



RESEARCH IP

Qualitative Fund Research

Harbour Income Fund

11 May 2020



The views and opinions in this document are considered valid from one year from the date published.

Research Factor Weighting

Research Process Category	Model Factor Weight	Analyst Average Score	Maximum Factor Score
Corporate & Investment Governance	15%	4.25	/ 5
Investment Philosophy & Process	20%	4.40	/ 5
People	25%	4.00	/ 5
Portfolio Construction & Implementation	15%	3.67	/ 5
Risk Management	15%	4.40	/ 5
Investment Fees	10%	3.86	/ 5
Overall Average Score		4.11	/ 5

What we look at?

The qualitative rating of a fund is a function of the Research IP Research Factor Weighting process, which incorporates the following:



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Introduction

Harbour Asset Management Limited (Harbour, the Manager) formed in December 2009 and commenced operations on January 2010. Harbour is principally owned by Jarden Ltd (Jarden), at 76.3% and the balance being owned by Harbour employees. Harbour states it is a well-resourced New Zealand based investment manager with extensive professional investment experience managing funds, further details of the Manager's core views are available [here](#).

Harbour has a group wide [investment philosophy](#), based around consistency, processes and people. Harbour operates a [governance framework](#) that is overseen by an experienced Board which includes three independent directors. Harbour provides full transparency and independence around the investing and management of clients' money. Research IP views corporate citizenship and governance frameworks as extremely important foundations from which a manager starts to engage with the client experiences.

Harbour manages twelve retail funds, including:

- Harbour Australasian Equity Fund
- [Harbour Income Fund](#)
- Harbour Australasian Equity Income Fund
- Harbour Australasian Equity Focus Fund
- Harbour New Zealand Equity Advanced Beta Fund
- Harbour NZ Core Fixed Interest Fund
- Harbour Corporate Bond Fund
- Harbour T. Rowe Price Global Equity Growth Fund
- Harbour Real Estate Investment Fund
- Harbour Long Short Fund
- Harbour Active Growth Fund
- Harbour Enhanced Cash Fund

The funds above are managed by a team of 13 in total. The Fixed Income team consists of four members. The equity team comprises four Portfolio Managers, who have analyst responsibilities and are well supported by four dedicated analysts. The operations team consists of three people and in some cases, shares resources with majority shareholder Jarden. Individual bios on the team at Harbour can be found [here](#).

Meet the Manager



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Key Takeouts

This is General Advice only and should be read in conjunction with the Disclaimers, Disclosures and Warnings at the end of this document.

Harbour Income Fund – Research IP Quantitative Tear Sheet

<https://platform.research-ip.com/funds/68345254>

Note: FREE to access via registration, updated monthly including performance.

[Factsheet](#)

[Report](#)

[PDS](#)

[Articles / Views](#)

The Fund

Objectives	Harbour Income Fund
Investment Objectives	The fund aims to provide you with capital growth and a steady and sustainable income.
Benchmark	Official Cash Rate (OCR) Reference Benchmark – 68% S&P/NZX A Grade Corporate Bond Total Return Index 16% S&P/ASX200 Industrials Index (100% hedged to NZ dollars) 16% S&P/NZX Portfolio Index
Alpha Objective	+3.5% pa over rolling three-year periods
Management Fee	0.52% management fee (GST exclusive, no performance fee)
Performance Fee	No performance fee
Estimate of Total Fund Charges	0.63% (ex GST) - 2 March 2020
Minimum Timeframe	Medium to long term investment horizon. Minimum 5 years
Portfolio Structure	Portfolio Investment Entity (PIE)
Distributions	The Fund intends to pay regular monthly distributions (currently set at 4.25% p.a.). (Note: that this is at the Manager's discretion and has been revised down from 5%.)
Strategy Inception	28 October 2015

The Harbour Income Fund (“the Fund”) is a diversified fund which will invest predominantly in a range of fixed income and equity securities that are compatible with generating a favourable level of income through different economic environments. The Manager utilises an active management style, with an eye for capital preservation. The Manager aims to deliver returns through a mix of beta and alpha, while there are a number of other alpha sources targeted including asset allocation, FX, security selection, duration, inflation-indexed bonds, as well as looking to add value in credit sectors.

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Factor	Lower Limit	Upper Limit	Reference
Cash Allocation	5%	40%	8%
Single Stock Limit	0%	15%	
Sector Limits	n/a		
Fixed Interest Limits:			
Investment Grade	20%	90%	40%
Non-investment Grade	0%	20%	5%
Private market debt (Loans)	0%	30%	15%
International	0%	30%	
Duration (yrs)	-2	8	
<i>Total Loans and non-investment grade credit</i>		30%	
Equity Limits:			
Australasian Equity Income	0%	40%	27%
Australasian Equity Focus	0%	15%	5%
International Equity	0%	20%	0%
<i>Total Equities</i>		30%	

As an active manager, the Fund will use the full asset allocation ranges when conviction is high. At extremes, the Fund can exit the equity and international fixed interest markets.

Harbour may have up to 30% of the Net Asset Value of this Fund invested in a Harbour managed fund or funds managed by an external manager. These holdings will be managed in accordance with the overall investment guidelines of the Fund. At the time of writing the Fund is exposed to the [Harbour Real Estate Investment Fund](#), the [Harbour T. Rowe Price Global Equity Growth Fund](#), the [Realm Strategic Income Fund](#) and the [Revolution Private Debt Fund II](#).

The Fund's neutral foreign currency positioning is 100% hedged to NZD. The allowable range of currency exposure to the Australian dollar for the overall Fund is +/- 10%. The allowable range of currency exposure to the currencies in the New Zealand Trade Weighted Index (TWI) basket is +/- 10% in aggregate. Research IP does not expect the Fund will include significant currency views, rather hedging will be used to ensure income and or distributions received are not meaningfully impacted by movement in currencies.

The Fund can use derivative contracts, where the underlying risk relates to interest rate, foreign currency, equity or credit risk. The Manager is mindful of any unintended consequences this may introduce. Accordingly, the Fund's effective exposure of equity and corporate credit must not result in the Fund being levered with regards to equity and credit risk.

Funds Under Management (FUM)

FUM	Harbour Income Fund
Fund	\$136m
Strategy	\$136m
Sector	\$203m
Manager (Australasia)	\$5,018m
Manager (Total Global)	\$5,018m

*at 29 February 2020

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The Risks

The Manager is aware of the broad range of risks, as identified in the [Product Disclosure Statement \(PDS\)](#) and is mindful of them when constructing and managing the portfolio.

The Manager endeavours to protect against downside risks by using asset allocation and diversification through uncorrelated exposures. Research IP believes the allocation between fixed income and equities and the types of securities used in each asset class (e.g. domestic or international and government versus corporate debt securities) is critical to the Fund achieving its forward projected income objective. As a result, the Manager allows the Portfolio Manager to use several levers, including broad asset allocation and security types and ranges, to assist in meeting the Fund's objective. Research IP believes the asset allocation has the potential to be dynamic and change quickly. In saying that, Research IP observes the Fund has been methodically and incrementally implemented asset allocation changes to date.

The methodical approach to risk management is reflective of the Manager's complete process to investing client money.

Using this Fund

Harbour believes the Fund suits an investor who desires income with some capital growth, but has limited appetite for capital loss.

The Fund is diversified, with holdings across different asset classes, has relatively broad asset allocation ranges and is reasonably unconstrained from an asset allocation perspective as well. Research IP believes the Fund is suitable as a core portfolio holding for investors seeking consistent income and some capital growth, while preserving capital.

The Fund is subject to fixed interest and equity market risk and movements (both positive and negative) in both the prices of fixed interest securities and share prices of the underlying securities in the portfolio. Accordingly, investors should therefore be aware that the Fund may experience periods of negative returns and that there is a risk of potential capital loss being incurred on their investment. Research IP believes an investor should have a minimum investment time horizon greater than three years, preferably longer.

The Fund has the flexibility to hold material positions ranging from 20% - 90% in New Zealand Fixed Interest, 0%-40% Australasian Equities and 5%-40% in cash. The Fund's asset allocation decisions can have a material impact on performance, as well as security selection.

What the manager says?

Insight	Manager view	Research IP opinion
<p>Who is accountable for managing the fund?</p> <p>Is the investment teams work history relevant to the funds they manage?</p>	<p>As Portfolio Manager, 27 year industry veteran Mark Brown holds ultimate responsibility for the Fund. Prior to joining Harbour, Mark spent much of his career as a fixed interest Portfolio Manager at large global investment manager and has served on several asset allocation committees. In constructing the portfolio, Mark draws on the expertise embedded in a number of Harbour's asset-classes investment processes. In particular, income equity security selection is managed by Craig Stent (10 years at Harbour) while Shane Solly manages growth equities (6years) and Simon Pannett (6 years) is responsible for credit analysis of investment grade and high yield credit.</p>	<p>The Portfolio Manager (Brown) has a very solid industry experience and has nine years tenure with the Manager. Brown has been responsible for the Fund since June 2017.</p> <p>While Brown carries accountability for the Fund, the Fund leverages the experience of Harbour's equity, fixed income, foreign exchange and manager selection skills. This is complimented with macro, rates and asset allocation inputs.</p> <p>This Fund draws broadly from the Harbour investment team. The tenure of the Fund's investment team is strong, with Andrew Bascand, Craig Stent, Shane Solly,</p>

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		<p>Susanna Lee, Simon Pannett and Chris Di Leva, all providing inputs.</p> <p>Christian Hawkesby left Harbour in February 2019. Hawkesby held the role of Head of Fixed Income since commencing with the Manager in 2011. As a result of this change, Brown assumed the responsibilities of Head of Fixed income immediately. While Hawkesby was considered a key person in the Fixed income team and his departure was viewed as being material in nature, Research IP believes Brown was more than capable of taking over and has since implemented a robust team structure.</p> <p>George Henderson, who joined Harbour in June 2018, assumed some Portfolio Management responsibilities within the Fixed interest team for Harbour's fixed income portfolios. Henderson has 13 years industry experience, 11 years of which was at Royal London Asset Management (RLAM) in London, including nine years as a portfolio manager for a range of global fixed interest funds with a similar investment philosophy and process as Harbour.</p> <p>Hamish Pepper joined Harbour as the Fixed Income and Currency Strategist in July 2019 from Barclays and previously the RBNZ. Pepper now acts as the lead on macro inputs to the fund, supported by Brown and Henderson.</p> <p>Since commencing operations in 2010, the Manager has added resources, building out the team as required. The continual team development has seen new analyst additions in 2016, 2017, 2018 and 2019. Research IP notes that the Manager has one of the larger investment teams and pleasingly continues to invest in the investment teams and importantly the business. Research IP commends the Manager for looking beyond today and investing for the future.</p>
<p>Has the CIO/ PM personally invested in the Fund? Are they paying the same fees as other investors?</p>	<p>The Portfolio Manager and a number of the analysts have a meaningful portion of their personal assets invested alongside clients on a full fee-paying basis. Each year a portion of the investment staff's</p>	<p>Research IP believes that the interests of investment personnel are better aligned to those of the investors, when investment personnel are significantly invested and at the same fees, which is the case for this Fund.</p>

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	<p>discretionary pay is invested into Harbour Funds with a three-year vesting period.</p>	<p>Research IP believes the vesting of discretionary remuneration of Harbour staff is a strong enhancement to the alignment with investors. Naturally Harbour staff want to maximise their outcomes, without excessive risk.</p>
<p>Why would you allocate to this fund?</p>	<p>The Fund has been designed for investors seeking a stable income, which is higher than bank deposit rates over time. It suits investors with a low to medium risk appetite.</p> <p>Harbour's principal competitive advantage is the quality and depth of our resources. Harbour has one of the largest and most experienced domestic investment teams in New Zealand. Our portfolio managers are supported by a team of analysts who produce proprietary qualitative company research, quantitative analysis and macroeconomic insights. This Funds combines the skills of all of Harbour's resources.</p> <p>The Fund has a breadth of investments that are not available to retail investors. We look for investments that offer a superior risk/return profile. For instance, in fixed income markets, attractive pricing is available in sectors that banks have become less committed to, due to capital requirements imposed on them by the central banks and other regulators. These types of assets can improve returns and boost diversification.</p>	<p>The Manager outlines its case as to why Harbour should be considered by an investor. The Manager also provides a series of links that outline their set of core values. Harbour believes these factors differentiate them from peers, across their product suite. Research IP believes that in conjunction with a disciplined approach to investing, the Manager, presents a clear rationale as to why a potential investor should consider investing in this Fund.</p> <p>Research IP believes this Fund provides investors with a well managed conservative strategy that provides income with the opportunity for some capital growth, while minimising the occurrence and magnitude of negative returns. The Fund also provides investors with a professionally managed solution that offers exposure to investments that are not easily accessible, which help diversify portfolio returns.</p>
<p>What are key factors in the buying and selling decisions of the Fund?</p>	<p>The Portfolio Manager employs an absolute-returns mindset. For example, the Fund will only hold equities if the asset allocation committee's research into market and economic conditions as well as valuations indicates there is upside available. From there, security selection is made by the experts in each area and is made consistently across similarly designed funds. For instance, if we analyse the credit worthiness and price of a new corporate bond issue and form a positive view, the security will be included in all eligible portfolios, subject to each portfolios' current strategy. Individual securities are assigned to sector specialists for continual monitoring to determine whether securities still justify their position in the portfolio.</p>	<p>Research IP observes the Manager's process is one of the more methodical, well-structured and consistently implemented. The process builds from determining which income asset classes are likely to achieve the Fund's objective. The Manager then steps into security selection, where Harbour's specialists are utilised, as well as external manager selection where necessary. Active risk management is then implemented through rates, FX and relative value trades to build the final portfolio. Research IP believes determining the choice of income asset classes is a critical first step, which dictates security selection, risk management and what the final portfolio is invested in. The mix of fixed interest</p>

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	<p>Within asset classes, securities must be consistent with the investment philosophy supporting our style. For example, Income Equities must score well on our screens that aim to identify sustainably high dividends.</p>	<p>and equities is key to how the portfolio will react to market and security pricing changes.</p> <p>The Manager's analyst teams undertake significant and detailed qualitative reviews of securities, security types and asset classes. This enables the Manager to understand the securities prior to investing in them. The qualitative input results in analysts scoring a series of factors, leading to a qualitative ranking.</p> <p>Brown takes some guidance around portfolio construction from the equity teams but is ultimately responsible.</p> <p>Macro inputs for fixed interest and asset allocation are led primarily by Hamish Pepper, with Henderson and Brown also contributing.</p> <p>Brown will also take input from the Asset Allocation Committee which is chaired by Chris Di Leva, who also manages the Active Growth (diversified) fund.</p> <p>The Manager's process across all asset classes is underpinned by fundamental, bottom-up research. The Manager incorporates a mix of predominantly internal, with some external research. External sources include sell-side brokers, independent research houses, as well as other data sources, although the Manager relies heavily on in-house investment models.</p> <p>Simon Pannett leads the research initiative for the credit allocation. The neutral weight in the Fund would be 60% and is therefore an important consideration in this review. The key objectives are to find investments with a solid credit outlook, sectors offering value from regulatory regime or investor bias and to seek broad diversification. Similar to the equity team there is detailed analysis conducted including a shadow credit rating. Research IP notes having access to the equity team's view on companies, rather than operating independently, as being beneficial to the process. In addition to the "vanilla" credit exposure, the team seeks to add value through other themes, e.g. MBS, High Yield and Loans. Given the funds size, it</p>
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		<p>can also gain exposure to themes via other managed funds.</p> <p>The Manager's fundamental bottom up process for equity research starts with focused quantitative filtering. Research IP notes that Harbour have included proprietary ESG factors in their investment processes since inception. Importantly it's not a new part of the process, but well established and well and truly embedded.</p> <p>Both quantitative and qualitative scores become a key component of the monitoring process for equities. A deterioration of a security's score, or belief that other security types better capture the asset class characteristics, will assist in the sell decision process. Deterioration of key security scores will trigger a review, which can lead to reducing the position size or exiting the company.</p>
<p>What are the key drivers of the Fund's performance and risk measures?</p>	<p>The Fund's performance will be mainly driven by the market performance of the asset classes we invest in. These are Australasian Equities and fixed income. Within the Equity investments there is an emphasis on income generating companies, where steady earnings can provide consistent dividend streams. In Fixed Income, returns will be a function of the yield plus capital gains/losses. Fixed income investments are mainly investment grade, but we can also buy up to 20% high yield securities.</p> <p>Beyond these core allocations, there are a range of other allocations we can make. We can invest in growth equities and global fixed income. We actively manage the Fund.</p> <p>Active positions include asset allocation, as well as other, more security specific positions that are eligible. Active positions can be quite varied. They include currency positioning and fixed income trades, such as inflation breakeven positions, cross-market spread trades, duration positioning etc. These investment activities are part and parcel of strategies used in our core fixed income and equity portfolios.</p>	<p>The Fund's performance reporting is available via the Research IP Quantitative Tear Sheet, on the Manager's website and the Disclose website. The Funds' performance has been in line with its hybrid benchmark and exceeded its objective over every time frame.</p> <p>Research IP believes the Funds' performance is reflective of the fixed interest and equity team's success, combined with the ability to maintain an appropriate mix of assets to meet the Fund's stated income objective. This is achieved whilst minimising drawdown in capital value.</p> <p>Through diversification and use of the asset allocation ranges, the manager will aim to minimise downside risk. However, it is important to note that the Fund will generally be exposed to risk assets and should not be considered an absolute return fund. There will be times when this Fund will deliver negative returns.</p>

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	<p>The risk measures that capture these investments are bond duration, credit risk, equity market risk, currency risk, liquidity risk. All are captured within our risk management process.</p>	
<p>On what basis are the fees charged justified?</p>	<p>Harbour's fees are transparent. There are no buy/sell spreads or entry/exit fees. The Income Fund has an estimated total fee (excluding GST) of 0.63% p.a. including investment management, Supervisor, legal and audit fees as well as the costs of unit pricing, investment accounting and custody. In addition, the Fund often invests in third-party products to gain exposure to niche asset classes. It fully rebates associated management fees, even if they are greater than the Income Fund's fee. In an environment of declining fee levels, the Income Fund fee is at the low end of comparable fees in the New Zealand market even though it invests in resource intense asset classes such as specialised credit. The Fund carries no performance fee because we do not believe this creates the right incentives for Funds that seek to protect investor's capital.</p>	<p>The Funds' basic fee is well below the sector peer average. As this is an actively managed Fund the Manager's ability to operate the Fund closer to passive fee levels is a strong positive.</p> <p>The Manager does not charge a performance fee on this Fund and notes that it is inappropriate given the absolute return focus of the Fund.</p> <p>Although no buy/sell spread is typically charged on this Fund, Harbour says that "in some market conditions, Harbour may apply a buy-sell spread to investments, withdrawals or switches in some Funds". Harbour believes they can typically cross trades and therefore minimise transaction costs. Research IP notes that that this may not always the case and existing unit holders may incur the cost of transactions resulting from investors entering or exiting the funds.</p>
<p>Describe the quality of the organisational and investment governance processes?</p>	<p>At the organisational level, Harbour's Board is led by an independent chair. Two other independents ensure client's best interests are put first, including a former experienced Portfolio Manager who chairs the Audit & Risk Committee. We have rigorous daily compliance procedures that ensure the portfolio is invested in adherence with its guidelines. We engage PWC to test the firm's operational and compliance processes. This assesses tasks such as the handling of client funds, investment management processes, trade execution, segregation of duties etc. This is an external and independent assessment of our processes. Lastly, an internal risk committee periodically scrutinises the Portfolio Manager's decision making and risk allocation.</p>	<p>The Manager has a strong governance structure which starts with the composition of the Board and leadership of key Board Committees. In addition to the out-sourced functions, there are sufficient internal personnel in operational roles, to ensure that the investment team members can concentrate on managing the portfolios, with appropriate oversight.</p> <p>The use of external directors for the Harbour Board is considered to be in line with industry best practice. Research IP notes the use of independent members extends to Board delegated committees and investment committees. The use of external non-executive directors is strong, this excludes those representing the major shareholder, Jarden.</p> <p>Research IP considers the Head of Compliance reporting directly to the Board and Audit Committee as being in line with global best practice, which is not always the case in New Zealand.</p>

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		<p>Harbour has a formal investment committee, which meets on a monthly basis. Research IP believes the structured investment committee formalises a process and provides oversight to the investment decisions.</p> <p>The Manager uses Bloomberg AIMS for pre and post trade compliance. This is used across all funds.</p> <p>There is also a clear allocation of responsibilities in the Fixed Income team, with appropriate backups.</p>
<p>Describe the Manager's ESG, Corporate Sustainability policies and engagement.</p>	<p>Harbour integrates ESG analysis into its security selections processes. We conduct an annual corporate behaviour survey with potential equity investments. The results of this survey directly impact the weight a company is held in the portfolio, with strong corporate citizens being held at a higher weight than poorly behaving corporates. This, along with our engagement of companies, helps to drive better outcomes. In fixed interest securities where the risk profile is asymmetric (either you are paid back or the company defaults) we will simply not hold a company's debt if we believe its behaviour is egregious or it participates in a sector that makes investment untenable (examples include gaming). Harbour has been recognised for its ESG approach by strong scores by independent agencies UN PRI and RIAA.</p> <p>At Harbour, sustainability has been included in our key business objectives.</p>	<p>Research IP notes that Harbour have included Responsible-Investing factors in their process since inception and is viewed positively. Notably Environmental ("E") and Social ("S") factors are treated differently to Governance ("G"). Governance is well established, the relationships between companies and the environmental and social aspects are less defined.</p> <p>The Manager's internally developed ESG process is considered to be very robust and can be applied to a company, regardless of its domicile.</p> <p>Harbour is also a signatory to the UNPRI. Investors should be aware that ESG and the United Nations Principles of Responsible Investing (UNPRI) are relatively loose and that ESG integration has a broad range of interpretations.</p>
<p>Is there alignment with the interests of investors through ownership of the Manager and/or remuneration of the investment team?</p>	<p>Yes. A portion of the investment team's discretionary remuneration is vested into Harbour funds over a period of three years. This discretionary pay is in turn determined by the Fund's performance amongst other factors such as client satisfaction. Harbour is 24% owned by its employees. A long-term incentive scheme sees annual awards of further equity ownership for staff.</p>	<p>By being partially owned by its employees and directors, there is strong buy-in from the team to work hard for the firm's long-term success - this is good news for investors. The Manager's continual development of and commitment to its staff is viewed as market leading.</p> <p>There is alignment between the bonus component of staff remuneration and the performance of the funds/portfolios.</p> <p>Research IP highlights that Harbour's vesting of short-term incentives (cash bonuses) in the Manager's suite of funds is market leading from a New Zealand</p>

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		<p>perspective. This brings enhanced staff tenure and alignment to the interests of investors.</p> <p>The support of largest shareholder, Jarden, is also significant, in both financial terms and operational support.</p>
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About Research IP

Research IP has provided client focused qualitative and quantitative financial product and security research since 2015. Research IP was also the consultant to the NZX wholly owned subsidiary FundSource, providing investment research to the New Zealand market since 2015.

Research IP is a specialist investment research provider which is used and trusted by investors & financial advisers for investment, KiwiSaver, Superannuation and other Pension schemes throughout the Asia Pacific region.

Research IP has grown its team and footprint by utilising the specialist skills of its analysts which include;

- ❖ data scientists,
- ❖ equity, bond and alternative asset specialists
- ❖ portfolio managers
- ❖ asset allocation analysts
- ❖ and ratings specialists.

Our experience has been gained in well over 20 years of roles across different facets of the industry, so we understand the key drivers and challenges for managers, as well as the impact for investors and the Financial Advice industry.

By leveraging the skills of specialists, Research IP is able to provide innovative and tailored financial services solutions to the marketplace. Client focused outcomes are underpinned by the belief that the role of business model innovation and accelerating technological change opens up new possibilities, to put client interests at the centre of the financial services industry focus. We have strong philosophical alignment with John Hagel's work on the possibilities for "Disruption by Trusted Advisors" and John Kay's views in "Other People's Money: Masters of the Universe or Servants of the People".

Research IP delivers high quality quantitative and qualitative fund research to financial advisers and the broader financial services industry. Research IP works with a number of expert providers to source this data. Quantitative data is supplied by a variety of sources, including directly from the Fund Manager, while qualitative research is provided by Research IP.

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