

Seven Investment Management Advertisement Feature

# Predictability

CV

## Tom Sheridan, Chief Executive

Tom, who has over 30 years' experience in the investment community, has a history of successful innovation. He spent two decades with Prudential Bache on three continents, latterly as COO of their International Division with a presence in 16 countries. He subsequently became the MD of Barclays Stockbrokers in the UK.

Together with Justin Urquhart Stewart and Graham Stott he founded Seven Investment Management (7IM) in 2001 and developed the first multi-currency US-style Wrap Account in the UK. 7IM now manages around £3.5 billion, working closely with financial planners and advisers to bring a unique combination of a discretionary service, a range of risk-rated multi-asset funds and a platform to their high net worth clients.



For Tom Sheridan, chief executive of Seven Investment Management (7IM), the key to cautious investing is taking on a common sense approach that minimises risk and keeps costs to a minimum.

It is also about giving investors a clear idea of the level of risk they are taking on and the amount of money they stand to gain – or lose – over different periods of time.

This philosophy lies at the heart of all of its funds, but especially the Moderately Cautious and Balanced funds, which are designed to appeal to investors looking for a cautious investment vehicle.

Mr Sheridan is, however, highly sceptical of the way in which the term “cautious” is bandied around in the industry, often used to describe funds that are anything but. Indeed, he supports the FSA's drive to encourage investment houses to explain their terminology, as well as welcoming the Investment Management Association's review of its guidelines for the Managed sectors, which currently permit an equity holding of up to 85 per cent in Balanced Managed and 60 per cent in Cautious Managed funds.

He says: “If we start with the word ‘balanced’, it conjures up in most people's minds the idea of a 50-50 split. Forget what the IMA says – 85 per cent in equities is crazy. In fact, the IMA maximum for cautious is higher than our understanding of balanced.”

Instead, the 7IM Balanced fund sits in the Cautious Managed sector, with the team aiming to maintain a reasonably even split between equities and fixed income, although the inclusion of other asset classes, including commodities, real estate and private equity, stops it being a clean 50-50 split. Indeed, the long-term strategic asset allocation model sees the fund with 41 per cent in

equities and 39 per cent in fixed income, with the balance in alternatives and cash. These allocations can be tilted to take into account the team's views of the various asset classes, but will stop short of going more than half way toward the volatility of the next fund up the risk scale, the 7IM Moderately Adventurous fund.

“We want investors to have a real sense of how much they could gain or lose by investing in a fund,” Mr Sheridan says.

“We then work hard to keep the fund within the limits we set out so we can deliver the performance the investors expect.”

So, with the Balanced fund, the analysis suggests a 90% degree of confidence that the average return investors could expect over three years – not including costs – is 7.19 per cent, with a range of a maximum gain of 18.81 per cent or loss of 3.3 per cent.

Meanwhile, over the same timeframe an investor in the Moderately Cautious fund could reasonably expect 5.81 per cent, with a likely maximum gain of 14.14 per cent and loss of 1.91 per cent. This is based on an asset allocation split of 19 per cent in equities, 59 per cent in fixed income and 12 per cent in alternatives.

“These return figures are more variable over the short term. Certainly, we would say to an investor that if they need the money in sooner than, say, three years, these are not the funds for them,” Mr Sheridan says.

“However, these models help us explain the likely results over various investment periods.”

With the strategic asset allocation model in place, the committee at 7IM, which is made up of a team of experienced people with expertise in different asset classes, then meet quarterly to work out the tactical tilt over this set

# while you sleep

neutral position. This is done on a three to 12 month view and has led to a current overweight in equities and underweight in fixed income for both the Moderately Cautious and Balanced portfolios.

In terms of performance, the strategy is paying off, with both the Moderately Cautious and Balanced funds offering strong returns at average levels of volatility. For example, the Moderately Cautious fund, which sits in the IMA Unclassified sector because of its low equity exposure, returned 24.86 per cent over five years to the end of 2010. This was achieved with a volatility of 6.52 per cent.

Meanwhile, the Balanced fund returned 24.89 per cent over that same period, compared with a sector average return for IMA Cautious Managed of 16.98 per cent. The volatility over that time was 9.34 per cent, in line with the 9.46 per cent recorded for the sector average.

"We are pleased with the figures, which have been strong despite a pretty messy time in history. There was certainly a black swan year in there," Mr Sheridan says.

"The most interesting thing is the funds are doing what they say on the tin.

"We are not saying we will be in the top decile. It is more likely we will be second quartile, but by maintaining that over time it leads to a good overall return. This is a 'get rich slow' scheme. We want high levels of predictability and to be able to sleep at night."

A further strand in the strategy of delivering good compound returns after cost is keeping those costs at a minimum. So, for the range of retail multi-manager funds the average TER is below the industry average of 2.27 per cent, based on the standard FSA calculations.

“Forget what the IMA says – 85 per cent in equities is crazy. In fact, the IMA maximum for cautious is higher than our understanding of balanced

Indeed, Moderately Cautious has a TER of 1.99 per cent, while Balanced has a total cost of 2.07 per cent. And these are set to fall further still as the increased number of investors coming into the funds helps drive down the expense of running them.

However, even lower costs are available through the AAP funds, which replicate the same asset allocation, but using passive vehicles. This results in a TER of 1.72 per cent and 1.68 per cent for the Moderately Cautious and Balanced funds, respectively.

Furthermore, there are plans to reduce these costs even further by undertaking security lending on the ETF portion of the portfolios. By fully investing the profits of this back into the funds, 7IM anticipates it will be able to reduce costs by a further 25bps a year.

"Another important point is to say that if advisers purchase the funds on the 7IM platform, there are no additional costs. They can use the institutional share class and wouldn't have to charge a fee to the clients.

"This means they can knock off another layer of cost and this brings the total cost down to 0.5 per cent," Mr Sheridan explains.

"This is as good value as anyone can expect to find in the market."

The message Mr Sheridan wants to put across to advisers, therefore, is that their clients can benefit from investing in strategies that are genuinely "cautious" and "balanced", can expect risk and returns within the parameters set out and can enjoy all of this at a lower than average cost.

"As we are heading for a lower growth world, cost is more important than ever," he concludes.

"However, with these funds you can achieve low costs without sacrificing what is sacred."