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Investment Risk & Strategy

Overview

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Our Investment Philosophy and Beliefs

We believe in a **structured and disciplined approach** to investing which seeks to manage risk and aims to help our clients increase the probability of achieving their financial and lifestyle goals. We do not believe in chasing markets, listening to hype or making emotional decisions.

Inflation over the medium to longer term can significantly reduce the real value of money. As a result when investing over a term of 5 years or more, we believe in investing into **real assets** such as equities, fixed interest and property. This not only offers the potential of protecting your assets from the effects of inflation but also the opportunity to achieve a real return over and above inflation. These investments do not include the possibility of security of capital which is afforded with a deposit account.

When arranging an investment for you we feel it is vital that we understand, and that you understand, **your attitude to risk and reward** to ensure the correct strategy is adopted.

One of our core investment beliefs is not putting 'all your eggs into one basket'. In investment terms this means adopting **an asset allocation strategy**. An asset allocation strategy should be based on extensive research. Asset allocation is an investment strategy that attempts to balance risk versus reward by adjusting the percentage of each asset in an investment portfolio according to the investors risk tolerance, goals and investment time frame and also consider their capacity for loss.

In addition to an asset allocation strategy we consider a portfolio should be **further diversified** to take into account geographical regions (i.e. UK, Europe, US), sectors (i.e. Industrials, Pharmaceuticals), stock section (i.e. small, medium, large companies) and fund management style (i.e. value or growth).

Once established, adjustments to the portfolios asset allocation and/or the diversification strategy, could potentially be made (within certain parameters such as your attitude to risk) to reflect **short term economic or investment trends**.

Our belief is that over the medium to longer term, **active fund managers could potentially add value** over and above the return of the markets. It is vitally important however, that the fund managers selected, and others available within the wide market, are actively monitored so that they can be selected/de-selected from the portfolio at the appropriate time.

In order to identify active fund managers who we consider **consistently add value** we believe in **deep and thorough research.** Such research includes taking into account various factors not just past performance. Industry endorsements / ratings are also seen as an effective way to help us with this process and useful in helping us to verify the quality of a fund.

As you know time does not stand still and things never stay the same. Therefore we believe that the periodic **maintenance of your portfolio is essential**. The maintenance should take into account your asset allocation strategy, diversification strategy and the fund selection, with your portfolio being adjusted or recalibrated accordingly.

Risk and Return

In constructing your investment portfolio, it's important that you understand the risks associated with the investments that are chosen.

What do we mean by risk?

Risk and uncertainty are different. The possibility that things may not turn out exactly as you expected is uncertainty. Risk, to some, may mean the possibility of losing a portion of your capital. For others, it is the worry that your capital may not produce enough income on which to live.

Risk and uncertainty cannot be eliminated. However, they can be measured and managed within your portfolio. The key is to determine the appropriate level of risk for you. Taking on greater uncertainty and short-term risk may be necessary for you to gain the long-term returns needed to achieve your lifestyle goals and objectives.

What are the types of risk?

There are a number of risks to be considered when constructing your portfolio:

Investment Market Risk is the possibility that all investments in a market sector, (e.g. shares) will be affected by an event.

Investment Specific Risk is the possibility that a particular investment may under perform the market or its competitors.

Inflation Risk is the possibility that your investment return is below the inflation rate, which reduces the spending power of your money.

Credit risk is the potential failure of a debtor to make payments on amounts they have borrowed.

Interest Rate Risk is the possibility that your investment will be adversely impacted by a fall or rise in interest rates.

Legislative Risk is the possibility that a change in legislation will impact the appropriateness of certain investments for you.

Liquidity Risk relates to the ease with which you can sell or liquidate your investments. Some investments impose exit fees or have limitations on your withdrawals. Other investments may be difficult to sell due to a lack of buyers.

Shortfall Risk is the possibility that your investment returns are insufficient and the value of your investment falls short of the required targeted value.

Risk and Return (cont'd)

Understanding risk?

In considering an investment strategy, you need to understand the risks that you may be exposed to and how they will impact your personal situation. Assessing risk and potential investment return should be in the context of your goals and the time that you have to achieve your objectives.

Your investment risk profile

An integral part of developing your investment strategies involves determining your attitude to risk. It has a direct impact on the likely returns of your investments. We call this your investment risk profile.

Your attitude to risk

We use a scale of 1 to 10 to grade attitudes to risk. On this scale, 1 denotes the most risk adverse and 10 the most aggressive investor. On which level you fall under depends on the outcome of the risk questionnaire that you complete and our analysis of your personal financial position and objectives.

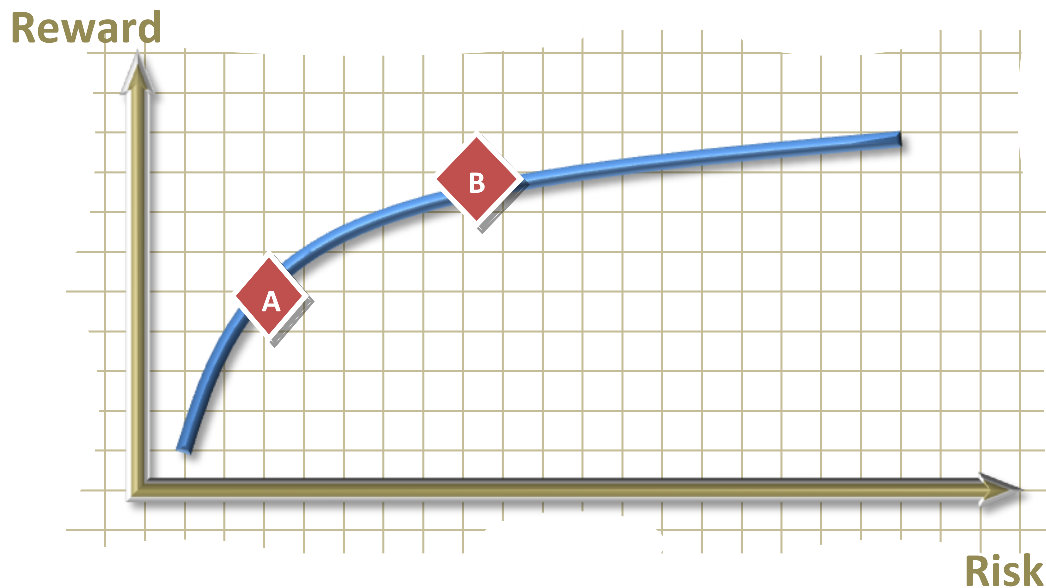
Capacity for loss

Almost every investment has the propensity to fall in value. It is a fundamental principle of investing that the investor should be willing to accept any potential losses in the hope of achieving the returns they require. The maximum capacity for loss an investor can withstand is important to understand and every investor should be provided with an investment portfolio that is unlikely to fall by more than this. If the capacity for loss is less than the investor's inherent risk profile then it is this that must determine the maximum risk an investor is willing to take.

The relationship between Risk and Return

Risk and return are closely related. The more risk an investor is prepared to accept, the higher the return expectations. Conversely low returns should be a reflection of the investment's greater security.

This relationship between risk and return can be depicted as below:



In the example above, Portfolio is achieving less return, but also taking less risk compared to Portfolio

As you move along the blue curve, left to right, you take on more risk for increased potential return. The line curves and flattens out as the marginal increase in return diminishes as you take on more additional risk.

Asset Classes

The assets that can be allocated to a portfolio include the following:

Gilts and Corporate Bonds
Gilts and Corporate Bonds are contracts that allow a number of investors to pool together to loan money to a company, government or other institution over a fixed term. The holders of the bonds expect to receive periodic interest payments over the length of the term and to get their capital back at the end. If the borrowing institution fails or defaults bondholders are unlikely to receive either the interest due or all of their original capital.

Equity Investments
Shares in companies are a popular choice for long-term investors. As a shareholder you may participate in the growth of the company through potential increases in the share price and may also benefit by receiving dividends.

Cash Based Investments
Money market investments, which may be familiar to investors, typically offer lower risk than other asset classes and are usually readily accessible. However, they are not without risk as interest rates may be lower than inflation. There is also a potential default risk if institutions go out of business or fail to make interest payments on time.

Property
Property investment can be via companies which own and manage a range of physical properties. The value of property is a matter of the valuer's opinion and not fact. Property may not contribute to diversifying your portfolio if you already hold a substantial proportion of your investments in property. There could be delays involved with property disinvestments and switches due to the time it takes to sell physical property assets.

Commodities
Investments in the commodity sector are focused on the sector which produces and trades raw materials such as oil, gas, industrial and precious metals as well as agricultural products. The manager of a commodity fund would tend to either trade in the commodity markets directly or to invest in the shares of specialist mining or commodity companies.

Alternatives
The 'alternatives' class covers a wide range of investments; the main categories are commodities, hedge funds, absolute return and infrastructure. These sectors have traditionally been less correlated with equities and bonds and so the class may offer good diversification benefits for a portfolio.
The Value of all the above investments can fall as well as rise and you may not get back the full amount invested

Asset Allocation

Volatility is a common measure used to highlight the level of risk of an investment. The higher the volatility, the more risky the investment is deemed to be. Volatility reflects the variability of returns. An investment that has produced steady and predictable returns over time would have a low volatility and therefore tend to be deemed low risk. In contrast, an investment with returns that fluctuate dramatically over a given period would have a high level of volatility.

Please note that, as highlighted in the Risk and Return section, this is not the only risk to consider when making investment decisions.

Investors who are prepared to accept more risk in an attempt to increase potential returns are better suited to an investment with larger equity (shares) content rather than a portfolio with a high allocation to cash and bonds. This decision is referred to as strategic asset allocation and is about deciding what should go into a portfolio in order to help achieve your individual goals while taking into account your attitude to risk.

The right mix of assets will depend on how long you plan to invest, what your financial goals are, and also how comfortable you are with short-term fluctuations in the value of your investment. Equities are likely to provide a better return over the longer term than cash deposits or bonds (fixed interest securities). Equities can rise and fall quite dramatically over short periods of time. The more risk you are willing to accept to improve potential returns, the greater the allocation of equities within your portfolio.

The graph below shows the performance over 10 years of some of the key areas of investing and as you can see there is no one asset class that wins year after year.

Past performance is not a guide to future performance

	2010	2011	2012	2013	2014	2015	2016	2010-2016	Ann. vol
Best	Gold 26.6	Gilts 19.6	High Yield 37.1	US Equities 30.4	Global Infrastructure 23.3	Japan 17.6	US Equities 33.4	US Equities 17.1	Cash 0.1
	FTSE All Share 21.8	Index Linked Gilts 14.7	UK Property 28.5	Europe Ex UK 26.5	US Equities 20.3	UK Property 11.6	Commodities 33.4	High Yield 12.0	Hedge Funds 4.1
	High Yield 21.2	Gold 10.9	Europe Ex UK 17.3	Japan 24.9	UK Property 20.2	US Equities 6.9	Emerging Markets 33.3	Global Infrastructure 10.7	Index Linked Gilts 6.2
	Commodities 20.5	Global Infrastructure 6.9	FTSE All Share 14.8	UK Property 22.6	Gilts 18.8	LGT Vestra Balanced 6.1	Global Bonds 26.6	FTSE All Share 10.3	Global Bonds 6.3
	Japan 19.0	US Equities 2.5	Global Infrastructure 11.8	Global Infrastructure 20.5	Index Linked Gilts 13.1	Europe Ex UK 6.0	Gilts 24.1	Japan 10.3	LGT Vestra Balanced 6.8
	US Equities 18.8	Global Bonds 2.0	US Equities 11.2	FTSE All Share 18.9	Global Bonds 7.6	High Yield 5.4	Japan 22.7	Gilts 9.5	High Yield 8.9
	Emerging Markets 17.6	Cash 1.2	LGT Vestra Balanced 10.6	LGT Vestra Balanced 14.0	FTSE All Share 7.5	FTSE All Share 5.2	Europe Ex UK 19.7	UK Property 9.0	Global Infrastructure 9.0
	Global Bonds 12.9	High Yield -3.0	Emerging Markets 9.0	High Yield 11.8	LGT Vestra Balanced 7.4	Emerging Markets 3.0	FTSE All Share 16.6	Europe Ex UK 7.9	Emerging Markets 9.3
	LGT Vestra Balanced 9.4	LGT Vestra Balanced -5.5	Global Bonds 7.7	Hedge Funds 6.1	High Yield 5.6	Global Bonds 1.8	Global Infrastructure 12.6	Emerging Markets 7.4	Gilts 9.6
	Gilts 8.0	Hedge Funds -7.7	Gold 5.0	Emerging Markets 1.7	Emerging Markets 5.1	Cash 0.7	LGT Vestra Balanced 10.9	LGT Vestra Balanced 7.4	FTSE All Share 10.2
	Global Infrastructure 7.0	UK Property -8.8	Japan 3.3	Cash 0.5	Japan 2.7	Index Linked Gilts 0.1	High Yield 10.5	Global Bonds 7.3	US Equities 11.4
	Index Linked Gilts 6.0	FTSE All Share -9.2	Hedge Funds 2.8	Gilts 0.1	Cash 0.6	Gilts -1.1	Index Linked Gilts 9.4	Index Linked Gilts 5.5	Japan 12.9
	Europe Ex UK 5.7	Emerging Markets -12.0	Index Linked Gilts 1.8	Index Linked Gilts -4.7	Europe Ex UK 0.0	Hedge Funds -1.8	Gold 7.6	Cash 0.9	Commodities 13.5
	UK Property 4.1	Commodities -12.7	Cash 1.4	Global Bonds -4.9	Gold -0.3	Global Infrastructure -4.6	Cash 0.7	Gold 0.0	Europe Ex UK 15.6
	Hedge Funds 3.3	Japan -12.9	Gilts 0.2	Commodities -11.2	Hedge Funds -2.5	Gold -12.5	Hedge Funds -3.1	Hedge Funds -0.5	UK Property 15.7
Worst	Cash 1.0	Europe Ex UK -14.4	Commodities -5.4	Gold -27.7	Commodities -11.9	Commodities -20.3	UK Property -8.9	Commodities -2.7	Gold 18.1

Diversification

One of the most effective means of reducing the different types of risk is to diversify your portfolio.

No one type of asset class, investment strategy, or investment manager provides the best performance over all time periods. So a range of investments should reduce the risk of the portfolio experiencing drops in performance across the board, at the same time. This is simply because one asset class or manager may perform well to counter the poor performance of another.

Diversification can be achieved in three distinct ways:

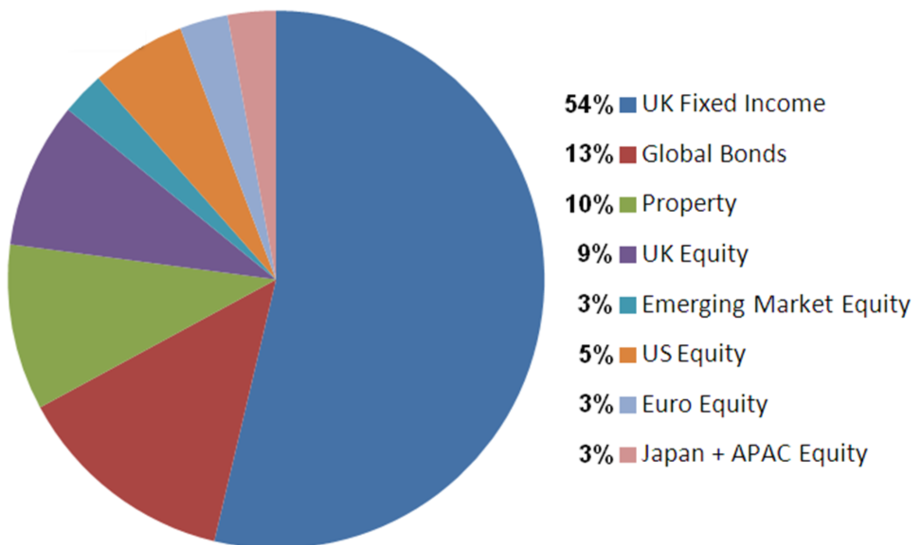
a) Diversification across asset classes
The major asset classes perform differently under different market conditions. Historically, no single asset class has consistently outperformed all others every year. So by investing across a variety of asset classes you may be able to reduce the volatility of your portfolio return.

b) Diversification across markets and regions
It is also valuable to spread your exposure within each asset class across a wide range of countries, currencies, industries and stocks. This global approach ensures that your investment is not narrowly concentrated in a particular region or industry, and helps to reduce the impact of a regional or industry downturn.

c) Diversification across investment management styles
Different investment management styles also tend to excel at different times under different economic and market conditions. By combining a range of investment managers with complementary investment styles you may be able to neutralise the bias to any one style in each asset class.

Diversification can greatly improve and have a vital role to play in the construction of investment portfolios. What it does not do is completely eliminate risk. Examples include the recent global economic recession and collapse of confidence in the international financial system. These cannot be eliminated and it is this risk that as an investor, you should know and need to accept.

A Typical Cautious Asset Allocation Strategy



The graph opposite is designed to give an *indication* of the types of assets that may be suitable for you and the *likely* proportions. However, this is not the only suitable investment solution, so your actual investments may vary from this model

Roles & Responsibilities

Your Risk Profile – Ongoing Reviews

Assuming you agree to the Preferred Ongoing service option when we review your situation with you, we may look to reassess your attitude to risk and investment requirements. If your circumstances have changed then it may be advisable to alter your investment strategy accordingly. It is also important that if, outside of any formal review, you feel your circumstances have changed and may effect your attitude to risk or investment requirements, that you contact us immediately so we can assess if any changes are needed to your investment strategy.