The adviser guide to risk-targeted multi-asset funds

Contact details:

0845 070 8684
fundsales@lgim.co.uk
www.landginvestments.com/funds/multi-index/

This is not a consumer advertisement. It is intended for professional financial advisers only and should not be relied upon by private investors or any other persons.

The value of investments and any income from them can fall as well as rise and is not guaranteed. Investors may get back less than they invest.

Legal & General (Unit Trust Managers) Limited. Registered in England and Wales No. 1009418. Registered office: One Coleman Street, London EC2R 5AA. Authorised and regulated by the Financial Conduct Authority.

Risk targeted multi-asset funds look set to continue to grow in popularity. However, due to the speed of innovation and evolution in this area, some advisers are struggling to find the time to keep up. As a result, some confusion has started to creep into the market place over the features and benefits of these types of funds. This article aims to provide a bit of clarity around some of the key topics.

Risk rated versus risk-targeted

Some of the industry press coverage of these funds fails to clearly differentiate between a fund that carries a basic risk rating and a fund that is actively risk-targeted, but there is a world of difference between the two.

Any fund can receive a 'risk rating' from a (preferably independent) risk profiling agency. However, very few funds have an explicit mandate or process to maintain this rating. Normally, funds have other targets, such as delivering income or outperforming a benchmark. Over time, they can succeed or fail in meeting these targets, but either way, they could, and often do, drift away from their original risk rating. This poses a challenge for advisers who must continually reassess whether or not the fund remains suitable for a given client and aligned to their risk profile.

In contrast, a 'risk-targeted' fund aims to maintain its risk level, or match a specific risk profile, over time. The managers of these funds aim to build a portfolio that delivers strong risk-adjusted returns while remaining true to a particular risk profile. Doing this successfully requires the fund to adapt over time by adjusting the asset allocation in the face of developing trends. Even as the markets cycle through the inevitable bull and bear phases, the risk profile of a risk-targeted fund should remain fairly consistent. This allows advisers to align the risk attitude of their clients to the funds' and hopefully avoid any nasty surprises.

Delivering performance versus managing volatility

Risk-targeted funds should aim to deliver the best return possible within stated risk parameters. Performance is therefore fundamental to managing such strategies. The risk-targeted element serves to provide advisers with the comfort that the strategy will remain aligned to their clients' risk profile.

Justin Onuekwusi CFA

Fund Manager
Legal & General Investment Management

Index fund based risk-targeted multi-asset funds may provide a cost-effective solution for advisers seeking to support clients who might otherwise not be able to afford advice – in other words, they could be the solution to closing the 'advice gap'.

Volatility is simply one measure of risk, which misses out other portfolio risks such as inflation risk, illiquidity risk and active manager risk to name but a few. Ultimately, the main risk that investors are interested in is the risk of losing money and risk-targeted funds must seek above all to generate the best possible long-term return within their risk parameters.

Index versus active components

One look at the IA sector performance shows that multi-asset strategies with an index fund bias are not the ones languishing at the bottom of their peer groups. Active funds certainly do have the potential to outperform, but it does come with a definite cost penalty attached which can detract from their utility as a component of a multi-asset portfolio. They tend to be more expensive than index funds, and due diligence can be an expensive and often resource-intensive exercise.

With investors and regulators increasingly focusing on fund management costs, demand for cost-effective multi-asset solutions has never been higher. Investors increasingly understand that costs will inevitably detract from overall performance.

Proactive risk targeting versus blindly following a risk profile

Different risk-profilers have their own strengths and weaknesses, making sweeping generalisations difficult. However, blindly following a risk profiler could lead to sub-optimal outcomes. There is no 'right' way to determine the correct asset allocation to meet a given set of investment objectives. Risk is a multi-faceted problem and has to be analysed in a number of different ways. The key is to do so smartly and not just rely on a simplistic view of past performance to guide future investment decisions.

People sometimes fall into the trap of assuming that markets follow a normal distribution, such as the classic 'bell curve' commonly used in statistics. One of the lessons from the 2008 financial crisis, however, was that it's possible to rely too heavily on risk models that are based on these simplistic assumptions. At times of stress – which is exactly when you need them the most – these models tend to break down. In the real world, risk doesn't obey rules.

One way to make historical data more useful is to look at what 'might' have happened, not just what 'did' happen. A robust strategic asset allocation process will do this by random sampling 'slices' of data from different periods of market history, re-ordering these again and again to create thousands of variations that 'could' have occurred historically. Each slice preserves the relationships between asset classes at the time, allowing for more rounded and detailed analysis of those relationships.

The rise of risk-targeting

Risk-targeted multi-asset funds represent the next generation of multi-asset investment solutions, and it's no surprise that they have seen significant inflows and a plethora of launches. The concept is still a relatively new innovation for multi-asset funds and understanding will improve over time and therefore will no doubt deepen. With increased competition among product providers, these are exciting times for investors who should ultimately benefit in the form of stronger risk-adjusted returns and products that meet their needs.

Index fund based risk-targeted multi-asset funds may provide a cost-effective solution for advisers seeking to support clients who might otherwise not be able to afford advice – in other words, they could be the solution to closing the 'advice gap'.

In addition, if these funds succeed in being consistent with specific risk profiles, the adviser and their client will both have peace of mind that, as long as the client's attitude to risk doesn't change, the funds should remain suitable.

Multi-asset suitability: risk-targeted versus risk-rated

In a post-RDR world, where risk management is increasingly dominating advisers' day-to-day lives, risk-rated and risk-targeted funds (the Rathbones funds are both) have been designed to make your lives more tolerable.

Since the announcement of regulatory reform in 2007 – coupled with the credit crunch – advisers have been looking for ways to manage client risk and reward expectations. Therefore it was no surprise to see the fund management world respond with a marked uptick in the availability of risk-benchmarked portfolios.

By investing with a professional fund and investment selector, your clients are invested with someone who has the purchasing power that you don't have – who can take advantage of special access to opportunities and prices you wouldn't be able to access. They also have the resources and expertise to get the timing and combinations right.

Sense and Suitability

Traditionally, these funds have been the remit of the multi-manager/multi-asset arena and have sat under the 'cautious', 'balanced' and 'active/growth' banners – the majority of which are now placed in the Investment Association's Mixed Investment sectors. Their rise in popularity has been met with concerns, not least because the RDR has forced many advisers to focus on the regulatory and administrative strands of their businesses. This has taken time away from fund selection, meaning the attraction of risk-rated funds as a means of saving time and costs is clear. The Financial Conduct Authority has also issued caution over the use of risk-rated funds in this way, claiming they cannot be used as a shortcut to determine investment suitability, with a specific focus on the risk-mapping exercise performed by advisers using the funds. All this boils down to whether advisers have enough information to feel confident about that they are buying, as well as monitoring the on-going suitability of a product and how effective it is as time and client circumstances change.

Having gauged the capacity for capital loss of your clients and how much time they have to achieve their goals, risk-profiling can then follow with an increasing number of tools to help – Capita Synaptic is a leading example.

Whilst risk-rated and risk-targeted funds are placed into the same risk-mapping bracket, they have fundamentally different characteristics and offer differing investment goals. Of the advisers we have surveyed who do not expect use of these funds to increase, 60% cite lack of understanding as the biggest concern. Let me explain.

Risk-rated funds

Essentially, risk-rated funds offer a backward-looking snapshot of 'risk' that is attributed to the fund at a point in time without any reference to the future behaviour at an asset class or market level nor to the correlation between asset classes and the changes in correlation that occur. This does not assume that the investment process or objective being used to guide the fund embeds a risk measure. Effectively, therefore, you are buying a fund that involves a particular level of risk at a specific point in time but makes no guarantees in regard to the level of risk that the manager might take in future. Nor does a reliance on peer group comparison make for a natural link to your clients' tangible goals. Moreover, we believe this inherent competitiveness only serves to encourage excessive risk-taking, and not always the kind of outcome implied by the category classifications.

The way in which advisers select risk-rated funds also poses potential problems. The fact that many of these funds sit in the four managed sectors that hold multiple types of assets, raises the question whether advisers are controlling, or seeking to control, risk by simply restricting the amount of equities exposure alone. This concern was highlighted during the credit crunch when many funds in the former Cautious Managed sector recorded greater losses those in the Balanced sector. Furthermore, just over 40% of advisers still view volatility as the best measure of risk. All this of course, calls into question its continuing suitability for clients over the longer term.

Risk-targeted funds

Whereas risk-rated funds view as static, risk-targeted funds are forward-looking and

David Holloway

Marketing Director
Rathbone Unit Trust Management Limited

The beauty of risk-targeted funds is that you do not get drawn into conversations with your client about how their fund is ranked against products they might have owned but don't.

dynamic in approach. The 'target' offers an explicit measure of the level of risk that the fund manager is prepared to take. This does not guarantee that capital cannot be lost, but it does commit the fund manager to working within certain boundaries. It also means that the manager recognises that volatility and the way assets move in relation to each other is not constant. The manager's skill is in watching for and acting on the signs of change on your clients' behalf. This will give comfort to nearly 60% of the advisers we surveyed who only review their clients' holdings once a year.

It's our experience that most goal-driven investors do not care about which fund is 'best' – but they do care if the fund has not met its investment objectives. The beauty of risk-targeted funds is that you do not get drawn into conversations with your client about how their fund is ranked against products they might have owned but don't. Instead, the sole focus is on matching the products you have bought for your clients to their goals and aspirations. For this reason, the Rathbone's funds are not classified within the four mainstream groupings mentioned above, but for now, until a more appropriate home is created, in the unclassified sector.

These products tend to work with tangible meanings, such as targeting a certain percentage over cash. Detractors of these products have often cited those parameters placed on a fund manager as too excessive when it comes to them being able to outperform; however, this is the point, as these products are designed to provide consistent returns across variable market conditions.

Looking Forward

With the appropriate forward-looking processes and embedded risk measures in place, and a timeframe by which to measure them, fund managers can be sure what risks they are taking. It follows that you can then assess whether the products chosen for your clients will continue to match their (potentially changing) risk tolerance and circumstances, and you can make realistic comparisons with alternative products.

We see risk-targeted funds assuming greater importance over the next 10 years or so. In fact, 61% of our advisers told us that they expect and increased use of risk-benchmarked products in the next three years. At Rathbones, our three multi-asset products are risk-targeted in the sense that they target relative risk benchmarks of one-third, two-thirds and 100% of world equity market volatility respectively.

We also have a range of strategies brought to you by our Investment Management team to meet your clients' needs. Find out more through Capita Synaptic or contact Rathbones on **020 7399 0399**.

The information contained in this note is for use by investment advisers and journalists and must not be circulated to private clients or to the general public.
Survey: Coredata, Use and Understanding of Risk Rated and Risk-Targeted Funds, 2014.

The Power of Monte Carlo in Retirement Planning

If you were to put one foot in a bucket of ice and the other foot in a bucket of boiling water, on average, your body temperature should be normal, or so goes the saying. But how confortable would you be, really?

Sadly, this this what we do as financial planners when you use deterministic models with clients. Most of the cashflow planning tools used by planners (such as Voyant, Prestwood/Truth) are primarily deterministic models, and even the highly regarded Certified Financial Planner accreditation is primarily assessed based on this model.

The fact is, assumptions of long-term averages are unhelpful. They can be easily thwarted by the powerful combination of volatility drag, sequencing risk and 'pound cost ravaging.' These are ever-present dangers in retirement portfolios.

Illusion of Certainty

The lack of robustness and rigour aside, perhaps more worryingly, deterministic cashflow planning models risk misleading clients. Because they are often used as tools to help clients visualise likely retirement outcomes, they give clients an impression that their investments grow in a smooth, linear format over time, when in reality nothing can be further from the truth. Add to this the fact that product illustrations are also deterministic, you end up with meaningless data being served to clients, with no real grounding in reality. Deterministic planning tools convey the illusion of certainty, where there is none. The reality is, investment outcomes are unknown, so why pretend to clients that they are? Using tools that attempt to simplify potential outcomes, but in the process miss some of the most important factors that could impact the plan's outcome is clearly an inadequate approach.

Monte Carlo simulation is a mathematical method used to estimate the most likely outcome and the odds that certain events will occur. Like the roulette wheels associated with the casinos of Monte Carlo, these simulations reproduce outcomes by generating random numbers within set parameters. Unlike a roulette wheel, the Monte Carlo method uses random numbers to quantify uncertainty and chance events.

The problem with a straight-line projection calculation is that it treats the outcome as certain, while in reality, and especially with the markets, nothing is certain. A Monte Carlo simulation provides a more 'colourful' perspective of the range of potential outcomes given the expected return and volatility of a portfolio.

Monte Carlo is a significant improvement on deterministic models, because it takes into account the unpredictability of returns and factors such as life expectancy and inflation. They are based on an assumed mean, standard deviation and correlation, and express potential outcomes in terms of the probability of successfully meeting clients' objectives. This is valuable information for planners to consider and communicate to their clients. It gets clients and their advisers talking about financial planning and retirement outcomes in terms of probability rather than certainty. And this goes right to the heart of communicating and demonstrating clients' capacity for loss.

By running thousands of scenarios using specific parameters, planners can determine the likelihood of specific outcomes. Some Monte Carlo simulations even allow users to adopt a more "fat-tailed" distribution method. This means that the odds of extreme events are counted as being greater than they are in a traditional bell-shaped distribution curve. This enables planners to define outcomes in terms of probability of success or failure – that is, the percentage of trials that resulted in a successful outcome (or failure). So for instance, the planner may decide, together with their client, that a success rate of below 70% probability is unacceptable to them and the plan needs to be adjusted by reducing withdrawals or changing asset allocation, to bring back the probability of success to an acceptable level.

They may also decide that a success rate of more than 90% is too cautious and have a

Abraham Okusanya

Principal
FinalytiQ

The lack of robustness and rigour aside, perhaps more worryingly, deterministic cashflow planning models risk misleading clients.

conversation about increasing withdrawals (if required by client). This communicates clearly to the client, the probabilistic nature of the potential outcomes and drives home the importance of ongoing financial planning.

A good Monte Carlo tool should also enable planners to investigate the magnitude of failure. In other words, if there is a 30% chance of failure, what is the magnitude of the potential shortfall?

Monte Carlo isn't the Holy Grail but it is a significant improvement on deterministic models. It has its shortcomings, not least of which is the fact it is too often utilised as if it is an absolute answer. Like all models, you need quality inputs to get quality outputs. It should never be treated as an absolute forecast, but rather as an educated guess of likely outcomes. And there are tendencies to focus excessively on the probability of success/ failure, and ignore the magnitude of failure and sensitivity of inputs. But these aren't shortcomings of the model as such, just how it's implemented by financial planning software providers.

In the UK, Monte Carlo software is directly accessible to advisers using the Synaptic Modeller tool. Powered by Moody's Analytics stochastic engine, this offers a major advantage given Moody's global risk modelling capability.

About Abraham Okusanya

Abraham is the principal at FinalytiQ, a research consultancy specialising in centralised investment propositions, platforms and technical support for financial planning firms.

A Chartered Financial Planner and CFP Professional with nearly a decade's experience, Abraham holds a Master's degree from Coventry University and more financial services qualifications that he or anyone else cares to remember. He sits on the investment committees of several financial planning firms, and his services are frequently sought by platform providers looking to build deeper and more meaningful relationships with advisers.

He chairs the London branch of the Institute of Financial Planning. A prolific writer, his articles regularly feature in industry press including Professional Adviser, FT Adviser and New Model Adviser.

Contact details:

Mobile: 07940 985 852
Telephone: 01268 502 454
Email: abraham@finalityiq.co.uk

CAPITA

Financial software

Caution!

Current very low volatility levels are masking true investment risk. What is it all about?

For many years, stock markets behaved in a relatively more consistent manner – with a gradual improvement in the main indices reflecting steady progress. Unfortunately today, equity prices, along with other asset prices have been drawn into the experimental vortex of central bank activities such as quantative easing. In the recent past we have had several 'once in 20 year' events including the Tech bust, Lehmans and the great depression. The extreme policy decisions (that have also saved investors skins it must be noted) have created artificial investment conditions that are influenced more by currency manipulations than traditional fundamentals.

No one knows how the unravelling which is being anticipated will play out in the investment portfolios of our customers. More than ever, risk is on the agenda. The specific point we have arrived at now, is one where both fixed interest and equity volatility is tracking very low across many areas, and may be a less reliable measure for risk than historically has been the case.

Most of us have evolved our approach to investment using volatility based measures, often aligned with more 'qualitative' research. Advisers know which Fund Managers have proved resilient in down markets, but across diversified portfolios, research teaches us that it is Asset Allocation that drives performance.

An adviser's experience and market intuition can no longer offer sufficient evidence of the objective research that the regulator expects to see.

Business as usual? Breakout or breakdown?

The Financial Conduct Authority (FCA) and investment suitability

The FCA made establishing 'suitability' of investment central to the RDR requirements. The FCA has stated that a professional adviser must:

- know and understand the financial circumstances of their client;
- use a robust process to establish their client's Attitude to Risk and Capacity for Loss;
- understand why they are recommending a certain Asset Allocation (strategy);
- understand how the funds recommended satisfy the strategy;
- understand the tools they use to arrive at these decisions;
- review the strategy on a regular basis.

The FCA has stated that not only should a client understand:

- what their attitude to risk means and agree with it;
- understand what their 'Capacity for Loss' may be;
- quantify possible losses;
- assess client's ability to absorb falls in the value of their investments.

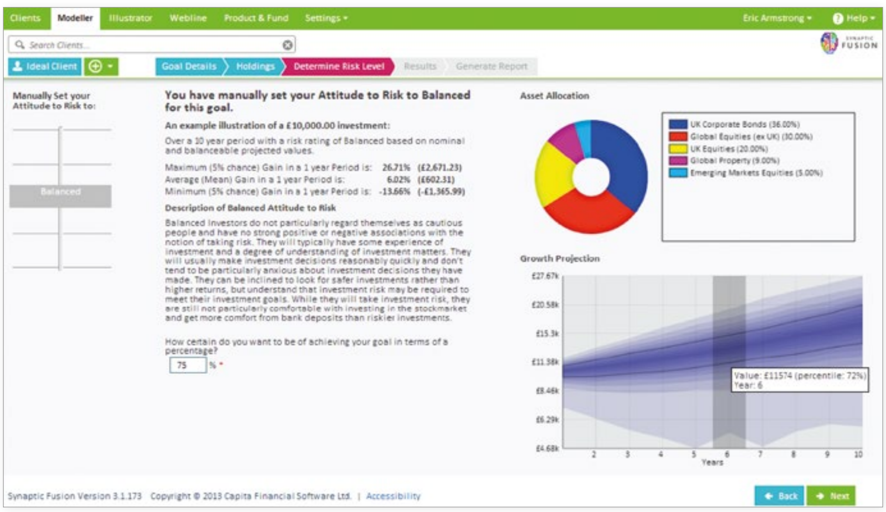
Synaptic Modeller assists you, as an adviser in meeting and evidencing the FCA requirements relating to client and investment risk and suitability. Request a demo by calling 0800 783 4477.

The Synaptic Capacity for Loss quotient – a consistent measure and single point of reference for risk:

- The Synaptic Risk Rating service is built around the stochastic model derived from the Moody's Analytics Economic Scenario Generator. The latter is an award winning engine that is widely recognised as one of the leading applications of its kind. A risk model is only as good as its ability to capture probabilities of unknowable outcomes. The Moody's Analytics (formerly known as Barrie + Hibbert) model has demonstrated its reliability through many market changes, including the recent downturn.
- A great advantage of replacing the traditional (backward looking) volatility route with the (forward looking) stochastic route is the removal of reliance on volatility as a proxy for risk, an approach which has several known drawbacks – including an inability to model the sequence of good and bad years within an investment horizon. (For example a bad year at the beginning of the term can mean losing money instead of gaining money due to the loss of compound interest).
- The outputs from the stochastic model form a distribution graph. The graph identifies the 'most likely return' in the form of a mean, but also the possibility of higher or lower gains. The 'Capacity for Loss' quotient is simply the '95th percentile' – identifying that the outcome has a "once in twenty year" chance of happening.
- Assuming our investment's asset classes are known, the stochastic engine projects possible outcomes over a given term (default 10 yrs), calculating the Capacity for Loss quotient (min gain), as well as the projected maximum and average returns.
- The Capacity for Loss quotient is therefore meaningful to any client in the context of their personal circumstances, allowing the adviser to document the client's Tolerance for Loss and actual Capacity for Loss quotient, based on a realistic understanding of the probability of those projected outcomes occurring.
- Fund managers and providers who have their investment instruments rated in this way can therefore be confident they know where their propositions fit in these advisory firms' risk categories.

See synaptic-risk.capitafinancialsoftware.co.uk/capacity-for-loss for more information.

The screen below form Modeller shows the ability of the adviser to explore the how different strategic asset allocations will perform according to the Moody's (formerly Barrie + Hibbert) stochastic engine.

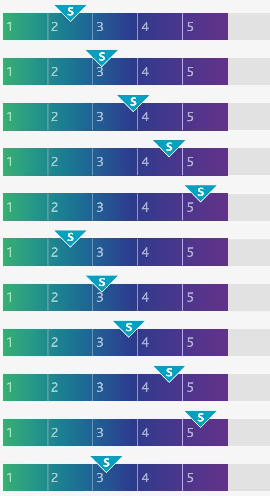


Synaptic Risk Rating Service

SYNAPTIC RISK

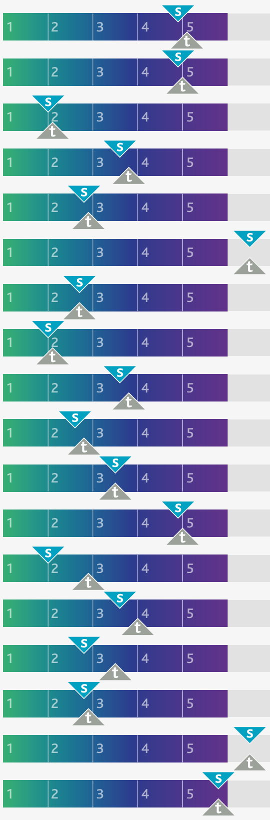
Canada Life Investments

- CF Canlife Portfolio III
- CF Canlife Portfolio IV
- CF Canlife Portfolio V
- CF Canlife Portfolio VI
- CF Canlife Portfolio VII
- Canlife Portfolio 3
- Canlife Portfolio 4
- Canlife Portfolio 5
- Canlife Portfolio 6
- Canlife Portfolio 7
- CF Canlife Total Return Fund



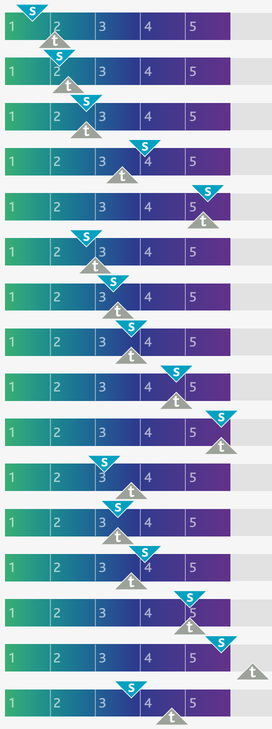
Fidelity Worldwide Investment

- Multi Asset Adventurous
- Multi Asset Allocator Adventurous
- Multi Asset Allocator Defensive
- Multi Asset Allocator Growth
- Multi Asset Allocator Strategic
- Multi Asset Allocator World
- Multi Asset Balanced Income
- Multi Asset Defensive
- Multi Asset Growth
- Multi Asset Income
- Multi Asset Income & Growth
- Multi Asset Open Adventurous
- Multi Asset Open Defensive
- Multi Asset Open Growth
- Multi Asset Open Strategic
- Multi Asset Strategic
- Open World
- Wealth Builder



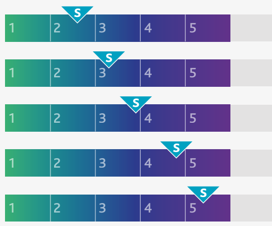
FE – Be Better Informed

- Risk Level 1 Short
- Risk Level 2 Short
- Risk Level 3 Short
- Risk Level 4 Short
- Risk Level 5 Short
- Risk Level 1 Medium
- Risk Level 2 Medium
- Risk Level 3 Medium
- Risk Level 4 Medium
- Risk Level 5 Medium
- Risk Level 1 Long
- Risk Level 2 Long
- Risk Level 3 Long
- Risk Level 4 Long
- Risk Level 5 Long
- Income



Legal & General Investment Management

- Multi-Index 3
- Multi-Index 4
- Multi-Index 5
- Multi-Index 6
- Multi-Index 7



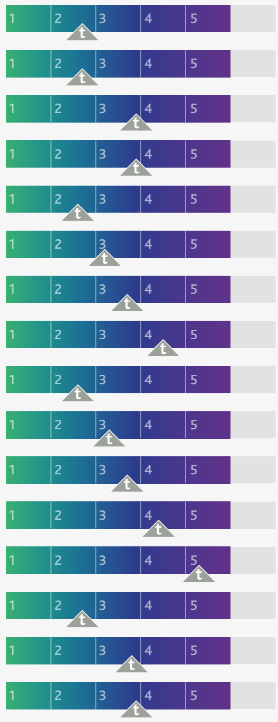
M&G Investments

- M&G Episode Balanced Fund
- M&G Episode Income Fund
- M&G Episode Growth Fund
- M&G Optimal Income Fund
- M&G Global Dividend Fund
- M&G Global Emerging Markets Fund
- M&G Recovery Fund
- M&G Strategic Corporate Bond Fund
- M&G Property Portfolio
- M&G Global Macro Bond Fund
- M&G Corporate Bond Fund

CAPITA

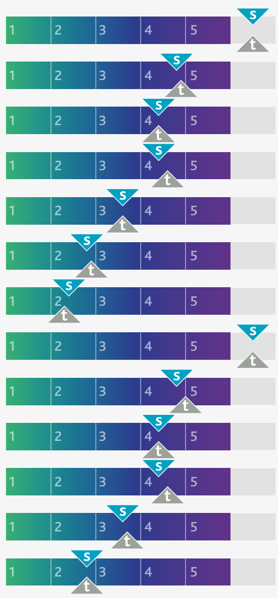
PRUDENTIAL

PruFund Cautious
PruFund Protected Cautious
PruFund Growth
PruFund Protected Growth
PruFund 0-30
PruFund 10-40
PruFund 20-55
PruFund 40-80
Defensive Portfolio
Cautious Portfolio
Cautious Growth Portfolio
Balanced Portfolio
Adventurous Portfolio
Managed Defensive
Cautious Managed Growth
WP Optimum Return



QUILTER CHEVIOT
INVESTMENT MANAGEMENT

MPS Global Growth
MPS Growth
MPS Balanced
MPS Global Income
MPS Income
MPS Conservative
MPS Cautious
MPS Global Growth (Platform)
MPS Growth (Platform)
MPS Balanced (Platform)
MPS Global Income (Platform)
MPS Income (Platform)
MPS Conservative (Platform)



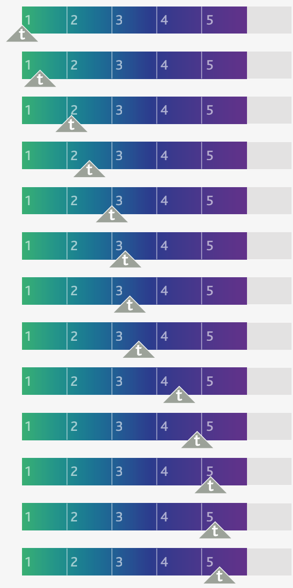
Premier
Asset Management

Funds

Premier UK Money Market Fund
Premier Defensive Growth Fund
Premier Corporate Bond Monthly Income Fund
Premier Multi-Asset Conservative Growth Fund
Premier Multi-Asset Absolute Return Fund
Premier Liberation IV Fund
Premier Multi-Asset Distribution Fund
Premier Multi-Asset Monthly Income Fund
Premier Liberation V Fund
Premier Diversified Fund
Premier Liberation VI Fund
Premier Multi-Asset Growth & Income Fund
Premier Liberation VII Fund
Premier Multi-Asset Global Growth Fund
Premier Liberation VIII Fund

Portfolios

Premier Cash Portfolio
Premier Cash Plus Portfolio
Premier Capital Builder Portfolio
Premier Capital Builder Plus Portfolio
Premier Income and Growth Portfolio
Premier Income Portfolio
Premier Conservative Portfolio
Premier High Income Portfolio
Premier Balanced Portfolio
Premier Balanced Plus Portfolio
Premier Growth Portfolio
Premier Growth Plus Portfolio
Premier Dynamic Growth Portfolio



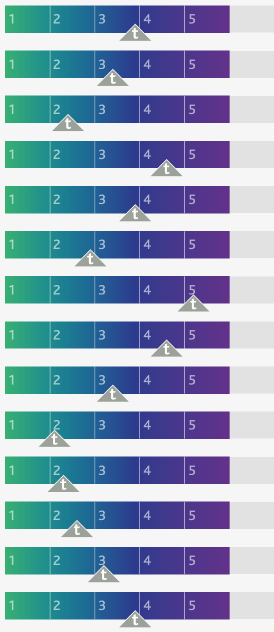
RATHBONES
Established 1742

RMAP Total Return
RMAP Strategic Growth
RMAP Enhanced Growth
Strategy 1
Strategy 2
Strategy 3
Strategy 4
Strategy 5
Strategy 6

SYNAPTIC RISK

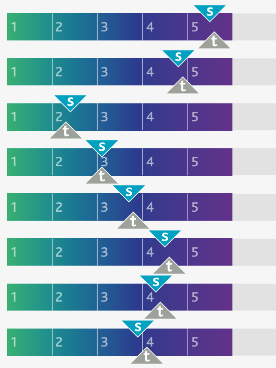
ROYAL LONDON

- RL Governed Portfolio 1 (l)
- RL Governed Portfolio 2
- RL Governed Portfolio 3 (s)
- RL Governed Portfolio 4 (l)
- RL Governed Portfolio 5
- RL Governed Portfolio 6 (s)
- RL Governed Portfolio 7 (l)
- RL Governed Portfolio 8
- RL Governed Portfolio 9 (s)
- RL GRIP 1
- RL GRIP 2
- RL GRIP 3
- RL GRIP 4
- RL GRIP 5



Sanlam PRIVATE Wealth

- Adventurous Plus Portfolio
- Adventurous Portfolio
- Conservative Portfolio
- Defensive Portfolio
- Moderate Portfolio
- Positive Plus Portfolio
- Positive Portfolio
- Progressive Portfolio

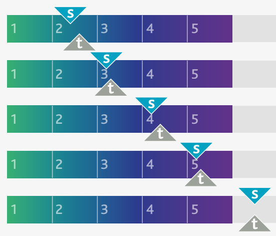


Vanguard®

- Vanguard LifeStrategy 20%
- Vanguard LifeStrategy 40%
- Vanguard LifeStrategy 60%
- Vanguard LifeStrategy 80%
- Vanguard LifeStrategy 100%

Santander ASSET MANAGEMENT

- Santander Atlas 3
- Santander Atlas 4
- Santander Atlas 5
- Santander Atlas 6
- Santander Atlas 7



Access the Synaptic Risk Fact Sheets and the Synaptic Attitude to Risk Questionnaire by visiting **synaptic-risk.capitafinancialsoftware.co.uk**

SYNAPTIC RISK RATING 1	SYNAPTIC RISK RATING 2	SYNAPTIC RISK RATING 3	SYNAPTIC RISK RATING 4	SYNAPTIC RISK RATING 5
Cautious	Moderately Cautious	Balanced	Moderately Adventurous	Adventurous

Synaptic Risk Rating based on following analysis: s Strategic Asset Allocation t Tactical Asset Allocation

(s) These portfolios were constructed with short investment timelines (5 year) in mind.
(l) These portfolios were constructed with longer investment timelines (15 year) in mind. Otherwise Synaptic Risk Ratings assume a 10 year investment horizon. You should consult Scottish Life directly for further information before recommending.

About the service: Synaptic Risk Ratings are worked out by analysing the underlying asset classes within the fund or portfolio. CFSL have requested asset allocation information from participating providers in a specific format aligned to the risk framework of the system. These asset classes are used by the model to determine the risk rating, a process that may result in a level of approximation though in most cases this will be insignificant. It is also possible that certain asset classes may not be represented exactly in the manner that providers would prefer.

Reasonable endeavours are made to provide accuracy and consistency, however neither participating providers nor CFSL can be held responsible for any errors or omissions. No recommendation should be made solely on the basis of the Synaptic Risk Ratings, and additional research should be undertaken for any case. This service is intended for use by investment professionals only.

The Synaptic Risk Proposition

Eric Armstrong

Provider & Platform Relationship Manager
Capita Financial Software

SYNAPTIC
MODELLER

The role of stochastic modelling alongside volatility based or qualitative research.

FT Adviser journalist Matthew Jeynes published a thought provoking piece on 29th April titled 'Advisers warned of 'dangerous flaws with risk tools'. The warnings were concerned with the reliance on volatility as the basis of 'risk-targeting' tools to build in-house propositions, reflecting on different aspects of the shortcomings of using volatility as a proxy for risk.

When you consider the overarching dominance of the couple of market leading solutions that have been adopted by the advice industry, you can appreciate that something of a systemic risk has developed. As Matthew's article points out, where such a uniform treatment of risk has been applied 'the methodology used by some.. has 'flaws' that could direct low-risk clients into assets set to collapse in value'.

This is an area of concern for the regulator, fund promoters and advisers alike. Matthew highlights recent research from Iveagh in respect of risk-targeted funds, indicating that 40 percent of respondents had said that they had 'developed our own in-house proposition, or intend to'. Not only are fund promoters uniformly aligning to the problematic risk rating services by default, adviser firms are building their own investment strategies in line with these frameworks. The risks inherent in such a 'mono culture' aside, it would seem the greater risk flows from the over reliance on the volatility based methodologies.

As reported by Matthew, experts in multi asset investing as diverse as Sarasin, Whitechurch Securities and Charles Stanley are adding to what are becoming increasingly well documented concerns over the reliance of Volatility as a proxy for risk.

In its various guidance around investment suitability, the regulator has highlighted the problems with over reliance on these tools, and puts the onus firmly on the adviser's shoulders to demonstrate that they have recommended levels of investment risk that are appropriate to their client's objectives, and just as importantly, that their clients fully understand and agree with the recommendation.
Having therefore, a consistent and reliable measure of risk is essential to complete the recommendation, in a way that is 'robust', 'repeatable' and 'reviewable'.

Synaptic have responded to this challenge by building an investment risk analysis and review tool, that accesses one of the most sophisticated risk engines in the market – the Moody's Analytics (formerly Barrie + Hibbert) Wealth Scenario Generator, the market leading 'stochastic engine'. The engine is at the heart of the Modeller tool, enabling the user to gain a view of investment outcomes, ensuring that the adviser can have an informed discussion of both growth and possible loss.

Leading distributors have embraced the advantages of a probability based risk model, sidestepping the challenges that over reliance on volatility pose. The stochastic model provides multiple economic scenarios, and the

Synaptic software allows specific holdings or notional investments to be 'projected' according to the various asset classes that make up the investment. Following the logic that asset allocation drives performance, this tool provides a comprehensive view of possible outcomes.

Pressure from the regulator to evidence research used in the evaluation of investment risk is turning the spotlight onto the research commonly used. The volatility based systems tend also to be combined with a 'qualitative' overlay. This is where the ratings agencies 'set' a risk level based on their opinion. This absolutely may have its place, but cannot be considered to be an objective risk measure, based on transparent methodology. This is why we are promoting the stochastic route, to be used alongside a firm's preferred 'qualitative' measures.

The Synaptic Risk Rating Service (See overleaf)

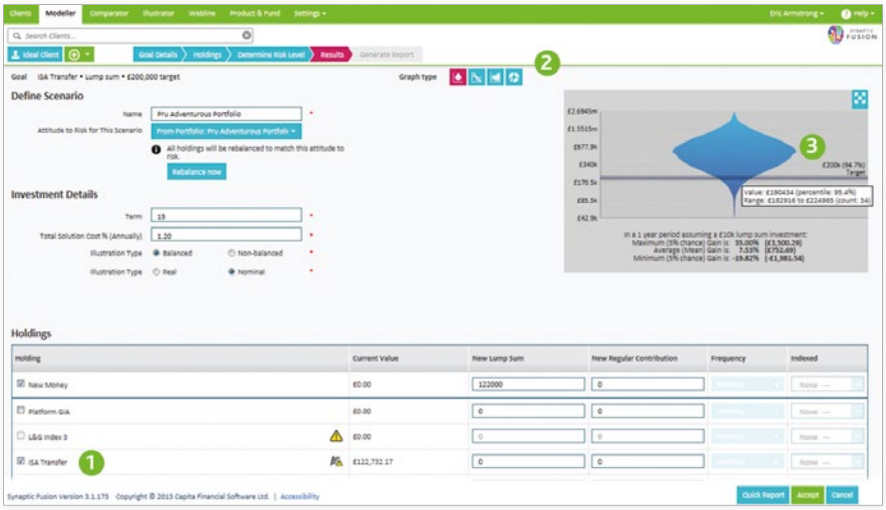
This is a new service that offers advisers research and reports based on the stochastic outputs of the Moody's engine. Subscribers to Synaptic have the ability to undertake this research using the Modeller tool, but the Risk Service maintains an updated range of investments, representing the choices of subscribers, including ratings on portfolio solutions from Providers such as Quilter Cheviot and Royal London.

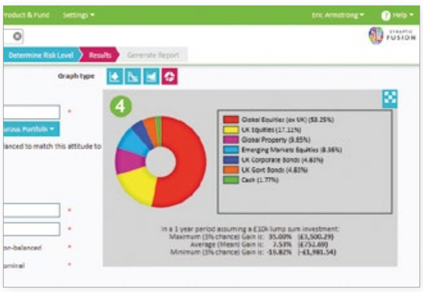
The Ratings service, along with the aligned Synaptic Attitude to Risk Questionnaire, is currently offered free to Synaptic and CCD users, and free for 6 months to others. This generous offer is borne out of a key objective we have with our wider tool set, which is to increase the adoption of stochastic metrics. You can visit the site to register at **synaptic-risk.capitafinancialsoftware.co.uk**.

Following the recent launch of the service, we have reviewed the format and included projections for both 'strategic' and 'tactical' asset allocations. Participating providers and their investments are included overleaf.

The Synaptic Modeller Risk Based Journey

As of next quarter, the users of Synaptic Modeller will have further options for conducting their research, following requests that portfolios built or distributed within an organisation can be projected within the Stochastic engine without going through the 'rebalancing' cycle within Modeller. This has been facilitated to streamline advisers' access to the stochastic engine. Please feel free to request a demonstration.





1. Pull preferred investment solutions, including portfolios into the research
2. Probability and extent of loss (and growth) is quantified and represented graphically in easy to understand metrics
3. Stochastic projections can be represented in different graphic formats
4. Synaptic system allows analysis and reporting of portfolio asset allocation

This article is for investment professionals only and should not be relied upon by private investors.

Risk-profiled funds – the perils of the peer group

A notable recent trend in the industry has been the increasing use of risk-profiled fund solutions by advisers. This is understandable given the FCA's increased focus on suitability and the fact that these solutions can provide a cost-efficient way of meeting client needs. However, because each of these products is very different in how it is constructed and the outcome it is designed to achieve – comparison is challenging.

Contact details:

fidelity.co.uk/multiasset
0800 368 1732

It is, of course, the client who is paramount in the minds of advisers and designers of fund solutions and it's imperative that the client is able to understand what to expect from any recommended product. It follows that when reviewing the performance of a solution, such a review should be carried out in the context of it is designed to achieve. In other words, is it delivering its stated outcome for investors – and therefore meeting your clients' expectations?

Assessing fund performance – there's a right way and a wrong way

Risk-profiled funds tend to follow a multi-asset approach, combining different asset classes in order to provide both a diversification benefit as well as offering a range of risk profiles.

While all risk based funds look to keep risk at an appropriate level, there are many different ways to achieve this. One way to ensure risk is kept at an appropriate level is to manage the fund to a long-term strategic benchmark, constructed to deliver a given level of risk over time. The methodology for constructing the strategic allocation will vary for each solution, but ideally it will be set using an in-depth analysis of the historical volatility and correlation of the different asset classes. At Fidelity, we test a large number of different scenarios for how asset classes could behave over the long term. Our approach is based not on the historical performance of individual asset classes, but how they tend to behave relative to each other. This means we can be confident that the portfolio will maintain the desired risk and return characteristics in the future.

Because managers approach this fundamental part of fund design differently, they will offer different asset mixes, potentially holding different asset classes. They will use different risk and return assumptions to underpin their modelling, resulting in different long term expectations. All in all, multi asset funds from different providers – while designed to have similar risk characteristics – may hold very different asset allocations and look very different to each other. This means that care needs to be taken when comparing funds and that makes a simple peer group analysis approach problematic.

Risk-profiled funds are often judged against funds which fall within the IMA 'Mixed Asset' sectors. However, the rules for the IMA Mixed Asset sectors are very flexible in terms of asset allocation. For example, one fund within the Flexible Investment sector can have an equity exposure of 100% while another could hold no equities at all. The

James Bateman

Head of Portfolio Management
Fidelity Solutions

About James Bateman

James Bateman is Head of Portfolio Management for Fidelity's Investment Solutions Group. The Investment Solutions Group is a 23-strong team* of specialists in solutions design, tactical asset allocation, manager selection and risk management. The group has a 20-year history of developing solutions tailored to match specific client objectives and risk profiles. Based in London, Paris, Tokyo, Singapore and Hong Kong, the team manage more than £28 billion* for investors around the world.

* Source: Assets and resources are those of FIL Limited as at 31 December 2013.

> Our approach is based not on the historical performance of individual asset classes, but how they tend to behave relative to each other. This means we can be confident that the portfolio will maintain the desired risk and return characteristics in the future.

sectors include many different funds following diverse investment approaches and asset allocation policies. In performance terms, such wide sector parameters will typically favour funds which take extreme positions. So, funds which maintain a relatively high exposure to growth-oriented assets should be expected to outperform in bull markets but underperform in bear markets. Conversely, funds which consistently maintain higher relative weightings to safer assets should be expected to outperform in bear markets but underperform in bull markets. Of course, there is nothing wrong with funds taking extreme asset allocation positions or having wide asset allocation parameters so long as the funds' investors have understood and are happy with the risks involved.

Risk based funds, however, are designed differently – they are managed to defined client risk profiles and so will generally have much more constrained asset allocation parameters. They are not designed to take big bets between asset classes – if they did, their risk profiles could well become incompatible with the profiles of the funds' investors at any given time. Comparing the performance of risk-profiled funds to funds which take much bigger asset allocation bets is therefore inappropriate – it's like comparing apples to pears. The performance of a risk-profiled fund should be compared to its strategic asset allocation benchmark. This is because the strategic benchmark is a proxy for the client's risk profile and this should be taken into account when analysing performance of any risk based solution. It may sound obvious, but if a fund is performing in line with or ahead of its benchmark, then it is meeting the needs and expectations of the underlying investors. It is for this reason that many providers of risk-profiled funds, including Fidelity, have removed their funds from the IMA peer groups.

Consequently, we recognise that it's not easy to compare risk-profiled solutions to each other but believe that there is no substitute for an in depth review of each solution under consideration as this is what allows the adviser to gain a solid understanding of the approach taken – and the investor outcomes expected. By investing time at this early stage, the adviser can demonstrate they have met suitability requirements in selecting the most appropriate long-term solution for their client, which in turn should lead to a long-term happy client base.

For more information please contact your local Fidelity representative, visit our website at fidelity.co.uk/multiasset or call FidelityLine 0800 368 1732.

This article is for Investment Professionals only, and should not be relied upon by private investors. The value of investments can go down as well as up and clients may get back less than they invest. Investments should be made on the basis of the current prospectus, which is available along with the Key Investor Information Document, current and semi-annual reports, free of charge on request by calling 0800 368 1732. Issued by FIL Investments International, authorised and regulated by the Financial Conduct Authority. Fidelity, Fidelity Worldwide Investment, the Fidelity Worldwide Investment logo and F symbol are trademarks of FIL Limited. RM0514/3379/SSO/1114

MOODY'S ANALYTICS

How do savers think about risk?

A population survey: implications for customer engagement and communications

As RDR and auto-enrolment wash through the UK retail investment market, customers will come face-face with a changing market-place: online and simplified advice, D2C and worksite platforms, default funds.

While the regulatory lines between these new models remain blurred, all of these will involve a fundamental change in the customer engagement model, and the way in which product information is communicated. The underlying challenges are clear enough:

- How do we engage customers to enable them to make savings decisions and take action: start saving, choose a suitable product, set appropriate contribution levels?
- How do we enable customers to make well-informed investment decisions?

The Pensions Institute, part of Cass Business School, has recently published the findings of a population survey which seeks to understand how savers' perceive risk and make investment decisions in relation to their savings goals[1].

This research highlights important inconsistencies between savers' attitudes to investment risk and their savings goals. The results demonstrate that investors' behavioural biases can lead to poor investment decisions, and outcomes which are misaligned with savings needs. The research findings have been summarised in the form of five "Key Lessons" (see the box below), and have clear implications for how we engage customers and communicate the risks and benefits of investment products.

Population Survey

The Pensions Institute commissioned a YouGov population survey of a representative sample of 4,154 individuals from the UK adult population. The sample included those not participating in the workforce, as well as employees and retired workers. The survey included questions relating to the respondent's attitude to risk, their capacity for loss, and the amount of savings risk (i.e. the size of shortfall in relation to savings goals) they were willing and able to take. The survey considered the trade-offs savers make in order to manage these risks.

Improving Savings Outcomes: Communicating Investment Risks

Traditionally, the management of risk for retail savers has relied on aligning attitude to risk with portfolio volatility. Many of todays' risk rating solutions continue to rely on this approach.

However, the Pensions Institute's research has shown that investors find it difficult to evaluate the trade-off between investment risk (fluctuations in portfolio value) and savings risk (the risk of failing to achieve savings goals). This leads to investment decisions which are predominantly influenced by the customer's attitude to investment risk and behavioural biases, rather than their savings needs.

The "Key Lessons" stated in the research report – summarised in the following section – can be applied to support the design of new engagement models and communications tools. These must enable investors to understand the unavoidable trade-off between investment risk and savings outcomes:

Savings Risk

- What are my savings goals? How much do I expect to get back from my savings plan?
- What would I regard as a 'good' or 'bad' outcome?
- What are the different risk factors that could impact my savings outcome?
- What is the size of the potential shortfall, in relation to my savings targets?
- Could I absorb this shortfall; would it have a material impact on my standard of living?

Investment Risk

- Do I understand and accept the expected level of portfolio volatility, i.e. likely fluctuations in portfolio value?
- Do I understand and accept the potential loss I might experience in a particularly 'bad' year?

New engagement and communication tools, such as the Synaptic Risk Rating service, are designed to communicate risk in terms that customers can relate to their savings needs and their capacity for loss. Investment solutions such as risk-targeted, target date and diversified growth funds reflect the industry's efforts to accommodate individual risk preferences and savings goals.

* A copy of the Pensions Institute Research report can be downloaded at: www.moodysanalytics.com/RetailWealthMgmt

Philip Mowbray

Moody's Analytics

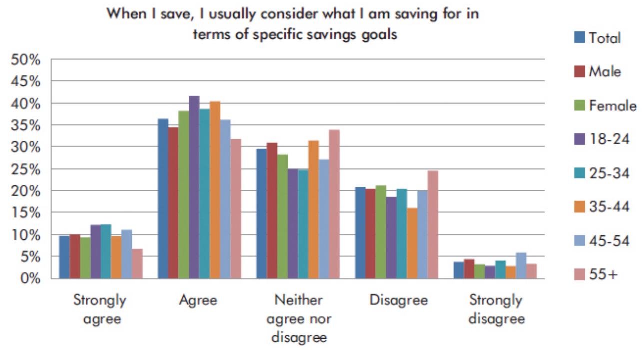
The following 5 Lessons are taken from the Pensions Institute research report:

Lesson 1: Help savers focus on their savings goals

Only half of respondents appear to consider what they are saving for in terms of specific savings goals.

Most people prioritise "rainy day" savings over specific savings goals.

Savers appear more concerned with what might happen, rather than what they know will happen and should plan for.



Source: Pensions Institute Research Report[1]

Lesson 2: Provide better information to help savers understand if their plans are adequate to achieve their savings goals

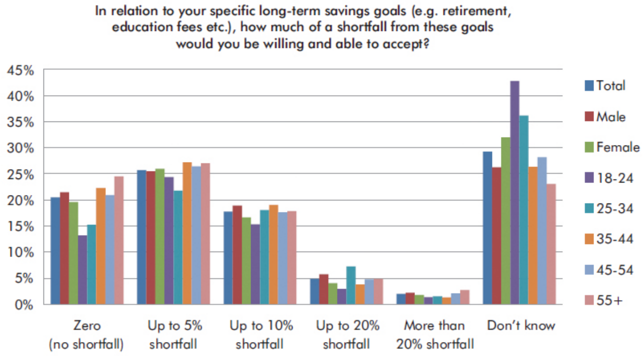
The survey identified that savers are reluctant to accept any significant shortfall (more than 10%) in relation to their long-term savings goals.

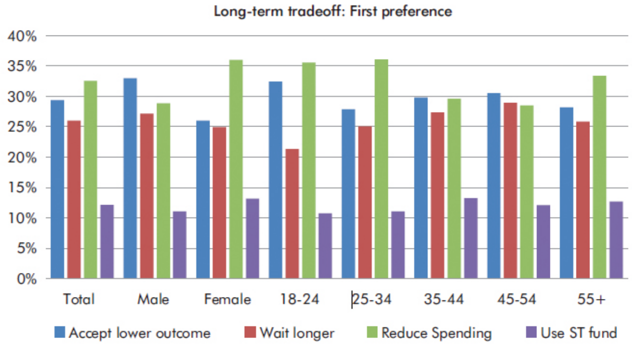
The survey also showed that savers prefer to reduce current spending and save more, rather than accept a bigger shortfall in long-term savings outcomes.

These results appear in stark contrast with broad evidence of a long-term savings 'gap'.

Savers would benefit from better information showing the relationship between the amounts saved today and the risk of failing to achieve future savings goals.

Pre-commitment devices such as 'save more tomorrow' can also be employed as effective nudges to ensure people remain committed to their savings plans.





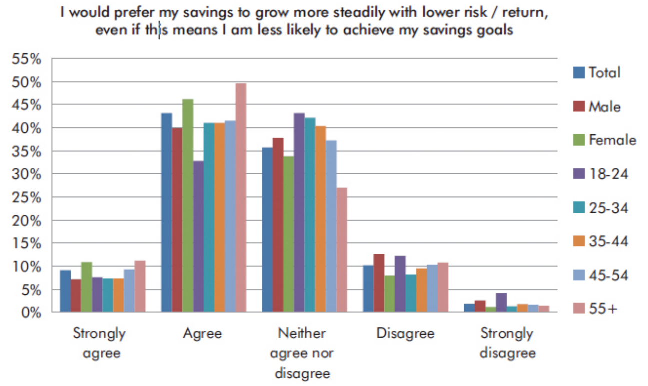
Source: Pensions Institute Research Report[1]

Moody's ANALYTICS

Lesson 3: Explain how investment risk helps achievement of savings goals

Savers find it difficult to evaluate the trade-off between investment risk and savings risk.

Over 50% of respondents said they would prefer to miss their savings goals than take investment risk, with only 10% not prepared to do this. This has been referred to as 'reckless conservatism'.



Source: Pensions Institute Research Report[1]

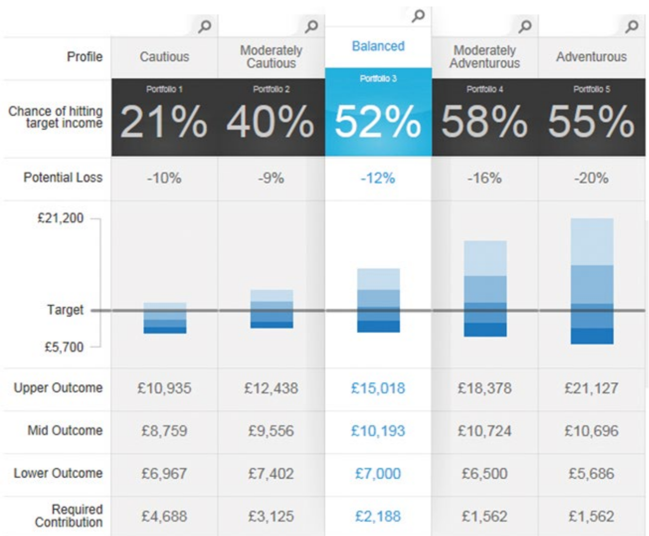
Lesson 4: Taken in isolation, a saver's attitude to risk score is not a good guide to the amount of savings risk a saver is able and willing to take

The research showed a clear relationship between the attitude to risk score and the level of investment risk people are willing to take.

In contrast, there was no relationship between attitude to risk and the amount of savings risk (i.e. the size of the savings shortfall) they are willing and able to accept.

Savers need information and tools to allow them to evaluate investment risk in terms of their savings goals:

- Explaining the effect of inflation in reducing the real value of savings
- Communicating investment risk in a way that does not simply show the 'downside' of investment in risk assets, but also explains the potential value in terms of achieving savings goals



Lesson 5: Savers would benefit from products with clearly communicated risk objectives

Investment products should have clearly stated risk objectives (e.g. volatility, downside risk or outcome targets), which can be aligned with the savings goals and risk appetites of different savers.

Recent responses from the fund management industry, including risk-targeted funds, target date funds, diversified growth funds and income targeting funds, are examples of the industry's efforts to accommodate individual risk preferences and savings goals.

Synaptic Risk Rating Service

Risk Category	Synaptic Risk Rating 1	Synaptic Risk Rating 2	Synaptic Risk Rating 3	Synaptic Risk Rating
Provider	Cautious	Moderately Cautious	Balanced	Moderately
Canada Life Investments	Managed Money Plus Fund	Portfolio 3	Portfolio 4 (Managed 0%-35% Shares) Fund CF Total Return Fund (Managed 20%-60% Shares) Fund	Portfolio 5
Fidelity Worldwide Investment		Multi Asset Open Defensive Multi Asset Defensive Multi Asset Allocator Defensive	Multi Asset Open Strategic Multi Asset Open Growth Multi Asset Strategic Multi Asset Growth Multi Asset Allocator Balanced Multi Asset Allocator Growth	
Legal & General Investments		L&G Multi-Index 3	L&G Multi-Index 4	L&G Multi-Index
Premier	UK Money Market Fund Cash Portfolio Cash Plus Portfolio	Corporate Bond Monthly Income Fund Defensive Growth Fund Conservative Growth Fund Liberation Absolute Growth Fund Capital Builder Portfolio Capital Builder Plus Portfolio Income and Growth Portfolio	Diversified Fund Multi Asset Distribution Fund Multi Asset Monthly Income Fund Liberation IV Fund Conservative Portfolio High Income Portfolio Income Portfolio	Multi Asset Incom Liberation V Fund Balanced Portfolio Balanced Plus Por

Pensions Institute

Santander ASSET MANAGEMENT

Statement

The Pensions Institute research project was jointly sponsored by Moody's Analytics and Santander Asset Management. Any views expressed in this article are those of the author alone.

For further information go to www.moodysanalytics.com/RetailWealthMgmt or call 0131 625 7054.

Financial software

Advisers should look beyond Volatility as a proxy for risk

The recently published 2014 Investment Outlook from Blackrock titled 'Squeezing out more juice' provides a fascinating perspective for anybody considering investment risk. Clients are being advised to be ready to pull out of global stock markets at short notice, or when the 'fruit starts running dry', in light of the challenges to the world economy.

The report suggests that it is 'momentum' that is driving stock markets, with price driving returns, not earnings. 'Rising correlations between bonds and stocks are making well diversified 'safe' portfolios riskier than they appear'. The report also outlines what has generally been accepted, that markets 'cannot deal with tapering', highlighting the uncertainties that central bank intervention brings. These escalating concerns point to the need for advisers to have a greater handle on the risk that their clients are exposed to than ever.

Blackrock present their 'forecast' for 2014 in probability terms – 55% 'Low for longer', 25% for the 'bull' market case, and 20% for 'bear'.

Of course 'pulling out of markets' goes against the orthodoxy of investing for the long term – 'time in the market', not 'timing the market'. Nobody is suggesting that advisers who represent investors should adopt speculative strategies. But equally, as markets continue to evolve in new ways that cannot be aligned with previous experience, then the assumptions that derive from examining volatility on the context of past performance will only get you so far. Volatility isn't what it used to be. For example, the consensus of experts including Blackrock is that bonds are very expensive, and investors should be factoring in the higher likelihood of high volatility in these markets should a correction ensue.

Nobody can predict the future, but what an adviser can do is consider the full range of possibilities, and put strategies in place that are optimised through diversification to perform across different possible outcomes. Modern Portfolio's concept of the 'efficient frontier' based on Volatility measurements is no longer sufficient in the light of what we have learnt in recent years. But if Volatility can only take you so far, how else can investment outcomes be modelled?

We contend that this is the role of the stochastic engine, such as can be found powering the Synaptic Modeller tool and the Synaptic Risk Rating Service. This offers a comprehensive 'quantitative' measure for risk that can be included with the 'qualitative' research on which an adviser normally relies. This is significant because, as many advisory firms attest, it is difficult to acquire an objective measure for risk.

An easy way to think about the advantage of using a stochastic model is its ability to capture the sequence of good and bad investment years. Where the bad year occurs in a term will have a massive difference in the investment outcome. It may make the difference between losing money and making money (should the bad year come early). Volatility may be consistent in both cases, so is not necessarily a reliable predictor of returns.

In our experience, most advisers have evolved effective and proven investment solutions. What many do not have is access to reliable risk based measurement.

> These escalating concerns point to the need for advisers to have a greater handle on the risk that their clients are exposed to than ever.

Visit synaptic-risk.capitafinancialsoftware.co.uk for more information about the Synaptic Risk Service, including access to the Synaptic Attitude to Risk Assessment tool.

This article is adapted from a piece written for FT Adviser in January 2014.

QUILTER CHEVIOT
INVESTMENT MANAGEMENT

Risk profiling Quilter Cheviot's Managed Portfolio Service (MPS)

Quilter Cheviot constantly strives to meet the evolving requirements of financial advisers and is now pleased to announce that our Managed Portfolio Service (MPS) strategies have been mapped by Capita's Synaptic Risk Rating Service.

Assessing the suitable level of risk that a client is willing and able to take is central to an adviser's investment decisions. Greater numbers of advisers are addressing this with the help of risk profiling questionnaires that generate risk tolerance scores and align clients to suggested products.

Some advisers produce their own robust risk rating scores using their in-house expertise but most have a preference for independent third party measures. Using established independent measures can prove a cost effective way of ensuring the consistency of risk measurements across a client base.

The general principle is that this type of risk profiling assesses an overall portfolio's level of risk, but does not necessarily indicate the suitability of the portfolio for each client. For example, an adviser may decide that a high risk equity portfolio is still the most appropriate investment strategy for their cautious client if the client has a large amount of low risk assets held outside of the portfolio.

It is therefore important to realise that risk tolerance scores are only one aspect of an adviser's suitability process and other factors should also be considered to provide a wider context. The FCA has stated that these other factors should also include the term of the investment and the client's knowledge and experience. We also feel that a face to face meeting between the adviser, their client and an investment manager should be a key part to any decision making process.

Capita's Synaptic Risk Rating Service

Capita's Synaptic Risk Rating Service is a research and financial planning system that aims to determine suitability based on six risk profiles that are underlined by Barrie + Hibbert probability-based models of future performance. This methodology is purely 'quantitative', so offers a measure devoid of any 'qualitative' overlay (or opinion).

Synaptic allows the adviser to illustrate risk in terms of the probability of losing money which ties in with the capacity for loss assessment ascertained in the client's questionnaire.

Six of our sterling-based MPS strategies have been reviewed by Synaptic and the conclusions of these profiles are shown below:

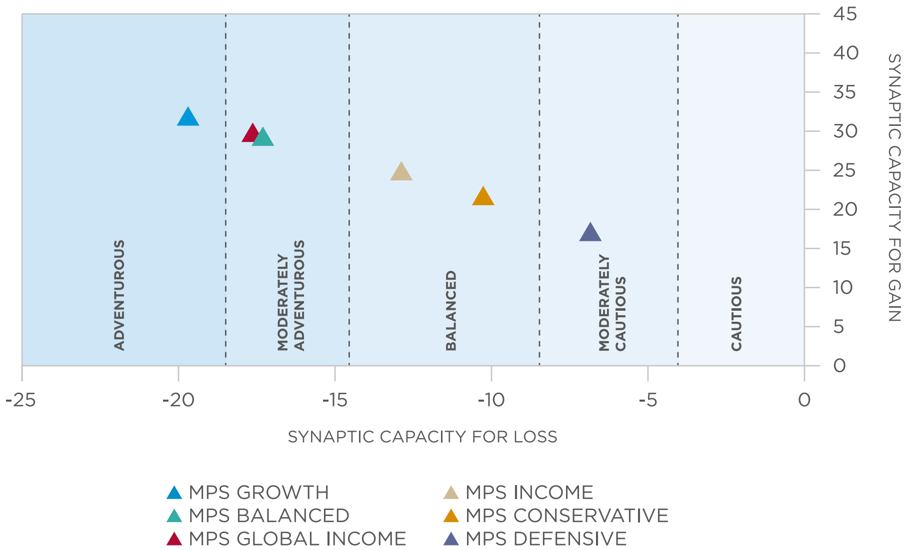
Please note that whilst the capacity for loss figure is generated by a Barrie + Hibbert stochastic model, the classification ranges have been defined by Synaptic and therefore they do not necessarily align with our internal definitions of 'balanced', 'adventurous' or 'cautious' portfolios. This difference highlights the arbitrary nature of a portfolio's name when assessing its risk and serves as a reminder of the need for detailed risk analysis when determining suitability rather than simply assuming a risk profile from a portfolio's name.

It is also worth noting that the varying weights of our MPS strategies, due to their active management, mean that they could move up or down a risk scale on Synaptic over time.

QUILTER CHEVIOT
INVESTMENT MANAGEMENT

Julian Menges & Benjamin Mountain

Joint Heads of Quilter Cheviot Managed Portfolio Service (MPS)
Quilter Cheviot Investment Management



Our Conclusion

Using risk profiling questionnaires that map to third party independent risk ratings can form a useful part of an adviser's wider assessment of suitability. The FCA's guidance on assessing customer risk and the suitability of investment recommendations means that advisers need to be able to understand the risk exposure of all the products they recommend and should not form recommendations solely based on risk tolerance scores.

By having Synaptic's independent risk profiling services available for our MPS, it helps financial advisers to map their chosen tools to the most appropriate MPS strategy as part of a wider product selection process.

If you would like more information on Capita's Synaptic Risk Rating Service please visit **synaptic-risk.capitafinancialsoftware.co.uk**

If you would like to discuss our MPS strategies in more detail, or organise a meeting with one of our investment managers, please contact Quilter Cheviot on **020 7150 4005**.

Disclaimer:

Investors should remember that the value of investments, and the income from them, can go down as well as up. Investment and investment services referred to may not be suitable for all recipients.

Quilter Cheviot Limited is registered in England with number 01923571. Quilter Cheviot is a member of the London Stock Exchange and is authorised and regulated by the UK Financial Conduct Authority.

About Quilter Cheviot

Quilter Cheviot is one of the UK's largest independently owned discretionary investment firms, which can trace its heritage to 1771. Our firm is based in thirteen locations across the UK, Jersey and Ireland and has total assets under management of £15.2 bn (as at 31 December 2013). Quilter Cheviot focuses primarily on structuring and managing bespoke discretionary portfolios for private clients, charities, trusts, pension funds and intermediaries.

We are at the forefront of development and innovation. We led the way in developing outsourcing solutions for financial advisers, providing access to a range of managed portfolio strategies constructed using carefully researched funds.

Our investment managers are committed to building long-term relationships with financial advisers and their clients, established on a foundation of exemplary personal service and investment expertise.

Our commitment to excellence has been recognised by the award of a Defaqto 5* rating for both our Managed Portfolio Service and Discretionary Portfolio Service in 2013.

Fidelity WORLDWIDE INVESTMENT

This article is for investment professionals only and should not be relied upon by private investors.

Dispelling the myths: risk-targeted versus risk-profiled multi asset funds

Over the last year or so, one of the major themes within the industry has been the growing popularity of risk-profiled and risk-targeted multi asset funds. This is hardly surprising given the regulator's increased focus on suitability. Additionally, these typically cost-efficient solutions have allowed advisers to cut costs at a time when they have been grappling with the implementation of the RDR.

Contact details:

For more information please contact your local Fidelity representative, visit our website **fidelity.co.uk/multiasset** or call the FidelityLine **0800 368 1732**

Risk-based solutions provide many benefits. However, the difference between risk-profiled (or risk-rated) funds and risk-targeted funds is not always clearly understood by everyone. Descriptions vary, although risk-targeted funds are usually portrayed as being designed to meet defined volatility targets where the goal is to manage them within a set volatility band or "risk budget". On the other hand, risk-profiled options are sometimes dismissed as funds which have merely been allocated a risk rating based on the past volatility of the portfolio or asset mix.

These are very simplified definitions. They do not address the complexity of the individual approach taken by a fund provider in constructing a particular solution. I believe it is very important that advisers should have an understanding of what is 'under the bonnet' when choosing between different risk-based solutions. Indeed, if a risk-based managed solution is being used as a firm's Centralised Investment Proposition, then the FCA requires firms to conduct adequate due diligence to ensure suitability for the client segment for which it is being employed. Therefore, in order to determine which solution is right for your clients, we need to investigate both options further.

Risk-targeted funds – a more constrained approach

Risk-targeted funds will, as the name implies, put distinct constraints on a fund manager in terms of the volatility band in which they can manage a portfolio. So, for example, a fund with a volatility target of between 4% and 5% over a particular time period will be managed to ensure the level of risk within the portfolio does not exceed or fall below this level on an ongoing basis.

This approach delivers certainty for the investor in terms of the level of risk they will be taking. However, it also brings some disadvantages. Having to stick to strictly-defined risk parameters can mean the manager is too constrained, potentially leading to poor outcomes for the investors. For example, funds which target a particular level of volatility have struggled in recent years as overall market volatility has been relatively low. While this may seem to deliver a "safe" outcome for investors, it could also be delivering a lower return than if the fund manager had taken a greater level of risk.

We believe that the flexibility for fund providers to take more risk – when it is appropriate to do so and when it may deliver a greater return for

James Bateman

Head of Portfolio Management, Investment Solutions Group, Fidelity Worldwide Investment

About James Bateman

James Bateman is Head of Portfolio Management for Fidelity's Investment Solutions Group. The Investment Solutions Group is a 23-strong team* of specialists in solutions design, tactical asset allocation, manager selection and risk management. The group has a 20-year history of developing solutions tailored to match specific client objectives and risk profiles. Based in London, Paris, Tokyo, Singapore and Hong Kong, the team manage more than £28 billion* for investors around the world.

* Source: Assets and resources are those of FIL Limited as at 31 December 2013.

> We believe that the flexibility for fund providers to take more risk – when it is appropriate to do so and when it may deliver a greater return for clients – is important.

clients – is important. Equally, on the reverse side, being able to reduce risk when the outlook is less certain provides greater capacity to preserve capital.

Risk-profiled funds – benefiting from greater flexibility

Let's now consider how risk-profiled funds are managed. Firstly, we need to put to bed the idea that they are backward looking with a risk rating based purely on the past volatility of the portfolio. The fund manager will, of course, study long-term historical data so that they have an understanding of how certain combinations of asset classes will behave over time. Having an in-depth appreciation of volatility and correlations is obviously crucial and this analysis will be used to develop a suitable long-term strategic benchmark for a fund which, in turn, defines its risk profile.

At Fidelity, our benchmarks are constructed using the output from a complex proprietary modelling process. An understanding of how asset classes have behaved in the past helps us to create long-term expectations for how they might behave in the future. The models and assumptions are reviewed regularly to ensure they remain appropriate in the "real" world as markets and conditions change. In essence, our asset allocation benchmarks are based on what we think is right in terms of risk and return outcomes for investors.

This strategic framework gives a risk-profiled fund its broad direction Our fund managers also make tactical decisions based on current market conditions and their view on the prospects for the various asset classes. This flexibility allows the manager to improve returns and/or to reduce risk. However, it goes without saying that any tactical decisions need to be made within clearly defined limits to ensure consistency with the fund's risk profile, as is the case for the Fidelity range of risk-profiled managed solutions.

In contrast, the parameters set for many risk-targeted solutions are often based on how markets have behaved in the past and so their investment restrictions can mean that they are less able to take account of current and future market developments. Of course, all funds are different and the issue of risk is very complex. Therefore, to put a fund in a box with a simple label can be difficult. However, I do think the flexibility of risk-profiled funds gives them a clear advantage over those which take a risk-targeted approach.

This is for Investment Professionals only, and should not be relied upon by private investors. The value of investments can go down as well as up and clients may get back less than they invest. Investments should be made on the basis of the current prospectus, which is available along with the Key Investor Information Document, current and semi-annual reports, free of charge on request by calling 0800 368 1732.Issued by FIL Investments International, authorised and regulated by the Financial Conduct Authority. Fidelity, Fidelity Worldwide Investment, the Fidelity Worldwide Investment logo and F symbol are trademarks of FIL Limited. RM0114/3052/SSO/0614