iNDEPENDENT WEALTH Partners

Independent Wealth Partners Investment Philosophy

Independent Wealth Partners is a "style neutral" investment manager with its core investment philosophy being to invest in investments that match its thematic view at any time. Independent Wealth Partners believes that investing using an index methodology is the key ingredient to providing outperformance over active managers of assets.

We follow a **strategic asset allocation approach** with allocations to specific asset allocations being varied based on long term expected returns (10 + years).

Strategic Asset Allocation approach

Independent Wealth Partners draws on the strategic expertise of the Vanguard Investment Strategy Group which has the equivalent of 45 analysts and 10 portfolio managers to help with both the Asset Allocation and the underlying investment selection. We use a quantitative optimisation process which draws on inputs, such as forward-looking long-term asset class returns and historical risk and correlation data, in conjunction with the framework set in place (i.e. additional constraints) to arrive at a recommended portfolio. A qualitative overlay is then applied to address additional factors such as; the practical implications of investing in certain assets, product availability, client expectations, structural changes that may not be captured by quantitative modelling and recognition of the limitations and sensitivity of quantitative tools to input assumptions.

The long-term asset class return assumptions are based on the expected market benchmark return The process of determining these return assumptions consists of the following four elements:

- Valuation model utilising financial and economic factors such as the dividend yield, real earnings growth, real GDP and inflation expectations.
- Historical asset class performance including the long-term growth trend, the risk premium for the individual asset class, and relativity between sub-asset classes.
- A survey of expected asset class return forecasts from diversified and specialist managers.

These inputs are then reviewed by the Vanguard Investment Strategy Group Investment Committee to assess whether the return forecasts from the previous year warrant any changes. The long-term asset class volatility assumptions (measured by the standard deviation of returns) are based on the median value of rolling five-year standard deviation measures, in this way we aim to balance the need for a sufficiently long-term time frame, while avoiding the issues of picking discrete beginning and end dates for analysis.

Individual Asset Selection Views

Index Investing will beat Active Investing most of the time : We take an evidenced based approach to investment selection by using the SPIVA data to support our findings.

Over the last 5 years the index has beaten the active fund managers 80% of the time, whilst over the last 15 years, the index beats active managers 84% of the time. [1] Importantly, the active managers that outperform in any one year, do not necessarily do this year on year. In fact, of the 75% of fund managers that were in the top quartile in June 2014, only 1.3% of those same managers have remained top quartile to June 2018.)[2]

SPIVA Australia Scorecard Mid-Year 2019

REPORTS

Report 1a: Percentage of Funds Outperformed by the Index (Based on Absolute Return)

FUND CATEGORY	COMPARISON INDEX	1-YEAR (%)	3-YEAR (%)	5-YEAR (%)	10-YEAR (%)	15-YEAR (%)
Australian Equity General	S&P/ASX 200	93.23	83.33	80.63	82.56	84.05
Australian Equity Mid- and Small-Cap	S&P/ASX Mid-Small	60.47	79.83	75.24	46.73	51.52
International Equity General	S&P Developed Ex-Australia LargeMidCap	72.91	74.00	82.82	92.08	91.95
Australian Bonds	S&P/ASX Australian Fixed Interest 0+ Index	84.62	77.59	90.57	72.41	NA
Australian Equity A-REIT	S&P/ASX 200 A-REIT	71.83	68.06	80.28	81.82	81.82

Source: S&P Dow Jones Indices LLC, Morningstar. Data as of June 30, 2019. Past performance is no guarantee of future results. Table is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Exhibit 3: Performance Persistence of Australian Active Funds Over Five Consecutive 12-Month Periods (June 2013-June 2018)

FUND CATEGORY	NUMBER OF FUNDS IN TOP QUARTILE AT START	% OF FUNDS STAYING IN TOP QUARTILE			
	JUNE 2014	JUNE 2015	JUNE 2016	JUNE 2017	JUNE 2018
Australian Equity General	75	24.0	14.7	2.7	1.3
Australian Equity Mid- and Small-Cap	25	32.0	12.0	0.0	0.0
International Equity General	52	13.5	3.8	1.9	1.9
Australian Bonds	13	38.5	23.1	15.4	15.4
Australian Equity A-REIT	18	11.1	0.0	0.0	0.0
All Categories	**183**	21.9	10.4	2.7	2.2

Source: S&P Dow Jones Indices LLC, Morningstar. Data as of June 30, 2018. The fund returns used in the analysis are net of fees, excluding loads. Table is provided for illustrative purposes. Past performance is no guarantee of future results.

This data confirms that you only really have advantage in any one year if your style (Growth, Value, Trading) outperforms in that year. As such, being able to pick the state of the market consistently and invest to outperform the index is almost impossible. As we consistently say – no-one can predict the future. However, note from the data above that the SPIVA data shows that active managers do outperform in the small/mid cap Australian Equity markets. This is simply because that end of the market it is far easier to determine quality stocks (ie. Companies making consistent profits) from companies that either aren't profitable or don't perform consistently.

1 https://www.spindices.com/documents/spiva/spiva-australia-mid-year-2019.pdf p5

2 https://www.spindices.com/documents/research/research-persistence-of-australian-active-funds-september-2018.pdf

As such, by using an index approach, you will receive index level returns for the asset class you are invested in and you are more likely to outperform active funds managers over time as per the SPIVA research attached.

The evidence shows (as per the SPIVA report) that it is highly unlikely that you will receive a return which outperforms that index over the longer term by investing in active fund managers. This is due to the following set of factors

1. Active Fund management fees – most active fund managers are charging 1.0%+ per annum, whereas we can access index funds management as low as 0.04% per annum, meaning there is a 0.96% differential in the level of return.
2. Active fund managers are so large that they often move the stock against themselves when they are either buying or selling making it incredibly difficult to buy enough of the stock at their preferred price.

3. The ASX20 makes up approximately 72% of the ASX200. That is the majority of the companies in the top 20 provide around 72% of the return of the ASX200. There are numerous broking houses/family offices/research houses providing research on those top 20 companies so its fair to say that pretty well all the information is known about the top 20 stocks in Australia. As such, the market moves before anyone can take advantage of extra knowledge about a particular stock anyway. As such, its incredibly difficult for any fund manager to pick a better stock than the other and then to do this on a consistent basis.

4. The people risk and the behavioural complexities are removed – Humans are not infallible and often make mistakes (that's what makes us human). In fact there is a field of behavioural finance that seeks to address behavioural biases and I list some of the biases that professional investment managers suffer from below
   - Anchoring or Confirmation Bias – Investors whose thinking is subject to confirmation bias would be more likely to look for information that supports their view about an investment. Ie. They will look for the good stuff and not the bad stuff..
   - Loss Aversion bias – This explains a persons reluctance to sell a losing investment to avoid confronting the fact that they have made a poor decision. For example, the portfolio manager wont sell a stock because there is currently a loss against it, irrespective of whether the future prospects for the stock are less than bright or not.
   - Disposition bias – This refers to the tendency to label investments as winners or losers. Disposition effect bias can lead an investor to hang onto an investment that no longer has any upside or sell a winning investment too early to make for previous losses.
   - Hindsight bias – This leads an investor to believe after the fact that the onset of a past event was predictable and completely obvious, whereas, in fact, the even could not have been reasonably predicted. An example of this would be the GFC.
   - Self Attribution bias - Investors who suffer from self-attribution bias tend to attribute successful outcomes to their own actions and bad outcomes to external factors. They often exhibit this bias as a means of self-protection or

self-enhancement. Investors affected by self-attribution bias may become overconfident.

There are a number of other biases that all investors suffer from, however, importantly an index fund/etf does not suffer from these biases, simply because they take a rules-based approach to investing.

Additional considerations when making investment decisions.

Importantly, we review each of the asset classes quarterly, taking into account the current and future economic environment including where we believe asset classes are expensive or inexpensive. When managing asset classes we use the following as a basis for making decisions:

- **The aim of portfolio construction and managing assets classes** is to meet investors long term cash flow needs;

- **Effective long term return forecasts of asset class returns** can be developed using a methodology that combines existing valuation data with assumptions for long term growth and valuation levels. This methodology is particularly effective at times when markets move into very dangerous territory, when the methodology will signal the need for caution almost regardless of future assumptions

- **Return forecasts are long term and forward looking** - in stark contrast to most of the industry. We use long-term, forward-looking return forecasts for each asset class, using a robust approach that has stood the test of time. We break returns into three components of income, income growth and the effect of changing valuation ratios, and provides clear insights into long-term future returns which are infinitely more reliable than historical extrapolations.

- **Risk is the chance of not meeting the investor's needs** - risk, like beauty, is in the eye of the beholder. We believe it is best assessed from the investors' perspective. The most important risk to any investor is rarely associated with a Greek letter - rather the key risk is poor, long-term, real returns resulting in insufficient cash flow to meet their needs. Excessive volatility is a secondary, albeit important risk. Tracking error or institutional business risk shouldn't enter into the equation.

- **There is more than one way to skin a cat.** There are many effective ways to meet client cash flow objectives. The objective is to avoid poor choices of asset allocation while finding an approach that sits comfortably with both the client and the adviser.
- **Transaction costs matter**; turnover should be kept to low levels.