Rathbones
Look forward

Understanding investment risk and return

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

For intermediated business

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.

Understanding investment risk and return

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

Investing in the stock market can be daunting – fast-moving prices, technical jargon and different types of investment can feel intimidating. At Rathbones we recognise this and are here to help. When you invest, we ensure that you understand the risk that you are taking and what it will be like to work with us when we manage your investments. This is why we have written this guide. It is important that you read it carefully. Having done so, if there is anything that you would like us to explain or clarify, please contact your investment manager.

The importance of balance	4
The difference between saving and investing	5
Risk	6
What you can expect from us and your adviser	8
Understanding you	9
Our investment process	12
How we manage risk in portfolios	13
Your portfolio	19
Risk monitoring and performance oversight	21
Investment terms and asset classes	22
Next steps	25

The importance of balance

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

Investment risk and return are inextricably linked.

Although some of us may have a basic understanding of the relationship between them, they can mean different things to different people.

As an investor, your attitude to risk and return is likely to vary throughout your life. Your views may be influenced by changes to your personal circumstances or by issues such as prevailing economic conditions or whether financial markets are rising or falling.

Risk or return may appear more or less important if your priorities or circumstances change. For example, you may want to switch from seeking growth from your investments to preserving capital as you grow older. Whatever the case, from the start of your relationship with us it is essential that we understand your requirements.

We have produced this guide to help you understand more about investing with Rathbones, our approach to managing risk and return and to help manage your expectations.

You should read this publication in conjunction with our *Terms of business* and *Our investment strategies* booklet, which we will provide to you before you become a client.

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 years or more to be the shortest time for any periods of loss 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 returns than those available from cash deposits and they could suffer a loss on the money invested. Before you invest any money with us, we will work with your financial adviser 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 only enter into an agreement to manage your investments once we are satisfied that your investment objectives, attitude to risk and your capacity to take risk are compatible with each other, and we believe that our services are suitable for you.

At this point, we will confirm our understanding of your needs 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.

We ask that your adviser inform 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. We will give your adviser regular opportunities to tell us about such changes, so that we can assess the ongoing suitability of your portfolio in meeting your requirements.

Risk

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

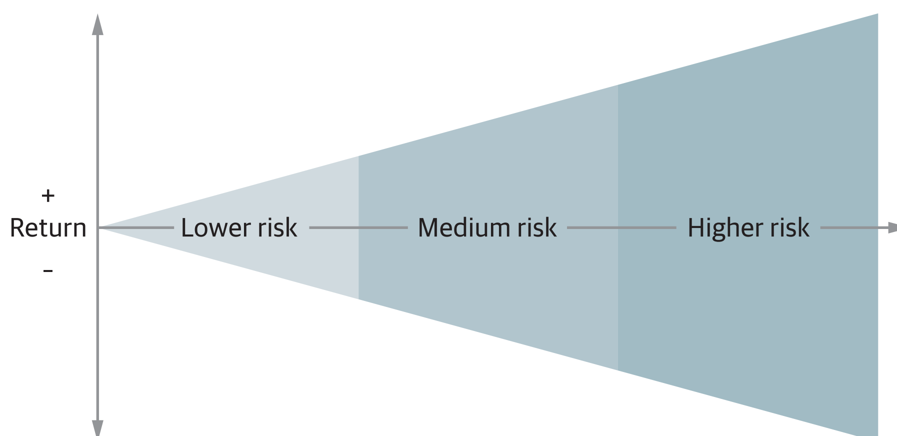
Volatility is often used as a measure to explain risk but it should not be used on its own. Volatility captures the fluctuations of a share price or, for investors with a portfolio, the overall value of an investment portfolio around its average value. High volatility means that the value can change 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.

Therefore, 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 seeking higher returns generally need to take more risk to achieve their objectives. 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 above 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.

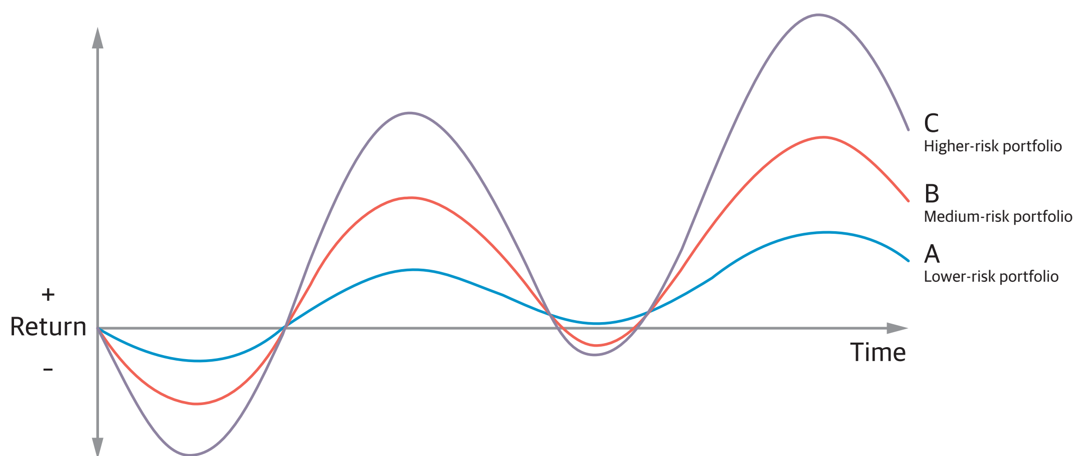
Portfolios will have different risk characteristics, which we explain in more detail later. But first, we need to establish some important principles.

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.

Figure 2: Exploring risk and return



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

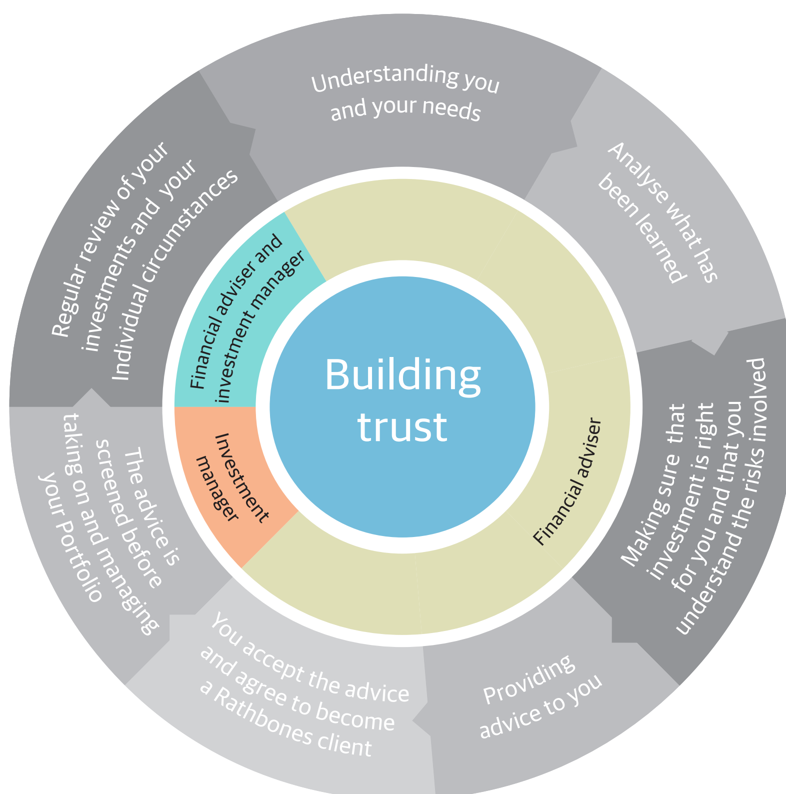
What you can expect from us and your adviser

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

Working with you, 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. In summary, our respective roles within the advice process will be as follows;

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 will 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).

Figure 4: You and your portfolio

Knowledge and experience

It is important for your adviser to assess your knowledge and experience of investments. Your level of knowledge and experience may not restrict the investments that we make for you but it does mean that we need to take extra care to explain things to you. This is so that you have sufficient understanding of what we do 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 us to understand your previous experience of investing because this can inform us 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. 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. We are keen to ensure that you feel confident when you give us your consent to begin investing on your behalf.

Your personal and financial circumstances

We appreciate that you may feel some of the information that we ask for is not necessary or may not be relevant. We only ask for information that is relevant to the services we can provide to you. There are also questions that we are obliged to ask to ensure that we are able, for example, to take decisions on your behalf when you take up our services.

At Rathbones, we strive to give our clients the best investment solutions to meet their needs. But before we can start talking about investments, we need to talk about you. Appreciating your needs and aspirations is important, but so is gaining a thorough understanding of your personal circumstances and financial situation. To help us determine what portfolio(s) we manage for you, we need to capture general factual information about you, your marital status, tax position, employment status and dependants, as well as details of your assets and liabilities, and of your income and regular outgoings.

We want to obtain sufficient information about you and your financial circumstances to ensure we have a sound basis for constructing a portfolio for you. The more we know about you, the better we are able to tailor 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 considered your attitude to risk, capacity for taking risk, your personal and financial circumstances, objectives and timescales, 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 formulate these recommendations and how we construct investment portfolios. We describe our investment process in the next section.

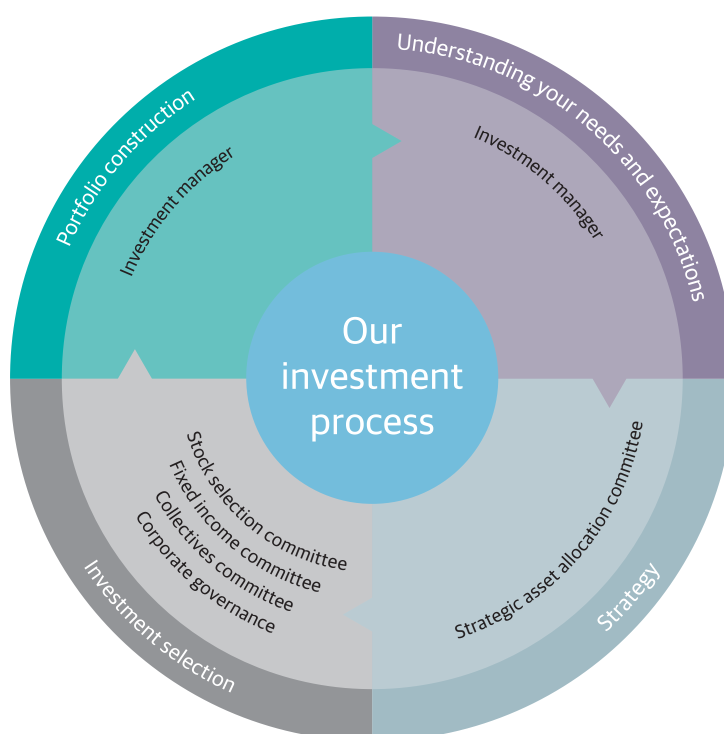
Our investment process

Our individual service is underpinned by a well-researched investment process, which we have designed to deliver appropriate returns for different levels of risk.

Once your adviser understands your situation and objectives, they will propose an investment strategy that is tailored to you. Our investment process is designed to deliver appropriate returns for different levels of risk. It guides the thinking of your investment manager who also retains the flexibility to ensure that we can meet your individual objectives.

When constructing your portfolio, your investment manager draws on recommendations and guidance from our investment committees. These committees include our investment managers and members of our research department. They cover a range of subjects from portfolio construction to the selection of individual investments, governance and stewardship. Committee recommendations are supported by thorough analysis conducted by an experienced and well-resourced research team of investment specialists.

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.

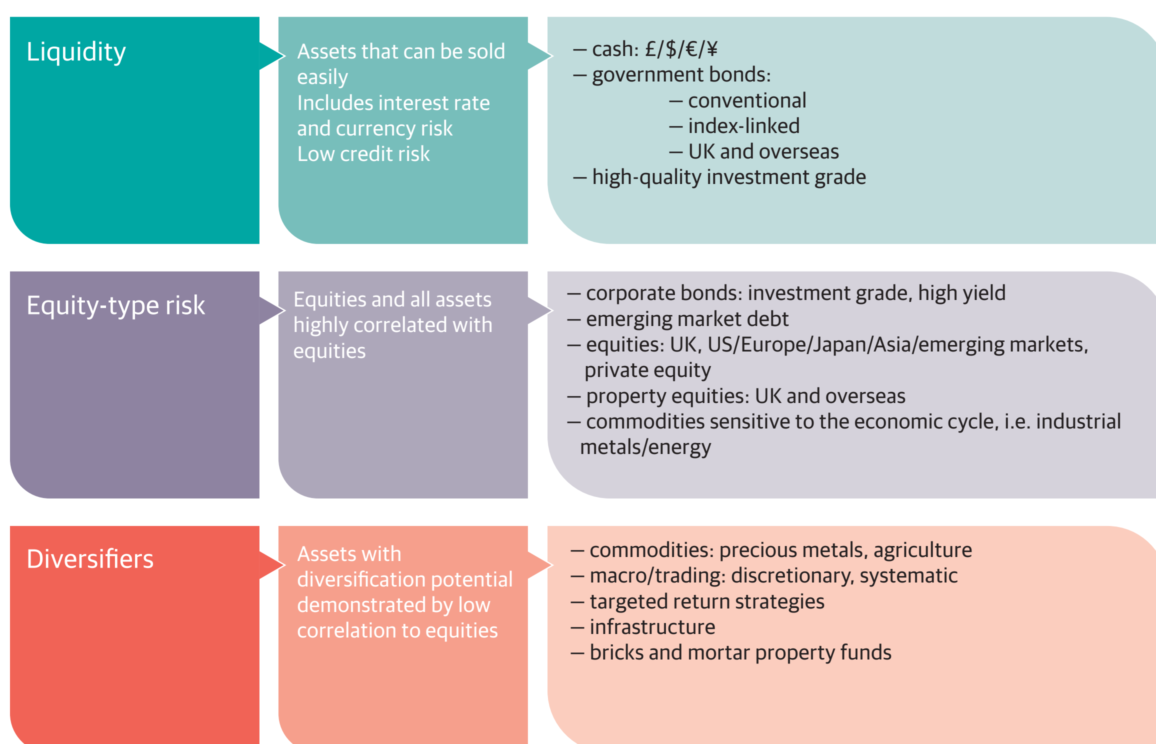
Our investment framework

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, even during periods of uncertainty. They tend not to lose too much value or, in some cases, can perform positively when the broader investment community becomes increasingly nervous about risk. These assets are viewed by the markets as having low credit risk (the likelihood that a default will occur is low). However, changes in interest rates and currency exchange rates may affect their value.

Figure 6: Group asset classes according to their behaviour



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 have the potential to reduce or offset equity-type risk over time, and possibly during periods of market stress. 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.

Characteristics of different types of investment

Figure 7 shows the returns from various types of investment (asset classes) over the 20-year period to 30 June 2019. "Annualised return" shows the compound annual percentage growth rate over the period on a total return basis in sterling (in other words, we are measuring the change in capital value plus the income generated and reinvested during the period).

"Worst drawdown" shows the largest fall in the value of an asset class between its highest point and its next subsequent lowest point during the period. Therefore, the table shows previous returns and the "worst" losses that investors might have experienced over this period if their investments had performed in line with the asset class returns.

We also show the time that it took to recover the loss from this worst setback in value. For example, equities in large UK companies have returned compound annual growth of 4.4% over the past 20 years. During this time, the largest drawdown in value that occurred was 44.4% and it took 37 months for their value to recover to its previous high point.

These returns are historical and offer no firm guide to future returns. They simply illustrate how different asset classes have performed over time to help you make an informed decision about the risk level that is appropriate for your portfolio.

Figure 7: 20-year returns

Asset types	Annualised return (%)	Worst drawdown (%)	Worst drawdown period	Months to recover
Liquidity				
Cash	+2.8	Not applicable	Not applicable	Not applicable
Government bonds	+5.3	-7.3	31/08/2016 to 30/11/2016	30
Index-linked bonds	+6.9	-12.7	29/08/2008 to 28/11/2008	11
Equity-type risk				
High yield bonds	+7.2	-33.8	31/05/2007 to 28/11/2008	9
UK large cap equity	+4.4	-44.4	31/12/1999 to 31/01/2003	37
International equity	+6.8	-48.8	31/08/2000 to 30/09/2002	56
Diversifiers				
Gold	+10.0	-37.5	31/08/2011 to 31/07/2015	Not recovered
Fund of hedge funds	+3.6	-20.4	31/10/2007 to 31/12/2008	62

Notes
1. Historical returns are calculated on a total return basis (the capital growth and the income generated by the investment) in sterling using the representative indices as set out on the following page.
2. Based on a performance period from 30 June 1999 to 30 June 2019.

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.

Definition of assets in figure 7.

Asset types	Representative index
Liquidity	
Cash	3-Month LIBOR (UK IBA Interbank LIBOR 3-month Total Return Index in £)
Government bonds	FTSE British Govt. Fixed All Stocks (FTSE Actuaries UK Conventional Gilts All Stocks Total Return Index in £)
Index-linked bonds	FTSE British Govt. Index-Linked All Maturities (FTSE British Government Index-Linked Bonds All Maturities Total Return Index in £)
Equity-type risk	
High-yield bonds	Bank of America Merrill Lynch Global High Yield, Hedged to £ (BOFA ML GLB HY Total Return Index Hedged to £)
UK large-cap equity	FTSE 100 (FTSE 100 Total Return Index in £)
International equity	FTSE World ex. UK Index (FTSE All-World Ex UK Total Return Index in £)
Diversifiers	
Gold	Gold Bullion LBM: GOLD Bullion LBM US$/Troy Ounce ~£
Fund of hedge funds	HFRI Fund of Funds Conservative (HFRI FOF CONSERVATIVE Total Return Index in US$)

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. Building diversified portfolios and monitoring the investment environment is a complex process that requires extensive resources and expertise.

Our investment strategies

We use six clearly defined risk levels. Our asset allocation committee maintains six corresponding investment strategies. These cover a broad spectrum of risk 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.

Overleaf, we show the theoretical cumulative performance of the six investment strategies over 20 years to 30 June 2019. Performance is calculated by using an appropriate index to represent each asset class and does not aim to illustrate potential value added through the selection of individual investments within each asset class.

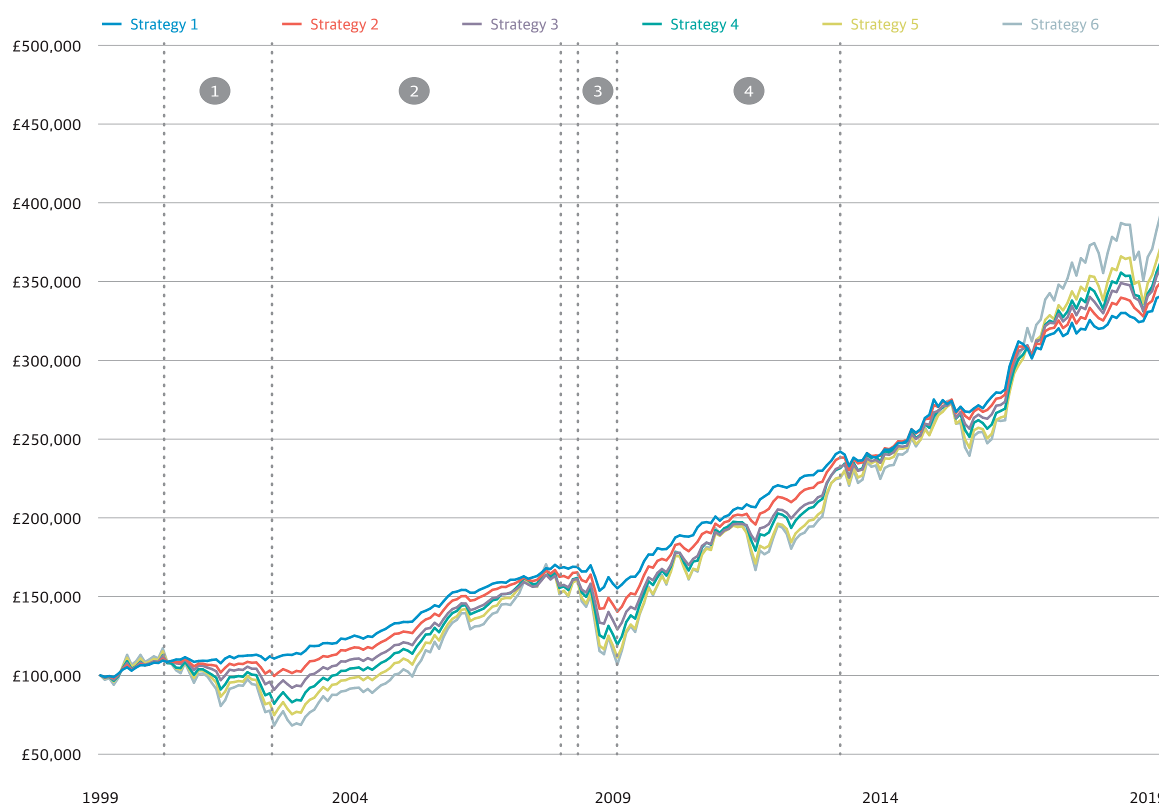
While figure 8 shows recent history, the performance of different asset classes cannot necessarily be viewed as typical when compared with the very long term. This 20-year period coincides with a positive environment for bonds and fixed interest assets, which have produced stellar returns through a combination of low inflation and falling interest rates.

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*.

Given that interest rates and yields on some government bonds are close to zero, such strong performance is unlikely to be sustainable in future. We note, however, that interest rates have fallen for a number of pervasive economic reasons over and above the more recent response to the global financial crisis and its aftermath. We do not believe that a return to the levels of 20 years ago is likely in the near term.

** The Barclays Equity Gilt Study provides a long-term analysis of returns from equities, gilts and cash between 1899 and 2016. The study states that over 117 years and after inflation the average annual compound return for equities was 5.1% and for gilts was 1.4%. Over the past 20 years these figures are 3.7% and 4.5% respectively (Source: Barclays Equity Gilt Study 2017).*

Figure 8: 20-year simulated performance of Rathbone strategies (from 30 June 1999 to 30 June 2019)



Note
1. The performance shown in figures 8 to 12 is for illustrative purposes based upon the calculation methods described below and does not represent actual returns achieved from individual investment managers. The performances of the Rathbones strategies shown are based on the long-term strategic portfolio compositions determined by our Strategic Asset Allocation Committee (SAAC). The SAAC reviews these strategic compositions once a year. Each chart reflects the performance of a set of indices designed to represent the combination of asset classes recommended by the SAAC. The performances of all the indices assume no costs or fees. The strategic weights attributable to the indices are rebalanced each quarter end. The indices are designed to reflect the typical currency exposures of sterling based investors. A full list of the constituent indices is available on request. The SAAC also regularly reviews the tactical composition of the strategies at least once a quarter. However, our investment managers are not obliged to follow these shorter-term recommendations. Indeed, they may be constrained from doing so for individual clients for tax reasons or due to specific client preferences. Therefore, we show the performance of the Rathbones strategies based on their strategic rather than their tactical compositions.

Source: Rathbones

By examining the cumulative simulated performance of the six investment strategies over the 20 years in question, it is possible to identify four distinct time periods where different market factors influenced the behaviour of the strategies to varying degrees. They are numbered from 1 to 4 in figure 8.

In the late 1990s stock markets experienced a strong period of growth. This culminated in a boom in technology and internet share prices. When the bubble burst, stock markets fell sharply and for an extended period (period 1). The markets recovered strongly between September 2002 and April 2008 (period 2).

Subsequently, the worst of the financial crisis made stock markets crash again over the eight months from August 2008 to March 2009 (period 3). In the stock market and economic recovery over the four years that followed between February 2009 and March 2013, stock markets powered ahead again (period 4).

Figures 9 to 12 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).

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.

*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 four charts are not the same.

Figure 9: Dotcom crash (31 March 2000 to 30 September 2002)*

Figure 10: Post dotcom rally (30 September 2002 to 30 April 2008)*

Figure 11: 2008–09 Global financial crisis (31 August 2008 to 27 February 2009)*

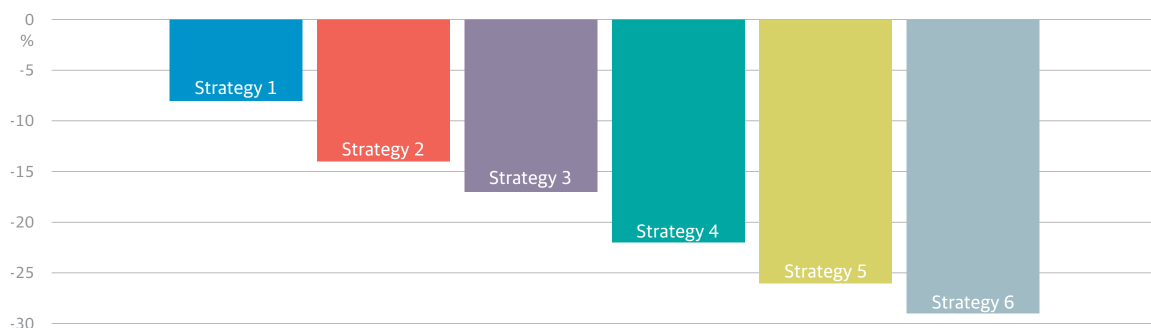
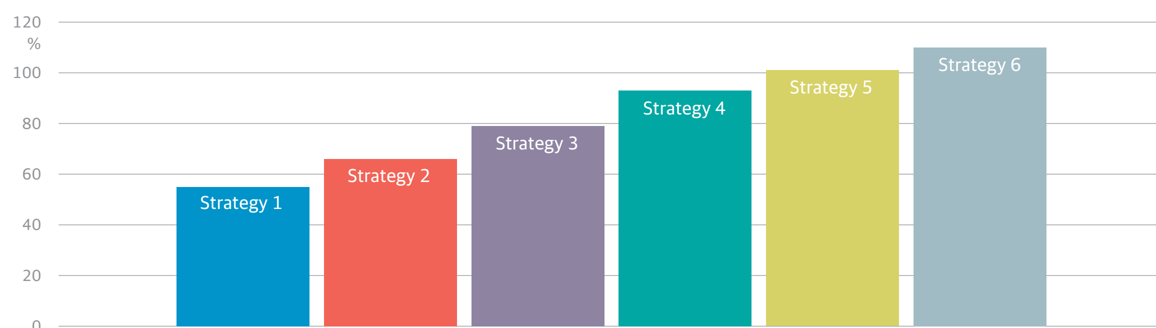


Figure 12: Post financial crisis rally (27 February 2009 to 31 March 2013)*



Source: Datastream

Figure 13: Simulated performance of our LED framework

Asset types	Cumulative returns (%)			
	Dotcom crash	Post dotcom rally	Global financial crisis	Post financial crisis rally
Liquidity				
Cash	+13.8	+30.6	+2.3	+3.6
Government bonds	+19.0	+25.3	+6.8	+30.9
Index-linked bonds	+10.3	+46.1	-8.9	+57.8
Equity-type risk				
High yield bonds	-7.1	+95.3	-24.7	+125.5
UK large cap equity	-39.3	+98.4	-30.7	+94.5
International equity	-44.7	+92.1	-27.4	+102.9
Diversifiers				
Gold	+18.3	+113.4	+46.0	+57.3
Fund of hedge funds	+5.3	+42.3	-15.9	+17.9
	31 Mar 00 – 30 Sep 02	30 Sep 02 – 30 Apr 08	31 Aug 08 – 27 Feb 09	27 Feb 09 – 31 Mar 13

Source: Datastream

Figure 13 shows how some asset classes within liquidity, equity-type risk and diversifiers performed over the same four periods shown above. Please see pages 13 and 14 for the definition of liquidity, equity-type risk and diversifier asset types.

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 agree with the investment recommendations that your adviser proposes, 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 adjusting the portfolio could lead to a capital gains tax liability under current rules.

Having agreed the appropriate asset allocation for your portfolio, your investment manager will select the individual investments to represent each asset class, guided by the investment committees and research team recommendations. These cover equities and bonds, collective investment funds and other investment types. We also make use of external research as an input to our investment process and to supplement our in-house research expertise.

All clients' portfolios are expected to fit the broad risk characteristics of the risk level in which they reside. However, all our clients are different and, therefore, portfolios are not standardised across the firm but are built to meet individual client needs. While we have a robust central investment process to guide everyone, your investment manager remains responsible for selecting the individual investments that make up your portfolio.

We can meet any specific requirements you may have. If you wish your portfolio to be managed in a particular way or to invest in (or exclude) particular types of assets, then we can accommodate your instructions. Your adviser will agree a specific mandate with you and this will be reflected in their formal advice to you. It is important that we agree the strategy with your adviser in advance (including any preferences and constraints) and that you understand the effect these constraints may have in relation to our ability to meet any wider investment goals.

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 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 situation or objectives change, as well as managing your expectations of what we can achieve. This is why it is so important that your adviser tells us if your circumstances or objectives 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 objectives and attitude to risk. It also teaches us about the importance of not investing in securities and strategies that are obscure or unnecessarily complex.

It is important not to invest for emotional reasons. Clients often have investments that they hold for personal reasons, such as family links to the underlying company. Where you wish us to consider such investments, we will only include them in your portfolio where they complement the strategy. It is often best to hold those assets separately from your main portfolio and we can easily arrange this.

Clear and transparent reporting

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

We believe in clear and straightforward reporting through regular portfolio valuations. You may ask us to send you an up-to-date valuation at any time and you can access your portfolio on demand 24 hours a day through our secure online portal.

We have invested in our ability to 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.

Risk monitoring and performance oversight

Your investment manager will monitor your investments to ensure your portfolio matches 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 make sure 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.

Stewardship and corporate governance

Strong stewardship means recognising our clients' interests and taking an active approach to the ownership of investments. Implementing effective stewardship is integral to our investment process as a means of protecting and enhancing value for our clients. We prefer to invest in companies with high standards of corporate governance because they prioritise the interests of shareholders rather than those of management.

We actively monitor the actions, policies and decisions of the boards of companies we invest in and participate in voting at annual general meetings and extraordinary general meetings. Where appropriate, we engage with companies to ensure your interests as a shareholder are protected.

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 financial adviser.

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, more commonly, 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

Our aim on these pages has been to describe the relationship between risk and return and how we will work with your adviser to deliver the right portfolio to meet your needs.

It is important that you understand these concepts at the start of your relationship with us. If you have any doubts or questions, please speak to your financial adviser. If you decide to invest with us, you should then make sure you always tell your financial adviser about any change in your circumstances or investment objectives.

Contact us

Your investment manager will monitor your investments to ensure that your portfolio matches your risk profile.

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

Transferring an investment portfolio to us is also easy. Once you instruct your current investment manager, we will do the rest.

Aberdeen
01224 218 180

Birmingham
0121 233 2626

Bristol
0117 929 1919

Cambridge
01223 229 229

Chichester
01243 775 373

Edinburgh
0131 550 1350

Exeter
01392 201 000

Glasgow
0141 397 9900

Kendal
01539 561 457

Liverpool
0151 236 6666

London (head office)
020 7399 0000

Lymington
01590 647 657

Newcastle
0191 255 1440

Winchester
01962 857 000

For ethical investment management, contact:
Rathbone Greenbank Investments
0117 930 3000

For offshore investment management, contact:
Rathbone Investment Management International Limited
01534 740 500

For more information, please visit:
rathbones.com

or email:
enquiries@rathbones.com

Important information

Unless otherwise stated, the information in this document was valid as at June 2019. Not all the services and investments described are authorised or regulated by the Prudential Regulation Authority or the Financial Conduct Authority. Rathbones, Rathbone Unitised Portfolio Service and Rathbone Greenbank Investments are trading names of Rathbone Investment Management Limited, which is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.
Registered office: Port of Liverpool Building, Pier Head, Liverpool L3 1NW.
Registered in England No. 01448919.

Rathbone Unit Trust Management Limited is authorised and regulated by the Financial Conduct Authority and is a member of the Investment Management Association (IMA).
Registered office: 8 Finsbury Circus, London EC2M 7AZ. Registered in England No. 02376568.

Tax, trust and company administration services are supplied by trust companies in the Rathbone Group. Rathbone Trust Company Limited is authorised and regulated by the Solicitors Regulation Authority.
Registered office: 8 Finsbury Circus, London EC2M 7AZ. Registered in England No. 01688454.

Rathbone Investment Management International is the Registered Business Name of Rathbone Investment Management International Limited which is regulated by the Jersey Financial Services Commission. Registered office: 26 Esplanade, St. Helier, Jersey JE1 2RB. Company Registration No. 50503. Rathbone Investment Management International Limited is not authorised or regulated by the Prudential Regulation Authority or the Financial Conduct Authority in the UK. Rathbone Investment Management International Limited is not subject to the provisions of the UK Financial Services and Markets Act 2000 and the Financial Services Act 2012; and, investors entering into investment agreements with Rathbone Investment Management International Limited will not have the protections afforded by those Acts or the rules and regulations made under them, including the UK Financial Services Compensation Scheme.

All above companies are wholly owned subsidiaries of Rathbone Brothers Plc. Head office: 8 Finsbury Circus, London EC2M 7AZ. Tel +44 (0)20 7399 0000. Rathbone Brothers Plc is independently owned, is the sole shareholder in each of its subsidiary businesses and is listed on the London Stock Exchange. 'Independent' and 'independence' refer to the basis of Rathbones' ownership as a corporate entity, and not to our use of non-life packaged products for clients of our advisory or non-discretionary investment management.

This document is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The information and opinions expressed herein are considered valid at publication, but are subject to change without notice and their accuracy and completeness cannot be guaranteed. No part of this document may be reproduced in any manner without prior permission.

© 2019 Rathbone Brothers Plc. All rights reserved.

RIM INF 031 UIRR – CR580 – 08-19 459040

Connect with us

rathbones.com

@Rathbones1742

Rathbone Brothers Plc

Rathbone Brothers Plc