

FORRESTER-HYDE INVESTMENT PORTFOLIOS - UNDERSTANDING RISK AND REWARD

• Introduction

Risk can be defined as probability of a negative event happening multiplied by its impact on your goals. The statistical tool used to measure volatility is the "standard deviation of returns". This is a measure of how far a periodic value moves above or below the average value. The greater the variation, the less predictable the outcome. As an example, we show below the average annualised volatility of various assets over the last ten years. As the percentage increases so does the potential loss and of course the potential gain.

1. Cash	0.74%
2. Property	3.42%
3. Corporate Bonds	5.58%
4. UK Equities	13.74%
5. Global Equities	15.71%
6. Emerging Markets	22.92%

Sources: Financial Express. All statistics discrete years to 31 March 2010.

1. Moneyfacts 90-day notice £10,000 account.
2. Finex UK Property Proxy.
3. IBOXX Sterling Corporate All Maturities.
4. FTSE All Share Index.
5. MSCI World ex UK.
6. MSCI Emerging Markets (Composite).

As you would expect Cash is the least volatile asset class and Emerging Markets are the most volatile with the greatest potential for loss and gain over this period. This is one of a number of factors we take into account when constructing and reviewing our Model Portfolios. At Forrester-Hyde we follow a four step guide to advising on investment, <http://www.forrester-hyde.co.uk/ bespoke/4827/downloads.htm>. Each of our five Portfolios, Conservative, Cautious, Balanced, Assertive and Aggressive in ascending order of risk, are benchmarked against an asset allocation model provided by Ibbotson Associates who are Independent Global Investment Analysts. The benchmark asset allocation is achieved through a process developed by Ibbotson known as 'mean variance optimisation', a Nobel winning economic theory. The process looks at the expected risk and return of each asset class along with the correlation among asset classes and determines which combination of asset classes will provide the highest expected return for a given level of risk. The aim is to identify asset allocations that maximise returns for a given level of risk or minimise risk for a given level of return. Ibbotson conduct resampling and sensitivity analysis to ensure the ongoing stability of the benchmarks under a variety of market scenarios.

The first step in the investment process is to establish an investor's risk profile, which entails their completing a Risk Assessment Questionnaire designed by Oxford Risk Research and Analysis. The object is to identify an investor's appetite for risk and volatility.

Forrester-Hyde's aim is to target each of our five Portfolios within an identified risk band over the medium to long term by which we mean a period of between six and fifteen years. In the short term, by which we mean five years or less, there is a greater margin for variation particularly at present when confidence is fragile and Equity Markets at home and overseas remain volatile. The risk weighting of the Ibbotson benchmark asset allocation over the past ten years has been as follows:-

Benchmark	Risk
Conservative	5.71
Cautious	8.19
Balanced	10.70
Assertive	13.00
Aggressive	15.80

Our Portfolios are bench tested against the Ibbotson asset allocation models. Ibbotson have determined what the maximum loss and gain would have been over the past ten years. This is then related to your individual risk tolerance, by which we mean how much potential loss you are prepared to tolerate and match this with the appropriate Model Portfolio.

	Maximum Loss %	Maximum Gain %
Conservative	-12.17	41.00
Cautious	-22.60	64.96
Balanced	-30.54	84.38
Assertive	-37.35	101.85
Aggressive	-45.69	127.21

The first column shows the loss under each Model Portfolio assuming the investment was bought at the highest level and sold at the lowest and conversely the maximum gain when the investment was bought at the lowest level and sold at the highest.

Returning to the "standard deviation of returns" the cyclical rule is that the expected return 68.2% of the time will fall within one deviation either side of the average return and within two deviations 95.6% of the time, see below:-

Benchmark	Average Return	Expected return 68.2% of the time	Expected return 95.6% of the time
Conservative	6.00	-0.29 to +11.71	-5.49 to +17.42
Cautious	7.00	-1.19 to +15.19	-9.38 to +23.38
Balanced	8.00	-2.70 to +18.70	-13.40 to +29.40
Assertive	9.00	-4.00 to +22.00	-17.00 to +35.00
Aggressive	10.00	-5.80 to +25.80	-21.60 to +41.60

In summary, we have shown:-

- The average annualised volatility of various asset classes over the last ten years.
- We have identified the risk weighting of the Ibbotson benchmark asset allocation for each of our five Portfolios.
- We have shown the maximum potential loss and gain for each Model Portfolio if the investment was bought at the highest level and sold at the lowest and conversely when the investment was bought at the lowest level and sold at the highest over the past ten years.
- Finally, using the "standard deviation of returns", we show the expected return for each Model Portfolio 68.2% of the time and 95.6% of the time.

These are all tools we use when seeking to match an investor's risk profile with one of our five Model Portfolios. The Portfolios are designed for the medium to long term, the asset allocation may be varied by the Forrester-Hyde Investment Committee and any variance will be identified and explained. Whilst we cannot predict the future, we can compare how the benchmark Portfolios have performed in the past. In the past ten years Equities have for the first time under performed Cash and Bonds but over a twenty year term, UK and Overseas Equities have out performed, see below:-

Cash	112.39%
UK Gilt	237.81%
UK Corporate Bond	259.29%
UK Equities	426.59%
Global Equity	321.72%
Global Emerging Markets	422.76%

Sources: Unit Trust Averages 20 years to 22 September 2010

• Conclusion

Having established an Investor's risk profile it is important any change in an Investor's circumstance or objective that might impact on their profile should be notified and the investor's appetite for risk and volatility retested. Our Model Portfolios are designed for the medium to long term. In the short term volatility suggests they choose a Portfolio with a lower risk profile accepting the potential for gain will be reduced but the upside is a more certain outcome.

IMPORTANT NOTICE

This is the view of Forrester-Hyde Ltd's Investment Committee as at the date of publication. Investment markets and conditions can change rapidly and as such the views expressed should not be taken as a statement of fact, nor should reliance be placed on these views when making investment decisions. Past performance is not a reliable indicator of future results.

Virtually any investment other than Cash on deposit in a Bank or Building Society can fall as well as rise in value and you may get back less than you originally invest.

The figures represented cover the period from 16 June 2000 to 15 June 2010 and are represented using the current Ibbotson Benchmarks. Therefore do not represent actual performance of Forrester-Hyde's Portfolios. The data is provided by Financial Express.

Forrester-Hyde Ltd

Authorised and Regulated by the Financial Services Authority

19 Clifftown Road, Southend-on-Sea, Essex SS1 1AB

Tel: 01702 432532 – Fax: 01702 431466

Email: Postmaster@forrester-hyde.co.uk

Web: www.forrester-hyde.co.uk

MODPORT/EXPECTRISK&RETURN/001

16/09/2010 - NKFH

E. & O.E.