



**Margetts Fund  
Management - Risk  
Profile Report**

**April 2014**



## Contents

<b>Executive summary .....</b>	<b>3</b>
<b>1. Introduction .....</b>	<b>4</b>
<b>2. Investment objectives.....</b>	<b>5</b>
<b>3. Analysis and methodology .....</b>	<b>6</b>
<b>4. Results and model profiles .....</b>	<b>8</b>
<b>5. Summary .....</b>	<b>13</b>
<b>Appendix A: Investment assumptions.....</b>	<b>14</b>
<b>Appendix B: Index data .....</b>	<b>17</b>
<b>Appendix C: Risk Profile boundaries.....</b>	<b>18</b>

## Executive summary

Distribution Technology ("DT") has reviewed and profiled four funds which include investment products offered by Margetts Fund Management ("Margetts") within the risk profiles used on the DT Dynamic Planner® platform.

The main objective of the DT risk profiles and fund risk profiling service is to provide financial advisers and their clients with a meaningful measure of the long-term investment risk of fund strategies and a mechanism for selecting funds appropriate for investor risk appetites and capacity for risk.

The profiles which DT has assigned to the funds are set out in Table 1.

**Table 1: Fund risk profiles**

Portfolio	Risk Profiles
Providence Strategy Fund	5
Select Strategy Fund	6
International Strategy Fund	7
Venture Strategy Fund	9

The information contained in this report supplements methodologies used on the Platform. The report should be used in the context of these methodologies and advice provided on the Platform and not in isolation.

## 1. Introduction

This report was commissioned by Margetts Fund Management ("Margetts"), who contracted Distribution Technology Ltd ("DT") to assess the appropriate risk profiles for some model portfolios within the risk profiles used in the Distribution Technology Dynamic Planner® platform. The following funds are reviewed in this report:

- Providence Strategy Fund
- Select Strategy Fund
- International Strategy Fund
- Venture Strategy Fund

The profiles provided in this report are based on DT's investment planning assumptions. The assumptions used are those set for the fourth financial quarter of 2013 which are given in Appendices A and B. Appendix C summarises the risk profiles based on volatilities which we allocate to each fund.

DT provides this analysis on the understanding that investors will access the funds through a regulated advice process. The recommendation on whether or not to include these funds in an investor's portfolio and the amount to include should be made by advisers with the necessary Financial Conduct Authority permission to give advice on investments. DT accepts no liability in respect of any advice given to investors relating to investment strategy or the purchase of specific products.

The analysis in this report has been based on data and information provided by Margetts and other third parties as set out in Appendix B. Data received has been assumed by DT to be correct as of the date of this report.

The following section sets out the results of our analysis and subsequent sections set out the methodology and assumptions in more detail.

## 2. Investment objectives

A summary of each fund's investment objectives is set out below.

### **Providence Strategy Fund**

The fund aims to provide a balance of long term capital growth and increasing income by investment in any economic sector in any geographic area in regulated collective investment schemes investing in a wide range of assets including equities, fixed interest and cash type instruments.

The fund typically invests in equity income and fixed interest funds with a bias towards the UK market and is intended to comply with the requirements of the Investment Management Association ("IMA") Mixed Investment 20-60% Shares sector.

### **Select Strategy Fund**

The fund aims to provide medium to long term capital growth on a medium risk basis through the cautious but active management of a diversified portfolio of UCITS schemes and non-UCITS schemes (that have the same characteristics and restrictions as a UCITS schemes) that invest in equity and fixed interest markets in the UK, Europe and throughout the world.

The fund typically invests in UK and international equities with some fixed interest exposure and is intended to comply with the requirements of the IMA Mixed Investment 40-85% Shares sector.

### **International Strategy Fund**

The fund aims to provide long term capital growth on a medium risk basis from an actively managed spread of collective investment schemes investing predominantly in equity, equity-linked and fixed interest and money market investments in the various world markets.

The fund has a bias towards developed sectors and is intended to comply with the requirements of the IMA Global sector.

### **Venture Strategy Fund**

The fund aims to provide long term capital growth by investment in any economic sector in any geographic area in UCITS schemes and non-UCITS schemes (that have the same characteristics and restrictions as a UCITS scheme) with particular attention being focused on Far Eastern and Emerging Market Funds.

The fund typically invests in global markets including the potential for high weightings in Emerging Markets, Far Eastern economies and specialist sectors and is intended to comply with the requirements of the IMA Flexible Investment sector.

### 3. Analysis and methodology

One of the key tasks for an investor is to determine how much investment risk to take on. This decision will depend on psychological, financial and other factors. The investor will want to maximise the reward for taking on this risk through the selection of optimal weights for each asset category included in the investment portfolio.

DT's asset allocation methodology is based on the principles of modern portfolio theory. The risk profiles provided by DT are risk profiles of the long-term strategic asset allocation adopted for a fund. The actual riskiness of a fund over the long term will depend on, among other things, the level of flexibility in the manager's mandate and how far the fund deviates from the strategic position and for how long.

The measure of risk DT has used for each fund is the fund's estimated volatility as determined using the fund's internal asset allocations and estimates of the returns, volatilities and correlations of the DT primary asset classes. The analysis assumes that the actual holdings in each asset class can be broadly represented by the benchmark adopted for that asset.

The investment assumptions used in this review are those set by DT at the end of the fourth financial quarter of 2013. Risk bands based on DT's assumptions (as set out in Appendix A) were used to ensure that the profiles assigned to each fund are consistent with profiles and practices adopted within the implementation of DT's Dynamic Planner® application. This ensures that the profiles can be used with outputs from psychometric risk profiling instruments used within the Dynamic Planner® application.

For the purposes of constructing the efficient frontier, estimating return distributions and rating funds, DT splits the investment universe into the following asset classes, called the primary asset classes:

- Cash
- UK Corporate Bonds
- UK Index Linked Gilts
- International Bonds
- UK Gilts
- Global High Yield Bonds
- UK Equity
- Europe ex UK Equity
- North American Equity
- Japanese Equity
- Pacific ex Japan Equity
- Emerging Markets Equity
- UK Commercial Property
- Commodities
- Hedge Fund

For each of these asset classes, DT periodically reviews the appropriate set of investment assumptions for forecasting future returns and return distributions. The assumptions are derived from historical and market data at each review date. Appendix A provides a summary of the methodology used to derive the investment planning assumptions used on the DT platform. Further details can be found in DT quarterly parameter estimation reports.

Volatilities and correlations are derived from historical data on a representative index for each asset class. The indices used for each asset class, along with the inception date for each index, are set out in Appendix B.

For the purpose of this review, we derived additional assumptions for the funds. These assumptions are also included in Appendix A.

## 4. Results and model profiles

The risk profiles assigned to these funds are based on the benchmark asset allocations, historical asset allocations and historical performance as provided by Margetts.

### 4.1 Analysis of asset allocations

Using the DT investment planning assumptions, we calculated the expected long-term volatility of the benchmark asset allocation of each fund. The following table sets out the fund risk profiles based on this approach.

**Table 2: Benchmark asset allocation positions**

Fund	DT Risk Profiles
Providence Strategy Fund	5
Select Strategy Fund	6
International Strategy Fund	7
Venture Strategy Fund	9

Margetts also provided us with the asset allocation of the fund on a monthly basis since December 2005. We have mapped these to our standard asset allocations and calculated the expected volatilities using our DT assumptions. These are summarised in the table below. The numbers in brackets denote the number of months the fund was within the relevant DT boundary.

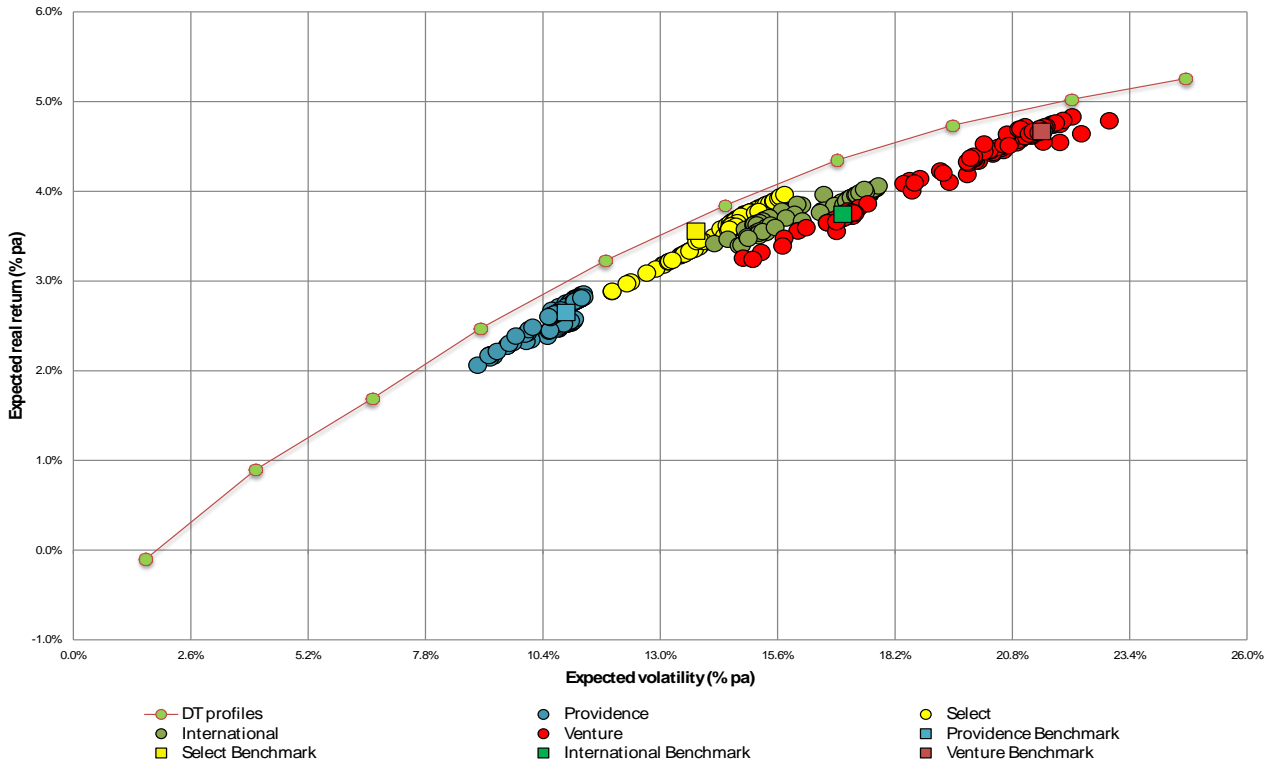
**Table 3: Historical asset allocation positions**

Fund	DT Risk Profiles
Providence Strategy Fund	4 (19) / 5 (74)
Select Strategy Fund	5 (6) / 6 (84) / 7 (3)
International Strategy Fund	6 (27) / 7 (66)
Venture Strategy Fund	6 (3) / 7 (21) / 8 (33) / 9 (36)



The figures from Tables 2 and 3 are illustrated in the following chart in which we show each allocation plotted on the risk-return spectrum. We also show the location of the standard asset allocations for each DT profile. The vertical gridlines indicate the boundaries of the DT profiles.

**Chart 1: Benchmark and tactical allocations expected risk and reward**



- Nearly 80% of the tactical allocations for the Providence Fund are situated within DT 5 along with the benchmark. However the tactical allocations differ from the benchmark allocation with roughly 20% extra allocation pulled from bonds to cash.
- The Select Fund has predominantly been underweight in its fixed interest exposure since inception, in favour of developed and emerging market equities. This exposure has led to the majority of the tactical allocations being overweight in expected volatility and sitting in the upper half of DT 6.
- The DT 5 and DT 7 allocations for the Select Fund are due to short periods of overweight cash and equity investment respectively, though DT 6 remains to more stable allocation. The lower profile periods for the International and Venture funds are also due to short periods of larger cash investment between 2006 and 2008.
- Within the Venture Fund the equity exposure has had strong biases towards either Asia/Emerging or Europe/North American stocks. We calculate the expected volatility of the most volatile positions to be of DT 9.

#### 4.2 Historical performance

Based on performance figures provided by Margetts from the inception of each fund to the end of November 2013, we analysed the long term performance over periods to November 2013. These are summarised in the table below.

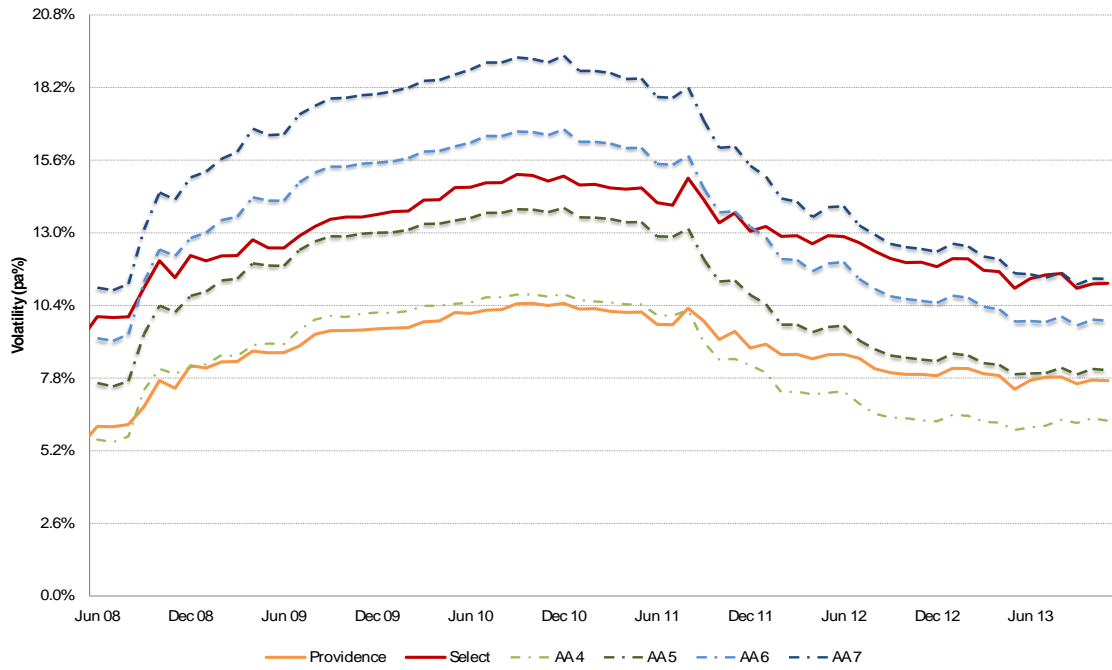
**Table 4: Fund risk profiles based on historical performance**

Fund	1 year volatility (% pa)	3 year volatility (% pa)	Volatility since AA inception (% pa)
Providence Strategy Fund	7.7%	7.7%	8.0%
Select Strategy Fund	10.4%	11.2%	12.0%
International Strategy Fund	12.1%	12.8%	15.0%
Venture Strategy Fund	13.0%	13.4%	16.1%
AA 4	6.9%	6.3%	7.7%
AA 5	8.2%	8.1%	10.0%
AA 6	9.8%	9.9%	12.0%
AA 7	10.9%	11.4%	14.0%
AA 8	11.7%	12.9%	15.6%
AA 9	12.5%	14.5%	17.9%
AA 10	12.6%	15.6%	20.2%

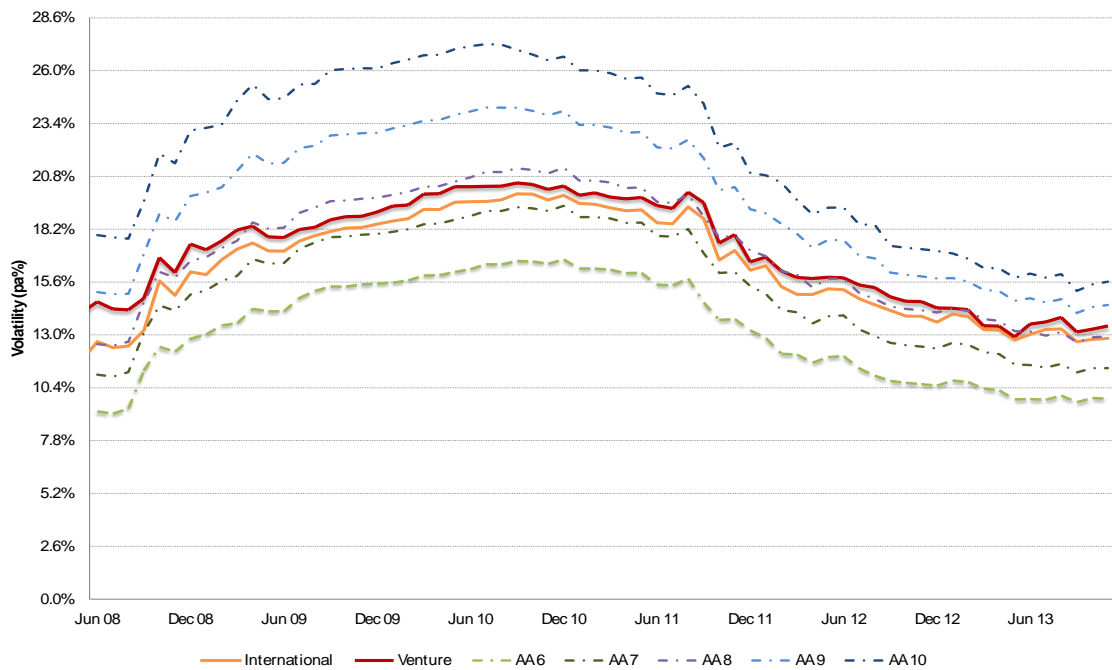
- For each of the time periods shown for the Providence Strategy Fund the volatilities are close to that experienced by either AA 4 or AA 5 over the same periods.
- Compared to the static DT boundaries each of the time periods for the Select Strategy Fund sits between that experienced by AA 6 and AA 7.
- The three year and since AA inception volatilities for the International and Venture Strategy funds both lie close to that experienced by AA 8. However, over the year to November 2013, the Venture Strategy Fund experienced a volatility higher than DT 10.

To show how these funds correspond to the DT risk profiles, the rolling three year volatility<sup>1</sup> of these funds and the DT asset allocations ("AA") has been plotted in charts 2 and 3 below.

**Chart 2: Providence and Select funds rolling volatility against DT**



**Chart 3: International and Venture funds rolling volatility against DT**



<sup>1</sup> The three year volatility at a given date is the annualised volatility of real performance over the previous 36 month period.

- Chart 2 shows that the Providence Strategy Fund's performance volatility was initially comparable to AA 4 but more recently has appeared like AA 5. Similarly, the Select Strategy Fund initially had volatility most comparable to AA 5 but most recently is similar to AA 6. This reflects the fact that Margetts will position the funds tactically.
- Within Chart 3 the rolling volatility of performance for the International and Venture funds remain very similar and broadly in line with the volatility of AA 8.

## 5. Summary

In Table 5 below, we summarise the risk profiles of the representative funds on the different measures set out above and our proposed grading for the funds.

**Table 5: Summary of risk profiles**

Fund	Benchmark positions	Historical asset allocation	Historic performance	DT assigned profiles
Providence Strategy Fund	5	5	3	5
Select Strategy Fund	6	6	5	6
International Strategy Fund	7	7	6	7
Venture Strategy Fund	9	9	7	9

- We have assigned the Providence Fund DT 5. This is due to the benchmark and the majority of actual allocations (including most recent) falling comfortably within the DT 5 boundary along with the rolling volatility of performance aligning closest to DT 5 in recent years.
- The Select and International Funds have been assigned profiles in line with their benchmarks and tactical allocations. The long term performance of the Select Fund is also mostly comparable to DT 6 on both an absolute and rolling basis. Though the rolling volatility of the International Fund has recently been comparable to DT 8 the Fund is also comparable to the MSCI ACWI which forms our Global equity assumption of DT 7.
- The Venture Fund has been assigned DT 9 due to its global equity investment strategy with an Asian and emerging equity bias. While the expected volatilities of this Fund's positions does fluctuate between DT 8 and DT 9, most have been of DT 9 in line with the benchmark, and the fund will always have the potential for DT 9.

## Appendix A: Investment assumptions

This appendix sets out the method used to generate the planning assumptions used on the DT platform and the additional assumptions required for residential property.

The correlations and volatilities used on the DT platform are derived mainly from historical index data for a representative index for each asset class.

The estimate of returns for equities, property and corporate bonds are calculated as a premium over gilts and then expressed as real returns (i.e. returns in excess of inflation). In addition to analysing historical index data, DT also use the following market data to arrive at expected return assumptions:

- Yields on UK Gilts; conventional and index-linked,
- UK corporate bond yields,
- Yields on global bonds,
- Equity earnings and dividend yields,
- Economic growth forecasts.

Full details of the DT estimation methodology can be found in DT quarterly estimation update reports, which are available on request.

Table 6 shows the real return and volatility assumptions for the fourth quarter of 2013 used to model assets.

Table 6: Asset class returns and volatilities

Assets	Expected Real Returns	Expected Nominal Returns	Volatility
Cash	-0.1%	2.4%	1.6%
UK Corporate Bonds	1.3%	3.8%	7.6%
UK Index Linked Gilts	0.0%	2.5%	7.2%
International Bonds	-0.4%	2.1%	8.2%
UK Gilts	0.7%	3.2%	7.0%
Global High Yield Bonds	2.2%	4.7%	13.0%
UK Equity	4.6%	7.1%	19.5%
Europe ex UK Equity	3.4%	5.9%	20.0%
North American Equity	4.0%	6.5%	21.0%
Japanese Equity	2.5%	5.0%	22.0%
Pacific ex Japan Equity	5.0%	7.5%	24.0%
Emerging Market Equity	5.5%	8.0%	27.8%
UK Commercial Property	3.1%	5.6%	14.0%
Commodities	3.7%	6.2%	23.0%
Hedge Funds	1.9%	4.4%	12.0%
Strategic bonds	1.3%	3.8%	8.5%
Global equity	4.0%	6.5%	18.5%
Asian equity	5.3%	7.8%	24.7%

Table 7: Additional mappings

	Asian equity	Global equity	Strategic bonds <sup>2</sup>
Cash			
UK Corporate Bonds			25%
UK Index Linked Gilts			
International Bonds			25%
UK Gilts			
Global High Yield Bonds			50%
UK Equity		8%	
Europe ex UK Equity		16%	
North American Equity		53%	
Japanese Equity		8%	
Pacific ex Japan Equity	50%	5%	
Emerging Market Equity	50%	10%	
UK Commercial Property			
Commodities			
Hedge Funds			

The table above contains mappings for any asset classes or funds that do not fit into any of our standard asset classes.

<sup>2</sup> M&G optimal Income & Schroder Strategic Bond



## Appendix B: Index data

Table 8 below sets out the indices used for each asset class and inflation data

**Table 8: Indices used for each asset class**

Region	Index	Inception date
Cash	Bank of England, Monthly Average of UK banks' base rates	Jan 1978
UK Corporate Bonds	iBoxx £ Corporate Index	Dec 1997
UK Index Linked Gilts	Barclays Capital UK Government Inflation-Linked Bond Index	May 1981
International Bonds	Merrill Lynch Global Broad Market Index	Dec 1996
UK Gilts	Barclays Capital UK Government All Maturities Gilt Index	Dec 1980
Global High Yield Bonds	Barclays Capital Global High Yield Bond Index	Jun 1990
UK Equity	MSCI UK Total Return Index	Dec 1969
Europe ex UK Equity	MSCI Europe (ex UK) Total Return Index	Dec 1969
North American Equity	MSCI North America Total Return Index	Dec 1969
Japanese Equity	MSCI Japan Total Return Index	Dec 1969
Pacific ex Japan Equity	MSCI Pacific (ex Japan) Total Return Index	Dec 1969
Emerging Market Equity	MSCI Emerging Markets Total Return Index	Dec 1987
UK Commercial Property	IPD UK Monthly Property Index	Dec 1986
Commodities	S&P GSCI Total Return Index	Jan 1970
Hedge Funds	HFRI Fund Weighted Composite Index	Dec 1989

## Appendix C: Risk Profile boundaries

The following table sets out the lower and upper volatility boundary for each risk profiles used in the implementation of DT's Dynamic Planner application.

Table 9: DT Risk Profile boundaries

Risk Profile	Volatility of Asset allocation	Lower Boundary	Upper Boundary
1	1.6%	0.0%	2.6%
2	4.0%	2.6%	5.2%
3	6.6%	5.2%	7.8%
4	9.0%	7.8%	10.4%
5	11.8%	10.4%	13.0%
6	14.4%	13.0%	15.6%
7	16.9%	15.6%	18.2%
8	19.5%	18.2%	20.8%
9	22.1%	20.8%	23.4%
10	24.6%	23.4%	26.0%

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**Publication date**

17/04/2014

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