Living with the new **norm** of **uncertainty**

HAMZA ALI, director of finance at the **Society of Chemical Industry,** shares his views with charity trustees on how they should work their way through the new investment world of uncertainty and volatility.

Living with paradoxes, dilemmas, contradictions, inconsistencies and sundry unexplained mysteries are all part of everyday life, right? Years ago rock legend Bruce Springsteen put it this way: *"You've got to be able to hold a lot of contradictory ideas in your mind without going nuts. I feel like to do my job right, when I walk out onstage I've got to feel like it's the most important thing in the world. Also I've got to feel like, well, it's only rock and roll. Somehow you've got to believe both of those things at the same time".*

The current economic debate is ripe with divergent views – the inflanistas v the austerians. The Europeans are determined to cut back the fiscal deficits while in the US there is talk of quantitative easing 2; Federal Reserve chairman Dr Ben Bernanke recently described the economic outlook as "unusually uncertain". For investors, this is The New Normal – market uncertainty and volatility.

The 1980s and 1990s were golden decades for investors. Most investors with a passive approach could have achieved exceptional gains using a simple "buy and hold" approach. Despite a sequence of major crises – Black Monday meltdown, Asian currency crises and Russian debt crisis, the market showed great resilience. While in between there were other crises.

The markets (Dow Jones Index) still delivered impressive returns; over 200% in the 1980s and over 300% in the 1990s. However, come the decade of the "noughties" of the new century the return was less than break even – indeed slightly negative. **So what has changed?**

The world has changed. Mr Market (DJI) dropped over 30% by 2003 from its peak in 2000, then peaked at a new record high of 14,000 in October 2007 – up over 40% and then came the waterfall decline to around 6700 in March 2009 – down 52%.

comfortable

So far in 2010 the market has recovered a staggering 62% from the March 2009 low. Yet I wonder how many charities are feeling comfortable today? **Welcome to the brave new world of volatility. It is the new black.**

The days of passive buy and hold strategies are gone; if not forever, then for the foreseeable future. In order to thrive and prosper, charity trustees need to consider robust investment policy tools with which to face the challenging economic environment.

There is no one tool box available to manage a portfolio. Even the hedge funds, with their smart algorithms and highly paid quantitative analysts, have not been able to avoid rather large losses during the recent market turmoil. **How then are charity trustees expected to manage future challenges?**

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The obvious first step in most instances is a thorough review of investment policy, the starting point of which should be an independent review of the investment portfolio. An impartial and critical evaluation of the portfolio by an outside professional provides a necessary global perspective of the portfolio – strengths, weaknesses and potential risks.

The next stage is to consider whether your existing fund managers have derived the expected returns and can deliver to your future expectations. The fund manager should clarify the level and nature of risk related to your returns target.

acceptable

An understanding of the risk/reward ratio is fundamental to investment management. It is possible to reduce risk for an expected rate of return and consequently to expect a higher return on an acceptable level of risk. The trade off is at the discretion of the charity trustees and their appetite for risk.

Risk is quite simply a function of asset allocation. Asset allocation is the process of matching the charity's investment objectives with the aggregate risk and reward profile of the assets held in the investment portfolio. The objectives obviously vary substantially between charities.

The critical factors to consider are market volatility and erosion of capital due to inflation over the prospective time horizon. Trustees should seek professional, experienced advice to develop a strategic

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asset allocation policy – baseline allocation to the principal asset classes, based on a comprehensive review of their financial position, time horizons and risk tolerance.

The agreed policy should be sufficiently flexible for the professional adviser to pursue tactical asset allocation to profit from market opportunities, protection form specific risks and enhancement of diversification.

The dilemma for charity trustees in the current environment of low interest rates, faltering growth and impending austerity is how to balance the requirement for income and the need to protect the purchasing power of invested capital.

For those concerned with risk, a shorter time horizon and a need for greater income the diversified portfolio will be geared towards high quality bonds.

Those with longer time horizons, lower risk and who are more concerned with inflation may have a higher proportion of their assets in equities (or substitutes) which will produce growth.

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However, for most charities the point on the risk/reward frontier is somewhere in between. The challenge is to find the optimal point, which can be distilled from a good understanding of the charity's activities, commitments and plans.

Ben Graham, an American economist, defined the process: *"An investment operation is one which upon thorough analysis, promises safety of principal and a satisfactory return. Operations not meeting these requirements are speculative."*

volatility

Charity investment strategy and objectives need to be periodically reviewed in consultations with professional advisers. In the current climate, with greater market volatility, it would be prudent to review the investment strategy annually.

To make the process seamless, the portfolio performance and market conditions should be discussed frequently throughout the year in order to make a thorough assessment of the performance and the performance against the benchmarks. Somehow, the trustees have not only to multi-task but to multi-think. Welcome to the NNW – the New Normal World.

NEWS BACKGROUND NEWS BACKGROUND NEWS BACKGROUND NEWS BACKGROUND NEWS

Charity marketing receives public support

According to research commissioned by the REaD Group, in spite of the grim economic outlook, it would appear that charities have cast off their old image as junk mailers. Indeed, 42% of consumers place high levels of trust in the way charities handle their personal data, which is in stark contrast to the government who was least trusted by 36% of consumers.

The REaD Group points out that often careless errors in the way data is used can lead to highly distressing situations for individuals, not to mention the money that is wasted on sending invalid mailings.

The research indicated that 29% of adults would stop supporting a charity which sent them badly targeted direct mail (e.g. sending a prostate cancer mailing to a young female), while 47% of consumers said they would cease supporting a charity which they deemed to be wasting money on marketing communications.

15% of consumers said they would stop donations to charities which use inaccurate name and address details, and overall men were more likely to cancel their donations if their personal details were wrong.

53% of consumers said they would complain if they were dissatisfied with a marketing communication they received from a charity.

Despite the rise in digital marketing channels such as email, it appears that direct marketing is still the most favoured. 30% of adult consumers prefer to receive postal communications from charities, which was closely followed by email and advertising.

Samantha Wilson of the Fundraising Standards Board says: "We at the FRSB are pleased that the results of this survey show that the public trust charities to look after their data. We would encourage all charities to make it as easy as possible for their supporters to let them know when they've got it wrong so as they can continue to successfully manage their data.

"With the risk that if charities get their personal information wrong they will simply take their donations elsewhere, it has never been more important for charities to look after their data and follow best practice guidelines."

According to the REaD survey, 60% of adults in the UK do not like being contacted by charities they do not have a direct relationship with. Women and people in the 55+ category would rather receive direct mail. 18-34 year olds are the most responsive to SMS. People in Wales prefer to receive email from charities they do not have a relationship with already over other forms of communication.

NEWS in brief

Apostleship of the Sea, which provides care for seafarers, is celebrating its 90th anniversary. In addition to numerous celebrations, members of the Pontifical Council for Migrants and Itinerants in Rome and representatives of AoS from eleven European countries and a few from further afield met in the Conforti Institute, Coatbridge, to celebrate the anniversary and to look to what the future will bring for AoS.