DRAWDOWN USING THE LEVENDI THORNBRIDGE DEFINED RETURN FUND DISTRIBUTION SHARE CLASS

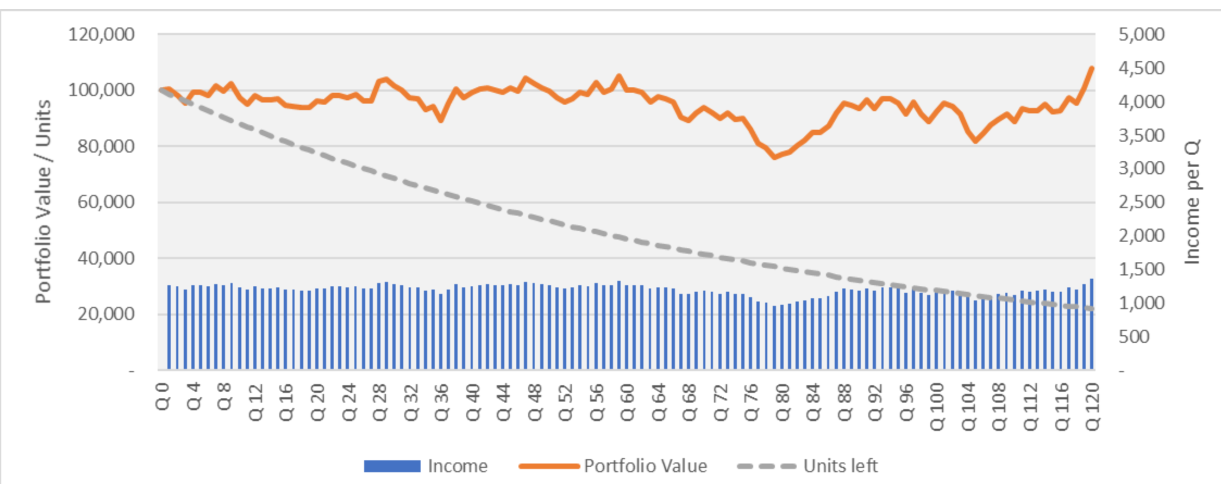
INTRODUCTION

The Distribution (Dist) share class of the Levendi Thornbridge Defined Return Fund (the Fund) has been designed for investors that want to receive a regular payment from their investment. The Distribution share class offers a quarterly payment of 1.25% (5% per annum) that is funded through the regular redemption of units. In this paper we look at how the Dist class can be part of a drawdown solution.

INVESTOR PROPOSITION

- The investor will receive regular payments from investment in the fund equal to 1.25% per quarter (5% per annum)
- Payments will be made in perpetuity
- If the fund performs as expected, the regular payments will increase over time and the residual portfolio value will rise.
- The share class can be held in a Pension, ISA, Offshore Bond and general investment account.
- If the fund is held in an ISA or Pension the payments are tax free
- If the fund is held in a general investment account, the investor may be able to reduce or eliminate any tax liability using their Capital Gains Tax Allowance.

DRAWDOWN USING THE DISTRIBUTION SHARE CLASS



In the illustration above we look at the income paid every quarter and the portfolio value over a 30-year (120 quarter) period for an investor that starts with a £100,000 investment. The income payments are made gross, and the example assumes that there is no tax payable.

The portfolio value and income per quarter varies from one quarter to another with changes in the share price but is broadly the same over time. The chart shows how number of units held by the investor declines steadily as units are sold to make the quarterly payments. The growth in the share price effectively offsets the effect of redemptions. Its worth noting that at the end of the period the investor still holds over 22,000 units having started with 100,000. A strategy of redeeming a fixed percentage of the remaining units will ensure that the remaining holding of units is never reduced to zero.

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HOW MIGHT THE FUND PERFORM?

Simulating the returns of a strategy like this require that we make certain assumptions about how the fund will perform. Our base assumptions are that the fund performs in-line with the return and volatility targets:

- Average annual fund return; 6%
- Annual volatility of the fund; 6%

With these assumptions it’s possible to simulate how the fund may perform and draw some broad conclusions about the income that will be received by the investor over time and the final portfolio value. The table below shows the results based on 500 simulated results.

	Average	Percentage of Initial Investment
Initial Income per quarter	1,271	5.1%
Max Income per quarter	1,900	7.6%
Average Income per quarter	1,463	5.9%
Minimum Income per quarter	1,107	4.4%
Final Portfolio Value	132,389	132.4%

The stress test shows that based on the core assumptions of risk and return the investor will receive a steadily rising income. The average income is 5.9% of the initial investment amount each year. At the same time, the increase in the unit price offsets the reduction in the residual units held by the investor, so the final portfolio value has increased by more than 30%.

BAD SCENARIO

By changing the inputs, we can see how the strategy may perform if the fund returns are lower and volatility is higher. In the "Bad Scenario" we have assumed volatility of 10% (in line with the volatility target used for the risk management overlay) and average returns of 3%.

	Average	Percentage of Initial Investment
Initial Income per quarter	1,236	4.9%
Max Income per quarter	1,491	6.0%
Average Income per quarter	942	3.8%
Minimum Income per quarter	551	2.2%
Final Portfolio Value	53,768	53.8%

The effect of increasing the volatility of returns and reducing the return is to reduce the best, average and worst income generated and the final portfolio value. Its worth noting that the investor still receives an income, albeit a lower income, over time.

BENEFITS AND RISKS

The fund has been developed to have a risk/return profile that will appeal to lower risk investors. The objective of the fund is to maximise the chance of achieving the target return. The fund aims to minimise the chance and scale of losses. This return profile may be attractive to investors who are considering income drawdown.

The fund does not hold any income generating assets and so does not pay any income. Investors that want to receive regular payments need to redeem units to fund these payments. The Dist share class does this automatically.

The redemption of a fixed percentage of the units held by investors each year to fund an income is strategy that differs from other drawdown strategies that are commonly used. The Dist shares may be used as a way of diversifying an investors drawdown portfolio.

BENEFITS

- The initial "income" is 5%.
- If the fund performs in-line with expectations, then both income and the residual portfolio value will grow over time
- Investors retain the ability to redeem or transfer their investment at any time.
- For many investors the initial income will be higher than the annuity rate for a flat, single life annuity with no guarantees.
- The Fund will continue to generate an income for investors in perpetuity.
- The drawdown process mitigates many of the problems cause by withdrawing a fixed GBP amount every period, so-called "pound-cost-ravaging".

- For assets held outside an ISA or Pension, the marginal tax rate on quarterly payments reflects the fact that a large part of these payments is a return of capital and that the only tax liability is CGT on realised gains.
- All the investor's assets are invested in the fund, minimizing any cash-drag caused by holding cash to fund short term income requirements.
- The Dist shares can be held through a wide range of wrappers and platforms.

RISKS

- The investors must accept that the income they receive will vary from one period to another.
- The residual portfolio value will vary.
- Neither the quarterly payments, nor the residual portfolio value are guaranteed or protected.
- The fund may not perform as expected. This means that the income they receive could fall significantly and the residual portfolio value will vary and may fall significantly.

CONCLUSIONS

The Dist share class offers an attractive drawdown solution for assets in an ISA, pension, offshore bond or general investment account. The drawdown schedule offers a perpetual income that will remain the same or grow if the fund performs in line with the target return. There may be attractive tax benefits of the share class is used for assets held outside an ISA or pension.

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