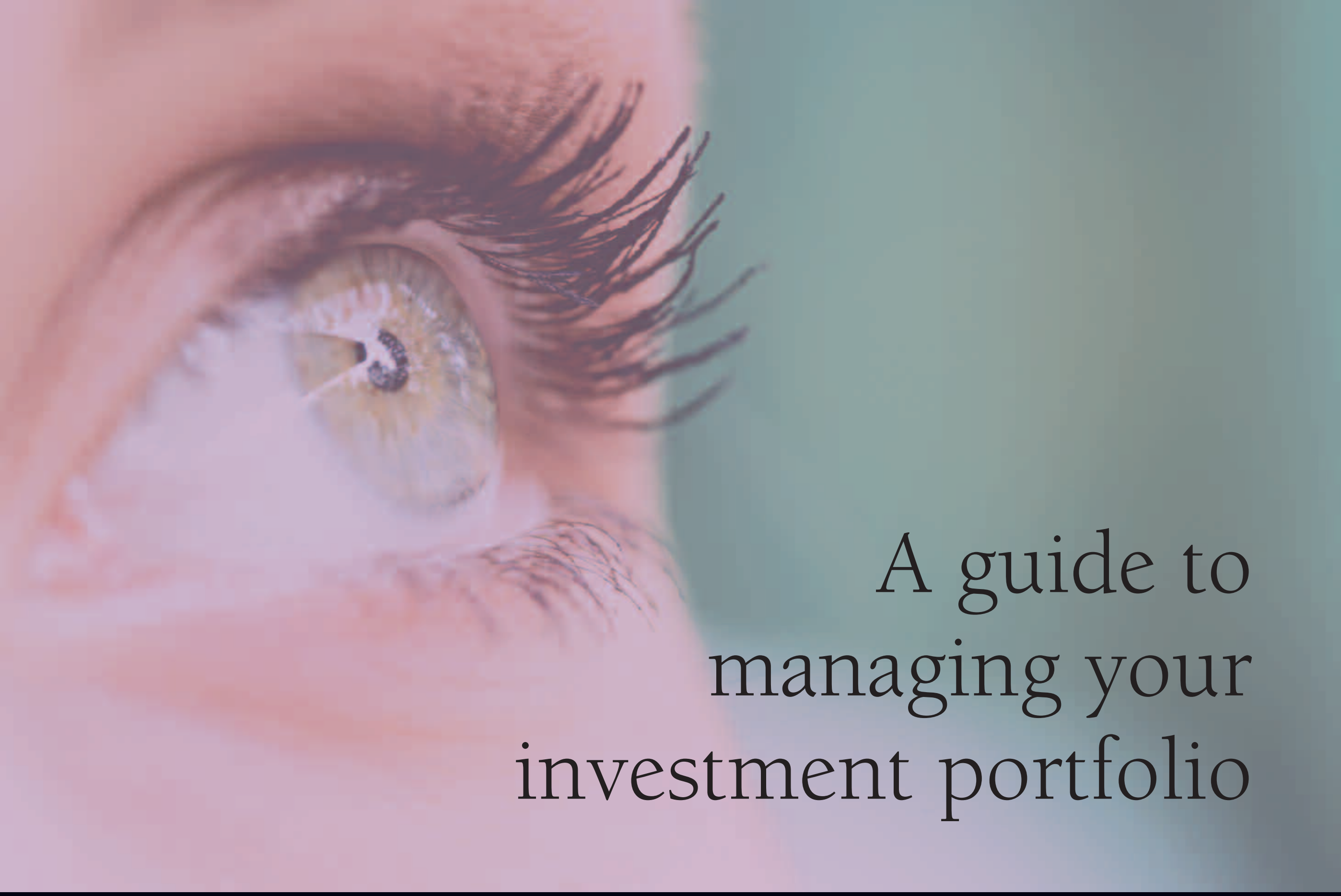


A guide to managing your investment portfolio

Financial Planners
Chartered

BreedElliott

introduction

Although some people are prepared to make their own investment decisions, the majority of our clients are keen to seek our advice on how 'best' to construct their investment portfolio.

The purpose of this Guide is to explain the process we follow when constructing and subsequently monitoring and reviewing an investment portfolio for you.

Our process has been developed based upon our interpretation of two influential studies on portfolio construction and performance.These are:

- Portfolio Selection: Efficient Diversification of Investments - **Harry M Markowitz** (1952)
- Determinants of Portfolio Performance II - **Brinson, Singer, Beebower** (1991)

Markowitz is best known for his pioneering work in **Modern Portfolio Theory**, studying the effects of asset risk, return, correlation and diversification on probable investment portfolio returns. Brinson, Singer and Beebower found that, whilst many investors concentrate on trying to choose the best stock and pick the perfect moment to buy or sell, what really matters to your long-term returns is **asset allocation** - that is, how you split up your portfolio amongst the different classes of asset.

We believe that the art of constructing an investment portfolio is to strike the right balance between achieving the returns you desire whilst taking a degree of risk with which you feel comfortable. This involves considering the respective advantages and disadvantages of different assets and then determining the most appropriate mix of these assets within your portfolio to deliver the required rewards over the term of the investment with the minimum amount of uncertainty.

This Breed Elliott Guide aims to explain for you, in plain English, each of the steps in the process of constructing, monitoring and reviewing your investment portfolio.

step one **Understanding our client**

In simple terms, there are three key areas where we need to understand you:

1 Your current personal and financial circumstances

An understanding of your current situation will provide us with essential facts such as the amount of money available for investment and start to give us an insight into what is important to you and your attitude towards saving and investing.

2 Your aims and aspirations for the future

As a firm, we put great emphasis on gaining a deep understanding of how you see your life mapping out. This is critically important for two reasons:

- Our experience shows us that when our clients are given the time and space to share with us their aspirations for the future, it is remarkable how closely the eventual reality matches the expressed hopes and dreams. The benefits of this foresight are endless when it comes to rewarding financial planning.
- Because the future vision is uncannily accurate, we are able to build a clear picture of when investments are likely to be needed. Being able to identify the likely timescale for any given investment is vital when constructing an investment portfolio.

3 Your attitude to investment risk

Having gained an understanding of the sums involved and the objectives and timescales for your investment, we need to understand your attitude to risk.

We have developed an Attitude to Investment Risk Questionnaire to work through with you. The questions have been designed to prompt discussion about investment risk and to look at different aspects of risk. For example, do you have other investments to fall back on which allow you to take a little more risk with a specific investment? How would you feel if an investment fell in value? Are you naturally a risk-taker?

The Questionnaire will identify you within one of five risk profiles, ranging from low to high risk, and we will check that you are comfortable with this classification.

Once we know how much you are looking to invest, your investment objectives and your attitude to risk, we can start to construct your portfolio. But before we do, we will make sure that you understand the different types of asset and their respective characteristics.

step two **Understanding the different types of asset**

The four main asset classes are cash deposits, fixed interest securities, property and equities or shares.

Cash deposits These provide a variable income in the form of interest with no capital growth. Because the capital is secure, cash is seen as low risk, so it is ideal for short term savings or for reducing the risk of a portfolio. However, in the long term, there is the risk of inflation reducing the buying power of the capital.

Fixed Interest Securities (e.g. Gilts and Corporate Bonds) These provide a fixed income, which is called a 'coupon.' Because these securities can be bought and sold in a secondary market, their capital value will fluctuate depending upon the attractiveness of the yield from the coupon, and for this reason they are seen as higher risk than cash deposits. However, they can perform the same role within a portfolio as cash, reducing the risk of the overall portfolio. Also, because they are higher risk than cash, they offer the potential for higher returns than from cash deposits.

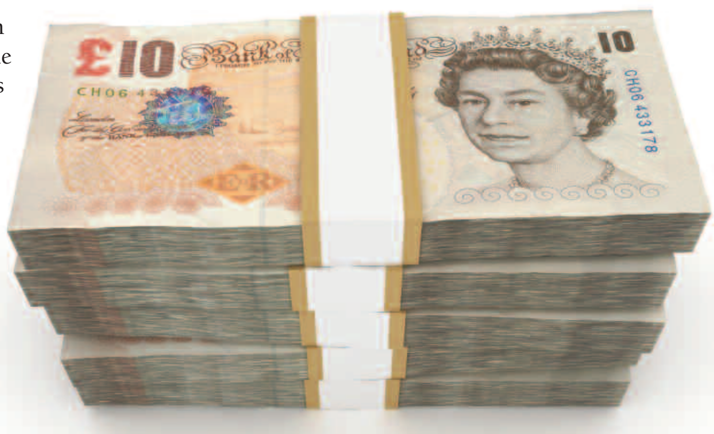
Property This is a familiar asset to many of us who own our own home. For investment purposes, it is sometimes easier to think about rental property rather than your own home when considering the characteristics of property as an asset class.

The income derived from property comes in the form of rent, which is variable and can stop if there is no tenant. Over the long term, rental income tends to increase because of inflationary pressures and this increase in investment income tends to lead to an increase in the capital value of the property. However, capital values may decrease if rental demand falls and the rental income reduces. Because there is a risk to both capital and income, property should not be seen as a short term investment, but its potential for long term returns is evident to many of us when we reflect on the changing capital value of our own home.

Equities/Shares Equities or shares have similar characteristics to property. The income (dividend) varies depending on the company's profitability but, like rental income, tends to increase over the long term partly because of inflationary pressures. As the dividend increases, the capital value of the share tends to also go up. As you will appreciate, share prices can be volatile and can fall sharply in value as we have seen in the past. Therefore, they are not a sensible asset into which to invest if the investment objective is short term. However, over the long term, equities have a strong record of consistently outperforming each of the other three classes of asset.

As explained, each of the asset classes has different characteristics and they provide different risks and rewards over time. For example, when equity prices are increasing, property values may be falling and vice versa.

The key to successful investment planning is to invest in a mix of these asset classes in such a way as to maximise the return whilst not exposing you to a level of risk with which you would feel uncomfortable.



step three **Determine the appropriate asset allocation**

The most appropriate asset allocation for you will be determined by equal reference to your risk profile and the likely time horizon for your investment.

As referred to earlier, we believe that the time horizon for an investment is such a critical factor in determining the asset allocation of a portfolio because of how the various assets behave over time.

For example, whilst the capital security of a cash savings account provides a low risk means of investing in the short term, in the long term, cash savings accounts struggle to maintain their value in real terms, i.e. the net interest rate can be less than the rate of inflation, so the buying power of the capital reduces. In other words, over the long term, it can be a risk to keep your savings in cash.

Similarly, whilst share prices can be volatile over short periods, making them high risk for short term investing, their long term growth potential offers the opportunity of providing real returns, i.e. in excess of inflation. In other words, the longer the time horizon for an investment, the less is the risk of losing money by investing in shares.

Therefore, for longer term investments, we will recommend that a larger percentage of the investment is allocated to shares and a smaller percentage to the other asset classes.

Taking into account your risk profile and the time horizon for your investment, we use the matrix on the next page to guide us to what we believe to be the most suitable asset allocation for each of our clients. Through a detailed analysis of the respective performance of each asset class over time, we have concluded that these model portfolios provide the greatest probability of achieving the maximum reward for a given risk profile.

Actual future returns are notoriously difficult to predict and past performance is no guide to the future. However, we believe that this approach offers our clients a sensible and simple way of constructing their portfolio.

Risk Profile

Time Horizon	High	Medium-High	Medium	Medium-Low	Low
Long Term 10+ years	0% Cash 10% Fixed Int. 10% Property 80% Equity	0% Cash 15% Fixed Int. 10% Property 75% Equity	0% Cash 20% Fixed Int. 15% Property 65% Equity	0% Cash 25% Fixed Int. 20% Property 55% Equity	0% Cash 30% Fixed Int. 25% Property 45% Equity
Medium-Long Term 7-10 years	0% Cash 15% Fixed Int. 10% Property 75% Equity	0% Cash 20% Fixed Int. 15% Property 65% Equity	0% Cash 25% Fixed Int. 20% Property 55% Equity	0% Cash 30% Fixed Int. 25% Property 45% Equity	25% Cash 25% Fixed Int. 20% Property 30% Equity
Medium Term 5-7 years	0% Cash 20% Fixed Int. 15% Property 65% Equity	0% Cash 25% Fixed Int. 20% Property 55% Equity	0% Cash 30% Fixed Int. 25% Property 45% Equity	25% Cash 25% Fixed Int. 20% Property 30% Equity	50% Cash 20% Fixed Int. 15% Property 15% Equity
Short-Medium Term 3-5 years	0% Cash 25% Fixed Int. 20% Property 55% Equity	0% Cash 30% Fixed Int. 25% Property 45% Equity	25% Cash 25% Fixed Int. 20% Property 30% Equity	50% Cash 20% Fixed Int. 15% Property 15% Equity	75% Cash 15% Fixed Int. 10% Property 0% Equity
Short Term 0-3 years	0% Cash 30% Fixed Int. 25% Property 45% Equity	25% Cash 25% Fixed Int. 20% Property 30% Equity	50% Cash 20% Fixed Int. 15% Property 15% Equity	75% Cash 15% Fixed Int. 10% Property 0% Equity	100% Cash 0% Fixed Int. 0% Property 0% Equity

Once we have identified the model portfolio most suitable for your investment objective and your risk profile, we will discuss this with you in more detail, make sure that you are happy to use this as a benchmark and decide how and where we will invest your funds within the different asset classes.

For example, within the fixed interest securities asset class, you have the choice of investing in UK government gilts, UK corporate bonds and overseas bonds and in equities you have the choice of investing in different sectors and different countries.

We will confirm the agreed asset allocation in writing to you and use this as the benchmark for the construction of your portfolio and when monitoring your portfolio at future reviews.

step four **Fund research and selection**

Once we have the benchmark asset allocation for your portfolio, we will decide into which individual funds we recommend you invest. We only recommend collective investments such as unit trusts, Open Ended Investment Companies (OEICs), insured funds, exchange traded funds, etc.

There is a galaxy of funds available managed by numerous fund management companies investing in different sectors within each asset class. At this stage, our role is to research the market of available funds for you and select those which we feel provide the greatest potential for competitive returns within their respective sectors.

It is impossible to predict which funds will be the best performers but our research increases the potential of identifying funds which will perform competitively.

It is also worth reiterating that portfolio performance research indicates that the most significant determinant of future portfolio performance is the asset allocation of the portfolio and not the selection of the individual funds held within the portfolio.

We will confirm the selection of funds which we recommend that you hold in your portfolio to you in writing.

step five **Monitoring, reviewing and rebalancing**

Our experience convinces us that a vital element of successful investing is to ensure that we regularly meet with our clients not only to review the performance of their investment portfolio but also to monitor their changing circumstances to ensure that the investment portfolio continues to be suitable for their needs.

The following are the key components of a regular review meeting with our clients:

- Check for any changes to our client's current situation or their aims and aspirations for the future.
- Confirm their attitude to risk has not changed significantly since the last review.
- Compare the current asset allocation of the client's portfolio to the benchmark.
- Rebalance the asset allocation of the portfolio if required. For example, if the equity markets have increased and the portfolio is now overweight in equity funds and underweight in, say, fixed interest funds, to switch some of the equity funds into fixed interest to restore the correct balance.
- Analyse the actual returns and the competitive performance of the individual funds held within the portfolios. If this is not satisfactory, to recommend switches away from poor performing funds to funds which we rate highly at that time.
- Confirm changes to the portfolio in writing.

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