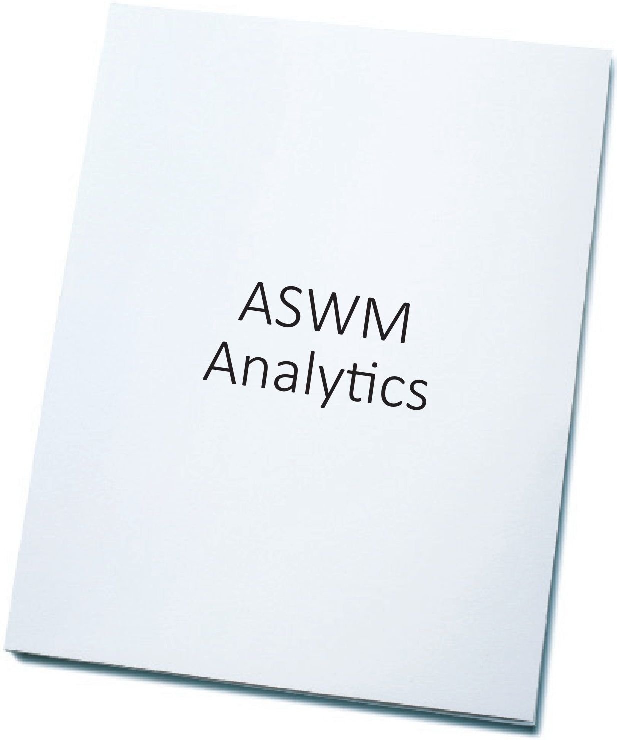
A client guide



Objective of the ASWM Analytics process

This “relative stop loss” process aims to limit the extent of falls in a portfolio, thereby maximising the potential for increasing the gains. It seeks to achieve this as follows:

Method:

1. On the 4th working day of each month the program monitors each of your funds against a set of criteria.[i] This process involves monitoring on a relative basis i.e. it compares how each of your funds is performing[ii] versus the average fund for each respective sector.[iii]

2. If any of your funds breach thresholds that we have set, then the program will issue a sell order to us.[iv]

3. Communication is sent to you from us, inviting you to review and accept our recommendation for a replacement fund.[v]

4. When we receive your ‘acceptance’ of our communication, the replacement fund is then purchased for you...
...and the whole process is then repeated every month.

The Results:

[vi] The potential benefits of the ASWM Analytics relative stop loss process can be seen by the following example:

If you had invested in June 1998 and remained invested in those funds until April 2015, based on exhaustive back-testing using actual past performance data from ASWM Analytics you would have earned a return of 5.65% per annum. However, if you had used the ASWM Analytics process, starting with an identical portfolio, net of all switching charges, you would have earned additional return of 2.89% per annum in excess of the static portfolio. Just as importantly, the risk as determined by maximum loss was reduced too. [vii]

An example of maximum loss is as follows:

Example: If a Fund has the following performance:

Month	Year		
Jan	2014	100	
Feb	2014	120	
Mar	2014	135	High
Apr	2014	126	
May	2014	127	
Jun	2014	112	Low
Jul	2014	125	
Aug	2014	137	New High
Sept	2014	135	
Oct	2014	127	
Nov	2014	132	

The maximum loss is measured by the difference in a high and a subsequent low. In this example, the maximum loss during this period is the difference between buying at 135 (March 2014) and selling at 112 (June 2014), the loss being 17.04%. Even though the fund went up several times over the whole period, it never went above 137. The investor who was unlucky enough to buy at 135 and sell at 112 sustained the maximum loss the fund ever made in this period. By using this method on the sector average we can then obtain the relative maximum loss for the fund as follows:

Fund Maximum Loss: 17.04%
Sector Maximum Loss: 20.5%

Therefore the fund's relative maximum loss is +3.46%, or put another way, 3.46% better than the sector average. Thus, the higher the relative maximum loss figure, the less capital loss the fund has actually exhibited, in comparison to its peer group, during the period.

Warning:

This is not an absolute stop loss process i.e. it will not sell your funds if any fund falls by a set percentage in absolute terms, say-5%,-10% etc. However some of the criteria used within the process do compare the loss experienced in the fund versus that for the sector average. e.g. If your fund fell by-10% in a month but the sector average fall was -15% then the relative loss is +5% i.e. your fund was 5% better that the average fund in its sector.

Frequently Asked Questions (FAQs)

1/ Why is the process not an absolute stop loss?

Although in theory this appears to be a good idea, when back-testing it became apparent that during periods when the markets experienced short sharp shocks, such as the Twin Towers terrorist attack in New York, the effect of an absolute stop loss would have been to crystallise the losses i.e. most investment markets fell by c. 16% within the 5 days following the attack, but some 6 weeks later the markets had all but fully recovered.

2/ If all funds in a sector are falling, why not just move all money out of that sector?

If you did that, then you may increase the risk to your portfolio as a result of reducing your exposure to a range of different sectors. This would be contrary to accepted investment practice of spreading your risk across sectors (modern portfolio theory).
The added difficulty would also be deciding when to move back into the sector.

Fidelity International produced interesting analysis that showed, for example, the detrimental affect of trying to 'time' the market by staying out in times of extreme volatility and missing the subsequent rebound (see below).

1999-2014 FTSE ALLSHARE RETURN

Stayed Fully Invested	3.94%
Best 10 Days Missed	-0.23%
Best 40 Days Missed	-7.15%

Source: Fidelity- Datastream, 31.12.99 to 31.12.14, annualised return.

Returns based on the performance of the FTSE All Share, with initial lump sum investment of £1,000, on a bid to bid basis with net income, excludes initial charge.

Therefore, it is highly unlikely we would recommend that your exposure to a sector was reduced to nil. However, within our process, the amount exposed to each sector that you hold may be reviewed as a result of your risk profiling questionnaires, which we will invite you to review at least annually.

Within the risk profiling software, data is fed by, and analysed by, leading consulting actuaries who regularly (typically each quarter) update their risk assessment of each geographical and asset class sector e.g. say the actuaries' calculations indicated an increased risk in the Japanese economy and previously you had an exposure of 5% of your portfolio to that sector.

FAQs continued

3/ Can this process eliminate all and/or any loss?

No! All markets move up and down including equities (shares), fixed interest (Gilts, Global Bonds, Corporate Bonds etc) and Property sectors etc. This is entirely normal. If you reduce all risks, you also reduce all potential for a return in excess of cash.

The process aims to reduce the risk of holding onto a fund that continues to exhibit a poor trade between risk and return. It entirely exploits the anomalies of 'behavioural finance' – this is the study into why people (both private investors and fund managers alike) invariably make irrational decisions when it comes to investing. Investors get influenced by the 'herd effect', peer group pressure and the rule of thumb, and our process aims to eliminate these vagaries by effecting investment decisions based on statistical probabilities.

4/ Will my fund fall if the sector falls?

Almost certainly. Your fund will be affected along with other funds in the sector, subject to the same forces that are influencing the direction of movements within that sector.

Notes:

i Most of the criteria used are recognised investment yardsticks. However, we have also incorporated a few proprietary criteria to further enhance the process.

ii By 'performing' we do not just mean profit/return, but the risk that the fund is displaying to achieve that return.

iii We only compare each fund with its peer group i.e. your UK Equity Income fund is only compared to the average of the UK Equity Income sector, your North America fund is only compared to the average of the North America sector etc.

iv To arrive at the threshold currently set, we have performed tens of thousands of back-testing scenarios. These thresholds will then be reviewed regularly, and the next review will be no later than 6 months following your registration.

v The replacement fund will, of course, only be taken from within the same sector as that of the fund sold. As such your risk profile (in terms of asset allocation) will not be altered.

vi The database includes over 20 million figures stretching back over 16 years and 10 months. The maximum past performance period used to evaluate our stop loss process means that the simulated portfolio starts from 30th June 1998, and the performance referred to ends 30th April 2015. Data used to help construct the original portfolio goes back an additional 3 years to February 1995. The data available to us earlier than this date is not comprehensive enough for our analysis.

The example balanced portfolio comprises of the following asset allocation: Asia Pacific Excluding Japan 3.53, Europe Excluding UK 3.53, Global Bonds 4.71, Global Emerging Markets 5.88, Japan 3.53, North America 3.53, Property 17.65, Sterling Corporate Bond 17.64, UK All Companies 15.3, UK Equity Income 5.88, UK Gilts 15.29, UK Smaller Companies 3.53.

vii The Maximum Loss represents the worst possible investment period in the term analysed. This includes temporary up periods.

The value of your investment can go down as well as up and you may not get back the full amount invested.

ASWM Analytics may not be suitable for everyone and we suggest you contact us for advice to see whether this would be appropriate for you.

The figures used relate to simulated past performance which is not a guide to future performance.

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