

Our Portfolio Construction Process



ATTITUDE TO RISK

Having established your existing financial position and objectives we assess your attitude towards investment risk through:

- completion of a bespoke psychometric questionnaire designed to assess:
 - your understanding of investment risk and reward.
 - your tolerance to short term fluctuations in value, i.e. volatility.
 - the overall level of risk you are prepared to accept in order to achieve your financial objectives.
- self-selecting your risk rating from our descriptive table.

We then use your self-selected risk rating to corroborate that generated from the psychometric questionnaire and confirm, or otherwise, your risk profile on our investment Richter scale.

ASSET CLASSES OR TYPES

Broadly speaking assets can be broken down into:

- Equities or shares, overseas and UK, larger and smaller companies.
- Fixed Interest securities such as Government bonds (Gilts) and corporate bonds.
- Property – bricks and mortar, UK and overseas.
- Cash – including bank and building society deposits and National Savings.

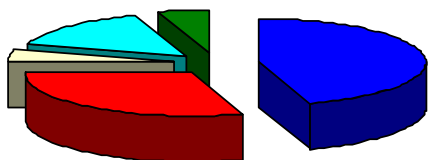
These have different characteristics and behave in different ways:

- Equities are predominantly for capital growth. Additionally, some, particularly those of larger more established companies, also pay dividends or income. Equities tend to be more volatile than the other assets types.
- Fixed interest securities main characteristic is to provide income. However, capital value increases and decreases in line with fluctuations in interest rates. They are less volatile than equities.
- Property, commercial investment as opposed to residential, tends also to provide income in the form of rent. Again, the capital value fluctuates this time in line with demand.
- Cash or deposits provide income and little or no capital growth. Whilst the least risky of the asset types its real value is eroded by the effects of inflation.

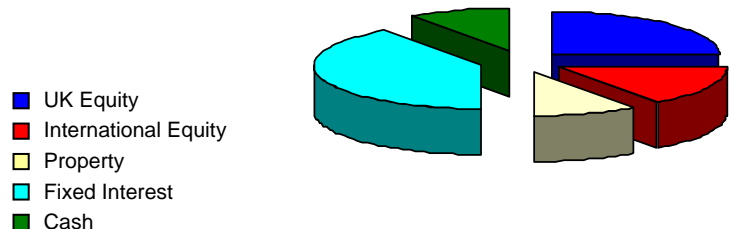
To create a balanced portfolio the different asset types are blended proportionally to match your risk profile and investment time scale. Adjusting the blend results in portfolios which exhibit different attributes. For example:

- More fixed interest and less equities provides more of an income bias and a lower volatility, whilst,
- More equities and less fixed interest provides a greater prospect for capital growth and correspondingly more volatility.

Adventurous Portfolio



Cautious Portfolio



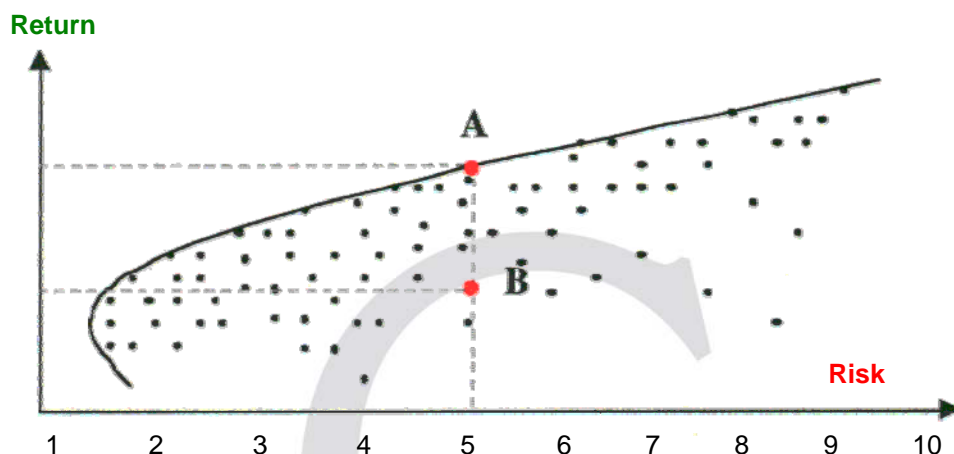
ASSET ALLOCATION

Using your risk profile and timescale we select the most appropriate of our predetermined asset allocation models. In reaching a final asset allocation recommendation we also take account of your existing assets and holdings.

Our predetermined portfolios have been established comparing 3 'Efficient Frontier' portfolio modelling tools and 2 industry standard models to create a consensus approach, which were then 'smoothed' or rounded. These asset allocation models and the underlying calculations and assumptions are reviewed regularly, at least twice a year.

The Efficient Frontier is where:

- Accounting for past and possible future returns on each asset and investment type, multiple portfolios are generated by making small adjustments to the asset and investment mix.
- Each of these slightly different portfolios is plotted on a graph showing its mathematically calculated likely returns and level of risk taken to achieve the projected returns.
- The graph demonstrates the optimal level of risk that can be taken for a calculated return.
- The resulting line which portrays the optimal returns is the efficient frontier.
- The optimal model portfolio is selected from the point on the efficient frontier which matches your assessed risk profile.



The black dots represent the plotting of each of the slightly different portfolios.

In this example **A** is the most efficient portfolio for risk profile 5, whilst **B** is an inefficient portfolio for the same risk profile.

Diversification is achieved by:

- Mixing asset types which do not react in exactly the same way as each other.
- Mixing or spreading the risk by holding different funds within each asset type, for example, holding not one but a balance of both opposing types;
 - Small companies and large companies.
 - US and Japan.
 - Growth funds and income funds.
- As each of these typically reacts differently to market and world events those that go down in value may well be countered by those that increase in value.

Correlation and non-correlation of holdings:

- Investments that move in unison are said to be correlated, such as UK equities or shares which will all, to a greater or lesser degree, move in the same direction at the same time.
- To reduce risk in a portfolio, assets that are non-correlated should be mixed. For example:
 - Japanese shares tend not to move in the same way as US shares.
 - Fixed interest securities generally react differently to equities/shares.
 - Property is generally neither correlated with fixed interest or equities.
- Mixing assets that are non-correlated also has the effect of reducing the overall risk of a portfolio.

Having determined a portfolio at the asset class level, we research funds within each category to select those with the best credentials. See our separate document for details of our fund research and selection process.

We confine our recommendations to collective investment funds rather than direct holdings in shares or other securities. Collective investment funds spread the risk by investing in a large number of shares and/or securities with the benefit of specialist fund management.

When reviewing portfolios, we revisit your risk profile and the corresponding prevailing optimal model asset allocation. Most importantly, we review the portfolio as a whole and not as individual holdings.

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