General Osteopathic Council
29 January 2014
Investment strategy review

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 2012 with no changes made to the agreed approach. This paper reviews the investment strategy and sets out a future approach for Council to consider.
Recommendation	to make no changes to the GOsC's investments pending a decision on charitable status.
Financial and resourcing implications	These are set out in the paper.
Equality and diversity implications	None.
Communications implications	None.
Annex	Real Return Fund factsheet
Author	Matthew Redford

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.

3. Just prior to the investment being made Council entered into a debate about whether the investment should be 'ethical' in nature. As background, the then Finance and General Purposes Committee did not ask the Executive to approach a solely ethical investment house nor to appoint an investment firm with a specialism in ethical investment. Newton Investment Management did not operate an ethical fund that is accessible to the GOsC as their ethical fund was available only to registered charities.

4. Ethical investment was discussed at length at Finance and General Purposes Committee meetings throughout 2012 with a recommendation that a broader understanding of corporate social responsibility issues was required before such an approach could be pursued.

5. From the discussions it was clearly apparent was that there were a number of strongly held, divergent views and reaching consensus would take significant time and resources from the Executive which would arguably be better spent on more pressing business plan priorities.

6. Equally clear was that an investment strategy which used a fund approach was not compatible with ethical investment, with the latter necessitating a higher-cost, segregated portfolio.

[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.

Discussion

7. 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. Can the GOsC achieve its objectives via a different route?

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

Is the investment risk profile still appropriate?

9. Council took the position that good financial stewardship meant it was essential 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.

10. 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.

11. Against the backdrop of austerity, the FTSE 100 index has continued to climb over recent months, and while not yet back at the levels seen post the financial crash in 2008, its performance belies reports from some financial commentators that a new housing bubble is being created in part due to the Government's 'Help to Buy' scheme, although this is disputed by the Treasury.

12. Turning to interest rates. 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 again this is disputed by some commentators who anticipate the Bank of England may need to raise interest rates earlier than planned.

13. 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?

14. 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

[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.

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.

15. 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.

16. It is for this reason that the fund performance will be perceived to be lagging behind equity markets over the last few years. When Council opted for the Real Return Fund it also considered two other funds. These were the Balanced Bridge Fund (middle of medium risk) and the Bridge Fund (higher end of medium risk).

17. By way of comparison the fund performance over the last four years is as follows:

Fund	**Fund performance (%)**			
	2010	**2011**	**2012**	**YTD 2013**[3]
Real Return Fund	9.7	-0.4	3.4	5.3
Balanced Bridge Fund	15.1	-4.5	8.5	9.8
Bridge Fund	14.5	-7.0	10.0	16.0

18. In the year to date the performance of the Real Return Fund has been 5.3% which is 0.8% above its target of LIBOR +4%. While the Real Return Fund performance is lower than the other two funds – 9.8% and 16.0% respectively – those funds are exposed to greater volatility and therefore greater risk. A factsheet provided by Standard Life Wealth on the Real Return Fund is attached at the Annex as additional information.

19. GOsC invested £500,000 into the Real Return Fund in 2011. As at 31 December 2013 the total value of the fund stood at £528k. 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.

---

[3] YTD figure accurate as at last day of trading in December 2013.

20. 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.

Can Council achieve its objective via a different route?

21. Council will be aware that in addition to the investment in the Real Return Fund, GOsC also holds a further £500k in a 120-day bond held with Secure Trust Bank, which pays a rate of interest of 2.35% AER.

22. GOsC is liable for corporation tax (21%) on its investment income generated through the bond. Gross interest is added to the bond on a quarterly basis.

23. The 120-day bond was opened in August 2011 with a £500k investment. There have been no capital additions or removals from the fund. As at 1 January 2014, the gross value of the bond has increased to £535k.

24. The gross interest received is £35k. Corporation tax is payable on this amount and as at 1 January 2014 is equal to £7.4k. As the value of the bond will not decrease the GOsC recognises receipt of the interest received in the financial statements. Over the last two financial years (to 31 March 2013), £5k has already been paid to HMRC in corporation tax.

25. The net effect is that the value of the 120-day bond is £528k after the deduction of corporation tax.

26. Council will note that the net value of the bond (£528k) is the same as the gross market value of the Real Return Fund (£528k). GOsC will still need to pay tax on its stock market investment when the fund is realised, unless we have successfully become a registered charity in which case no taxation will be due.

27. However, putting the issue of charitable status to one side as this will take time to progress, what is clear is that the 120-day bond is performing as well, if not better, than the Real Return Fund over a similar investment period. Additionally, the 120-day bond is arguably a safer investment as it is not subject to any adverse value fluctuations.

Conclusion

28. There is often a fine balance to be struck when making a decision to change investments. The investments we have still appear to be appropriate, however with a possible move to charitable status other options which are more tax efficient or aimed specifically at charities may open up and a further review would at that time would be appropriate. We therefore do not recommend making any changes in the interim.

Recommendation: to make no changes to the GOsC's investments pending a decision on charitable status.