accordia

the advantage

Spring 2013

On the road again

Research in the US and UK

Accordia's Investment Manager, Caliber Investment Limited, is headed by Mark Wooster.

Mark has been on the road again, to London and the US. It's all part of the very important work of ensuring portfolio construction is carried out at the highest level.

In London, the weather was warm and balmy so, although studying, Mark managed to see some familiar London sights. He attended a course at Butler's Wharf which is very close to Tower Bridge and the newer financial district. The topic was "Modern Asset Allocation and Portfolio Construction". There were about thirty in the class put on by London Financial Studies (www.londonfs.com). London Financial Studies is widely acclaimed as a leading provider of study courses for capital markets professionals from institutions and governments world-wide. The tutor, Andreas Steiner, combined theory with practical experience, Mark said. He is an Austrian whose background includes performance and risk-related roles in banks and investment management companies as well as being Head of Investment Risk Management at a private bank in Switzerland.

Mark's fellow class mates, all "blokes," were central bankers from Switzerland and Belgium and others from Italy, Austria and the UK. Mark was the only person from "Down Under".

Mark says he really enjoyed the course as it helped to re-enforce the "factor driver" approach which is now used in portfolio construction in place of the older, traditional models that haven't stood the test of time. Those older approaches weren't robust enough to protect clients through some of the most erratic and volatile market events of this century. A bit like the 100 year floods that occur every 7 years, "black swan" events are happening more and more.

private wealth management solutions

On the road again from front page

More robust frameworks are required to deal with the many and varied factors that drive investment risk/return.

Whilst in London, Mark took the opportunity to visit one of our current managers, the AHL program that's part of Man Investments in the "Specialty" area of portfolios. Mark found himself on the trading floor looking at a simply enormous (4m x 3m) computer monitor with live algorithms and trading. The AHL program is a 24/7 activity with teams rostered day and night. PhDs are two a penny, Mark says, and there are several hundred people involved in the London operation.

The East coast of the US was Mark's next stop. As well as putting in some long work-days around New York and Boston, Mark was able to visit some historic places and have a look at Harvard University. He was impressed by the wonderful architecture. Travel hassles were a problem, though, having to wait on the tarmac at one airport for a long time whilst Airforce One got out of the way and being caught up in major rail and road works.

San Francisco was the last port of call. It just happened that the Louis Vuitton Cup was in progress with Prada dashing about the harbour. It was a pity Mark couldn't catch more of the action as he's a keen sailor.

Some of the time in San Francisco was spent visiting Blackrock, another of Accordia's managers. Mark discussed opportunities with them and others for some different investments.

All the organisations Mark visited are strong players in the financial world. That's comforting because they're big enough for operational risk to be out of the picture. "Eye-balling" these people is not common amongst New Zealand investment managers. Caliber thinks there's no substitute for engaging in this way and, following the visits and receipt of all the other data, work is now progressing to implement some portfolio changes.

Ponzis versus safe money-handling

The saga about Ross Asset Management has been well reported. David Ross pleaded guilty and has been remanded in custody. That's cold comfort to the 700 investors. It's also a blow to all advisers whose reputations are tainted by association. We had a couple of calls from clients when this story about David Ross was first publicised. It's concerning when something like this happens and, until some of the details are clear, it's natural to want to have some re-assurance. We all need to have confidence in financial markets and the institutions that operate in them that we can be protected from fraud. Here are 10 reasons why investors should have confidence in Accordia.

1. Accordia is an issuer of securities (The Accordia Portfolios). Our Prospectus is registered with the Companies Office. The Companies Office holds a bond as security for investors.
2. All money is handled by Public Trust (PT). Investors deposit funds via PT and, when money is withdrawn, PT handles the funds.
3. Bank account details are administered in a secure environment with multiple layers of data checking and sign off.
4. PT also holds the assets on behalf of all investors. When Accordia wishes to trade within the portfolios (say, sell some shares and buy some bonds), it issues instructions to PT. They settle the transactions with the parties concerned.
5. An independent third party (MMc) carries out weekly valuations of the assets in the portfolios. All sales and purchases of assets are made at prices determined by MMc.
6. PwC audits the financial statements for the portfolios annually. These reports are available to all Clients and are also filed with the Companies Office.
7. Accordia reports to the Financial Markets Authority and is also a reporting entity to the Department of Internal Affairs and the Financial Intelligence Unit of the NZ Police regarding Anti Money Laundering and Countering the Financing of Terrorism.
8. Accordia has a Compliance Officer who oversees a range of compliance matters including the professional behaviour of its Advisers. Accordia obtains securities law advice from Chapman Tripp.
9. Accordia has an internal and external process for handling complaints. Its external dispute resolution scheme provider is the Insurance and Savings Ombudsman.
10. Accordia is governed by a Board of Directors who report in writing to PT every quarter and have an annual, personal meeting to ensure all matters are being conducted in accordance with its Deeds.

Not all investment management businesses have so many strong governance and management features. Unfortunately, David Ross's business may have had only one or two.

Fixed income investments; are they risky?

Many investors regard fixed income investments as either less risky or even riskless. They buy a bond with a fixed rate of return (coupon) and imagine that's that; bank the coupons and find another bond to buy when that one matures. Many investors hold a collection of bonds and imagine they're following a low risk strategy.

Bonds are neither riskless nor less risky than other sorts of investments, particularly in the sort of economic position we're in right now. We've had a very long period (apart from 1994 and the more recent credit problems of 2008) when returns for bonds have been very attractive. We've had a long period where interest rates have been trending down. That era is over, for now. Interest rate risk is back on the table.

Interest rate risk is different from credit risk – that's always there. Credit risk is where coupons and/or the principal might not be paid. Credit risk is managed by holding high quality bonds where's there a low possibility of default.

It's interest rate risk that's the major problem right now and many investors may be unaware of it. If an investor needs to sell a bond prior to its maturity date, it could well be worth a whole lot less than they paid for it. Similarly, if bonds are being valued in a portfolio, they will now probably be showing losses. Interest rates are poised to rise and bond values are falling. This may be happening to the extent where the fall in value is wiping out the coupon return, producing an overall negative return.

The risk inherent in fixed interest investments actually increased a while back and is only becoming evident now.

Investors have some options. One is to hold more cash for the time being. Cash and term deposit rates, whilst low, are still attractive and are not affected by the issues attached to tradable bonds. Locking money up in term deposits is not so appealing. There's much less flexibility and loss of liquidity. To access the higher rates, locking up for longer is needed. The longer-dated deposits offer the higher rates. On call rates are low but at least the money's available.

Allocating more to equities is another option. This could be an appropriate time to re-think the overall risk-return level that's right for the long term. It won't be everyone's cup of tea but will suit investors with a long time horizon and a requirement for better risk-adjusted returns.

"Grin and bear it" is always there too. The losses from bonds happening at the moment will be a bit uncomfortable for a while. The most important lesson – as usual – is to be diversified and not rely on one asset class to do all the work.

The Accordia Portfolios are well-structured investment solutions where risks like these (and others) are identified and managed professionally.

A knock at the door

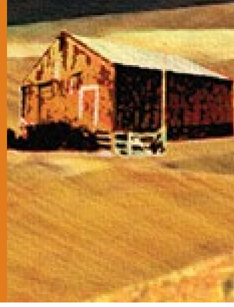
The Financial Markets Authority (FMA) came calling in June, knocking on the doors of Selwyn Paynter and Rodney Hartles. The FMA regulates financial services providers in New Zealand. It's the watch-dog organisation, ensuring regulations are being observed. All providers of financial services have to be registered on the Financial Service Providers Register (FSPR). (You will have noticed our FSPR numbers on material.)

Selwyn and Rodney were advised by an FMA representative they would be visiting and would require certain documents. The focus was on their "Adviser Business Statements". Minus hundreds of pages of appendices, the main part of our ABSs is about fifteen pages long and describes how we provide services to clients. Each Adviser has to keep their ABS up to date continuously, assure the FMA annually that it's been reviewed and provide it to them when they ask.

Selywn's and Rodney's ABSs are essentially the same. That's because Accordia has established a set of standards, based on the legislation, and Advisers comply. The FMA saw the same ABS for each with some details personalised, of course.

The FMA also looked at a selection of Investment Policy Statements, Investment Plans and Reviews. All Advisers are obliged, by law, to make client files available to the FMA. Selwyn and Rodney had a lot of discussion with them about Accordia's processes and, as it should be, they found the FMA's visit was a positive experience. Feedback from the FMA about Accordia was very complimentary. Where suggestions were made, they've been taken on board and everyone's documents have been modified.

There has been a lot of publicity about the role of the FMA. Some say they haven't done enough. After an initial "advice" phase, the next period for the FMA, they say, is about enforcement. We're pleased to see them getting tough. There are still too many people getting burnt. The FMA needs to keep up its focus on advisers and firms without defendable processes.



Please explain

Portfolio Insurance

This is a loose, general term. All forms of insurance involve paying an insurer to take some risk away from an insured. You pay your insurance company $x a year and they agree to pay you $x if an insured event occurs and you have a loss. (Do we hear "Yeah Right" from Christchurch people?)

Everyone's familiar with insurance like that but insuring against portfolio loss isn't a subject that's talked about every day.

The aim of portfolio insurance is to transfer investment risk from an investor to an insurer. An example would be putting in place a contract to pay out $x if, say, the share market fell x%.

Just like you would do for your home insurance, you don't insure small losses. They're affordable but you do put in protection against significant losses where you'd be hard pressed to recover.

There are many forms of portfolio insurance as well as contracts that cover losses from trading real things like tea, coffee, iron ore etc. Premiums are struck according to the likelihood of the event – a high probability being more expensive. If the cost is more than the likely benefit, you're better off not to insure. The biggest problem is trying to assess the variables and work out whether you might be worse or better off.

Portfolio insurance is not a technique that's available to most investors on their own unless there is significant wealth and/or expertise. Nor can portfolio insurance be used when investments are held on custodial platforms. However, this and other techniques to manage risks, are used in The Accordia Portfolios. All investors share the cost and all benefit from the outcome.

Anne Simpson's retirement

Anne has advised us she'd decided to retire. Anne has been with us for many years and has been a highly-valued member of the team.

We all wish Anne a long, busy and enjoyable retirement. Anne says the chickweed in her garden has until the end of October then its "watch out". We're sure the docks are worried too.

Christmas Break

Our office will close on Friday December 20th and re-open on Monday January 13th. We will be checking messages left by phone at the Hamilton and Christchurch offices as well as emails sent to service@accordia.co.nz

Our best wishes for a very enjoyable Christmas and New Year.

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