endorse the core principles of Dimensional, regarding market efficiency, using factors like Market, Value, Small-Cap and Profitability and using scientific analysis to formulate an investment portfolio, rather than trying to time the market or predict what will happen.

We use Dimensional's passive funds to give exposure Global Bonds, UK Core Equity, International Value and Emerging Markets. Dimensional do not forecast; they are not restrained by an index. Their investment strategy is about logic and decades of academic research. One of their founders (Eugene Fama) even won the noble prize in economics!

Dimensional represent a new model of investing: a model based not on speculation but on the science of capital markets. Decades of research guide the way. The mission of Dimensional Fund Advisors is to deliver the performance of capital markets and increase returns through state-of-the-art portfolio design and trading.

Q: Why do we use iShares (Blackrock)?

A: iShares is the biggest fund house in the world with over $7 trillion assets. They have a large array of funds, including the Global Property Securities Equity Tracker Fund, which tracks the 'FTSE EPRA/NAREIT Developed Index' giving you exposure to property at an efficient and low cost. iShares fit the principles of TRAILS™ by offering clarity and transparency. This fund does not invest in direct property i.e. actual buildings, it instead invests in equity securities. This means it does not suffer the same liquidity issues that the more traditional property fund can.

Q: What is 'Value Investing'?

A: Value stocks tend to trade at a lower price relative to their fundamentals (i.e. dividends, earnings, sales, etc.) and thus are considered to be undervalued by a value investor. Common characteristics of such stocks include a high dividend yield, low price-to-book ratio and/or low price-to-earnings ratio. 'Price to Book' is a key indicator for Dimensional when selecting stocks for one of their passive funds. The ratio is made up of the price of a share multiplied by all shares in circulation for that company, divided by the book value (essentially the balance sheet: all assets minus all liabilities).

Q: What does 'Small-Cap Equity' mean?

A: Refers to stocks with a relatively small market capitalisation. The definition of small-cap can vary among brokerages, but generally it is a company with a market capitalisation of between $300 million and $2 billion. In the UK as an example, if you were to list all stocks that trade on the FTSE All Share, small-cap would be the bottom 15% in terms of size. One of the biggest advantages of investing in small-cap stocks is the potential for outperformance (in all geographical regions), largely due to the ability of small companies to be more flexible in certain market conditions, albeit one must consider the potential risks and often higher volatility than large cap stocks.

Q: What does 'World Market Cap' (Capitalisation) mean?

A: Market capitalisation (or market cap) is the total value of the issued shares of a publicly traded company; it is equal to the share price times the number of shares outstanding. As outstanding stock is bought and sold in public markets, capitalisation could be used as a proxy for the public opinion of a company's net worth and is a determining factor in some forms of stock valuation. World Market Capitalisation is the value of all issued shares of all publicly traded companies in the world. The US comprises 54% of this number, the UK 5% and Japan 7%. Europe is c. 15% and Emerging market account for c. 12%. See the chart HERE* to show these percentages for each of the world's major countries as a map of the world. You may be surprised! This is exactly why it is important to have a large exposure to US Equity in all TRAILS™ portfolios, because it is where more than half of the world's market shares are traded. * **https://bit.ly/3a61OBz**

Should you have any further questions, please feel free to email info@tandemfinancial.co.uk or call us on 01438 879262.