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UNDERSTANDING INVESTMENT & RISK

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THE PROCESS

This guide to Understanding Investment & Risk forms the basis of our conversations with you about your investment preferences and should be retained for future reference. It also provides you with a reminder of our investment process, should you need it. If you have any questions regarding the content of this guide, please contact your adviser.

Name:

Date:

Adviser:

Assessment Objective:

Understanding Risk

Before entering into any investment, we believe it is fundamental that you have an understanding of the risks involved in investing your money, and the ways in which risk can be managed.

With this in mind, we undertake to guide you through an overview of investment risk and our Investment Philosophy, and also to test your understanding and experience of investing through our risk profiling process.

Risk is an element of our everyday lives; whether it be the risk we take in crossing a busy road, or that of committing to buy a new house or switch to a new job. Consciously or subconsciously, we evaluate the risks involved in, and the potential outcomes of our actions and make decisions based upon our understanding of, and willingness to accept, the risks involved.

We undergo a similar process of evaluation when it comes to investing money, the difference being that it is often difficult to imagine the risks involved in the decisions we make, and hard to predict the outcomes as it is difficult to know what the future may bring.

In order to assist you in understanding the risks surrounding your investments, we will discuss with you your specific objectives and the risk factors which may affect your investment. We will help you to design a financial plan which takes risk in all its forms into account, and provide you with an investment recommendation which is suited to your risk profile.

The principle types of risk to which your money can be exposed are summarised below. Your adviser will discuss with you how these risks impact on your personal objectives.

Interest Rate Risk

This is the risk that the capital value of an investment in an interest bearing security (e.g. a government or corporate bond) will fall if general interest rates rise. As the rate of return from the security is fixed, its value relative to the market will fall if interest rates rise.

Business Risk

Also known as unsystematic risk, this is the risk that is specific to a particular security, such as the risk that the underlying business will fail or that the industry to which it belongs will experience difficulties. Generally speaking, all businesses in the same industry have similar types of business risk. A common way to reduce the impact of unsystematic risk is to diversify: that is, to buy securities offered by a range of many different companies, and/or in different industry sectors.

Market Risk

Also referred to as systematic risk, Market risk affects all securities in the same manner, and cannot be mitigated by diversification. Often, Market risk is influenced by major world events, for example, war or political upheaval, and is difficult to predict.

Credit Risk

This refers to the possibility that the party responsible for meeting the interest or principal repayments of a security fail to do so.

This is a particular risk associated with investments that include debt instruments.

Inflationary Risk

Inflation risk is the threat of rising prices eroding the buying power of your money. Since 2009, the Bank of England base rate has been at historic lows of 0.5%, meaning savings rates have also been low. In many cases, they have been lower than inflation, meaning that the returns savers are making on their money are not enough to keep up with the rising cost of living.

Liquidity Risk

Liquidity risk refers to the possibility that an investor may not be able to buy or sell an investment as and when desired or in sufficient quantities because opportunities are limited. A good example of liquidity risk is selling real estate. In most cases, it will be difficult to sell a property at any given moment should the need arise, unlike government securities or blue chip stocks.

Social/ Political/ Legislative Risk

This is the risk associated with the possibility of unfavourable government action or social changes resulting in a loss of value. Such risks can be unpredictable and difficult to mitigate against.

Currency/Exchange Rate Risk

Currency or exchange rate risk is a form of risk that arises from the change in price of one currency against another.

The constant fluctuations in the foreign currency in which an investment is denominated vis-à-vis one's home currency adds risk to the value of a security.

Term

All types of investment risk interact with the term of the investment and can be considered greater or lesser risks as a result. To illustrate; an investment made for a term of 3 years into UK Equities would be considered high risk as this asset class can be volatile as a result of business and market risks, and the investment would have little time to recover from any falls in value.

Conversely, capital held for a period of 15 years in cash would not be expected to achieve rates of interest to match inflation and would, as a result, lose value in real terms over the period due to inflationary risk.

With this in mind, your adviser will discuss with you the time horizon for your investment in conjunction with your risk profile to determine the most suitable investment strategy to give you the best chance of achieving your goals.

Your Risk Profile

The starting point for determining suitable investments for you is to establish your personal risk profile. We do this by discussion with you, and analysis of the four key elements of your profile:

Risk Requirement

As part of our work with you we will establish your objectives, and the timescale over which you need to achieve them. We will also assess your current and anticipated income and expenditure needs, and the resources you have at your disposal to provide for those needs.

This analysis allows us to determine the annual return your investments need to achieve in order to meet your objectives. From this, we are able to estimate the level of risk your investment would need to be exposed to in order to achieve the desired outcome, and we can then determine how realistic your expectations of achieving your objectives are, taking into account your risk profile.

Capacity for Loss

Your capacity for loss is, simply put, your ability to manage financially if a loss occurs. We will assess your financial position (including a review of your income, expenditure, assets and liabilities) and discuss the effect the loss of any capital invested would have on your standard of living and/or your future objectives.

Risk Tolerance

Unlike "risk required", and "capacity for loss", which are financial calculations, "risk tolerance" is psychological. Risk tolerance is how comfortable you feel about taking risk. For example, you may say that it is very important that your investments maintain their purchasing power and also that any fall in the value of your investments would make you feel uncomfortable.

Together we will complete a risk tolerance questionnaire and discuss the outcome, along with any inconsistencies which arise from your answers.

Knowledge & Experience of Financial Products

In order to understand your knowledge of investment generally, and specific investment experience, we consider the types of financial products you have purchased in the past, and whether you have done this having received advice, or acted on your own without any advice. This helps us to assess your level of understanding of different products.

Your Risk Profile

Having taken each of the four elements into account, we establish your personal risk profile by aligning you with one of 10 risk categories. We will then ask you to confirm that you are happy that our definition of your risk profile is accurate. Once we have determined your risk profile, we will use this along with the timescale of your investment to determine an appropriate asset allocation for you.

Your risk profile forms the basis of your investment strategy, and is the measure against which your investments will be tested, monitored and re-balanced. We will also review your risk profile with you periodically to ensure your investment strategy remains appropriate.

Shown below are summaries of our risk categories, along with examples of a typical model asset allocation for an investor matching the associated risk profile (the models assume an investment term of 11-15 years and are for illustrative purposes only, your personal asset allocation will depend upon your risk profile, timescale and other factors such as existing investments which need to be taken into account).

Typical Risk Profiles & Definitions

Very Cautious Investor

Typically is prepared to take only a small amount of investment risk and it is important that capital is protected. This means that the portfolio will concentrate on investments which provide low returns in the long term but present no risk to capital. Only a small amount of riskier assets will be included in the portfolio in order to increase the chance of obtaining better long term returns.

A cautious investor will be invested mostly in fixed interest and cash with a small element (up to about one third) in equities and property which can boost longer term returns but are associated with more risk. A very cautious investor will have slightly more invested in fixed interest and cash.

Cautious Investor

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A cautious investor will be invested mostly in fixed interest and cash with a small element (up to about one third) in equities and property which can boost longer term returns but are associated with more risk.

Low end of Cautious to Moderate Investor

Typically is prepared to take a limited investment risk in order to increase the chances of achieving a positive return but only wants to risk a small part of their capital to achieve this.

A cautious to moderate portfolio will have up to half invested in fixed interest products which are low risk but have low returns. The larger part of the portfolio will be invested in equities and property which can boost longer term returns but are associated with more risk. Because you are a low end of cautious to moderate there will be slightly more invested in fixed interest and cash.

Cautious to Moderate Investor

Typically you have agreed with your adviser that you are prepared to take a limited investment risk in order to increase the chances of achieving a positive return but you only want to risk a small part of your capital to achieve this.

A cautious to moderate portfolio will have up to half invested in fixed interest products which are low risk but have low returns. The larger part of the portfolio will be invested in equities and property which can boost longer term returns but are associated with more risk.

Low end of Moderate Investor

Typically you have agreed with your adviser that you are prepared to take a moderate amount of investment risk in order to increase the chance of achieving a positive return. Capital protection is less important to you than achieving a better return on the investment.

A moderate investor will usually invest in a variety of assets to obtain diversification.
There would be a substantially higher proportion of equities and property compared to fixed interest and cash. Because you are a low end of moderate investor there will be slightly more invested in fixed interest and cash.

Key: ■ UK Government Bonds ■ Corporate Bonds ■ UK Equity ■ Overseas Equity ■ Specialist Equity ■ Property

Moderate Investor

Typically you have agreed with your adviser that you are prepared to take a moderate amount of investment risk in order to increase the chance of achieving a positive return. Capital protection is less important to you than achieving a better return on the investment.

A moderate investor will usually invest in a variety of assets to obtain diversification. There would be a substantially higher proportion of equities and property compared to fixed interest and cash. The range of asset types helps reduce the overall risks as well as increasing the chance of better returns.

Low end of Moderate to Adventurous Investor

Typically you have agreed with your adviser that you are prepared to take a medium degree of risk with your investment in return for the prospect of improving longer term investment performance. Short term capital protection is not important to you and you are willing to sacrifice some long term protection for the likelihood of greater returns.

A moderate to adventurous investor will be invested mainly in equities but with other assets included to provide some diversification. There may be a small amount of specialised equity within the portfolio. Because you are a low end of moderate to adventurous investor there will be slightly more invested in fixed interest and cash.

Moderate to Adventurous Investor

Typically you have agreed with your adviser that you are prepared to take a medium degree of risk with your investment in return for the prospect of improving longer term investment performance. Short term capital protection is not important to you and you are willing to sacrifice some long term protection for the likelihood of greater returns.

A moderate to adventurous investor will be invested mainly in equities but with other assets included to provide some diversification. There may be a small amount of specialised equity within the portfolio.

Adventurous Investor

Typically you have agreed with your adviser that you are prepared to take a substantial degree of risk with your investment in return for the prospect of the highest possible longer term investment performance.

You appreciate that over some periods of time there can be significant falls, as well as rises, in the value of your investment and you may get back less than you invest. This strategy holds significant risk in the shorter term. An adventurous investor will be invested entirely in equities, both in the UK and overseas. There may be a significant proportion of the investment in specialised equities.

Very Adventurous Investor

Typically you have agreed with your adviser that you are prepared to take a substantial degree of risk with your investment in return for the prospect of the highest possible longer term investment performance. You appreciate that over some periods of time there can be significant falls, as well as rises, in the value of your investment and you may get back less than you invest. This strategy holds significant risk in the shorter term.

An adventurous investor will be invested entirely in equities, both in the UK and overseas. There may be a significant proportion of the investment in specialised equities. Because you are a very adventurous investor there will be slightly more invested in specialised equities. In all cases, the range of asset types helps reduce the overall risks as well as increasing the chance of better returns.

Key: ■ UK Government Bonds ■ Corporate Bonds ■ UK Equity ■ Overseas Equity ■ Specialist Equity ■ Property

Investment Objectives

Having established your Risk Profile, we give consideration to your investment objectives. Whilst your individual goals will be personal to you, we find that the majority of clients' objectives fall into at least one of the following three categories:

Accumulating capital

Whether saving for a future need, such as school fees, retirement or mortgage repayment, or simply accruing surplus income, there are some common themes which inform investment decisions when accruing capital:

- A medium to long term investment period meaning time to recover from market downturns, but at the risk of inflation eroding the value of capital;
- A desire to minimise the long term impact of investment charges on savings;
- The need for the investment to be maintained over a longer period of time within the risk profile identified, meaning a regular review and rebalance of the investment may be necessary.

It is our view that clients within the accumulation phase of their investment life benefit most from low cost, well diversified and re-balanced investment structures, and that minimising investment costs is often of greater benefit than the additional value to be gained from active management.

Preserving capital

Clients within this phase of their financial life have generally accrued sufficient funds for their requirements, and wish to preserve the value of this capital for the stipulated need. Often clients requiring capital preservation have a short, or medium term need and less appetite for risk as, having accrued their desired capital, they do not wish to risk loss just before the moment of need. However, there will also be clients who wish to preserve capital over the longer term. Again there are some common considerations for clients within this category:

- Inflation is likely to impact negatively on their financial plans where the term is longer;
- Reduced appetite for investment risk as downturns in capital value are not easily recoverable;

- The need to minimise the impact of charges on the investment;
- Exposure to inflation risk where longer term capital preservation is the objective;
- Liquidity either on an ongoing basis or at a fixed point in the future.

Income

The need for income creates some specific issues from an investment point of view as the term may or may not be clear (for example in the case of retirement planning), and volatility can have severe consequences for the sustainability of an investment. Consideration for clients within this category are:

- Minimising volatility and, consequently, reducing the negative impact of taking income;
- Ensuring immediate and/or short term needs are secured;
- Returns are still likely to be needed in order to maintain the investment for the required period;
- Re-balancing will be needed to maintain the investment within the chosen risk profile;
- The longer term impact of inflation on income.

Investment Philosophy & Process

At Ernest Grant, we strongly believe that we will achieve the best results for you as our client by ensuring our advisers are able to focus on spending time understanding your circumstances, and your aims and aspirations, and designing a financial plan fit for the purpose of achieving these goals. Your adviser will develop a lifetime financial planning strategy with you and will support you in making decisions regarding your financial future.

Often, this will involve the use of investments, carefully constructed to meet your needs in terms of financial outcomes and attitude to, and tolerance for, investment risk.

Once your initial financial needs are understood, your adviser will oversee the implementation of this strategy through the arrangement of any plans, policies and investments required. Dependent upon your agreed service level, your adviser will also monitor and review your financial plans with you on a regular basis to ensure they remain on course, and to help you to adapt to any changes in your circumstances which impact upon your plans.

In constructing a suitable investment strategy to support your financial plans, we follow a robust process, led by our Investment Committee, in order to select and oversee the use of appropriate investments, managed in line with our Investment Philosophy, by selected investment experts that meet our stringent due diligence criteria.

Investment Philosophy

The Ernest Grant Investment Philosophy is founded in the following core beliefs:

- asset allocation and diversification are the principle drivers of long term investment performance;
- our clients are unique and a “one size fits all” investment strategy is not appropriate;
- our clients place high value on minimising the costs of investment;
- employing the skills of investment experts to manage our clients’ investments produces better outcomes - using the right people to do the right jobs gets the optimum results.

Asset Allocation and Diversification

In line with the most prominent theory on investment currently available: Marcowicz's Modern Portfolio Theory, we at Ernest Grant believe that the principle objective of any investment strategy is to maximise returns whilst minimising investment risk. Furthermore, we believe that:

- risk can be reduced within an investment portfolio by holding a range of different assets which behave in different ways in relation to the market (i.e. are negatively or non-correlated);
- asset allocation is the principle driver of investment performance, with stock selection and market timing being of secondary influence.

Asset Allocation

Research suggests that as much as 90% of a portfolio's performance is determined by its asset allocation, with stock selection and market timing being the main factors responsible for the remaining 10%.

Asset Allocation is the selection of the types and amount of each asset that make up a portfolio. The core assets that are generally used to form the asset allocation of a portfolio are equities, bonds, cash and property, with other assets such as commodities, derivatives, or foreign currency featuring to provide further diversification, or to take tactical advantage of market conditions.

The various asset classes carry differing levels of inherent risk, and the aim of asset allocation is to construct a portfolio that is balanced towards the level of risk that the investor is able to tolerate to offer the optimum returns for their investment.

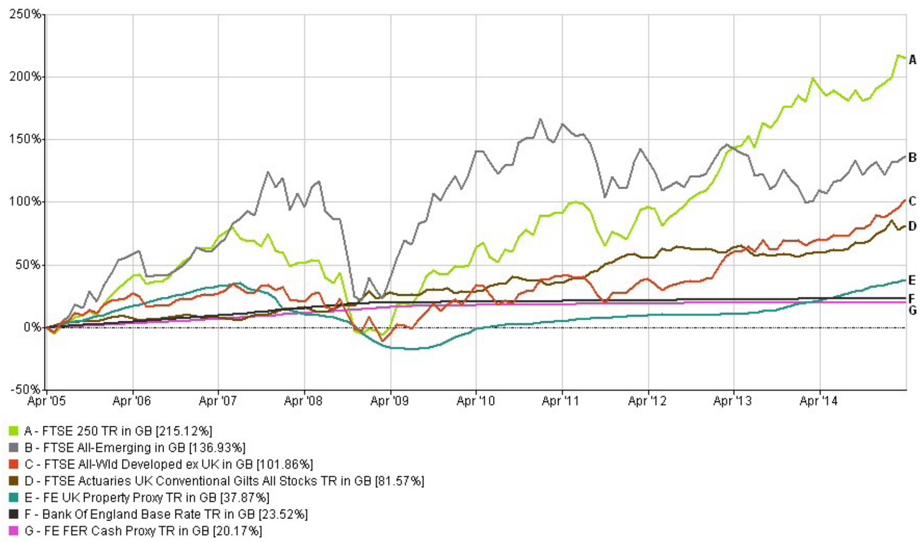
For example, we would expect, based on historical data, that a portfolio which contained only bonds would be outperformed over the long term by a portfolio that contained bonds, cash, equities and property, although the level of risk to which the portfolio was exposed may be similar.

We use pre-determined model asset allocations which are adjusted dependent on risk profile and investment term, with more cautious portfolios, and shorter timescales, being reflected in asset allocations containing a higher proportion of UK Government and Corporate Bonds, and more adventurous portfolios, and longer timescales being reflected in proportionately higher allocations of UK and overseas equity.

The below graphic demonstrates the way different sectors of the market have performed over the last 10 years. An investment held in Cash (G), for example, would have produced very little by way of returns over the period, but would have experienced no volatility.

At the other extreme, Emerging Markets (B) demonstrates high levels of volatility, but correspondingly higher returns over the longer term. This trade off of risk for return is often referred to as the "risk premium".

Performance of representative indices over 10 years to April 2015:



Diversification

Diversification is important not just between different types of investment (asset classes) but also within asset classes themselves. For example, we might recommend that the equity - or stocks and shares - portion of your investment is further diversified by spreading it across different geographical areas, different industry sectors, or by holding investments in both large and small companies. The aim is to hold a range of assets which are ideally, negatively or non-correlated - that is, assets that do not all behave in the same way in relation to market conditions.

Stock Selection and Market Timing

Our belief is that the majority of the return achieved within an investment is a result of the asset allocation. For this reason, we focus our attention on ensuring that we have constructed an appropriately asset allocated and diversified portfolio for you.

The other elements of performance are Stock Selection and Market Timing. It is our view that expert investment management can contribute to additional performance, by providing these elements of investment strategy, however, this comes at additional cost to the investor.

We do not therefore adhere to a "one size fits all" strategic investment approach, and instead select the appropriate investment management strategy for you based upon your views, objectives and needs. This might mean that we introduce a discretionary manager to manage your investments actively for you, or use a multi-fund approach utilising the skills of a fund manager to optimise this element of your investment.

Active or Passive Fund Management

Whilst asset allocation and diversification are the main contributors to the performance of a portfolio, it is also important to consider how the chosen investments gain access to these assets and sectors.

There are two main schools of thought within the investment industry regarding how this is done in practice:

1. **Active Investment Management**

Although this comes at a slightly higher cost, the assumption is that a good investment manager will add enough extra value through their investment process to more than outweigh this. It also assumes that it is possible to reasonably predict which investment managers will do best in the future. Active managers believe that the market is not completely efficient and that it is possible to add value for their clients by exploiting pricing anomalies.

2. **Passive Investment Management**

This theory, conversely, suggests that it is not possible to predict which investment manager or investment management process will achieve future out-performance.

It is more important to get the asset allocation and diversification right and achieve this at the lowest cost. This method uses "Passive" or "Tracker" funds to achieve returns in line with the selected asset classes over the medium to long term.

It is our view that this is a decision best determined on an individual client basis, and as such we do not favour one or the other of these strategies.

Investment Management

At Ernest Grant, we do not believe that "one size fits all" in investment terms, and different investment management approaches are suited to different investors, depending on aspects such as the size of the investment, the term, the client's risk profile and their objectives. As such we discuss a range of investment management styles with you before selecting the approach which is best suited to your needs.

Model Portfolio of Funds

There is an enormous universe of collective investment funds which specialise in particular assets, sectors and geographic regions. It is possible, from this universe, to select a diversified range of funds designed to closely match your risk profile and model asset allocation.

Having determined your asset allocation, and identified a suitable investment product for you, a portfolio of funds is designed to match your asset allocation as closely as possible. We will then regularly (as determined by your service level agreement) review and rebalance the portfolio to maintain the asset allocation and replace under-performing funds as necessary.

The cost of this approach may be higher or lower than a single fund approach, dependent upon the costs of the selected funds.

This approach is often suitable for moderately sized investments which can benefit from more precise asset allocation, and accommodate the possible additional costs. The approach is also suitable for individuals with a range of different products which need to be managed under a single investment strategy as it allows asset allocation anomalies to be offset by fund selection.

Occasionally we may recommend a pre-determined portfolio of funds managed and re-balanced by a provider in line with their governance procedures. Where this is the case, we will explain the reasons why this approach is considered suitable, and why we have discounted the alternative of selecting funds ourselves in line with your asset allocation.

Single Fund Solution

There is a wide market of collective investment funds which aim to provide a single fund investment solution which can be broadly matched to your risk profile.

The advantage of a single fund solution is often cost, as single funds charges tend to have less of an impact on returns due to economies of scale. However, the drawback of the single fund approach may be the need to compromise somewhat in terms of asset allocation and diversification.

Single fund solutions are often suitable for smaller investments, where cost, and the practicality of managing asset allocations are considerations.

Discretionary Management

Discretionary Management employs the services of a dedicated professional investment manager to take over responsibility for all investment decisions surrounding an investment on behalf of an individual investor. Discretionary Portfolios are bespoke, and built around your individual risk profile, objectives and requirements. A Discretionary Portfolio will be invested in a range of collective investment funds, and other types of investment, at the discretion of the investment manager, and relies upon the manager's investment philosophy and expertise.

This approach is generally suitable for larger investments and where clients have specific income and/ or capital needs which require bespoke management services to accommodate. Discretionary Management is the most expensive of the approaches outlined, and as such will only be recommended where this level of service is required, and the additional cost is justifiable.

Capital Gains Tax

It should be noted that where employing the services of a discretionary manager, either on a Model Portfolio or fully discretionary basis, the investments held within the portfolio are segregated, whereas under a multi-manager style approach, investments are integrated within a single fund. This has implications for Capital Gains arising on the sale/ switch of investments.

Within a multi-manager fund, no capital gains arise for the investor when underlying investments within the fund are sold, meaning that there is no liability to capital gains tax for the investor until the holding in the multi-manager fund itself is sold. However, within a discretionary portfolio, gains realised on the sale of individual investments within the portfolio are subject to capital gains tax on the investor. This may result in additional tax liabilities as a result.

In Summary

Before entering into any investment, you should ensure you understand the level of risk you are able to tolerate, and that you understand whether the proposed investment matches your risk profile. You should also understand the nature of the investment, how it will be managed and the types of risk you may be exposed to. With this in mind, please ask any questions you might have of your adviser before proceeding, and read the factsheets and suitability report that we will provide you with.

Considerations

Investments should be considered a long term strategy (5 years plus). Past Performance is not a reliable indicator of future returns. Investment returns, and the income from them, can go down as well as up and are not guaranteed. You could get back less than you invested.

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