RATHBONES

UNDERSTANDING INVESTMENT RISK AND RETURN

How we design and manage a portfolio in line with your objectives

30 June 2024

For clients via Reliance on Adviser

Please read this publication in conjunction with our ‘Terms of Business’ and ‘Our Investment Strategies’ publications

YOUR GUIDE TO CONFIDENT INVESTING WITH RATHBONES

Investing in the stock market can seem overwhelming with its rapidly changing prices, complex terms and various investment options. At Rathbones, we are here to guide you and your adviser through it all.

Before you invest with us, we want to make sure you have a clear understanding of the relationship between risk and return, the risks involved and what it's like to have us manage your investments. Whatever your situation may be, it's crucial for us to understand what you need from the start of our relationship.

We've crafted a comprehensive guide that we believe is essential for you and your adviser to read thoroughly. After you've gone through it, if there's anything you'd like us to clarify, please don't hesitate to contact your investment manager. We are here to make your investment journey as smooth and straightforward as possible.

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THE IMPORTANCE OF BALANCE

Managing the balance of investment risk and return is at the heart of what we do

When we think about the term 'investment risk', we mean that what you earn from your investments may not be what you expected, and you may not receive back what you put in. Higher potential rewards often mean more uncertainty. Risks can arise from many sources, including market conditions, company events, political shifts, interest rate changes or the ability to sell your investment without a loss.

Investment return is the profit from your investments, such as dividends from shares, coupons from bonds or from selling at a higher price. These returns are typically shown as a yearly rate, the yield, which includes both the earnings and any growth in your investment's value over time.

As an investor, your approach to risk and return is likely to evolve over time. Your perspective might shift due to personal life changes or the current state of the economy, including whether the financial markets are on the upswing or in decline. At times, shifting priorities may overshadow the importance of risk and return, but as situations evolve, so might your investment focus.

It's important to remember that usually, the chance for higher profits comes with an increased risk of financial loss. It's all about finding a balance that fits your comfort level and financial goals. A diverse mix of investments can help manage risk, ensuring that a loss in one area may be offset by gains in another, providing a more stable financial journey.

THE DIFFERENCE BETWEEN SAVING AND INVESTING

At Rathbones we provide investment services, not savings products

The term savings describes 'a store of value'. Typically, it is associated with cash deposits where the principal aim is to preserve capital and allow you to access your money at relatively short notice. The return is normally limited to a nominal interest payment, which may or may not exceed the rate of inflation.

Savers do not generally perceive their capital to be at risk and the interest paid on cash deposits is often called the "risk-free rate".

In contrast, investing is the process of buying an asset or a portfolio of assets with the prospect of providing a regular income or seeking an increase in value over time, or both.

Typically, there is no guarantee that you will be able to achieve any income or growth as the future returns from most investments are unknown at the outset. Therefore, public references to investments are usually qualified with a statement such as:

"The value of investments and the income from them may go down as well as up and you may not get back your original investment. Past performance should not be seen as an indication of future performance."

As a consequence of the uncertainty of returns, investments are usually only considered for a period of years. Positive returns can be made over shorter periods, but we generally consider five-year periods over which losses are likely to be offset by periods of gain. Therefore, we would normally expect clients who are willing and able to take more risk with their investments to be able to invest for a longer period of time.

We provide investment management services and not savings vehicles or products. Many of our clients are seeking higher percentage returns than those available from cash deposits and they could suffer a loss on the money invested. Before you invest any money with us, your financial adviser will work with you to assess and agree your risk tolerance, your ability to take investment risk and your investment objectives (such as generating an income or increasing the value of your capital, or a combination of both). We will also discuss your views on responsible investing. Refer to the section headed Investment Terms and Asset Classes for more information on responsible investing.

We will only enter into an agreement to manage your investments once your financial adviser is satisfied that your investment objectives, attitude to risk and your capacity to take risk are compatible with each other, and they believe that our services are suitable for you.

At this point, we will confirm our understanding of your needs with your adviser and propose a portfolio that meets your investment objectives, and is aligned with your ability and willingness to take investment risk. We will construct your portfolio using a combination of different investments in order to diversify your overall risk. Refer to the section headed *How we manage risk in portfolios* for more information on diversified portfolios.

We ask that your adviser informs us of any change in your circumstances that might affect your investment objectives, your need to access your capital, your attitude towards risk or your financial ability to withstand risk.

RISK

Risk is not necessarily a concern in itself because it can lead to higher returns, but it may not suit everyone

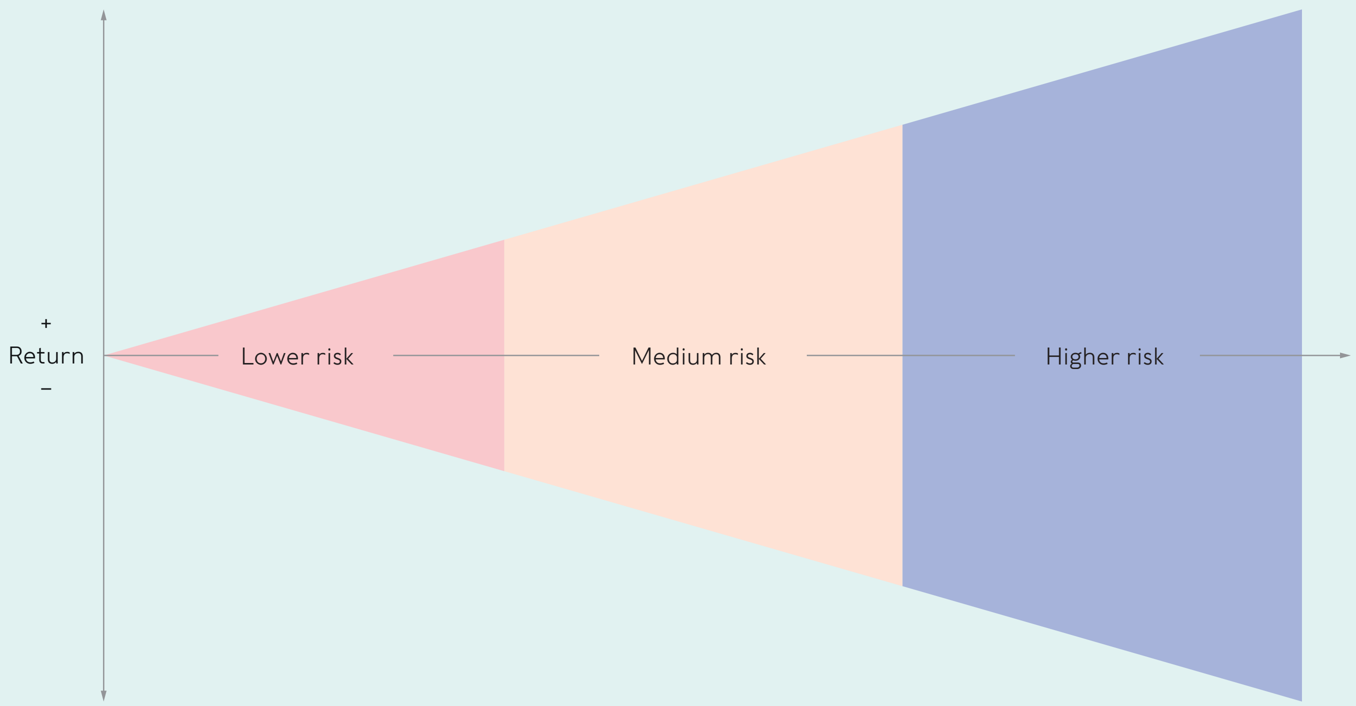
Volatility is often used as a measure to explain risk but it should not be used on its own. Volatility captures the fluctuations of a share price or, for investors with a portfolio, the overall value of an investment portfolio around its average value. High volatility means that the value can change dramatically over a short time period in either direction. A lower volatility typically means that value fluctuates less dramatically and may be more likely to change at a steady pace over a period of time.

For an investor volatility is a good way to demonstrate the ups and downs that they might experience but its importance can sometimes be overstated. For many people, the possibility of permanent loss of capital is more important than short-term fluctuations in price, especially if they have a sufficiently long timeframe over which they are investing and no immediate need to sell their investments. Therefore, volatility is not the same as risk – but volatility does tend to increase the chances of making a loss.

Although risk is often seen to have negative connotations, it is inherent to investing – all investment involves risk to some extent. In theory, return is directly linked to risk – in other words, investors taking more risk typically demand a higher rate of return to compensate them for that risk. Therefore, risk is not necessarily a concern because it often leads to higher returns, but taking more risk may not suit everyone.

Investment loss may occur in many different ways, including the loss of capital incurred by a fall in the value of your portfolio or relative loss where your investment fails to perform in line with expectations. For example, such relative loss can be a failure of an investment to maintain its real value against inflation or the failure to deliver a return in line with an agreed benchmark. The value of an individual investment may even be lost completely, but investing in a diversified portfolio of assets helps to reduce the impact of such a loss on your capital as a whole.

Figure 1
This diagram shows the theoretical relationship between risk and return.



The diagram illustrates a concept only. It is not based on historical returns for particular types of investment and it does not relate to a real period of time.

Your attitude to risk may differ over time. Our role is to understand your investment objectives, to agree an appropriate approach reflecting your attitude to risk and then to construct a suitable portfolio for you, as instructed by your financial adviser.

Portfolios will have different risk characteristics, which we explain in more detail later. But first, we need to establish some important principles.

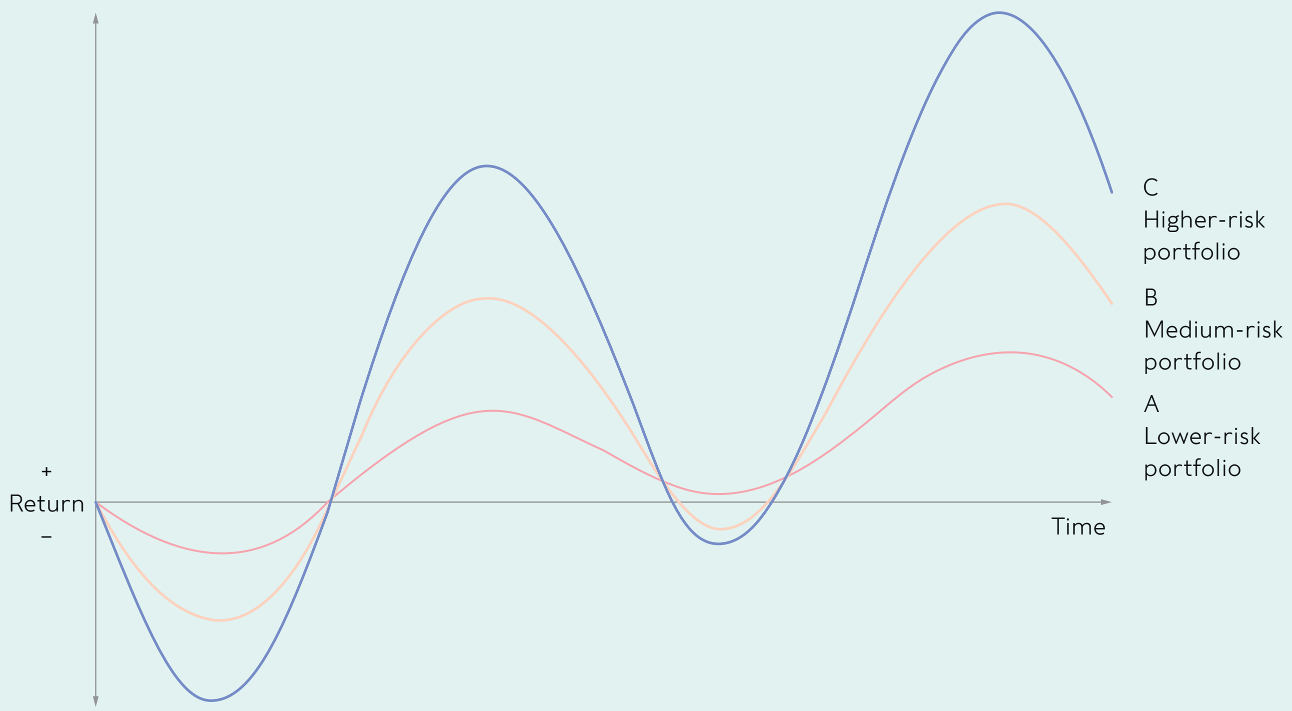
Figure 2 illustrates the possible performance of three different portfolios over time. The lower-risk portfolio (A) performs modestly over time, but its value rises and falls by less than the other two portfolios. The medium-risk portfolio (B) generally performs better over time than portfolio A, but is subject to greater fluctuation in value and initially suffers a material temporary loss in value. Having recovered, it endures a second period of loss, before recovering again.

The higher-risk portfolio (C) performs better over time than both A and B, but is subject to significantly greater fluctuations in value than the other two portfolios. It suffers a significant capital loss initially and, although it recovers, it endures a second period of loss, which is worse than that experienced with portfolio B.

Although portfolio C performs better than A and B over the full period illustrated by figure 2, it also experiences periods where its capital value is less than A and B. An investor in portfolio C would need to be prepared to accept and be able to withstand greater losses than investors in portfolios A and B. Portfolio C is higher risk and should be expected to experience greater fluctuations in value.

In reality, over the long term your portfolio could experience periods of performance that are similar to any of these three theoretical paths.

Figure 2
Exploring risk and return



This diagram is an illustration only. It is not based upon historical data and nor does it represent a real period of time.

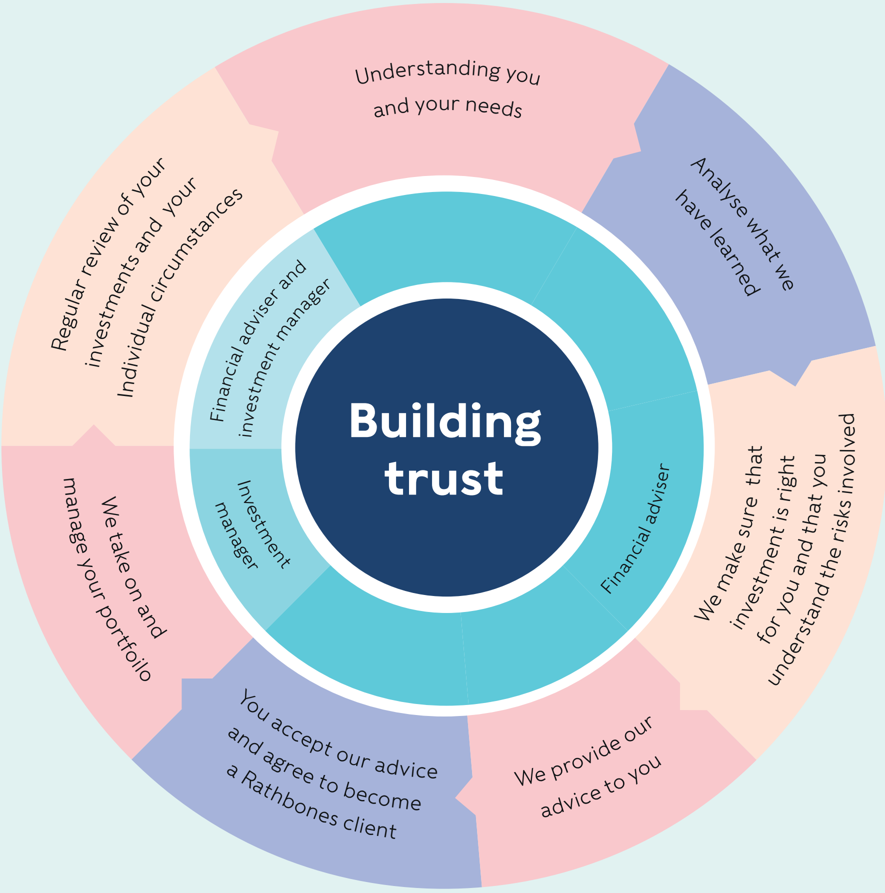
WHAT YOU AND YOUR ADVISER CAN EXPECT FROM US

We will work with you and your adviser to agree a strategy that meets your individual needs and then make sure this approach remains right for you

Working together, your financial adviser will define what you would like to achieve. Are you looking to provide a secure financial future in retirement? Do you require regular income or are you looking to meet specific expenses? Are you looking to downsize your home or buy an additional property? You may also have started to think about passing on money to the next generation.

You should be clear as to how your financial adviser and Rathbones investment manager work together ensuring the delivery of an investment portfolio to meet your needs and objectives. Figure 3 shows our respective roles within the advice process.

Figure 3
Building trust



UNDERSTANDING YOU

Before you invest with us, your adviser will work with you to understand your individual circumstances and investment objectives and to agree the amount of risk that you should take

They will guide you through this discussion and make sure that you understand the risk you are taking.

Assessing your attitude to risk

Your adviser will often begin assessing your risk tolerance using a questionnaire. This typically asks you to express your views on a range of questions about investment risk and return. Your answers provide an indication of the amount of investment risk you might be prepared to take.

Your adviser will gather wider information from you to add context to this assessment as well as assessing your knowledge and experience of investing. This will help your adviser understand how familiar you are with financial markets and investment matters. Your adviser will also ask about your financial ability to take investment risks.

Your financial ability to take investment risk

Your financial ability to withstand losses is known as capacity for loss. Your financial circumstances determine how much of your capital and / or income you can lose without it materially affecting your standard of living. Most people are sensitive to a fall in the value of their capital and / or income, and some more than others. However, while some investors can absorb such a loss, for others it could have a material impact on their lifestyle.

Investing with Rathbones requires you to have both the willingness and the ability to take investment risk. However, the risk that you take to achieve your aims and objectives should not be more than the risk that you are willing to take (attitude to risk) or the risk that you are able to take (capacity for loss).

Knowledge and experience

It is important for your adviser to assess your knowledge and experience of investments. This is so that you have sufficient understanding of your investment mandate and the choices that you make.

Clearly, experience cannot be a requirement for investing because everybody who invests does so for the first time at some point. However, it is important for your adviser to understand your previous experience of investing because this can inform them about your likely composure or attitude to market fluctuations, the types of investment that you have held in the past and, perhaps, how your investment affairs have been managed.

We are keen to ensure that you feel confident when you give us your consent to begin investing on your behalf. Where you feel that you need more information about a particular type of investment or in relation to how different investments and strategies can be used, please speak to your financial adviser.

Your personal and financial circumstances

We only ask for information that is relevant to understanding your investment mandate and providing our services to you. There is also information we are obliged to capture to ensure that we are able, for example, to take decisions on your behalf when you take up our services.

Your adviser will have spent time appreciating your needs and aspirations as well as a thorough understanding of your personal circumstances and financial situation. This enables them to determine the investment mandate you require Rathbones to deliver.

We want to obtain sufficient information about your mandate requirements to ensure we have a sound basis for constructing a portfolio for you.

Investment objectives and time horizons

We appreciate that your primary aim in seeking investment services is not to manage risk, but to achieve a positive return on your money. Your adviser will have discussed your investment objectives, which may comprise a number of individual aims.

We classify these objectives into those that have a requirement for income to support your current and future living standards; those that have no requirement for income and are seeking capital growth; and those that require a balance between income and growth, taking into account the impact of inflation.

If you have an investment objective relating to a specific time period (what we call an investment time horizon), then we will consider this when constructing your portfolio. However, many investors do not have a specific objective or a defined time horizon. Instead, their requirements are more general, such as to achieve a higher investment return or financial security in retirement. Also, you may not be investing purely for your own lifespan, but seeking to achieve the best return for the next generation. You may also have more than one specific objective or time period in mind, in which case we will establish more than one portfolio for you.

Time horizon is an important element when assessing investment risk and return. The economy and financial markets are subject to fluctuations and there are periods when the outlook may be more or less favourable for investing, leading to periods of stronger or weaker returns. If you have a longer time horizon, you may be more likely to be able to accept short-term falls in the value of your investments in anticipation of recovery when the outlook improves, providing you do not require early access to your capital.

Some investors may think they have a medium-risk appetite, but are investing for the very long term, say 20 years or longer, possibly for their children or grandchildren. In many cases, it may be appropriate to have substantial exposure to investments, such as shares, which, while not so high risk if held over such a time period, must be deemed higher risk over the short term. For such investors, your investment manager will understand your requirements and when selecting investments for your portfolio, will be mindful of your particular risk appetite and investment objectives. However, we will classify your portfolio as higher risk due to the potentially larger fluctuations in value that may occur in the short term.

Having agreed your mandate with your adviser, we will provide you with a formal document replaying our understanding of the investment mandate and portfolio(s) we need to construct for you. It is important for you to understand how we construct your portfolio based on your agreed mandate. We describe our investment process in the next section.

Figure 4
You and your portfolio

OUR INVESTMENT PROCESS

We have a well-defined investment process, which is fundamental to the service we provide

Our investment process creates a strong yet flexible framework for our experienced investment professionals to work together, sharing ideas and challenging each other's views. It is constantly evolving, and we continue to invest in the people and resources required to ensure this process remains robust.

We have a well-resourced research team with experience across a range of investment disciplines. These include asset allocation, investment selection, responsible investment and investment risk. They also have expertise in different assets such as equities, gilts, corporate bonds and other fixed income investments, and funds. A series of investment committees meet regularly to discuss the investment environment as well as any opportunities and risks they have identified.

We believe that material environmental, social and corporate governance (ESG) issues, including both risks and opportunities, can affect the long-term performance of investments and should therefore be given appropriate consideration as part of the investment process and in the construction of client portfolios.

Through the use of ESG data, an active engagement programme and our own judgment, we aim to develop a more comprehensive understanding of each business' strategy and operational execution and its sector dynamics than can be achieved solely through a financial lens. Where we invest in stocks directly for you, this helps us to identify companies with the potential for stronger sustainability performance or those where, through engagement, there is potential to improve business practices to create value for shareholders.

Our investment managers actively participate in our investment process. This includes company visits and internal discussions, analysing external broker research and ESG factors, and assessing investment themes. Whilst this process informs their decisions, your individual requirements remain paramount. The search for the best possible financial outcome for you remains our highest priority.

Figure 5
Our investment process

HOW WE MANAGE RISK IN PORTFOLIOS

Our investment process supports our investment managers in compiling diversified portfolios with the appropriate level of risk for you

Asset classes and asset allocation

Your portfolio will comprise a series of different investments. It is likely (but not always the case) that your portfolio will be exposed to different types of investments. We often refer to these as asset classes.

An asset class is a group of securities that exhibit similar characteristics. However, different asset classes can offer varying degrees of risk and behave in different ways. Therefore, investing in several different asset classes in a portfolio can ensure some diversification among your investments. Examples of asset classes include equities (shares), fixed income (bonds) and cash. A more comprehensive list of asset classes along with explanations is provided in the later section "Investment terms and asset classes".

Typically, different assets react to conditions in the underlying economy and financial markets in different ways. For example, equities tend to suffer when economic conditions are deteriorating; whereas government bonds can sometimes perform well in times of severe stock market stress. The performance of asset classes and the relationships between them can also be affected by other factors including interest rates, regulatory changes, the political climate and investor sentiment.

The starting point for designing your portfolio is to determine the right combination of assets to meet your investment objectives and appetite for risk.

Why build diversified portfolios?

Diversification means not putting all your eggs in one basket. A diversified investment strategy (sometimes called a "balanced portfolio" or "multi-asset portfolio") that blends different assets can be one of the best ways to preserve and enhance wealth over the long term. This approach can provide exposure to a wide set of investment opportunities and help to reduce losses when market conditions are challenging. This is because different asset classes tend to perform in different ways through the economic cycle. We use our proprietary tools to analyse portfolios and understand how different combinations of investments affects the overall risk in the portfolio.

Our investment framework

We divide assets into three building blocks, which play complementary roles in your portfolio. These building blocks differentiate asset classes according to their expected behaviour.

LIQUIDITY

These are assets that can usually be sold easily, both under normal market conditions and during periods of uncertainty. Such assets may also have the potential to perform positively if market participants become nervous about risk. These assets are viewed by the markets as having low credit risk (the likelihood that a default will occur is low). A default is when an issuer is unable to repay its debt. However, changes in interest rates and currency exchange rates may affect their value.

EQUITY–TYPE RISK

Assets that can drive growth in your portfolio include equities (shares) and other securities which can behave in a similar way to equity markets. It is important to note that these investments may lose value from time to time. They can also become illiquid during periods of market stress, which means they can be difficult to sell and may not be converted back into cash without a loss in value.

DIVERSIFIERS

These are investments that are designed to perform differently to global equity markets by taking different risks. Therefore they should help reduce fluctuations in the portfolio value without significantly reducing the long-term returns. For Rathbones to classify an investment as a "diversifier" it must pass a range of in-house tests. Only then will we claim to feel confident in its diversifying characteristics across a range of market conditions.

Our investment strategies

We use seven clearly defined risk levels. Our asset allocation committee maintains seven corresponding investment strategies. These provide a range of investment risk and return objectives and help demonstrate how our investment process and framework can be used in practice. In a separate document called *Our Investment Strategies*, we state the objective of each strategy, the likely fluctuations in value of such a portfolio, the types of assets that might be included and also give an indication of an appropriate time horizon.

We construct each strategy from a range of asset classes, usually by incorporating a diversified mix of investments according to the risk level and investment objectives. The strategies incorporate varying mixes of the different asset types in order to differentiate them by risk. We have designed Strategy 1 to be the lowest risk and Strategy 6 the highest risk.

Figure 6
Grouping asset classes according to their behaviour

LIQUIDITY	EQUITY-TYPE RISK	DIVERSIFIERS
Assets that can be sold easily. Includes interest rate and currency risk. Low credit risk.	Equities and all assets highly correlated with equities.	Assets with diversification potential demonstrated by low correlation to equities.
— cash: £/$/€/¥ — government bonds: — conventional — index-linked — UK and overseas — high-quality investment grade	— corporate bonds: investment grade, high yield — emerging market debt — equities: UK, US/Europe/Japan/Asia/ emerging markets, private equity — property equities: UK and overseas — commodities sensitive to the economic cycle (such as industrial metals/energy)	— commodities: precious metals, agriculture — macro/trading: discretionary, systematic — targeted return strategies — infrastructure — bricks and mortar property funds

Liquidity Only is classified under Risk Level 1, however it is not the same as Strategy 1. Due to Liquidity Only's permitted investment universe (cash, discretionary time deposits, money market funds , treasury bills, UK gilts, UK index-linked gilts and other qualifying corporate bonds (all gilts and bonds must have no more than 3 years to maturity)) and shorter investment time horizon (6 months to 3 years), this risk level is intended to be lower than Strategy 1 which instead invests according to our LED approach over a longer term (3 to 5 years).

In response to the "Global Financial Crisis", central banks adopted a number of measures with the aim of stimulating economic demand. These included cutting interest rates to close to zero and buying assets such as bonds. As lower risk strategies tend to have a higher allocation to bonds, they have enjoyed stronger returns over this period compared with what has been observed over the very long term*.

Stock markets experienced a strong period of growth in the mid 2000s. This culminated in the financial crisis which made stock markets crash over the eight months from August 2008 to March 2009 (period 1). In the stock market and economic recovery over the four years that followed between February 2009 and March 2013, stock markets powered ahead (period 2). In early 2020, the world was struck with the Covid-19 pandemic. With the high levels of uncertainty and economic lockdown looming, stock markets tumbled over February and March 2020 (period 3). Soon after, the markets started their recovery, regaining lost ground over the remainder of the year (period 4).

Figures 7 to 10 show the simulated historical performance of the six Rathbones strategies over the four periods in question. When stock markets fell significantly (periods 1 and 3), the least risky strategies performed best (Strategies 1 and 2). Alternatively, for the extended periods when stock markets rose (periods 2 and 4), the most risky strategies delivered the highest returns (Strategies 5 and 6). Liquidity Only was launched in quarter 4 of 2023 and is classified under Risk Level 1, however it is not the same as Strategy 1, therefore it has not been included in the simulated historical performance.

* The Barclays Equity Gilt Study provides a long-term analysis of returns from equities, gilts and cash between 1899 and 2020. The study states that over 121 years and after inflation the average annual compound return for equities was 4.9% and for gilts was 1.4%. Over the past 10 years these figures are 2.9% and 3.8% respectively (Source: Barclays Equity Gilt Study 2021).

*Please note that the time periods shown below are not of equal length and the simulated historical performance of the strategies may not be indicative of their future performance. You should examine the rises and falls in value that are shown carefully. The scales for the below charts are not the same.

Figure 7
2008—09 Global financial crisis
(31 August 2008 to 27 February 2009)*

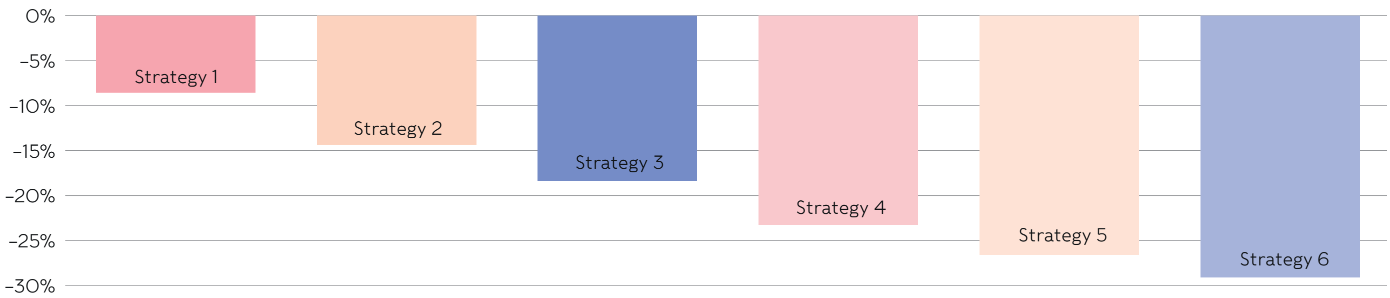


Figure 8
Post Global financial crisis rally
(27 February 2009 to 31 March 2013)*

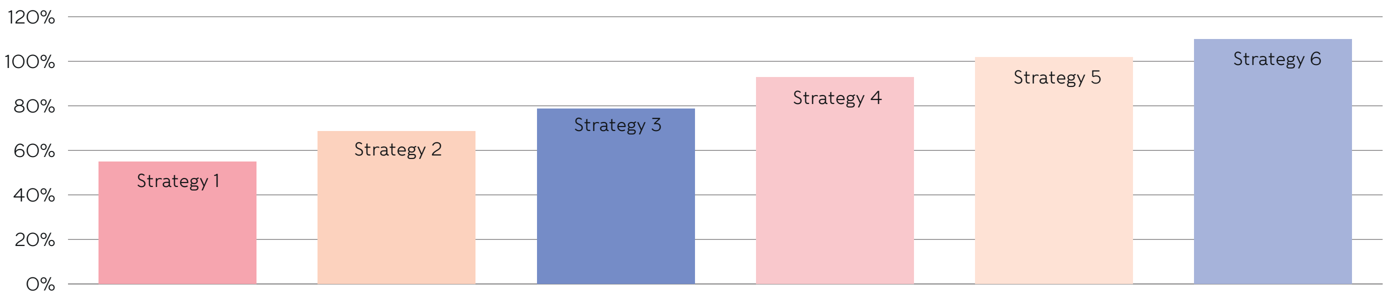


Figure 9
Covid-19 pandemic crisis
(31 January 2020 to 31 March 2020)*

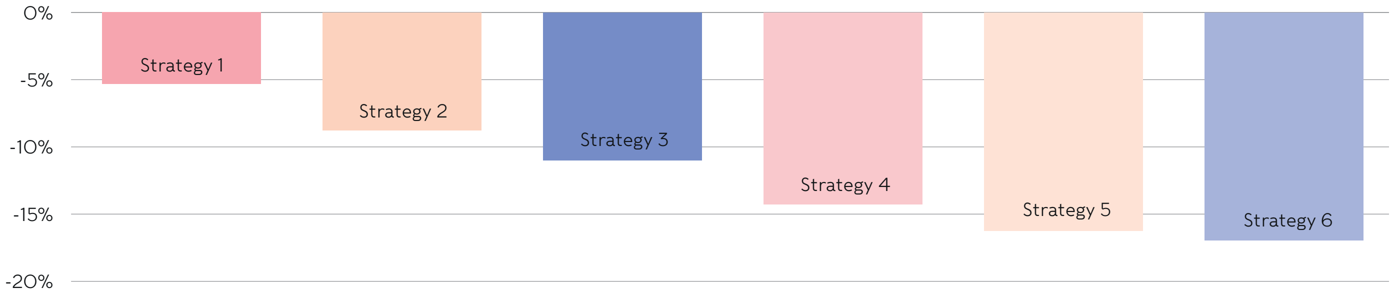
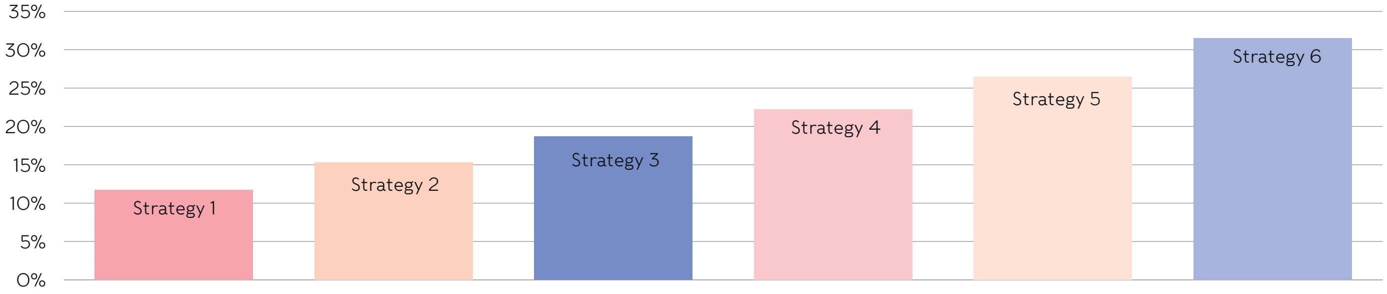


Figure 10
Post Covid-19 pandemic crisis rally
(31 March 2020 to 31 December 2020)*



Sources: Datastream

Figure 11 shows how some asset classes within liquidity, equity-type risk and diversifiers performed over the same four periods shown above. Please see page 12 for the definition of liquidity, equity- type risk and diversifier asset types.

Figure 11
Simulated performance of our LED framework

	CUMULATIVE RETURNS (%)			
	Global financial crisis	**Post financial crisis rally**	**Covid-19 pandemic crisis**	**Covid-19 pandemic crisis rally**
LIQUIDITY				
Cash	+2.3	+3.6	+0.1	+0.2
Government bonds	+6.8	+30.9	+2.7	+1.8
Index-linked bonds	–8.9	+57.8	–2.4	+9.2
EQUITY-TYPE RISK				
High yield bonds	–24.7	+125.5	–14.4	+22.5
UK large cap equity	–30.7	+94.5	–21.2	+16.1
International equity	–27.4	+102.9	–15.4	+35.4
DIVERSIFIERS				
Gold	+46.0	+57.3	+8.0	+6.8
Fund of hedge funds	–15.9	+17.9	–7.6	+14.7
	31 Aug 08 – 27 Feb 09	27 Feb 09 – 31 Mar 13	31 Jan 20 – 31 Mar 20	31 Mar 20 – 31 Dec 20

Source: Datastream

The value of investments and the income from them may go down as well as up and you may not get back your original investment. Past performance should not be seen as an indication of future performance. Changes in rates of exchange between currencies may cause the value of investments to decrease or increase.

YOUR PORTFOLIO

Your financial adviser will take you through a clear and structured review and provide a set of recommendations that reflect your circumstances and objectives

Building portfolios

Once we receive your investment mandate from your adviser, we then invest your money and construct your portfolio. It may take time to invest your funds and, if you transfer existing investments to us, it may take some time to adjust your portfolio to better reflect your requirements. Such transfers do not usually constitute a taxable event, although the portfolio could lead to a capital gains tax liability under current rules. If you need further information on this speak to your financial adviser. You may incur a tax liability when switching between funds or strategies where you are not investing via an ISA, investment bond or pension scheme.

Having agreed the appropriate asset allocation for your portfolio, your investment manager will invest in a core strategy to represent each asset class, guided by the investment committees and research team recommendations. This process will include taking ESG factors into account.

All clients' portfolios are expected to fit the broad risk characteristics of the risk level in which they reside. While our clients may have different investment requirements we have a robust central investment process to support your investment manager, who is responsible for ensuring the core strategy aligns with your personal investment strategy.

We will look to accommodate any specific requirements you may have. If you wish your portfolio to be managed in a particular way or to invest in (or avoid) particular types of assets, we will try to reflect your requests where possible and appropriate as agreed with your adviser. Your adviser will agree a specific mandate with you and this will be reflected in their formal advice to you.

In addition, we have a policy that applies across all our client portfolios of not investing directly in businesses that undertake certain activities. These activities do not align with our responsible investment commitments due to the significance of their ESG risk and impact and our belief that the majority of clients would share similar concerns.

Our investment process and our risk level framework will ensure that we both know where the portfolio should sit in terms of its likely risk characteristics. Lastly, we will agree with your adviser the best way to measure the performance of the portfolio through a mutually agreed and appropriate performance benchmark.

Managing your portfolio

Your investment manager will manage your portfolio actively to respond to changing conditions in the global economy and financial markets. They will also be responsible for making any adjustments if your financial adviser changes your investment mandate. This is why it is so important that your adviser tells us if your mandate needs to change.

We take a realistic approach to managing portfolios. Recent history reminds us that the unpredictable happens more frequently than expected, so we seek to position portfolios to protect value within the context of each client's investment mandate. It also teaches us about the importance of not investing in securities and strategies that are obscure or unnecessarily complex.

You may wish us to consider specific investments because of strong beliefs, support for a particular cause, or possibly for other personal reasons, such as a family link. In such cases, we will only include them in your portfolio where they complement the agreed strategy. Alternatively, it is easy to arrange for such assets to be held separately from your main portfolio. If you require assets to be held separately to you main portfolio, please speak to your financial adviser.

Clear and transparent reporting

When you ask us to invest your money, effective communication is important and we will provide you and your adviser with timely information.

We believe in clear and straightforward reporting through quarterly portfolio valuations. You or your adviser may ask us to send you a fund valuation at any time and you can both access your portfolio on demand 24 hours a day through our secure online portal.

We have invested in our ability to regularly monitor how your investments perform. The sophisticated, market-leading software that we use enables us to provide you with comprehensive performance data and portfolio information.

Our systems also enable investment managers to manage tax issues that may arise in your portfolio and prepare the information needed in support of your annual tax returns.

We provide other information to our clients through various publications in print and online. These include *Investment Insights*, which covers the main themes affecting today's global economy and financial markets, and *Rathbones Review*, which explores broader issues relating to money.

THINKING, ACTING AND INVESTING RESPONSIBLY

Together with your investment manager we will monitor your investments to ensure your portfolio continues to match your risk profile

Robust performance and risk oversight
We want you to feel comfortable and secure knowing that we are managing your wealth according to the mandate you have given us. Our internal procedures and risk management systems help us ensure this happens.

While our investment managers enjoy flexibility and discretion to deliver our service to you, it is important to have a formal oversight framework to support the investment process. Our investment executive committee is responsible for establishing and overseeing this framework. It monitors the overall fluctuation of portfolios and reviews investment performance.

The committee makes sure we are managing all portfolios to the same high standards, while being able to adapt to changing client requirements and market conditions. It promotes best practice and oversees all aspects of the process from portfolio construction and investment selection to implementation. This framework, supported by risk management systems, due diligence procedures and regular reviews, makes sure your portfolio remains in line with your investment objectives and risk level.

We have dedicated performance measurement and investment risk teams, both of which operate independently of our investment managers. Information on investment performance and risk is reported regularly to our group risk committee, which is one of our main board committees and is chaired by an independent, non-executive director.

Our approach to responsible investment
We feel being a responsible business means operating in a way that creates long-term value for our stakeholders, benefits society and actively addresses any adverse impacts our activities might have on society, people and the environment.

We have a long-standing commitment to responsible investment, dating back to our launch of ethically screened portfolios in the 1990s. As part of our responsible investment policy, we expect the companies in which we directly invest to have strategies to manage ESG risks. We practise responsible investment through four core principles:

ESG integration
We recognise that ESG risks can have an impact on the performance and valuation of investments. Where we hold direct investments for you, we are developing our research process to integrate ESG factors more fully in the evaluation of investments. This helps to identify not only ESG risks but also emerging investment opportunities.

Voting with purpose
The cornerstone of all responsible investment is an active and considered approach to proxy voting. Where we hold direct investments for you, we actively vote across all votable equity holdings, unless these holdings are de minimis. We vote on many issues including executive pay, climate change, diversity and audit independence.

Engagement with consequences
It's important that we maintain a dialogue with the companies we invest in, using our voice to influence companies towards better, more sustainable long-term performance. We prioritise engagement where we can make a real difference in addressing the world's systemic environmental and social challenges. We are also prepared to reduce our holdings in companies that continue to present an ESG risk over time.

Transparency
We're committed to transparency about our approach to responsible investment. Each year we produce annual responsible investment reports detailing our voting and engagement. In addition, we benchmark our performance against industry peers through involvement in the annual reporting cycle of the UN-backed Principles for Responsible Investment, an investor group.

Figure 12
We practise responsible investment through four core principles:

1. ESG integration

We consider ESG factors in the evaluation of investments to help identify ESG opportunities and risks.

2. Voting with purpose

We actively vote in a manner that allows us to focus our resources where we believe we can make the most difference. This may involve voting against management to help drive positive change.

3. Engagement with consequences

We prioritise engagement where we can help make a difference in addressing systemic ESG challenges. We are prepared to escalate our engagement activity or reduce our holdings in companies that continue to present an ongoing ESG risk.

4. Transparency

We are committed to being transparent about our approach to responsible investment. We will actively report on the progress of our responsible investment activities to our clients, shareholders and other stakeholders.

For further information please refer to our Responsible Investment policy, which can be found on our website at www.rathbones.com/investment-approach/responsible-investment

INVESTMENT TERMS AND ASSET CLASSES

The range of asset classes and investments we use to build portfolios

Although extensive, this list of types of asset is not exhaustive. In the appendix to our *Terms of business*, we explain some more of the risks of these investments. It also sets out the risks associated with certain investment techniques as well as more general risks associated with financial markets. If you have any questions regarding types of investments or the risks disclosed here or in the appendix to our *Terms of business*, please ask your investment manager.

Investment terms

Responsible business

This means operating in a way that creates long-term value for stakeholders, benefits society and actively addresses any adverse impacts activities might have on society, people and the environment

Responsible investing

This is the purposeful integration of environmental, social and corporate governance (ESG) considerations into investment management processes and ownership practices

ESG (Environmental, social and governance)

We define the three components as

- Environmental: issues relating to the quality and functioning of the natural environment
- Social: issues relating to the rights, well-being and interests of people and communities
- Governance: issues relating to corporate governance and corporate behaviour

ESG integration

This is the systematic and explicit inclusion of material ESG factors (e.g. environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters) into investment analysis and investment decisions.

Engagement

This refers to the process of working with organisations, industry bodies or policymakers to address issues of concern and bring about positive change. It encompasses many approaches, for example:

- meetings with senior management
- public statements
- collaboration with other investors
- tabling or voting on resolutions at company AGMs.

Types of asset

Cash

Most people view cash as the safest way of storing value – it does not reduce in nominal terms. This makes it different from most assets, the values of which change constantly. However, in the past cash has been a poor asset to hold as an investment over the longer term because it is subject to the negative effect of inflation. Its long-term return can be poor, and sometimes it can return even less than inflation.

UK government bonds

UK government bonds are also known as treasury stock or gilt-edged securities ("gilts"). They are securities representing capital lent to the UK government to fund public expenditure. Gilts are traditionally considered one of the lowest-risk securities because they are backed by the UK government, and repayment at maturity is all but guaranteed. The market in gilts is usually very liquid, making them easy to buy and sell, even in times of financial distress.

Gilts are exempt from capital gains tax but tax is payable on the interest that they provide. They pay a fixed rate of interest until they mature, when the investor receives back the principal capital (the original loan). In theory, bond prices move inversely to interest rates, so investors benefit from rising bond prices when interest rates are falling, and suffer when interest rates rise. This means that the bond price can move above or below the purchase price and even its eventual repayment value.

Although gilts are considered a low-risk investment, in certain circumstances they can be vulnerable to sharp falls in value, which may lead to a capital loss for investors. The returns can also be negative after adjusting for inflation.

UK index–linked government bonds

UK index-linked government bonds are securities issued by the UK government to fund public expenditure. Their income payments and the principal sum to be repaid are linked to official inflation data over the bond's life – the Consumer Price Index (CPI) or Retail Price Index (RPI). Through this, the inflation risk of traditional bonds is mitigated with the aim of preserving the real value of invested capital.

However, if inflation turns negative (in other words, prices fall in a period of deflation), the interest payments and redemption values could fall.

A feature of these bonds is their lower rate of income return, which may make them unsuitable for some investors. However, they are exempt from capital gains tax, so can work well for higher-rate taxpayers since a large part of the return can come as untaxed capital gains.

Corporate bonds

Corporate bonds are securities representing capital borrowed by companies. Although similar to government bonds, there is a greater likelihood of default in repaying capital to investors because companies are generally less financially robust than governments and their central banks.

Investors should consider the solvency of the company issuing the bonds. In the event of it falling into liquidation, the bondholder would be treated preferentially to holders of equity, but would be unlikely to receive back all of their capital. However, default is rare and most companies pay the interest and capital on their bonds.

For many of our clients, we access the bond markets through collective investment funds, such as unit trusts, where an external fund manager manages a portfolio of many different bonds. This diversification reduces the impact of default by any particular borrower.

Corporate bonds are useful for those seeking income from their investment portfolio for yields tend to be higher than those on government bonds, reflecting the higher risk. This risk is often measured by the increase in potential return over a comparable gilt to give investors a frame of reference (known as the "credit spread") and also by a credit rating assigned by an agency. Apart from the risk of default, inflation is another risk because it erodes the real value of income payments and capital.

High yield corporate bonds

Some investors are prepared to invest in higher-risk corporate bonds to obtain a higher return. Typically, issuers of such bonds are medium-sized companies, with a high level of debt or financial problems. Financial distress usually results in an independent ratings agency downgrading a company's credit rating followed by a fall in price and increase in yield.

Yet not all high-yield bonds involve financial distress and many will run to redemption without missing a payment. Caution must be exercised when investing in these bonds and our experts in this area advise our investment managers on potential risks. It is also common for managers of bond funds to invest a portion of their funds in high-yield corporate bonds and we will consider the risks when making investments in these funds.

Equities: UK

Equities are suitable for a wide range of clients with varying degrees of risk tolerance and differing investment objectives. As a shareholder, you own part of the company and the value of the shares will reflect the market's expectations of its future financial performance. Therefore, the potential rise in share prices has no upper limit. However, large falls in capital value in a short space of time are also possible. Companies often pay dividends and these may grow over time by more than the rate of inflation, thus representing real growth in income to investors. Reinvestment of income can also be a significant component of the growth in investors' portfolios over time.

Although these investments are listed and priced in sterling, many larger UK-quoted companies have foreign currency revenues and overseas interests. Therefore, share price values can increase when sterling is weak.

Diversification of shareholdings between companies and across business sectors mitigates the risk of severe or permanent capital loss. We can also achieve diversification by using collective funds, such as unit trusts.

Equities: international developed markets

We diversify some portfolios further by investing in overseas stock markets, either directly into company shares or using collective funds. We can seek to enhance returns by investing in geographical regions with a faster rate of economic growth than the UK.

Apart from the risks associated with equities in general, one main risk of investing in international developed markets equities is currency risk – an adverse move in sterling against a local currency may reduce investment gains or exacerbate losses. The converse is also true. When sterling weakens, the value (in sterling terms) of "overseas" investments rises. By investing part of a portfolio overseas, political and regulatory risk may be increased including the risk of adverse changes in overseas tax laws. Generally, developed markets are subject to stringent rules on company reporting and have liquid, well-regulated stock markets.

Equities: international developing markets

The economies of developing nations may offer the potential for strong growth, but this can be fragile and depend on investment from developed nations. As a result, the stock markets of developing countries can be more volatile than those of developed markets. In addition, corporate governance, reporting and accounting standards, and market liquidity can be unsatisfactory.

For these reasons, we rarely buy direct equities in these markets and mainly invest using collective funds managed by a specialist investment manager with expert knowledge of the relevant countries and their associated stock markets.

Commodities

A commodity is a marketable class of goods that is produced to satisfy a demand. These goods are produced to observable standards. Commodities include basic agricultural produce and industrial materials, such as wheat, copper and oil.

Investing in commodities is a way of diversifying away from equities and bonds. Commodity markets can be very volatile, with investment flows causing price movements far larger than the underlying changes in supply and demand. As a result, substantial gains or losses can be made in short periods of time.

Typically, we gain exposure to commodities through listed investments known as exchange-traded funds (ETFs). These ETFs may not necessarily reflect the change in the daily market price of the underlying commodity.

Precious metals

Investing in precious metals, such as gold, can be an effective way to offset the risk of inflation. Gold has been seen as a safe store of value against cash, which may deteriorate in terms of its purchasing power.

We can invest in gold by buying ETFs that are backed by physical gold. ETFs are convenient for clients because they are liquid and easy to trade. We can also invest in gold mining companies, or collective funds that invest in them.

Private equity

This term refers to equity investments where the underlying investments are not quoted on public stock exchanges. It can describe investments in unquoted family businesses or funds that invest in a range of unquoted businesses, including infrastructure projects. These funds tend to be managed by specialists. Their funds may be listed on the stock market and, therefore, freely available for the public to buy and sell; or they may be very limited offerings where the investor has a private share in a partnership.

The advantage of private equity is that investors can gain access to private companies and benefit from the skills of expert investors who can identify and manage undervalued assets. As a result, private equity funds can offer a great deal of capital appreciation in the right conditions.

The main risk is that unquoted investments have no readily available share price indicating the current value and can be illiquid. Values are quoted at intervals which does not enable a daily estimate. In addition, the quality of the underlying investments within a fund can be difficult to assess. Private equity funds also often use borrowing to leverage their returns, which can be a risk at times of financial stress.

Property funds

Property funds invest mainly in commercial property, although some also invest in residential property. Commercial property includes offices, industrial buildings and distribution warehouses, as well as retail property, such as shopping centres and high-street units. Many property funds are oriented to deliver a high-income return.

Although property funds offer diversification from the risks of investing in individual properties, there are other risks involved. The property market can be illiquid and there have been cases where funds have been closed, trapping investors' capital. Some funds, such as investment trusts that issue shares, commonly use borrowing (also known as "gearing") to achieve their objectives, making them vulnerable to interest rate rises.

To mitigate some of the risks of investing in property funds, we prefer to invest via real estate investment trusts (REITs).

Please note: hedge funds and structured products are not asset classes, but represent alternative ways to apply an investment strategy to the various asset classes that are detailed above.

Hedge funds and other actively managed strategies

Hedge funds and some actively managed strategies have the ability to diversify portfolio risk. They can profit from falling as well as rising asset prices by using a wider range of investment tools than traditional strategies, which can only benefit from rising asset prices. Such investment tools include futures and options and short selling (selling assets with the expectation that they might be bought back at a lower price). Positive and negative returns can also be magnified using leverage, and strategies can incorporate allocations to a range of different asset classes.

When a hedge fund manager constructs a portfolio, the short positions can serve as "insurance", offsetting the risk of other positions within a portfolio. Therefore, the overall fund is protected or hedged against falls in the broader market. No fund is perfectly hedged, as zero risk would imply zero return. There are many different strategies and we assess them all on an individual basis.

Structured products

Structured products can be designed to provide a tailored risk and return profile for investors based on the performance of an underlying asset.

There are several types, but those most commonly used by Rathbones are defined return and market participation products. Typically, their performance is related to the performance of an underlying asset, which is usually a major equity market index such as the FTSE 100. However, structured products can be created to reference individual securities or a pre-defined basket comprising a variety of securities.

In basic terms, structured products are a hybrid between equities and bonds. Capital is placed on deposit for a fixed term and the interest that would have been earned over the fixed term is used to pay for options on the underlying asset. Structured products are typically exposed to the credit risk of an issuing bank. While issuers seek to provide a secondary market to allow investors to trade their shares, there is a risk that the issuer ceases to provide this ongoing liquidity.

NEXT STEPS

If you decide to invest with us, please speak to your investment manager.

You can also get in touch with any Rathbones office to talk to an investment manager about your financial priorities.

Call your local office

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0131 550 1350

Exeter
01392 201 000

Glasgow
0141 248 4311

Guernsey
01481 723 506

Guildford
01483 304 707

Jersey
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