General Osteopathic Council



**Council**
**4 February 2015**
**Investment report**

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|---|---|
| **Classification** | Public |
| **Purpose** | For decision |
| **Issue** | Council approved an investment strategy in April 2011 which recommended an investment in the Newton Real Return Fund. The investment strategy was reviewed in 2014 with no changes made to the agreed approach.<br><br>This paper reviews the investment strategy and sets out a future approach for Council to consider. |
| **Recommendation** | To make no change to the investment portfolio and to review it again later in 2015-16 prior to the start of the next business planning cycle. |
| **Financial and resourcing implications** | These are set out in the paper. |
| **Equality and diversity implications** | None |
| **Communications implications** | None |
| **Annex** | Newton Real Return Fund factsheet |
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## Background

1. In April 2010 Newton Investment Management was appointed to help the GOsC develop an investment strategy for investing in the stock market. Their appointment was felt necessary given the fall in bank interest rates and the rise in inflation which resulted in a lack of real return on the current investments.

2. Council approved an investment in the Real Return Fund[1] in April 2011. The investment was based on the following key principles:

    a. Good financial stewardship aims to increase the asset value above inflation

    b. The investment profile of the GOsC was at the lower end of medium risk

    c. The portfolio needed to be diverse in order to spread risk of fund fluctuation

    d. The investment should be made via a fund route rather than a segregated portfolio

    e. No significant capital additions or withdrawals were anticipated

    f. The funds could be liquated quickly if required

    g. That Council should review the investment strategy regularly.

## Discussion

3. In order for the investment strategy to be reviewed, there are some questions which need to be addressed:

    a. Is the investment risk profile still appropriate?

    b. Has the investment performed in line with expectations?

    c. What are the alternative options?

4. Each of the key questions will now be taken in turn.

*Is the investment risk profile still appropriate?*

5. Council took the position that good financial stewardship meant it was necessary that the capital value be kept slightly above inflation and the investment should remain at the lower end of medium risk, and if possible at low risk, to seek a return above inflation. The Real Return Fund, which had low volatility and steady growth above inflation, was identified as the most appropriate vehicle to use.

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[1] Newton's private client business was purchased by Standard Life Wealth in 2013. The transfer of assets from Newton to Standard Life Wealth was completed in October 2013.

6. Council, when choosing the Real Return Fund, was mindful of the external economic environment. Since April 2010 the economic environment has improved although the future outlook remains uncertain. The pace of future UK economic growth is improving although it remains susceptible to global financial shocks.

7. Turning to interest rates and inflation. The Bank of England, under the new Governor, has issued forward guidance suggesting that interest rates are unlikely to increase beyond their 0.5% low until at least 2016-17, although this is disputed by some commentators who anticipate the Bank of England may need to raise interest rates earlier than planned.

8. In December 2014 inflation fell to a 15-year low, with the Office for National Statistics measuring consumer price inflation at 0.5%, its joint lowest level on record, slowing from a rate of 1% in the previous month caused by falling petrol prices and lower gas and electricity bills.

9. In light of the continuing economic uncertainties maintaining the value of the capital and delivering steady growth above inflation appears to remain the best fit for the GOsC at this time.

*Has the investment performed in line with expectations?*

10. Standard Life Wealth advise that the philosophy behind the Real Return Fund is that while it may have a target return of 1 month Libor[2] + 4% as its stated objective, preservation of capital is of greater importance. The return target remains important but only if the risks taken to achieve it are in proportion.

11. For the past few years the Real Return Fund has been cautiously positioned, predominately because of concerns about rising debt levels in the global economy. At present Standard Life Wealth do not consider the risks of investing heavily in equities to be justified as debt levels continue to rise. As the Real Return Fund is unconstrained (meaning that it seeks a targeted level of return while not being required to follow market indices) the manager of the fund can position the fund as he/she considers appropriate.

12. By way of comparison, the fund performance over the last five years is as follows - factsheet at Annex refers:

| **Fund** | **Annual fund performance (December - December) %** | | | | |
|---|---|---|---|---|---|
| | 2009-2010 | 2010-2011 | 2011-2012 | 2012-2013 | 2013-2014 |
| Real Return Fund | 9.29 | -0.75 | 2.98 | 4.88 | 2.67 |

[2] Libor – The London Interbank Offered Rate is the average interest rate estimated by leading banks in London that they would be charged if borrowing from other banks.

13. GOsC invested £500,000 into the Real Return Fund in 2011. As at 31 December 2014 the total value of the fund stood at £547k. It was agreed when launching the investment that income generated is reinvested back into the fund in furtherance of the aim of maintaining the overall value of the capital.

14. For the purpose of the financial statements any increase or decrease in the total value of the fund will not be recognised until those funds are deposited into the GOsC bank account. Once the funds have been deposited into the GOsC bank account any increase in funds would become subject to taxation.

*Has the investment performed in line with expectations?*

15. Standard Life Wealth advise that the philosophy behind the Real Return Fund is that while it may have a target return of 1 month Libor[3] + 4% as its stated objective, preservation of capital is of greater importance. The return target remains important but only if the risks taken to achieve it are in proportion.

*What are the alternative options?*

16. There are a number of alternative approaches that could be taken, including:

    a. Transfer the investment into a higher performing fund;

    b. Transfer the investment into a segregated portfolio;

    c. Liquidise the funds and invest them in a high interest bond.

17. Taking each option in turn:

*Transfer the investment into a higher performing fund*

18. While it might be attractive to consider the benefits of higher performing funds, with the potential for greater return comes the potential for greater volatility and therefore greater risk. Council, when agreeing its investment strategy, opted to keep its funds invested at the lower end of medium risk. Changing to a higher performing fund will first need Council to reconsider one of the principles on which the scheme is based. In light of the continued economic uncertainty, Council will need to be clear it fully understands the impact of changing to a fund which contains more risk.

19. In addition, transferring to an alternative fund would not be a cost-free process. If Council wished to explore higher performing/alternative funds it would need to consider whether the costs associated with the transfer warranted the move.

[3] Libor – The London Interbank Offered Rate is the average interest rate estimated by leading banks in London that they would be charged if borrowing from other banks.

*Transfer the investment into a segregated portfolio*

20. When agreeing the investment strategy in 2011, Council ruled out the use of a segregated portfolio on the basis of the cost and risk implications of running such a scheme.

21. Within a segregated portfolio, investments are primarily invested in individual securities providing the opportunity to control the scope of the investment to a much greater degree than a fund. However, with a fund approach, this means that in addition to equities a fund can benefit from derivatives which help to offset any downturns in equity values.

22. In addition, the current fund approach means that the 'asset' is protected within a wrapper which offers some tax protection. For example, the fund approach prevents paying VAT on fees and additionally, Capital Gains Tax is only payable on the sale of units, which is more favourable than a segregated portfolio where gains would be chargeable on each disposal.

*Liquidise the funds and invest them in a high interest bond*

23. Council will be aware that it has invested a further £500k in a 120-day bond with Secure Trust Bank earning 2% AER. The interest paid on the bond has reduced since the GOsC first invested.

24. GOsC is liable to Corporation Tax on the interest earned which is paid quarterly.

25. The bond was opened with a £500k investment in August 2011. As at 1 January 2015, the gross value of the bond has increased to £546k. The gross interest is £46k and as at 1 January 2015 the Corporation Tax payable is equal to £9.7k. As the value of the bond will not decrease the GOsC recognises receipt of the interest received in the financial statements. Over the last three financial years (to 31 March 2014), £7.9k has already been paid in Corporation Tax.

26. The net effect is that the value of the 120-day bond is £536k after tax.

27. Council will recognise that the net value of the 120-day bond (£536k) is lower than the gross value of the portfolio (£547k) however; tax will need to be paid on the stock market investment unless GOsC becomes a registered charity in which case no taxation will be due. This demonstrates that overall the return on the two investments has been very similar.

28. A further investment in the same bond is not an option as it is closed to new capital investments and therefore another suitable bond would need to be identified.

*Summary of options*

29. While the current investment has underperformed against expectations it has continued to meet our initial objective of maintaining the asset value. At present we continue to think that there is no identifiable gain from the options above

that would meet the objectives set out at paragraph 2, although the Executive should continue to monitor the situation in order to be alive to any opportunities which may arise.

*What are the next steps?*

30. When Council agreed the investment strategy in 2011, the funds were invested in the portfolio with the provision that a longer term view was sensible overlooking any immediate short term fund fluctuations. In 2011, Council considered a cycle of five years to be a sensible period of time. This approach will take Council through the next financial year ending March 2016.

31. In light of the continuing economic uncertainty and the satisfactory performance of the fund as demonstrated by its current value, it would be prudent to make no change to the strategy and allow a full five-year investment cycle to occur.

32. In a year's time, Council will be in a clearer position about a number of things including: its position around charitable status; changes to legislation; financial requirements for the next three year Corporate Plan 2016-19. This time next year Council will be able to decide if it should continue with the investment for another 3-5 year cycle, whether an alternative investment portfolio was appropriate or whether the investment should be liquidated.

**Recommendation:** to make no change to the investment portfolio and to review it again later in 2015-16 prior to the start of the next business planning cycle.