TRAILS

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Rationale for recommendations

& Frequently Asked Questions

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TRAILS™ 2024 Portfolio Review

Foreword

2023 was quite a year. After a fairly miserable 2022, 2023 began with rising markets, followed by continued volatility as interest rates continued to rise to combat inflation. It wasn't until late in the year (early November) that we had a little rebound in markets. In the calendars year 2023, ALL of our TRAILS™ models performed positively ranging from 6.87% return (for the Broads) to 9.41% return (for Cairngorms).

Whilst investing, remember that volatility is your friend, investing means 10 years, don't look at it (often), remain diversified and ideally add if an accumulator, (pre achieving financial independence) contribute monies via monthly regular payments and lump sums. Investing is a mindset. It is a habit. Get into the habit and don't over analyse it and all will be well.

Bonds recovered in 2023, but the real story was (and is) the growing domination of US Tech. In the old days, there were the FAANGS (Facebook – now Meta, Amazon, Apple, Netflix and Google (now Alphabet). That picture is now out of date. Now it is the 'Super Seven' – in alphabetical order: Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla. This group's domination is the story of 2023.

The index MSCI All Country World Index (ACWI) covers approximately 85% of the global investable equity opportunity. It measures almost 3000 large and mid-sized companies in 23 developed markets and 24 emerging ones. The bigger a company becomes in value, the greater the weighting in the index. The 'Super Seven' are SO big that they account for 17.2% of the whole thing! The combined representatives of Japan, the UK, China, France and Canada contribute 17.3%! Microsoft recently eclipsed Apple as the world's biggest company with a market cap of just over $3 trillion. That is 3000 billion dollars.

The Super Seven companies were up 74% in 2023 compared with 12% for the rest of the world's companies. As tech firms they are largely responsible for both growth, scientific development, AI development (another story!) and innovation. It is almost impossible to try to invest in equity funds without having a sizeable allocation to these firms.

When investing in TRAILS™, each model has an allocation to all of these companies, naturally. But you also invest in over 12,400 stocks and if your portfolio has bonds, over 15,900 bonds. We also allocate monies as per market cap, (see below FAQ for definition) and so geographically, your monies are diversified globally in the proportion of where stocks and bonds are traded. We feel this is the best way to invest to give the greatest potential for a reasonable return, whilst limiting excessive volatility.

Conclusion:

We will always continue to monitor our funds and model portfolios. We will almost control what we can control. See our latest article on this HERE and the image HERE. Keep doing what you are doing. Take notice of Warren Buffet when he said:

"The stock market is designed to transfer money from the active to the patient."

Detailed Rationale for suggested fund changes:

Why we are SELLING the iShares Property fund:

1. Originally included to provide an allocation to property and for diversification purposes.
2. However, the volatility of the fund has been too great and above our permitted levels to retain it.
3. There is already an allocation to property via the rest of the portfolio; the iShares fund is not physical property, but property shares (equities) instead.
4. The change of name last year from the iShares Global Property Securities Equity Property fund to iShares Environment & Low Carbon Tilt Real Estate Index Fund (UK) D Acc. demonstrates to us that there has been 'green washing' of the fund. This may not be the case, but it is a factor of concern. (Greenwashing is the act of making false or misleading statements about the environmental benefits of a product or practice.)
5. The fund is quite concentrated with only 340 stocks in it.
6. After the Covid pandemic, lots of companies started downsizing their office spaces. This meant they were not renting big offices, which in turn affects the fund's performance (as the fund OWNS property companies, Prologis being the largest holding). This, in conjunction with current and recent economic circumstances (e.g. rising interest rates in 2022-23 to combat high inflation), causes concern for potential future fund growth.
7. Overall, we feel the fund is too volatile and heavily aligned to commercial property for inclusion in our TRAILS™ models.

Why we are SELLING the Vanguard UK Investment Grade Bond Fund:

1. We have too much exposure to UK bonds at present, which is called a home bias. This was originally intentional but as the economic circumstances in the UK have changed, we have decided to reduce our allocation to this asset class.
2. To widen the opportunity for corporate credit and increase the allocation to government bonds, specifically global bonds. This means reducing allocation to UK corporate bonds.
3. We wish to reduce the concentration of UK debt to better protect the portfolio against a possible UK recession in the forthcoming years.
4. We feel that the three remaining bond funds within TRAILS™ give a sensible allocation to UK government bonds (which appear to be good value at present deposit having fallen considerably in 2022 and 2023) as well as a diversified allocation to global bonds based on the levers of term and credit.

Frequently Asked Questions:

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. You can also view The TRAILS™ National Parks document HERE.

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. For these reasons we tend not to use Investment Trusts or ETFs in our low-cost passive and index model portfolios.

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 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, Fidelity 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 £130 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 $7 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 factor tilts which include 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 don't 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: 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. As at 31st Dec 2022, the US comprises 59% of this number, developed countries ex-US (inc. UK, Europe, Japan) account for 28%, Emerging markets account for c. 12% (plus 1% other). Click here to see a map of this here or type: https://bit.ly/3Hxqlkc 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.

Should you have any further questions, please feel free to get in touch using the details below.

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