GUIDE TO CHARITY INVESTMENT

CASTLEFIELD

THE THOUGHTFUL INVESTOR

John Eckersley

Founder & Chair

One thing we share as Co-owners of Castlefield is the fundamental belief that we can earn competitive long-term financial returns for our clients, by investing in a values-based way, alongside making a positive difference to the world around us; if you like, the returns we deliver extend well beyond the financial.

Over more than two decades of investing, we've delivered competitive, values-based returns through an approach which is as rigorous as it is genuine.

We've carried this belief and these values right through to the way in which we've built and run our firm; together as its Co-owners, with our own corporate sustainability very much in mind.

We're generally plain speakers and that's a fair number of words. But it's just our way of explaining what we mean when we say that we offer values-based investing from the perspective of being a values-based manager.

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WHY CHOOSE CASTLEFIELD?

Over two decades generating competitive values-based returns for charities by investing in an authentic ethical way.

Charities are in our DNA; we're part-owned by a charitable organisation.

Our lived values align with the charity clients we work with.

WHAT YOU CAN EXPECT FROM THIS GUIDE

- Understand the basics of charity investment.
- Learn about your investment responsibilities as a charity trustee.
- Find out how to align your investments with your charity's mission and values.
- Gain access to other helpful charity-specific materials.
- Become a Thoughtful Investor ®.

At Castlefield our investment team has decades of collective experience of looking after investments for charities. Not only that, but typically we're charity trustees in our private lives too. We'd like to share some of our own professional and personal experience with you.

We expect that you're a charity trustee or perhaps thinking of becoming one. It may not be the convention of your organisation to refer to you as a 'trustee', but if you act like one and are jointly responsible for the activities of your charity, then you'll undoubtedly be one in law.

It's very important to be clear what you're expected to do as a trustee and equally what you're not expected to do. For starters, you're expected to set the strategy and direction of your organisation and to take responsibility for its finances. Jointly, with your fellow trustees, you've taken on some important legal obligations. You'll be held to a standard established both by statute and legal precedent over many years. That means that there's an accepted way for trustees to act when looking after money. That can be a challenge if your own experience hasn't previously involved looking after a meaningful amount of money on behalf of someone else. The good news is that you're not expected to be an investment expert, but you are expected to seek help from others who are. You must exercise care and apply your own skills diligently.

We hope to give you some pointers as to what the role of a trustee entails and how you can fulfil your legal obligations and thereby see your organisation prosper and achieve its goals. As it's not possible for us to know about your charity's own, unique circumstances we can't offer you tailored advice here. However, we hope that having read the guide you'll know what to do next.

One of the benefits of looking after the investments of many dozens of charities over several decades is that we've developed a good feel for 'what charities tend to do' and why. We share with you here how charities we look after and charities in general tend to invest their money and the key things that lead them to their decisions.

We focus on sharing our own experience with you, without going into the detail of our precise charity-specific products and services. That said, we're hoping that what we say chimes sufficiently to encourage you to consider asking how we might help you – either by way of strategic advice, day-to-day investment management or both.

I'M A TRUSTEE; WHAT EXACTLY IS MY ROLE?

THE DUTIES AND RESPONSIBILITIES OF A CHARITY TRUSTEE

The recently updated Charity Commission guidance CC14 outlines your duties and powers regarding the effective management of your charity's funds.

We recommend that you read the guidance in full (available here -https://bit.ly/3Et6i4L). but we've outlined below specific trustee duties when making financial investments:

- You must have a written investment policy.
- You must consider any restrictions or requirements to invest (or not invest) that are detailed in your charity's governing document and investment policy. This includes considering diversifying your organisation's investments.
- You should regularly review your charity's investments, keeping a record of the review, even if you decide not to make any changes to how, where or by whom the funds are invested.
- When reviewing investments you must consider proper advice about whether the existing investments should be kept or changed.
- The Charity Commission guidance says that trustees must take advice from someone experienced in investment matters. See more on the next page.

EXPECTATIONS AS A TRUSTEE:

- ☑ Make investment decisions to further your charity's purposes.
- ☑ Ensure your charity has an up-to-date Investment Policy in place.
- ☑ Align investment decisions with Investment Policy.
- ☑ Consider suitability of investments.
- ☑ Act in good faith and only in the best interests of your charity.
- ☑ Review your charity's investments on regular basis.
- ☑ Seek experienced investment advice.
- ☑ Comply with legal duties and requirements.

SUITABILITY

You'll need to consider the suitability of investments both in terms of how your investments are broadly allocated between different types and then more specifically in terms of individual selections.

INVESTMENT POLICY

Your organisation must have a written investment policy, and all investment decisions made should be in line with it. This includes identifying the level of acceptable risk and how to manage it along with your charity's stance on ethical investment.

At Castlefield, we've helped many charities with their investment policy and can offer further guidance on what to include in your own version.

EXPERT INVESTMENT ADVICE

Trustees should seek expert investment advice from an experienced adviser. The Charity Commission guidance says that, unless there is good reason for not doing so, trustees must take advice from someone experienced in investment matters. Reasons for not doing so will differ from charity to charity, but may include the relevant expertise existing within the organisation or on the board, or that the amount of money to invest is so small it isn't cost-effective to do so.

It's important to understand the distinct roles of investment advisers (who can provide strategic advice, initially and ongoing) and investment managers (who'll manage your investments day-to-day). You'll undoubtedly require the services of both from time to time, but not every investment manager is able to act in this dual capacity. Castlefield provides both strategic advice and ongoing investment management.

FURTHER INFORMATION ON THE TRUSTEE ACT

The Trustee Act (available here - https://www.legislation.gov.uk/ukpga/2000/29/contents) gives trustees wide powers of investments, as long as you follow the strict duties and responsibilities which are set out in the guidance.

TOP TIP

- Before investing any money you'll want to write down what your plan is and resulting approach is to be.
- This is your 'investment policy' and is the means by which you'll spell out what your objectives are, how much of your total resources you feel able to commit to long term investment and why.

Note: You need to think about your attitude to risk and whether, if your plans falter, it would threaten the viability of your charity. You're not permitted to speculate as a charity but you are expected to accept calculated risk.

WHAT'S THE DIFFERENCE BETWEEN 'INVESTING' AND 'SAVING'?

Most of us are familiar with the concept of saving money. We may have a savings account into which we transfer the balance of our current account each month, after allowing for our day-to-day living expenses. Or we may benefit from an inheritance and feel we want to keep it safe for a 'rainy day'. There are certainly benefits to having money put aside in a safe place, knowing that its capital value is protected, even if the interest it earns is pretty minimal.

There are disadvantages too. Over time, if a capital sum has no link to capital growth, its 'real' value, based on the volume of goods and services it's able to buy, will erode. What seemed like a valuable sum at the outset can become much reduced in real terms in just a few years.

As charities often benefit from having a very long-term planning horizon, the act of wishing to keep money safe in a savings account can ironically actually result in putting your organisation's very future at risk.

The following is a quick comparison of the differences between saving and investing. If your organisation is planning a long-term future and expects to have cash which it has no current plans for, then it can be very difficult to conceive of not investing at least part of your money.

INVESTING

Investing involves putting your money into investments.

For example, company shares, bonds, commercial property or funds.

The hope is that your money will provide a growing income or a capital return (or both), but also in the knowledge that your money could shrink or, in extremis, disappear completely.

This risk is assumed by investors in the expectation that, over the long term, they will not lose money but instead make more money than they would if they simply stuck to a savings account.

SAVING

Saving is the act of putting money away, with the intention of accessing and spending the money in the future.

The capital value remains static, but protected, if a solid deposit-taking institution is used.

The best one can hope for is some modest interest, added to the original capital sum.

But how safe are your savings if you leave your money in an account for a long time and the interest this money earns does not keep up with inflation?

While the nominal value will remain the same, its 'real' or relative value won't, as its so-called 'purchasing power' has been eroded by price inflation over time.

ALIGN YOUR INVESTMENTS WITH YOUR PURPOSE

When we refer to investing in this guide we're referring to 'financial investment'. In other words, we're thinking about how a charity can best put its assets to work to produce the best financial return, so that it can achieve its charitable objectives.

> "Increasingly, charities wish to use their assets to further social aims too."

Increasingly, charities wish to use their assets to further social aims too. We think this is laudable, but we and the Charity Commission are keen to stress that the reason for making any investment needs to be clear at the outset. There is a developing language associated with making social investments – 'impact investment', 'programme-related investment' and 'outcomes-based investment' being just three such terms. Such investment essentially seeks to combine in one investment instrument the financial element of return with some non-financial outcome. This is a development of the traditional charity investment approach (the focus of this guide) which assumes that charities typically seek to invest their money wisely, to get the best return for the risk they take, so as to put themselves in the best financial position to 'do good'.

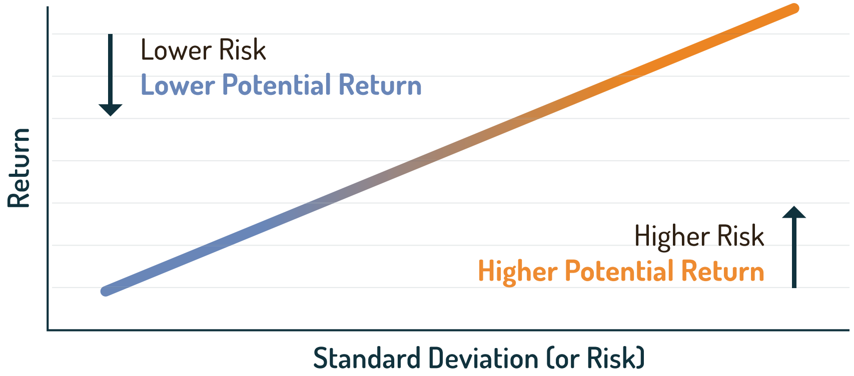
It is accepted that social investment can be a form of financial investment, but the former requires an ability to measure each category of outcome during and at the end of the investment. That is beyond the scope of this guide.

However, to the extent that we take environmental, social and governance factors into account in the way we invest money for all of our clients we definitively take account of a broad range of non-financial criteria in our approach. That said, we see this as being about taking account of all possible risk factors. In our experience, non-financial criteria have a habit of becoming financial ones very quickly if proper attention is not paid to them. Some high-profile breaches of health and safety law or poor corporate governance can cost companies and their shareholders dearly – both in human and financial terms. We prefer to manage these risks as an integral part of our portfolio management role and our existing clients want us to do this too.

RISKY TO INVEST OR RISKY NOT TO?

RISK MANAGEMENT

When it comes to investing money, risk can be defined in a variety of ways. One simple way is to think about it as the chance that the actual outcome an investment produces for you could turn out to be different from the one you expected at the time when you invested your money. This includes the possibility of losing some or all of the money you invest. How significant would that be for your charity? Good investment returns can't be achieved without taking on at least some risk. That said, effective risk management can certainly improve the odds for investors. However, let's be clear, risk management is not a process designed to eliminate risk altogether.



READ OUR GUIDE ON 'RISK & REWARD: AN EXPLANATION'

If you've not already read our additional guide called 'Risk & Reward: An Explanation' you might like to read that too. It's written as a guide for all types of investors, not just charities, but much of the content is very relevant for charities too. In particular, it talks about types of risks you may be exposed to and the importance of time horizon to charities in particular.

DOWNLOAD HERE

ACHIEVING THE RETURNS YOU NEED WHILST REDUCING RISK TO A MINIMUM

DIVERSIFICATION

If your charity can embrace the idea of moving beyond simply saving and is able to invest, then controlling the necessary risk you need to take on becomes paramount. That's where 'diversification' comes in.

This is a technique designed to reduce risk by allocating money available for long term investment not just to a single underlying investment but to a whole range of investment assets – providing in turn a mix of investment types, giving exposure to different sectors of the global economy.

'Not putting all one's eggs in one basket', as we often hear.

PORTFOLIO

As mentioned previously, the resulting diversified collection of investments is often called a 'portfolio'. Each component of a diversified portfolio will, individually, react differently to the same economic or political event. Sometimes a particular economic environment or event is good for one type of investment but not so good for another.

This means that a carefully selected combination of different types of investment (or 'asset classes' as they're sometimes called) will reduce your portfolio's sensitivity to economic and investment market swings. Generally, if your portfolio is diversified across assets, unpleasant movements in one area may be offset by positive results in another. Over the long term, the total portfolio should then produce an average annual return which is attractive relative to a simple savings account, in exchange for taking on a known and controlled level of risk. This is what professional investment managers do every day.

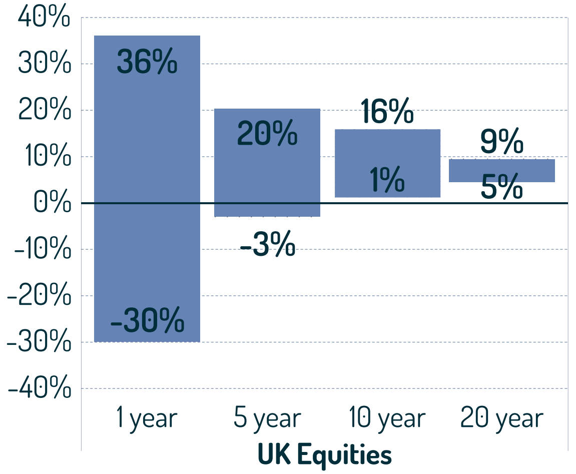
"HAVING PROFESSIONAL ADVISERS THAT HAVE THE UTMOST INTEGRITY IS ABSOLUTELY, VITALLY IMPORTANT TO US. MY TRUST IN CASTLEFIELD HAS GROWN YEAR ON YEAR."

- Charity Client

TIME IS YOUR BEST FRIEND AS A CHARITY WITH MONEY TO INVEST

As we've heard, at the heart of every investment decision is a basic 'trade off' between risk and possible reward or return. Broadly speaking, the greater the risk attached to an investment, the greater the potential reward but the greater the possibility also of not achieving your objective. Economic, political and business cycles can cause significant changes in the value of investments – both up and down. As a result, it's generally accepted that investment in stock market-linked investments should only be undertaken on the basis that you expect to remain invested for at least five years – ideally longer if possible. The following diagram illustrates why...

TIME ENSURES THAT THE OUTCOME IS MORE LIKELY TO BE POSITIVE



Source: Castlefield. UK equity market total return (31.12.1989 - 31.12.2023). Maximum and minimum returns over different discrete time periods.

Past performance is not a reliable indicator of future returns. Your investment may go up or down. With investments your capital is at risk.

The diagram shows the maximum and minimum possible annualised (per annum) returns an investor could have achieved from a 100% investment in the UK stockmarket over all possible one, five, 10 and 20-year investment holding periods. The data covers a 34-year period to 31 December 2023 and for the sake of illustration assumes that investors could have accessed an investment fund giving the same return, after costs, as the main stockmarket index during each year. This is for illustration purposes only, but the conclusions are valid.

> "Remember, as a charity, you mustn't involve yourself in short-term speculation. Don't try to predict where the stockmarket will be in 12 months time – that's not your role."

Looking at each individual 12-month period making up the entire period, the maximum gain an investor could have made in the best year would have been +36%. However, the worst 12 month period over this timeframe would have been -30%. That's why it's not considered prudent to invest money in the stockmarket with the firm intention of withdrawing it only a matter of months later. Over a one-year period you might be lucky and make a large gain but equally you might be unlucky and make a large loss instead. If you don't have the ability to sit out such periods of short-term poor investment returns, by remaining invested and waiting for a recovery in values, you shouldn't invest in the stockmarket at all. Remember, as a charity, you mustn't involve yourself in short-term speculation. Don't try to predict where the stockmarket will be in 12 months' time – that's not your role.

However, history has shown that if you can afford to look at a period of investment of at least five years, then the return over any five-year period is most likely to be positive; with a much-reduced chance of being negative. For periods of 10 years and more, historically the returns have always been positive.

Time is the investor's friend and effectively neutralises the risk of possible investment loss. With many charities able to take a very long-term view, they have a distinct advantage over other types of investor and should look to maximise that advantage. Personal trusteeship can be thought of as looking after the assets of a charity just for one generation before handing them onto the next. Whilst the human occupants of the trustee role change over time, the role itself and the obligations that go with it are often permanent and the decisions of one generation of trustees can have profound implications for those who hope to benefit from the activity of the charity many decades in the future. Decisions about investing a charity's assets are therefore of major importance.

DID YOU KNOW THAT HOLDING TOO MUCH CASH IS AN INVESTMENT DECISION?

As mentioned earlier, the suitability of investments needs to be considered - both in terms of the allocation to different types of assets to individual investments within each asset class. This is often referred to as the difference between 'asset allocation' and 'stock selection'. Your investment policy should always identify how much of your money needs to remain in a current account or savings account. A current account will be suitable for holding monies which are immediately needed to cover day-to-day operational expenditure. Any money which may be needed within the next twelve months (but which isn't available for longer term investment) can be deposited in an interest-bearing savings account.

Beyond that, trustees should consider any restrictions or requirements to invest (or not to invest). Keeping your charity's money in the bank is an investment decision. In high and increasingly inflationary environments, as we've recently experienced, the real value of cash can erode rapidly. Holding all of your charity's money in cash, or a substantial amount of it, may be difficult to align with the responsibilities and obligations of a trustee.

The investment time horizon of many charities tends to be "long term" (even, implicitly, "infinite"). Charity trustees can therefore take a much longer-term view of investment than if they were investing their own money - which in investment terms is a distinct advantage.

As markets rise and fall, charities can ride out those peaks and troughs and harness the benefits of long-term investing. By choosing to invest you have the opportunity to grow the value of your capital and protect the value of your reserves. You also have the opportunity to use your money to make a difference to the environment and society around you, by investing in companies shaping the future.

It's important to bear in mind at this stage that most forms of investment utilised by charities may be cashed-in within a matter of days. So, whilst you may invest properly at the outset with the long-term in mind, you could cash-in your investment if unforeseen circumstances required you to access the money.

One approach would be to think of investment in terms of money you can commit for between three years and five years as one portion and then money you can commit for more than five year as another portion. The former should allow you to access an investment with the potential to produce better returns than a savings account, but without taking on the full extent of day-to-day stockmarket risk. The latter, with the longest time horizon, will allow you to maximise the 'charity advantage' of being a truly long-term investor. This will allow you to access a well-diversified investment portfolio or fund, offering the best prospect for long term returns, in exchange for accepting the risk of the investment markets to which you will be properly exposed.

THE NEXT STEP...

LINKS TO MORE INFORMATION:

Learn more about how Castlefield could help your charity, and find out why we're known as the Thoughtful Investor ®:

By clicking here, or scanning the QR Code (right)

For further support, you can access a range of charity guides, reports and other useful investment documents by visiting the document library on our website:

By clicking here, or scanning the QR Code (right)

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