Powering financial insight

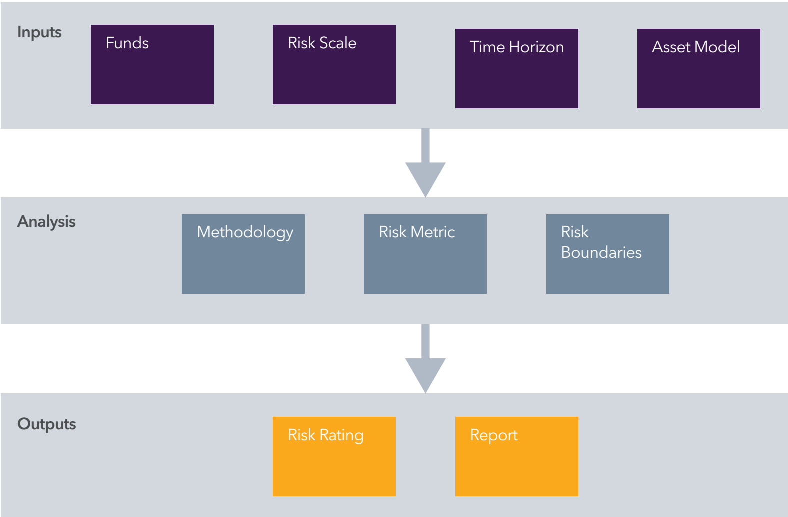
HOW DO WE RISK RATE A FUND OR PORTFOLIO

October 2016

1. INTRODUCTION

Funds Risk Assessor can risk rate any investment proposition (whether an individual discretionary fund, a model portfolio or any other central investment proposition). It does this by applying a consistent and robust approach to determining the risk of the fund compared to the asset allocation benchmarks from any standard risk profiling questionnaire or process.

The risk rating process can be summarised as follows:



1.1 INPUTS

Funds

The funds to be included in the assessment can be added from the extensive database of data provided by Financial Express, a leader in the provision of investment data to the financial services industry. The funds cover all available UK funds.

Additional funds which do not appear in publically available information, such as in-house managed funds, can be added to the assessment by specifying the assumed asset allocation of these funds. The asset allocation of the funds is used to objectively assess the degree of investment market risk to which the fund is currently exposed. There are no subjective judgements made about the investment managers ability to add future value (for example, high returns for a lower level of risk).

Risk scales

In order to calculate a risk rating a scale to compare the risk against must be set.

Funds Risk Assessor uses target asset allocations to determine the position on the risk scale against which alternative asset allocations determined by the funds selected can be assessed.

The system has 3 pre-set asset allocation targets that can be used:

- EValue Standard 10
- EValue Standard 7
- EValue Standard 5

The adviser can choose to set their own target asset allocations, for example the target asset allocations of their own risk profiling approach.

Time horizon

Different asset classes have different relative risk over different time horizons.

The risk assessment of funds depends upon the time horizon considered for the investment.

The default time horizon is 15 years but the assessment can be run over any time period.

Asset model

In order to assess the risk of the fund, the potential performance and future variability of this must be projected. To do this the same EValue calibration of the asset model which underlies all Adviser Planning tools is used.

1.2 ANALYSIS

Methodology

The risk measure of the selected target asset allocation is calculated. These risk measures are then used as the benchmark for assessing the portfolio relative to these benchmark risk measures. So for example a portfolio with the same risk measure as the risk category 6 benchmark would be rated 6, whilst one with a risk measure mid-way between the risk category 6 and 7 benchmarks would be give a risk rating of 6.5.

Risk measure

The choice of the risk measure to be used is critical when a full asset model is used to determine the risk rating.

The risk measure used should:

- map to a risk to which the investor is exposed
- be objective and understandable by users of this information
- be a single measure so that there is no complexity of the calculation that can distort the results and prevent users understanding what has been done.

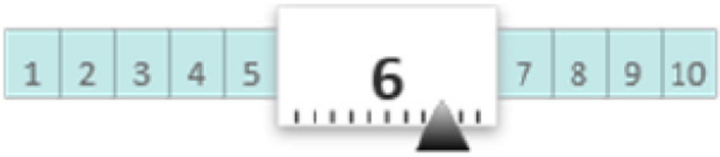
The standard deviation of return (broadly how spread out returns are) is perhaps the most widely used definition of risk. The risk measure used by eValue in Funds Risk Assessor is the standard deviation of the natural logarithm of the cumulative return.

1.2 OUTPUTS

Risk rating

For the risk assessment, Funds Risk Assessor will calculate a decimal risk score as described above.

The decimal risk score is shown on a pictorial scale as follows:



Risk scores are calculated as a decimal but rounded to the nearest whole number risk category, so that decimal risk scores between 5.51 and 6.49 will be rated as risk category 6.

If the arrow in the diagram is directly under the risk rating number the portfolio is equal to the volatility of the investment allocation of the target risk. The example above shows how a decimal risk rating score of 6.3 out of 10 will be shown within risk category 6.