QUILTER CHEVIOT

FOR INVESTMENT PROFESSIONALS ONLY

Five key questions to ask your MPS provider

The FCA's Consumer Duty directive, which came into effect in July 2023, is causing advisers to appraise and realign their processes and propositions. In the following five questions, we outline what to look out for to ensure that your clients are getting the best outcomes from your chosen Managed Portfolio Service (MPS).

At Quilter Cheviot, our innovative 'Building Blocks' approach to portfolio construction provides key benefits for advisers and their clients. The structure gives our fund managers greater flexibility at a lower cost, so they have complete freedom to base investment decisions on the quality of investments, rather than the cost of the investments.

Now is the time to review your MPS providers to make sure they have the right answers to the following five questions:

1 How active is your management of my clients' portfolios?

Access to active management is a key attraction of an MPS. It offers several potential advantages in terms of flexibility, returns and risk management.

There are three features which characterise a 'typical' MPS:

1. It is composed of a blend of externally managed funds.
2. This blend typically comprises both active and passive holdings.
3. It is rebalanced on a periodic (prescriptive) basis.

Ask yourself whether these factors limit a manager's ability to implement swift, decisive portfolio change. We know from our previous experience that they do: externally managed active funds tend to cost more than direct equities, bonds or passive investments, and so cost targets force many managers to adopt a hybrid active/passive approach. Furthermore, the nature of third party funds also means that managers investing in them are buying a group of securities, rather then specifying exactly how much of each underlying security they would like to own. This can lead to them owning more of some securities and/or less of other securities than they would ideally want, settling for a broad, or partial, approximation rather than being able to choose precisely the desired exposure.

It is not unusual for 'traditional' MPS managers to have as much as 50% invested in passive investments in a bid to reduce client costs. Due to the growing weighting of a handful of tech stocks in many passive investments, this means a high concentration in a small number of companies that have not been specifically selected for their investing credentials, but rather for the low cost of exposure.

Furthermore, operational challenges with onboarding new holdings and implementing a service-wide adjustment can inhibit a manager's options. Should market conditions change, managers can be stuck with unwanted exposures for longer than necessary.

Approver: Quilter Cheviot Limited 13 March 2024

At Quilter Cheviot we believe our offering is the most active proposition in the MPS space and our unique approach tackles these challenges.

- **Our strategies are constructed solely using our 'Building Blocks'** — eight purpose-built funds specifically designed for use within Quilter Cheviot's MPS. This allows a far greater degree of active management without burdensome costs, as we can select individual securities and fine tune holdings to our desired exposure.
- **Quilter Cheviot is both the MPS model manager and underlying manager to these funds.** This means changes to the underlying holdings within each Building Block can be implemented at the fund level in a dynamic manner. Changes are immediately reflected across all holders, preventing the need for a portfolio rebalance and all the accompanying operational complexity created by a 'traditional' MPS. Quilter Cheviot does not charge a management fee for the running of the Building Block funds, removing any conflict of interest - the funds are solely to enhance the investment proposition.
- **The Building Blocks reflect our highest conviction investment views** and they go beyond open-ended funds. They can invest in direct equities, direct bond holdings, exchange-traded commodities (ETCs), and closed-ended or exchange-traded funds (ETFs), irrespective of the wrapper in which a client's portfolio is held.

Passive funds are only considered judiciously, for instance as a temporary home for flows or a targeted exposure to a specific index, instead of being relied on as a tool to lower costs. This avoids the pitfall of diluting active exposures and alpha-generating potential.

See Figure 1 below for an illustration of how these funds are used across our MPS strategies.

Our Hand-picked Watchlist **Managed Portfolio Service**

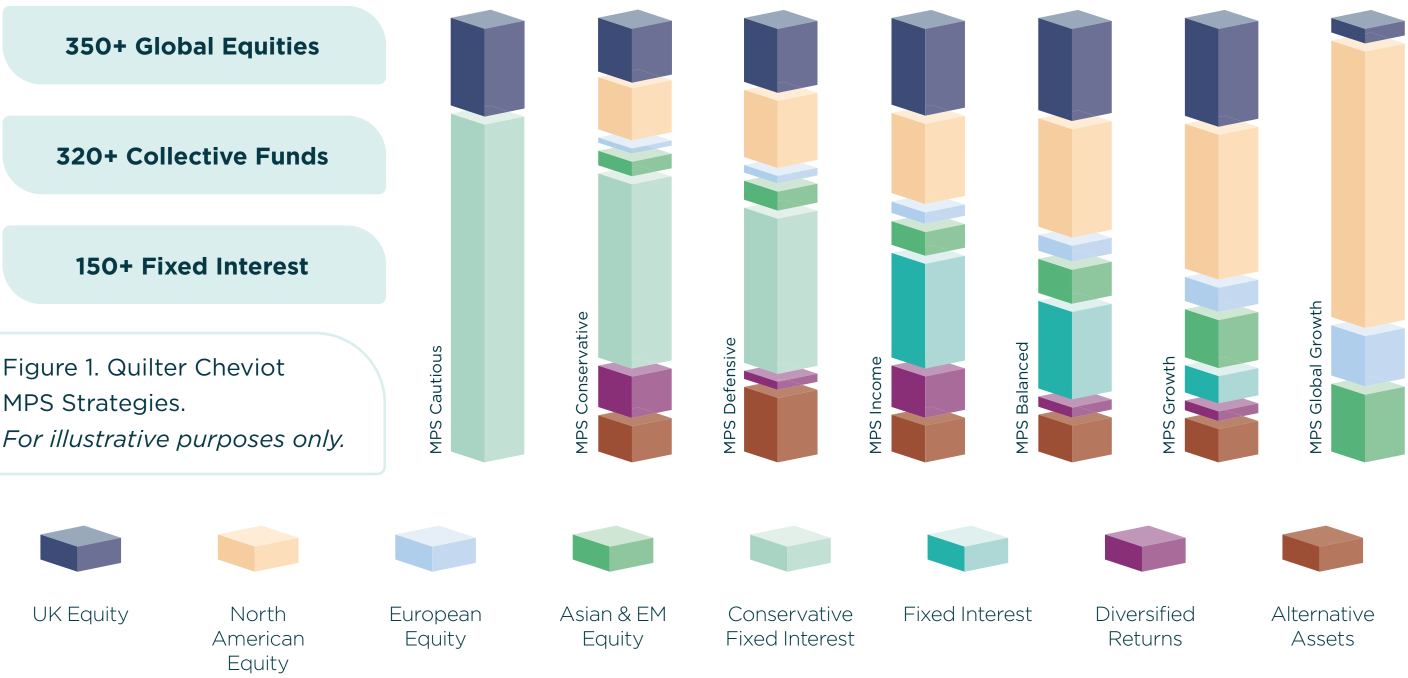

Figure 1. Quilter Cheviot MPS Strategies.
For illustrative purposes only.

2 How dynamic and responsive is your investment process?

We believe that service growth – whether adding new platforms, new strategies, strategic partners or bespoke portfolios – should not come at the cost of investment dynamism.

From previous experience, we know that implementing a rebalance across multiple platforms can be a laborious process, taking days, if not weeks, to plan and execute.

Many MPS providers schedule rebalances on a quarterly basis for operational efficiency, particularly if they run multiple "bespoke MPS" mandates. In recent years we have experienced fast-moving markets, and this prescriptive, periodic approach can have a detrimental effect on performance.

Trade prioritisation is another issue with this approach as some MPS offerings may receive preferential treatment in executing trades, at the expense of others managed by the same provider. A firm may be rebalancing multiple bespoke or tailored MPS', as well as their standard MPS – these must be put in order of priority by the MPS provider when scheduling that rebalance. Where do your clients sit in this order?

At Quilter Cheviot, we adjust our holdings at the fund level when required; typically on the same day as the decision is made to adjust the investments. This change is immediately reflected at the fund level across all shareholders and distribution channels. Full rebalances take place on an ad hoc basis to reflect our latest asset allocation views. This approach ensures that we do not need to compromise investment timing and positioning to account for operational bandwidth.

Our Building Blocks structure allows us to prioritise agility and precision in adjusting our market exposure, while remaining a model-based portfolio service. We dynamically reflect our "house view" in a responsive manner, capitalising on the research insights provided by our in-house equity, fund and fixed interest specialists.

3 How consistent are your MPS portfolios across different custody arrangements?

The costs incurred by your clients and the performance they receive should be the same across all platforms.

Wherever you choose to access your MPS strategies, you should receive consistent exposures and management costs.

Fund and share-class availability can differ across platforms, meaning that proposition costs vary according to platform availability. MPS providers may be forced to make fund substitutions if boutique fund managers or certain share classes are not available on a particular platform, so you and your client may gain a different market exposure than expected.

The other option for MPS providers is that they prioritise consistency, with fund availability the determining factor behind security selection, to the detriment of investment merit. This can impose significant restrictions on the resulting model exposures.

Our Building Blocks structure ensures consistency without any impact upon the investment preferences reflected across the strategies. We simply onboard our eight Building Blocks to each platform as the constituents of our models, resulting in the same holdings and share classes, irrespective of your chosen platform. And of course within these funds, we are able to reflect the full investment universe of research recommendations that we wish to use.

4 Is your MPS designed for platforms?

An MPS should be a solution not a problem. Adjusting an MPS constructed using only third-party funds can impact time in the market for your clients.

Platforms typically operate on a "sales-then-buys" basis. Whilst this is standard practice, where an MPS provider relies on a rebalance to adjust the holdings in their strategies, this invariably equates to time out of the market.

When the instruction is made to sell holdings, the different funds held may have different valuation points, trading profiles and cut off times. This means that it can take several days before a sale price is confirmed. It is only after this that purchases can be placed, which can be 3-5 business days from the initial instruction.

While this may not appear a major concern, it can have an adverse impact on returns. For instance, if 10% of the portfolio is rebalanced each quarter and this 10% is effectively out of the market for three days at a time, it results in a tenth of the portfolio being uninvested for 12 days a year — roughly 5% of trading days.

In addition to time out of the market, MPS providers may avoid certain funds due to their clunky trading profile i.e., those that require longer notice periods, have irregular valuation points or delayed pricing confirmation, thereby reducing the investable universe.

How do we avoid this? Our 'Building Blocks' structure simplifies the operational aspect of adjusting our holdings in 3 key ways:

- All changes to security selection are made at the underlying fund level as and when required without the need for a full rebalance, so there is no time out of the market.
- We only carry out a rebalance when we need to adjust the asset allocation.
- In this instance, the Building Block funds all have the same ACD, trading and settlement profiles, keeping time out of the market to a minimum.

As an ancillary benefit, this means that portfolio turnover is significantly lower, which is beneficial from a capital gains tax perspective. In 2023, for a typical MPS Balanced client, portfolio turnover was on average 6%, down from 14% in 2022 and 26% between 2018-2020 prior to the move to the Building Blocks structure.

5 How can my clients truly understand their investment exposures?

Client understanding of the services you are providing is key.

We provide detailed read-through reports (see example overleaf) so that you and your clients can see the top holdings in each Building Block fund and what is driving the performance of their portfolio. The quality of the research recommendations that inform our MPS investment decisions is evident in both our reports and our monthly factsheets. This provides far more granular detail on holdings, rather than just showing exposure at the fund level.

Our approach allows us to gain diversification benefits, avoiding being too concentrated in one area and therefore reducing risk. The Building Blocks structure facilitates specific exposures and avoids conflicting messaging which can occur in less precise MPS strategies e.g. blending a 'deep value' fund alongside a 'growth-orientated' manager. This allows us greater freedom and accuracy so that we can invest in line with our house view, developed by the MPS managers and our in-house research team.

Holdings in the North American Equity Building Block fund (as at 29 February 2024).
Source: Quilter Cheviot Balanced Strategy (Platform) factsheet

MI QUILTER CHEVIOT NORTH AMERICAN EQUITY FUND

Top Holdings	Fund weight %	Model weight %
Microsoft Corp Com USD0.00000625	7.62	2.06
Amazon Com Inc Com USD0.01	4.80	1.30
Apple Inc Com USD0.00001	4.58	1.24
Ishares Core S&P 500 UCITS ETF USD (Dist)	4.36	1.18
Alphabet Inc Capital Stock USD0.001 Cl A	3.69	1.00
Merck & Co Inc Com USD0.50	2.83	0.77
Union Pacific Corp Com Stk USD2.50	2.78	0.75
Visa Inc Com Stk USD0.0001 'A'	2.78	0.75
Thermo Fisher Scientific Inc Com USD1	2.77	0.75
Linde Plc Com EUR0.001	2.66	0.72
Advanced Micro Devices Inc Com Stk USD0.01	2.60	0.70
United Rentals Inc Com Stk USD0.01	2.29	0.62
Netflix Inc Com USD0.001	2.16	0.58
Palo Alto Networks Inc Com USD0.0001	2.13	0.57
Nvidia Corp Com USD0.001	2.12	0.57

SECTOR EXPOSURE

- Information Technology - 30%
- Financials - 11%
- Health Care - 11%
- Communication Services - 10%
- Industrials - 9%
- Consumer Discretionary - 8%
- Consumer Staples - 5%
- Collectives - 4%
- Energy - 4%
- Materials - 4%
- Real Estate - 2%
- Utilities - 2%
- Cash Products - 1%

MPS Redefined

We redesigned our MPS in 2021 because we believed there was a better way to provide a Managed Portfolio Service. A cost-effective way that makes life easier for advisers, whilst enabling clients to benefit from a more agile, flexible, transparent and truly active structure.

Find out how our MPS can help you and your clients by contacting your local Business Development Manager or emailing **enquiries@quiltercheviot.com**.

Quilter Cheviot
Senator House
85 Queen Victoria Street
London EC4V 4AB
+44 (0)20 7150 4000

quiltercheviot.com

Investors should remember that the value of investments, and the income from them, can go down as well as up and that past performance is no guarantee of future returns. You may not recover what you invest.