

November 2014

Investment Philosophy, Values and Core Beliefs



Introduction: Why is an Investment Philosophy of importance?

The investment philosophy underpins any investment strategy. It is the basic set of fundamental beliefs that govern the investment process and the values which encompass everything that the business stands for and aims to achieve. The investment philosophy explains the rationale for the beliefs which encapsulate what we do, which in turn translates into the finer detail of how this is done, as incorporated within an investment strategy, which continually references the aforementioned philosophy.

Our Investment Philosophy

Our Investment Philosophy encapsulates both our **Investment Values** and our **Core Beliefs**.

These principles and beliefs are the fundamental investment truths which we believe govern not only sensible investing, but also the principles and corporate values which embody our day-to-day conduct. These values are not only the social bond that governs our interaction with counterparties and within our firm, but also forms part of the commitment to our clients.

Our Core Beliefs

Empowerment of all stake-holders to enable them to make better and more appropriate choices is the central tenet of everything we do and strive towards in the variety of ways which we seek to see it manifest. This includes empowerment of:

Clients - helping to secure their life-long goals of obtaining financial freedom and security, along with the means to be able to enjoy their savings and successes, not merely in retirement but throughout their lives. Money has meaning. Clients' real needs and desires need to be articulated into appropriate and realistic benchmarks.

IFAs and Trustees – providing other parties with the tools, systems and information to empower them to appropriately interpret with greater ease and clarity the large amount of manager research, portfolio data and the incumbent risks. Advisors need to be in a position where they can have meaningful discussions with clients about realistic expectations, covering both the return and risk requirements.

Staff – building a business and brand which is not only a source of pride, but an energising and self-actualising environment where employees are motivated, challenged and nurtured, which will appeal to future generations of intellectual capital and expertise. Team members are encouraged to strive for authenticity, to challenge all assumptions, imputed or explicit, to be aware of inherent behavioural biases, and to be a part of the constant re-engineering and improvement which helps to make 2IP a hotbed of innovation and an environment in which individuals can realise their full potential, their personal aspirations as well as their professional ambitions and goals.

The investment community and our peers – debunking staid and outdated modes of thought. While we do not profess to be paragons of knowledge, we encourage and freely share our thoughts and ideas on how improvements, not motivated by self-interest, could help shape the future sustainability of our industry. We support a worldview where professional values always outweigh business values.

2. We are the custodians of Other People’s Money (OPM), for assets which never constitute our assets under management (AUM).

It has seemingly become common practice for asset managers to refer to their assets under management in the first person, as a virtuous indicator of success. At 2IP we are humbled by the reminder that the assets never become “our” assets and that we are merely entrusted with this fiduciary responsibility as the temporary custodians on behalf of the true owners and benefactors, namely clients. You may therefore hear us referring to assets housed with our multi-management and alternative investment solutions as OPM (Other People’s Money) as opposed to “our” AUM.

Aside from our human capital and IP, our one and only true asset remains the trust and goodwill of our clients which we have painstakingly earned and which is a function of an ability to display consistent skill and investment acumen, as vested within our people, systems and investment processes.

Being custodians of Other People’s Money, we undertake to act with integrity at all times. Mutually beneficial, sustainable and ethical conduct underscores our dealings with clients and counterparties.

This ethos incorporates a culture of respect – towards clients, colleagues, the business and the broader investment community. We strive for excellence in everything that we do and will continue to endeavour to raise the bar.

3. Transparency – upfront, honest and complete disclosure

In what might sound like an obvious and basic principle, we are continually astounded at how the investment and banking industry is permeated by a culture of complicated and opaque disclosures, to the point of obviating factual accuracy.

Our principle is substantially simpler – being entirely transparent and up-front regarding the value proposition that we put forward to our clients and then ensuring that our disclosed fees are our

sole source of income. We do not receive, nor do we pay, any form of third-party rebate for services artificially or otherwise rendered.

This does not preclude us from offering more than one product or service to our clients and, where it is genuinely warranted, charging a fee if it requires additional resources and where we can evidence the value add.

We will however never charge our clients a fee where the scope or extent is a mere fabrication or duplication of an existing offering or service or where it is not completely disclosed and agreed up-front. Ethical, fair and frank treatment of clients is a cornerstone and essential pillar of our business within the context of making it a sustainable business model (see below).

4. Accountability

We do not purport to be all things to all clients, but for areas where we do hold ourselves out to be professionals, we are similarly accountable to ensure that clients' long-term needs are met. Regular, reliable and accurate feedback-reporting on product performance and the scope of services rendered is a key element of the above. There are times when markets baffle minds that are a lot smarter than our own. While we naturally delight in reporting back on good performance, we similarly highlight when we are witnessing more challenging periods and give an honest and accurate account of events.

5. Cost and Sustainability

We take great pride in being dedicated and pro-active as regards continually negotiating with service providers and underlying fund managers in order to deliver the most keenly priced service offering we possibly can.

Our experience, insight, good standing and reputation have granted us the ability to know when we can press for cost advantages with 3rd-party product and service providers and where the fine

line lies between obtaining a superb deal on behalf of clients and doing those same clients a disservice in the longer term. Cheaper is not always better under all circumstances, particularly when it compromises a manager's (or service provider's) ability or willingness to excel and deliver on uncompromising performance and service delivery.

While being zealous about reducing cost, we also acknowledge that beyond a point it merely fosters a business model which is unsustainable or leads to potential compromise, which is not a trade-off which is in the best interest of clients or which we are prepared to accept.

Our Investment Values

Several basic investment truths often manifest as common-sense clichés, yet this does not necessarily detract from their legitimacy in cases where these common wisdoms are valid cornerstones of existing investment practice, as per our core investment beliefs. There are also some common pitfalls – often rationalised aptly within behavioural finance – which we guard against as key destroyers of long-term value.

1. Diversification is the only free lunch (however it is not a three-course meal)

More than merely an age-old adage which we see little evidence, theoretical or empirical, of being able to debunk, this basic yet important principle permeates our approach at a variety of company and investment levels.

Whereas the most obvious application of diversification manifests within the investment products and solutions, the proper application of this concept presupposes that everyone has the freedom to allocate without impediment or predisposition.

Within our investment products we don't merely diversify for the sake of diversification alone – the focus is on risk mitigation following identification of our exposure to different sources of risk.

Thorough investment due diligence enables us to construct portfolios without the need to over-diversify for the sake of mitigating operational risks.

2. Our organisational Independence means that we do not have an affiliation or predication which may contradict our own aspirations of intellectual honesty and integrity. This translates into solutions which are agnostic based on investment house, platform or manager.

We make a point of also not falling prey to our own long-held beliefs of what constitutes excellence, but encourage all staff members and practitioners to continually challenge and reinvigorate their ideas on concepts - organisational and investment-related.

3. Risk Reduction – Smoothing the volatility journey for investors

We firmly believe in the importance of avoiding material portfolio drawdowns. The latter is not merely a means to an end, but in this instance the means facilitates the end. Large drawdowns require disproportional percentage gains in order to remedy. As such the avoidance of large drawdowns prevents the erosion of positive compounding, but instead lets the power of positive compounding work in the clients' favour.

After setting the suitable investment objective and benchmark for a client's investment, our responsibility is to target only the desired return and then further seeking to reduce risk to the extent that this is possible.

As important as understanding the asymmetric nature of market risk and how this varies - an important consideration which is unique to each client – is defining risk (in particular the most important facets of risk e.g. permanent loss of capital and long-term underperformance of stated objective).

We strive to be innovative in our investment solutions, yet not to be overly clever merely for the sake of trying to be perceived as being or looking intellectually smart. At the end of the day, simplicity does indeed remain the ultimate sophistication.

4. Remaining invested is half the battle won

Numerous studies have shown that the average investor does not receive the average index return, which in turn is also not even captured by the average mutual fund or unit trust. Although these are two distinct and separate challenges which the investment approach has to address, the former is most often and correctly ascribed to the average investor's inability to time the market. Very little in terms of investor behaviour has been more destructive for wealth preservation and – creation than this point.

We believe that portfolios have to take cognisance of the fact that the volatility of the portfolio impacts deeply on an investor's behaviour – the volatility of the journey can prevent investors from

staying the distance, thus reducing the likelihood of them achieving their desired end result. To this end, managing the journey volatility is every bit as important as delivering the targeted long-term returns and why we focus as much on managing risk as we do on achieving the stated return with the lowest possible risk.

In an era where investment information is much more readily available and we are all bombarded with financial news on a daily basis, the temptation is often wrongly to focus on the day-to-day occurrences (encouraging short-term thinking) as opposed to the recognition that remaining invested over the more substantive long-term, within a consistent and risk-appropriate framework, is what facilitates the creation of wealth.

5. The performance beauty-parade is an entrapment within the Loser's Game

One of the more hotly debated internal beliefs has been the realisation that the appropriate benchmarking for one's performance is what you tell investors you aim to deliver. This in turn is unrelated to either the performance or promises made by other product providers, i.e. our peers.

In investment terms this belief translates into ensuring that our products are appropriately positioned and that our principles are grounded in beliefs and procedures which allow for the highest possible degree of consistency and repeatability.

The trickier part of this equation is having the foresight to realise that additional risk taken for the sake of looking good relative to peers, namely risk beyond the aforementioned stated benchmark, is a risk taken with money which is not ours and which we are not mandated to undertake.

Managing products relative to a moving, external peer-group is not only a near-impossibility, but introduces variables into the management process which one cannot authentically deliver upon with any degree of consistency, hence our naming of this form of alluring entrapment as trying to win the loser's game.

6. Consistency and Repeatability – an enduring endeavour

Consistency and repeatability are fundamental cornerstones of our investment philosophy and much of our process-based approach is geared towards ensuring the sustainability, success and longevity of everything that we do.

Our investment mind-set is deeply rooted in research in a variety of different forms. We encourage the pursuit of knowledge in order to broaden the boundaries of our own understanding. This invariably encapsulates the use of dedicated resources to conduct in-depth analyses of the investable universe, which allows us to construct the best solution or course of action for our clients. Stagnated models and modes of thinking as well as a lack of intellectual authenticity are the common enemy in this regard.

The following processes and conduct evidence our mind-set towards consistency and repeatability:

- Manager due diligence, portfolio construction, risk management - unearthing the less obvious risk overlaps, as well as cognisance of only taking risks for which we are going to be rewarded.
- Robust processes, sufficient resources (intellectual and physical) and the agreement, documentation and redundancy planning surrounding the aforementioned functions and procedures, are all elements which contribute to consistency, repeatability and longevity in terms of a sustainable business model and investment approach. This also implies the efficient use of resources that enable us to focus on our core areas of expertise, i.e. investment and risk management for our clients. Given that clear and efficient communication is important to us, our processes and resources must be geared towards increasing channels of communication to all stakeholders, including clear communication within the team.
- Importance of an investment framework and the ability and discipline to stick to it.
- Persistence of delivering on the stated objectives is more important than beating a peer-group over any given timeframe.

Performance will be the end result of a successful process executed with consistency. Fortune favours the prepared mind. Without a repeatable process, the latter cannot readily incorporate a sustainable business model.

7. Risk Management as an underpin to everything we do

Risk evaluation impacts every investment decision that is made, but it is not a one-dimensional concept.

Investment risk changes its nature over time: risk in the short term is represented by volatility (or uncertainty of return) whereas the long-term concern is the effects of inflation (real return impact) on purchasing power.

Intended timeframe is therefore an important insight in the portfolio design process. We understand that different investors will have different investment objectives and that these are accompanied by varying time horizons, which is why our solutions seek to cater for a combination of the ultimate level of individualisation and/or customisation, yet within a framework that is robust, institutional in rigour, yet remains cost effective. This is akin to bringing the concept of asset-liability matching which prevails within the pension fund space to the retail environment, within the context of the various frameworks IFA clients may espouse (e.g. life-stage planning, cash-flow matching, risk-categorisation, etc.).

Certain aspects of investment risk, rather than being avoided, should instead be understood, embraced and appropriately managed, within the context of the particular mandate.

Investors need to be empowered to understand which facets of risk it is they seek to prioritise in arriving at a solution that will address their real needs as opposed to their perceived wants. Every investor decision is based on a set of trade-offs.

Any investment decision taken without a proper understanding, modelling and management of risk, lessens its efficacy.