Risk Profiling Explained

It is vitally important, as your chosen investment adviser, that we ask you a series of questions to determine the extent to which you are prepared to take risks with your money, before recommending any investment. Your attitude to risk is an essential part of the advice process because the more accurately we establish your risk profile, the greater the chance of achieving the most suitable investment recommendation for your needs and objectives.

With any investment there is a risk of making a loss and you may get back less than you invest. Investments usually carry some risk of making a loss. One of the upsides is that generally speaking, the higher the risk the potential for higher returns over the longer term. Whether you consider yourself to be a high risk investor, cautious or somewhere in between, the main thing is to be comfortable that the funds selected within your portfolio as a whole, your investment portfolio, represents as closely as possible, a level of risk acceptable to yourself.

Your risk profile is established through discussion with your adviser and with his help, you will be asked to complete as accurately as possible a client risk questionnaire.

We establish your risk profile for your investment by asking you to complete as accurately as possible, a client risk questionnaire. Your responses (After completing this client risk questionnaire your answers) will be placed into our risk profiling software. This system has been developed by Skandia (our chosen Investment Process platform provider) in conjunction with a leading investment consultancy company, Towers Watson & Co. Your answers to these questions will translate your views about investment risk into a risk score.

We do not describe your attitude to risk with words or phrases as we believe that these may be misleading. Instead, our system will assign you a risk score number between 1 and 10, with 1 being the lowest level of risk and 10 being the highest level of risk. These risk score numbers will translate into a range of annual expected returns that you have indicated you are willing to subject your investment to by answering our client risk questionnaire. These ranges of expected returns are clearly expressed over the page in a graphical format.

Source: Skandia Investment Marketing, Towers Watson as at 18 June 2010.

Example

£100,000 invested in risk level 5, may potentially drop to £86,100.
£20,000 invested in risk level 6, may potentially drop to £16,634.

The ranges of expected annual returns give you an ability to compare each risk number and its potential returns and losses. The above figures are calculated to a 95% confidence level and thus, will not be completely accurate all of the time. After formally confirming your risk number, the risk profiling system will then design an investment portfolio that aims to maximise your investments returns. There may be times when even having determined your risk level we will agree to reduce or increase the level of risk to be adopted for a specific investment. This will be based on our discussions, your circumstances at the time of investment as well as your short and longer term objectives. The reasons for any change will be fully documented and confirmed in our Suitability Letter.

The system aims to maximise the returns of your investment, although of course this cannot be guaranteed, and adopts the principals of Modern Portfolio Theory (MPT). MPT began with the publication of a doctoral thesis called 'Portfolio Selection' by Professor Harry Markowitz in 1952. The theory states that the risk of a portfolio should be considered as a whole, rather than in terms of its individual asset classes.

The value of the individual investments within the investment portfolio will fluctuate over the term of investment, and because they usually behave differently from each other, the peaks and troughs may cancel each other out. The aim is to optimise that cancelling out process to achieve the highest possible level of return for your chosen level of risk. The system calculates the asset allocation for each risk score by using a complex mathematical formula known as Mean Variance Optimisation (MVO), an integral part of Modern Portfolio Theory. The asset allocation then aims to maximise your portfolio's investment returns.