McInroy & Wood Portfolios

McInroy & Wood Funds
Assessment of Value – as at 29th February 2020

INTRODUCTION

The McInroy & Wood funds were originally established to provide an alternative format for the firm's private clients to access its discretionary investment management services on an economic basis. The same investment approach and principles are employed in managing the MW funds as for discrete segregated private client portfolios.

Professionals, charities and individuals to whom our investment approach appeals, but who do not require a discretionary management service, can invest directly in the MW funds but still receive a very high quality level of service. The MW funds can be held in ISAs and junior ISAs, as well as in personal pension schemes.

An annual assessment of value is required by COLL 6.6.20 of the FCA's (our regulator) Handbook to consider whether the payments out of each fund's scheme property are justified in the context of delivering overall value to unitholders. The FCA require us to consider seven key areas, as noted below, when undertaking this Assessment of Value.

The Authorised Fund Manager (the "Manager"), McInroy & Wood Portfolios Limited ("MWPL") has carried out this assessment in consultation with its parent company and Investment Adviser to the funds, McInroy & Wood Limited ("MWL"). The Manager has allocated responsibility for ensuring compliance with these regulations to Simon Fraser, its independent non-executive Chairman.

CONSIDERATION & FINDINGS

The Manager has considered data and other information available throughout the year as well as information prepared specifically in connection with this assessment.

1) Quality of service

The Manager has assessed the quality of both the services it provides directly, and services where it has been responsible for appointing third parties, including transfer agency, custody and depositary services, fund pricing and accounting and audit.

Quality of service is one of the Manager's key differentiators with investor access to both a dedicated investment team and a dedicated administrative team.

a) Administrative communications and investor interaction

MWL actually employs the staff who are responsible for managing communications with individual retail investors, and it does not outsource this activity to others. Their activities include telephone calls and correspondence, in addition to oversight of the production of written investor communications and providing help in rectifying any issues. Our team also applies rigorous oversight to the work done by third parties, identifying any errors made by them, with the aim of rectifying them before they reach the investor. Investors are provided with an individual employee name they can speak or correspond with in the event of any issues. This approach results in a highly personalised service to all unitholders, resulting in a better overall investor experience.

Queries are normally dealt with the day they are received.

The investment the Manager has made in administrative staff, key suppliers and systems has resulted in a very low level of complaints. It has also resulted in highly resilient systems that have supported investors throughout the coronavirus crisis, without any systems outages.

An online investor service is scheduled for implementation by the end of this calendar year for those investors who prefer to invest online, but that will not be to the exclusion of those who wish to continue with a paper-based service. We want our service to be available to investors in the form in which they wish to take it.

b) Access to the fund managers and investment process

MWL's investment managers, who are responsible for the investment management of the funds, are available to talk directly with investors. They can answer any investment questions relating to the funds' objectives, their investment strategy and how they are being managed. This level of access is unusual for retail investors, and a service we believe adds to investors' understanding of the funds in which they invest. This approach is, we believe, partially responsible for the very low level of complaints received by the Manager.

The Manager has oversight of the Investment Adviser's investment process, which it considers to be robust and disciplined. The investment process has delivered the performance to investors necessary to meet each fund's objectives as detailed in section 2), while limiting risk to acceptable levels. The investment team is highly qualified and experienced, consisting largely of CFA® charterholders and qualified accountants with an average investment career spanning 22 years.

c) Benefits from being a subsidiary of a discretionary private client manager

MWL, in its capacity as an independent private client discretionary investment management firm, significantly assists the Manager in understanding the needs of fund investors and the services they require. The same level of attention to detail that is required by private clients is also applied for the benefit of investors in the funds.

d) Genuinely putting investors' best interests first

The Manager was amongst the first to proactively move investors from what was a more expensive 'Legacy' unit class to the less expensive 'Personal' unit class, years in advance of the regulator demanding firms do so. While taking such action was detrimental to the firm's revenue, it resulted in investors paying a lower level of fees. This example typified the firm's approach to putting investors' needs first. The firm is also completely transparent with its fees. While the regulations do not require it to do so, the Manager includes the underlying cost of the gold funds (which are structured as debt securities) in which it invests on behalf of investors within its ongoing charges figure (OCF). This may put it at a disadvantage when comparing its fees to many others, but it is right that investors should understand the true cost of their investment within the funds.

e) Fund provision based upon need rather than producing products to be marketed

The Manager has never designed funds to be marketed and provides a limited range of funds primarily based upon the needs of its associate's private clients. While these funds have broad appeal to a wide variety of investors, the firm must ensure that it is providing a high level of service and value across all of the funds managed by it. They are all important to the firm as it does not launch new products upon which to base marketing activity. The firm does not actively market its funds and relies on its reputation and word of mouth for new business. It is therefore incumbent upon the firm to ensure that existing investors are properly looked after, and that in itself leads to a high level of service.

f) The MWPL Board actively considers the service provided to unitholders on a quarterly basis.

Conclusion:

The quality of service provided by the firm is high.

Actions Proposed:

The Manager's intention is to make online unit dealing for individuals available by the end of 2020. It also continues to consider the activities and costs of any third parties (such as auditors, trustee and transfer agency services) with which it engages to ensure investors continue to receive value for money.

In addition, the Investment Adviser has undertaken its first investment webinar with investors in the funds to provide them with a further opportunity to engage with the Manager. It is anticipated that similar webinars will continue in the future.

2) Performance

The Investment Adviser's rigorous investment approach aims to identify and hold equity investments for the long-term. The average holding period of equities in the Balanced Fund and Income Fund is 9 years, while it is around 7 years in the Smaller Companies Fund, Emerging Markets Fund and HTT Fund. Equity investment is usually in financially strong, profitable companies that will stand the test of time. Other assets such as bonds, gold and cash may be held, where relevant to each fund, and are designed to protect investors when equity markets are weak. The Manager has considered, within performance, the risks that have been taken in achieving the performance.

Investment in the Manager's funds is aimed at those investors with a medium to long-term investment horizon i.e. those with a minimum time horizon of three years, but more typically 5 years or longer. The Manager considered the net (of fees and all other costs) total return (capital appreciation/depreciation plus any income received) of each fund in relation to its investment objective. The first table below shows the total returns for 3, 5, 10 years, and since each fund's inception, while the second table shows the annualised returns for each period.

The Investment Adviser focuses its Environmental, Social and Governance (ESG) efforts on areas where it can make a real difference, rather than treating it as a 'box-ticking' exercise. Investment in companies involved in the manufacture of arms and tobacco has always been avoided. The most recent example of the firm's success in the ESG area has been in relation to the use of plastic pellets in the supply chain where it was instrumental, through its membership of Investor Forum, in initiating a project with the BSI, in its role as the UK National Standards Body, to create the first specification that will help prevent plastic pellet pollution. The full press release can be seen here https://www.bsigroup.com/en-GB/about-bsi/media-centre/press-releases/2020/june/project-launch-first-specification-to-prevent-plastic-pellet-pollution/. The Investment Adviser is small compared to many of its competitors, but size does not act as an impediment in making a tangible impact in stewardship.

Performance of all funds managed by the Manager

Total Return, net of all fees, to 29/02/20	MW Balanced Fund %	MW Income Fund %	MW Smaller Companies Fund %	MW Emerging Markets Fund %	MW HTT Fund %	UK RPI %	Euro CPI %
3 years	10.6	6.2	24.5	4.2	9.4	8.8	3.9
5 years	33.6	20.2	61.0	22.0	19.6	13.8	5.8
10 years	113.1	86.2	207.3	77.1	118.0	33.2	13.8
Since inception	880.6	500.3	652.4	163.5	262.1	-	-
Inception date	23/2/90	24/3/94	26/3/01	1/3/07	1/9/03		
RPI Inflation since inception	144.4	105.5	69.8	43.8	-		
CPI Inflation since inception	-	-	-	-	28.7		

Annualised Total Return, net of all fees, to 29/02/20	MW Balanced Fund %	MW Income Fund %	MW Smaller Companies Fund %	MW Emerging Markets Fund %	MW HTT Fund %	UK RPI %	Euro CPI %
3 years	3.4	2.0	7.6	1.4	3.0	2.8	1.3
5 years	6.0	3.8	10.0	4.0	3.6	2.6	1.1
10 years	7.9	6.4	11.9	5.9	8.1	2.9	1.3
Since inception	7.9	7.1	11.2	7.7	8.1	-	-
Inflation since inception	3.0	2.8	2.8	2.8	1.5	-	-

Source: McInroy & Wood & Bloomberg

Each fund's performance is considered below:

McInroy & Wood Balanced Fund

Investment Objective:

The investment objective of the MW Balanced Fund is to maximise the total return to unitholders, by preserving and growing the real value of investors' capital and income, placing an equal emphasis on the generation of income and on capital growth. Real value is defined as the value of capital and income after adjusting for the impact of inflation. The UK Retail Price Index is the measure of inflation used by the Manager. The investment should be held for a minimum period of 3 years. Total return is defined as capital appreciation, if any, plus income received, and does not imply that a positive return will be consistently achieved over this or any other time period.

Performance:

> *The MW Balanced Fund achieved an annualised real total return, over and above UK RPI, of 4.9% per year since inception, 5.0% per year over 10 years, 3.4% per year over 5 years and 0.6% per year over 3 years.*

Conclusion:

> *The fund has not only preserved but grown the real value of investors' capital and income by more than UK RPI over the short, medium and long term, while taking a limited amount of risk. It has therefore met its objective.*

McInroy & Wood Income Fund

Investment Objective:

The investment objective of the MW Income Fund is to preserve and to grow the real value of investors' capital and income, with an emphasis on the generation of income. Real value is defined as the value of capital and income after adjusting for the impact of inflation. The UK Retail Price Index is the measure of inflation used by the Manager. The investment should be held for a minimum period of 3 years.

Performance:

> *The MW Income Fund achieved an annualised real total return, over and above UK RPI, of 4.3% per year since inception, 3.5% per year over 10 years and 1.2% per year over 5 years. The fund did not exceed UK RPI over 3 years, achieving 0.8% less per year than inflation over this short time period.*

Conclusion:

> *The fund has grown the real value of investors' capital and income by more than UK RPI over the medium and long term, while taking a limited amount of risk. It has therefore met its performance objectives for these investment periods. However, it has not preserved the real value of investors' capital and income over 3 years, the shortest recommended holding period.*
>
> *UK companies have historically paid higher levels of dividends than those overseas, and the fund has therefore had a higher concentration of its equity content in UK companies. The UK equity market has performed poorly (-7%) over the three years to the end of February 2020, depressing the fund's return.*

Proposed Action:

> *Efforts are being made to reduce the fund's reliance on income derived from UK equity dividends but it should be noted, as already communicated to investors, that income generated from the fund's investments in the coming year is highly uncertain due to companies cancelling, postponing or cutting their dividends as a result of the coronavirus pandemic.*

McInroy & Wood Smaller Companies Fund

Investment Objective:

The investment objective of the MW Smaller Companies Fund is to grow the real value of investors' capital and income. Investments will primarily be in global smaller companies, which do not form part of the leading market indices. An equal emphasis will be placed on the generation of income and on capital growth. Real value is defined as the value of capital and income after adjusting for the impact of inflation. The UK Retail Price Index is the measure of inflation used by the Manager. The investment should be held for a minimum period of 3 years.

Performance:

> *The MW Smaller Companies Fund achieved an annualised real total return, over and above UK RPI, of 8.4% per year since inception, 9.0% per year over 10 years, 7.4% per year over 5 years and 4.8% per year over 3 years.*

Conclusion:

> *The fund has not only preserved but grown the real value of investors' capital and income by more than UK RPI over the short, medium and long term. It has therefore met its objective.*

McInroy & Wood Emerging Markets Fund

Investment Objective:

The investment objective of the MW Emerging Markets Fund is to grow the real value of investors' capital and income. Investments will primarily be in companies operating or incorporated in developing countries. An equal emphasis will be placed on the generation of income and on capital growth. Real value is defined as the value of capital and income after adjusting for the impact of inflation. The UK Retail Price Index is the measure of inflation used by the Manager. The investment should be held for a minimum period of 3 years.

Performance:

> *The MW Emerging Markets Fund achieved an annualised real total return, over and above UK RPI, of 4.9% per year since inception, 3.0% per year over 10 years and 1.4% per year over 5 years. The fund did not exceed UK RPI over 3 years, achieving 1.4% less per year than inflation.*

Conclusion:

> *The fund has grown the real value of investors' capital and income by more than UK RPI over the medium and long term and met its performance objectives for these investment periods. However, it has not preserved the real value of investors capital and income over 3 years, the shortest recommended holding period.*
>
> *Emerging Markets have performed poorly over the last three years, achieving 1.3% per year less than UK RPI. The fund's focus has been on investing in high quality stocks exposed to the growing wealth of consumers in the emerging markets. MWL, the Investment Adviser, believes that continuing with this strategy remains appropriate and they are not prepared to compromise on the quality of stocks in which it invests on behalf of unitholders, believing a continued focus on quality will serve long-term investors well. It remains likely that growth in the emerging markets will exceed UK RPI in the longer term.*

Proposed Action:

> *No change of strategy is anticipated as the Investment Adviser believes its approach remains appropriate for long-term investors.*

McInroy & Wood HTT Fund

Investment Objective:

The investment objective of the MW HTT Fund is to maximise the total return to unitholders, by preserving and growing the real value of investors' capital and income, placing an equal emphasis on the generation of income and on capital growth. Real value is defined as the value of capital and income after adjusting for the impact of inflation. The Eurozone Consumer Price Index (the Harmonised Index of Consumer Prices) is the measure of inflation used by the Manager. The investment should be held for a minimum period of 3 years. Total return is defined as capital appreciation, if any, plus income received, and does not imply that a positive return will be consistently achieved over this or any other time period.

The fund is priced in €.

Performance:

> *The MW HTT Fund achieved an annualised real total return, over and above Euro CPI, of 6.6% per year since inception, 6.8% per year over 10 years, 2.5% per year over 5 years and 1.7% per year over 3 years.*

Conclusion:

> *The fund has not only preserved but grown the real value of investors' capital and income by more than Euro CPI over the short, medium and long term. It has therefore met its objective.*

3) Authorised Fund Manager (AFM) Costs

The main component of the Ongoing Charges Figure (OCF) is the Annual Management Charge (AMC) charged by the Manager. The MW group does not delegate its investment responsibilities to any third party and takes responsibility for investing directly around the world. To do so requires an experienced and well-resourced team, that can ultimately control the underlying investment exposures while keeping down the total cost of investment. MWL's investment team operates on a collegiate basis. All investment managers and analysts are involved in the selection and monitoring of all securities across all of the Manager's funds. It is therefore inappropriate to consider the investment team's cost per individual fund as they are all required to manage each fund.

The Manager has considered its (and its associate MWL's) underlying costs that relate to this charge in aggregate and as they relate to each fund. They reflect both the resources required to deliver our direct, active investment approach and the personal service delivered. McInroy & Wood Limited absorbs all research costs, including the material cost of buying in external research. The costs also reflect the group's internal operational, administrative and regulatory costs and the cost of retaining our talented staff in both employee remuneration and share ownership/dividends.

The Manager's profit margin has remained broadly unchanged over the last three years and is considered reasonable. It has been successful in continuing to grow the value of assets managed through both organic growth and increased market value. However, costs have increased commensurately and primarily relate to further significant regulatory and legislative change.

The group's primary concern is to ensure that it remains a well capitalised business which can provide security to unitholders during both good times and difficult periods, such as the one currently being experienced. It has always managed its affairs in a conservative manner and consistently reinvested in the business over many years to ensure that it can continue to provide the highest quality services to unitholders. The other component of the OCF is the external operating costs of the funds. The Manager negotiates proactively on behalf of investors with auditors, trustees, depositaries etc. to ensure they are receiving value for money within each fund. Examples are transfer agency fees (last renegotiated in January 2018), brokerage costs (last renegotiated in August 2019) and custody fees (last renegotiated in June 2019). All charges payable from the property of the fund are reviewed periodically against comparable market rates and have been found to be reasonable. Changes to those external parties who provide additional services to the fund are to be anticipated if value for money is not being provided. The costs of making such changes are not borne by the investor.

The Investment Adviser also reviewed commission rates charged by brokers when it deals in securities within each fund. The Investment Adviser deals at institutional market rates in each security market in which the fund invests. It should be noted that neither the Investment Adviser nor the Manager receives any income as a result of dealing activity.

Conclusion:

The Manager's charges are reasonable in relation to its cost base.

Action Proposed:

The Manager should remain vigilant to costs borne by investors.

4) Economies of scale

The Manager is responsible for a limited number of unit trusts. Where possible, cost savings have been negotiated with third parties on a group-wide basis to gain the maximum economies of scale. These savings are passed on to unitholders on a pro-rata basis. Tiered fees, reflecting economies of scale, have been agreed within transfer agency, trustee, fund pricing and accounting services.

The annual investment management charge is a flat ad valorem (% of assets managed within each fund) rate for each fund, aligning the interests of unitholders and the Manager. Company policy ensures that unitholders cannot access the Manager's funds more cheaply than if they come directly to the Manager.

As set out above in relation to AFM costs, it is inappropriate to consider the investment team's cost per individual fund as they are all required to manage each fund.

The Manager took the decision in 2013 to create a new unit class ('Personal') with a lower annual management fee of 1%. This decision was only possible by virtue of the economies of scale gained by the firm over many years. All investors for whom MWL had discretion were then moved to this new unit class for the benefit of those unitholders. The Manager also made stringent efforts to contact all other unitholders to encourage them to move to the new cheaper unit class. The Manager ultimately decided to close its 'Legacy' unit class, which charged the higher AMC of 1.5%, in 2016 with the result that any remaining unitholders who hadn't responded to our communications were forced to convert to the lower fee unit class. While this wasn't required by regulation at the time, it was felt that the firm was in a position to do so as assets being managed had grown significantly over prior years, and it was fair and reasonable that some of this growth ultimately benefitted unitholders.

As set out above in relation to AFM costs, the Manager has been successful in continuing to grow the value of assets it manages through both organic growth and increased market value. However, costs have increased commensurately and primarily relate to further significant regulatory and legislative change. It is not therefore anticipated that any further economies of scale can be passed on to unitholders at this point in time, but the Manager will continue to consider any benefits economies of scale may bring over time and whether it would be appropriate to pass those on to unitholders.

Conclusion:

The Manager believes that unitholders are benefitting in the economies of scale afforded to the firm in relation to the firm's size. We do not believe there are material further economies of scale to pass on to investors at this point in time.

Action Proposed:

The Manager will ensure there is a full analysis undertaken once per year to consider whether it is appropriate to pass any further economies of scale on to investors.

5) Comparable market rates

The Manager has compared costs charged by the funds it manages with peer group funds, being those with similar investment objectives, an active management style, and where the fund's scale is comparable.

Investor Share Type: Retail	AMC Median	AMC Average	OCF Median	OCF Average	OCF excl AMC
IA Mixed Investment 40-85% Shares Sector	0.75	0.69	1.09	1.07	0.34
		AMC		**OCF**	**OCF excl AMC**
MW Balanced Fund		1.00		1.14	0.14
MW Income Fund		1.00		1.14	0.14
MW HTT Fund [Note 1]				0.99	

Investor Share Type: Retail	AMC Median	AMC Average	OCF Median	OCF Average	OCF excl AMC
IA Global Sector	0.75	0.75	0.97	1.01	0.22
		AMC		**OCF**	**OCF excl AMC**
MW Smaller Companies Fund		1.00		1.15	0.15

Investor Share Type: Retail	AMC Median	AMC Average	OCF Median	OCF Average	OCF excl AMC
IA Global Emerging Markets Sector	0.81	0.89	1.06	1.14	0.25
		AMC		**OCF**	**OCF excl AMC**
MW Emerging Markets Fund [Note 2]		1.00		1.26	0.26

Source: Morningstar & MWPL

It can be seen that the Manager's AMC is higher than the Median AMC of the funds' peer groups, reflecting the firm's transparent single fee structure, its operating model and the level of service provided.

The Manager has also compared the external operating costs of the funds (OCF excl AMC). Its strong focus on negotiations with external service providers has resulted in these costs being lower than the median of the funds' peer groups. It should also be noted that other Managers can include their administrative costs within the OCF, outwith the Annual Management Charge. In the interests of transparency, the Manager includes its own administrative costs within the Annual Management Fee.

Given the varying fee structures used by different firms in the industry, we consider the OCF (of which the AMC forms the largest part) to be the most reliable cost comparison, as this is calculated consistently across the industry as required by regulation. The overall costs of operating the fund, measured by the OCF, are higher than the average of their peer group in the case of four of the five funds by between 0.07% and 0.14%. We consider this small premium reasonable in the light of the high level of individual service provided.

The funds have never charged entry, exit or performance fees. Over a ten-year period, the funds' OCF percentage rates show a significant reduction, made possible by the growth in the funds' assets under management.

Notes

1. The MW HTT Fund is a dedicated, euro-denominated, fund created for a very limited number of investors and has a higher initial investment threshold and very low unit dealing volumes.

2. The custody and tax costs of investing in emerging markets are higher than those in developed markets, leading to higher third party charges in the Emerging Markets Fund.

Conclusion:

The Manager's OCFs for four of its funds are slightly higher than the OCFs of peer group funds, but this small premium is considered reasonable given the level of service provided and therefore no action is required. The MW HTT Fund's OCF is slightly below that of similar funds.

6) Comparable services

The Manager has compared its associate's, MWL's, investment charge for a private client discretionary investment portfolio with a similar investment objective to the fund, to the AMC levied by the fund. This information has been published for many years on McInroy & Wood's website. Discretionary clients of the firm have their assets managed on either a pooled basis, utilising the Manager's funds, or where those funds are not suitable, a segregated portfolio of individual stocks.

The Manager's funds were originally designed for use in portfolios within MWL's discretionary investment management service, and remain widely used in that context today. Where the Manager's funds are utilised within discretionary managed portfolios, those clients pay a discretionary investment management fee of 0.2% (plus VAT) for the additional services provided, such as suitability, quarterly reporting service and capital gains tax and ISA management in addition to the standard OCF charges within the funds. The investment cost to a discretionary client and an investor in the funds is therefore identical, being that of the OCF of the fund.

MWL also provides portfolios on a segregated basis, where the investment management fee is 1% (plus VAT) i.e. 1.2%. The investment management fee is therefore the same as that of the funds, but it is acknowledged that the constitutional safeguards of the funds (the trust structure, formal auditing requirement, daily pricing etc.) do result in additional costs, as noted in the OCF, that make the Manager's funds more expensive than that of a segregated portfolio by the amount of those external costs. That said, the Manager's funds can invest directly in some countries that are not available to segregated portfolios, particularly in emerging markets.

MWL does not provide services to large institutional clients and therefore does not offer the same or comparable mandates at institutional pricing levels. However, MWL does offer concessions on its investment fees to discretionary private clients, depending upon individual circumstances, where their portfolios are greater than c. £5m in value or, in the case of charities, where their investment portfolio value exceeds £2m. In some of these cases, the client's investment mandate is similar to that of the Balanced Fund or Income Fund. The Manager has considered those cases and has concluded that the difference in charges is reasonable and appropriate having regard to factors including account longevity and the difference in the nature of the overall services provided. As stated above, the Manager's policy for investors is that no investor can access the Manager's funds more cheaply than if they come directly to the Manager.

Conclusion:

Comparable investment services supplied by the group result in comparable costs.

7) Classes of Units

The fund has a single unit class, so no assessment is required on this criterion.

Wherever possible the Manager seeks simplicity in its fund structures. In 2013 a new class of units was introduced with an AMC 0.5% below the existing unit class. The Manager was then proactive in both encouraging non-advised unitholders to convert to the lower cost unit class and, in 2016, in terminating the more expensive legacy class.

Conclusion:

There is only one unit class.

OVERALL CONCLUSIONS

MW Balanced Fund

The Manager has concluded that payments out of scheme property set out in the prospectus are justified and appropriate in the context of the overall value provided to unitholders.

MW Income Fund

The Manager has concluded that payments out of scheme property set out in the prospectus are justified and appropriate in the context of the overall value provided to unitholders. Efforts are being made to diversify the fund's income away from its dependency on UK equities.

MW Smaller Companies Fund

The Manager has concluded that payments out of scheme property set out in the prospectus are justified and appropriate in the context of the overall value provided to unitholders.

MW Emerging Markets Fund

The Manager has concluded that payments out of scheme property set out in the prospectus are justified and appropriate in the context of the overall value provided to unitholders. While the fund failed to meet its objective for the shortest investable time horizon, MWL remains convinced that its current investment strategy continues to be in investors' best interests.

MW HTT Fund

The Manager has concluded that payments out of scheme property set out in the prospectus are justified and appropriate in the context of the overall value provided to unitholders.

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