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Discretionary Portfolio Service (DPS) for external Financial Advisers

Consumer Duty Information

Summary

This document sets out the details required for distributors to undertake their Consumer Duty assessment on DPS. This document is intended for use by external financial advisers as distributors of the service, in partnership with an Evelyn Partners dedicated Investment Manager as the manufacturer of the service.

Target Market statement

The Discretionary Portfolio Service (DPS) seeks to provide clients (individuals, charities, trusts, companies and pension schemes) with an actively managed, discretionary portfolio through the adoption of one of seven investment strategies, ranging from a low risk to a high risk portfolio. The strategy appropriate for each client will depend on their willingness and capacity to accept investment risk, and their associated investment objectives.

The DPS allows for personalisation of the investment strategy to accommodate individual client preferences and investment restrictions. The DPS may not be suitable for clients who wish to protect the nominal value of their capital, or where funds for investment are available for less than two years.

A DPS strategy seeks to achieve diversification both across, and within, various asset types, global regions, and sectors, using both direct and collective investments. Collective investments are pooled funds which themselves are diversified by holding many individual investments. To offer flexibility our DPS strategies can include different types of funds, such as actively managed open-ended funds (OEICs and Unit Trusts) listed investment companies, as well as passively managed funds such as Exchange Traded Funds (ETFs).

Portfolios are available in GBP, EUR and USD.

In defining the target market, we have considered the needs of a typical investor the DPS has been designed for.

Distribution and accessibility

The DPS is available to clients who are being advised by an authorised financial adviser who is responsible for monitoring the investment manager, the initial and ongoing suitability of the investment strategy and communicating with the retail clients invested in the DPS. The financial adviser can access the service directly with Evelyn Partners on their appointed custodian.

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Main features of the service

DPS offers clients;

- A bespoke discretionary portfolio allowing for individual preferences and investment restrictions;
- Optimisation of Capital Gains and ISA allowances (as applicable);
- An efficient custody and dealing service which reduces dealing costs by aggregating transactions with the transactions of other DPS clients;
- Performance reporting by email or post at standard quarter-ends (March, June, September, December) and annual tax schedule;
- A secure online portal which allows clients and their financial advisers to view key information such as portfolio valuations, asset breakdown, fund information, portfolio performance and transaction history; and
- A dedicated Investment Manager who can attend portfolio review meetings with the financial adviser.

Who is DPS likely to be suitable for?

The DPS is **likely** suitable for clients who:

- Have a minimum of £250,000 to invest. Whilst it might be suitable for a client with less than £250,000, careful consideration should be given to other Evelyn Partners' services which may be more cost effective;
- Are looking for a diversified investment portfolio, designed and actively managed so as to stay within a specific risk profile;
- Have an investment objective and attitude to risk consistent with one of the seven investment strategies set out in **Appendix 1**;
- Have a minimum investment horizon of two years – i.e., no current expectation of any requirement to withdraw capital within two years of the initial investment;
- Would like to incorporate specific investment preferences and/or restrictions into their portfolio such as management of their capital gains allowance;
- Require management of their portfolio in USD or EUR or to be booked offshore;
- Would like direct access to a dedicated Investment Manager; and
- Are advised by a regulated financial adviser who can work with the Investment Manager to establish a suitable investment strategy.

Conversely, who is DPS unlikely to be suitable for?

The DPS is **unlikely** suitable for clients who:

- Are not prepared to accept any capital loss;
- Have less than £250,000 to invest;
- Have an investment time horizon of less than two years;

- Want to be heavily involved in the investment decision making;
- Do not require a bespoke portfolio or any CGT management; and
- Do not want a dedicated Investment Manager.

Fair Value assessment

The DPS is considered to represent fair value now and for the foreseeable future. We have assessed the Fair Value of the DPS against a number of factors:

1. The **Service and Support** we provide financial advisers for onward distribution to the end clients.
2. **The Investment Management Fees** we charge are formerly assessed by our Product Services Oversight Committee through in house competitive analysis and third-party data providers. Evelyn Partners' fees are in the middle range of fees charged for similar services and we will undertake an ongoing analysis periodically.
3. **The breadth of our investment offering remains appropriate and fair for our consumers**. We offer a range of services available to retail clients via financial advisers. Each is assessed against its own merit and alongside the other as to the fair value of the service we provide to enable clients to fully understand the differences between our services, including investment style, fees, and target market.
4. **We continuously seek your feedback** to assist with maintaining fair value of our services.

In undertaking the Fair Value assessment for our products and services, we have determined that in relation to pricing for our services where financial advisers are acting in a *reliance on others* arrangement, that there is a lower cost to serve as a result of additional work the financial adviser undertakes and this is reflected in our pricing which we will continue to monitor and assess.

Foreseeable harm

We do not believe that the design of the service could cause foreseeable harm by a retail investor accessing this service through a regulated financial adviser and/or Evelyn Partners Investment Manager. The client accepts associated risks and that portfolio values can increase or decrease.

Conflicts of interest

There are no conflicts of interest between Evelyn Partners and the intended client or the distributor.

Key risks

We summarise some of the most important risks which can influence the return from most investments within **Appendix 2**. We also explain the various asset classes that we might consider as suitable investments to be held within the DPS. There are many factors which can influence the return from most investments, and you should bear in mind that past performance is not an indication of future performance, and clients may not ultimately get back the amount invested.

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Point of contact

Financial advisers should contact one of our Business Development team for further information. Contact the UK team | Evelyn Partners Retail clients should contact their financial adviser or the Evelyn Partner representative.

Appendix 1 – DPS Investment Strategies

Investment Strategy Descriptions
Strategy 1 – Rate of return projection CPI+ Appropriate for an investor who is comfortable with low volatility of returns, typically having around 17.5% of their portfolio invested in equities, and who is able to tolerate a loss of up to 7.5% of the value of their portfolio in any one year. This percentage loss is based on what might be reasonably expected 95% of the time.
Strategy 2 – Rate of return projection CPI+1% Appropriate for an investor who is comfortable with low volatility of returns, typically having around 30% of their portfolio invested in equities, and who is able to tolerate a loss of up to 10% of the value of their portfolio in any one year. This percentage loss is based on what might be reasonably expected 95% of the time.
Strategy 3 – Rate of return projection CPI+1.5% Appropriate for an investor who is comfortable with low volatility of returns, typically having around 40% of their portfolio invested in equities, and who is able to tolerate a loss of up to 12.5% of the value of their portfolio in any one year. This percentage loss is based on what might be reasonably expected 95% of the time.
Strategy 4– Rate of return projection CPI+2% Appropriate for an investor who is comfortable with medium volatility of returns, typically having around 55% of their portfolio invested in equities, and who is able to tolerate a loss of up to 15% of the value of their portfolio in any one year. This percentage loss is based on what might be reasonably expected 95% of the time.
Strategy 5 - Rate of return projection CPI+2.5% Appropriate for an investor who is comfortable with medium volatility of returns, typically having around 65% of their portfolio invested in equities, and who is able to tolerate a loss of up to 17.5% of the value of their portfolio in any one year. This percentage loss is based on what might be reasonably expected 95% of the time.
Strategy 6 - Rate of return projection CPI+3% Appropriate for an investor who is comfortable with medium volatility of returns, typically having around 75% of their portfolio invested in equities, and who is able to tolerate a loss of up to 20% of the value of their portfolio in any one year. This percentage loss is based on what might be reasonably expected 95% of the time.
Strategy 7 - Rate of return projection CPI+4% Appropriate for an investor who is comfortable with high volatility of returns, typically having around 95% of their portfolio invested in equities, and who is able to tolerate a loss of up to 25% of the value of their portfolio in any one year. This percentage loss is based on what might be reasonably expected 95% of the time.

Appendix 2 – Key risks

1. The risks and rewards involved in investing in various asset classes

We explain below the various asset classes that we might consider as investments for you and point out the main risks and rewards associated with them. This is an extensive subject and our aim here is to provide a clear and simple introduction to it, not an exhaustive discussion of all the issues involved. There are many factors which can influence the return from most investments and you should bear in mind that past performance is not an indication of future performance, and you may not ultimately get back the amount you invested. We begin with a summary of the most important risks which can influence the return from most investments. It is essential you read this carefully.

1.1. Summary of general risks when investing in all asset classes

i. Liquidity
This is the risk that an investment cannot be bought or sold quickly enough to prevent or minimise loss. Under certain trading conditions it may be difficult or impossible to buy or sell an instrument at a reasonable price or at all. This may occur, for example, at times of rapid price movement if the price rises or falls to such an extent that trading is suspended or restricted by the relevant market. The liquidity of an instrument is directly affected by the supply and demand for that instrument. Liquidity risk can be reflected in large differences between buying and selling prices, and large and rapid price movements. Lack of liquidity can also push assets higher than their asset value leading to gains.

ii. Concentration
Concentration risk is the lack of diversification in a portfolio. If a large percentage is invested in any one currency, security, country or issuer then fluctuations in value can have a disproportionate effect.

iii. Credit or counterparty
This is the risk of loss caused by banks, bond issuers, bond guarantors or counterparties failing to fulfil their obligations, or the risk of their creditworthiness deteriorating.

iv. Market
The price of an investment depends on market supply and demand and fluctuations in financial markets. Overseas investments, or investments with an overseas element, may involve risks different from those applying in your home market.

v. Sustainability
Sustainability risks are environmental, social or governance (ESG) events or conditions that, if they occur, could cause an actual or a potential material negative impact on the value of an investment. Environmental factors include such matters as how a company safeguards the environment, including corporate policies addressing climate change. Social factors include how it manages relationships with employees, suppliers, customers, and the communities where it operates. Governance factors include a company's leadership, executive pay, audits, internal controls, and shareholder rights.

vi. Interest rate
The relative value of a security, such as a bond, may fall when interest rates rise. Rising interest rates may particularly affect investments in companies or funds which have high levels of borrowings.

vii. Currency
Transactions in currencies, including securities in currencies other than that in which your portfolio is based, will be affected by movements in exchange rates which can create or increase a loss. Currency movements are linked to many economic, political and social factors and can be rapid. Some countries have foreign exchange controls which may include suspending the ability to exchange or transfer currency, which may cause difficulty in completing transactions in investments denominated in that currency. Hedging aims to reduce or eliminate currency risk.

viii. Foreign exchange forwards
One of the most common types of foreign exchange transaction is the foreign exchange forward contract (FX Forward), which is an agreement to buy one currency against the delivery of another currency, at a conversion rate set on the trade date and which will settle on a specified date in the future. FX Forwards are settled later than a normal ("spot") contract, which for most currency pairs is usually two business days after trade date. An FX Forward may be of use to settle bargains in investments where a foreign exchange transaction is required or to hedge a holding of an asset priced in another currency to that of the base portfolio, or to take a speculative position. FX Forwards are not traded on exchanges, and they cannot be cancelled except by the mutual agreement of both parties involved.

The period between trade and settlement dates could be lengthy. During this time market, economic, social, and political factor may affect the exchange rate. Consequently, the FX Forward will provide a level of protection from fluctuations in currency prices by giving certainty as to the exchange rate. It may be the case that the exchange rate moved in such a way that you would have been better-off exchanging currencies on the transaction settlement date at an available spot rate, and not entering into the FX Forward.

FX Forwards may sustain a total loss of any margin deposited in order to maintain a position. If exchange rates move against the position substantial additional margin may need to be paid at short notice to maintain the position. Failure to pay required margin calls may result in your open position being liquidated at a loss.

ix. Emerging markets

Emerging markets in particular can give rise to additional risks posed by volatile political, legal and commercial conditions, which may affect the value of or result in the loss of investments. The quality and reliability of official data published by governments and their agencies in emerging markets might not be equivalent to that available in developed markets. Similarly, accounting, auditing and financial reporting standards may be lower than those in more developed markets. In addition, the absence of developed securities markets can lead to poorer levels of transparency, liquidity and efficiency. Potentially underdeveloped regulatory, banking and communication infrastructure in such countries may give rise to greater custody, settlement, clearing and registration risks. Foreign investment in emerging markets may be restricted – sometimes such restrictions may not be published and investors may not be readily made aware of them, or changes to them.

In such circumstances, there may be restrictions on repatriation of capital or an investment may have to be scaled down to comply with local foreign ownership restrictions. Legal rights may not be enforceable, which could result in a partial or total loss.

x. Legal, political and regulatory

Legal, political and regulatory risks are unpredictable and depend on many factors. The risks apply anywhere but are greater in less developed markets where there is generally less government supervision of business and industry practices, markets and stock exchanges. The laws and regulations that are familiar in developed markets may not exist in some places and where they do, may be subject to inconsistent or arbitrary application and may be changed with retrospective effect. Investors may encounter difficulties in pursuing legal remedies or in obtaining or enforcing judgements in overseas courts. Investments may also be subject to unforeseen impediments or restrictions on full realisation of value.

xi. Taxation

The impact of changes in taxation on ownership, income and any gains from capital must be taken into account.

xii. Operational

The risk of losses caused by flawed or failed processes, policies, systems or events that disrupt business operations. Employee errors, criminal activity such as fraud, and physical events are among the factors that can trigger operational risk. Business risk, such as the risk that a business is run incompetently or poorly, could affect investors in any company.

xiii. Cyber

Cyber risk relates to dependency on IT systems. Failures or malfunctions in systems can be caused by unauthorised access, disruption or modification and can result in financial loss, operational disruption, or damage of all companies and financial product providers.

1.2. Mainstream asset classes

The three mainstream asset classes and the risks and rewards of investing in them are detailed below.

i. Cash

Cash is money that is held at a bank or other financial institution.

Rewards

Cash is the most liquid form of investment and usually pays a rate of interest, which can be fixed for a term or variable. As long as the counterparty (see section 1.1.iii) remains solvent, there is minimal risk of loss in nominal terms. For this reason, cash held with reputable banks and financial institutions is amongst the lower risk investments and can be used to support known short-term liabilities.

Risks

In the short term, the main risk in holding cash is that of default by the entity where the money is held. Spreading exposure amongst good quality counterparties, with security as a main concern, can reduce this risk.

Over the longer term, the greater risk in holding cash is inflation. If inflation is higher than the rate of interest being paid, the purchasing power of cash will decline, leaving the saver worse off in real (inflation-adjusted) terms.

ii. Bonds/fixed interest
A bond represents capital that has been lent to an institution. Bonds are issued by both governments and corporations as a source of finance. The two most common types are: conventional bonds and money market instruments that pay a fixed rate of interest and are usually redeemed at a specified date; and index-linked bonds where the income payments and redemption proceeds are usually adjusted for inflation. There are also convertible bonds that combine a conventional bond with the option, subject to specific terms, of conversion into equity (rather than repayment). The creditworthiness of issuers varies enormously and therefore so do the terms on which capital is lent to them.

Rewards
Bonds can provide reliable income to a portfolio. This income is often higher than that available from cash or from many equities and is often paid to holders before the deduction of taxes. Global bond markets are large and usually liquid and exposure aids portfolio diversification. The market value of conventional bonds should rise in an environment of falling interest rates. The nominal value of a conventional bond is repaid on redemption. Index-linked bonds can provide protection against inflation.

Risks
Bondholders can lose some or all of the capital and interest payments if the borrower defaults. Returns are therefore not guaranteed, though bondholders are paid before shareholders should the issuer become insolvent. The market value of bonds will generally fall if interest rates rise. Other common reasons for bonds to fall in value are increasing inflationary expectations and a reduction in credit quality (see section 1.1.iii). Conventional bonds with distant maturities are more exposed to these risks and hence more volatile. Corporate bonds are less liquid than government bonds. The issuer may redeem a bond before its maturity date, in which case the return from the investment may be lower than originally expected. Governments or regulators have the power to impose losses on bondholders under bail-in provisions, which means that the value of a bond could be lower than the value determined on issue.

iii. Equities
Equities (shares) are rights of ownership in a business and confer entitlement to a share of its profits and include ordinary and preference shares and may also be held in the form of depository receipts. Unlike most forms of debt, shares do not have a fixed life, nor do they usually promise a pre-determined rate of return. Legally, they rank behind debt and other creditors if the issuer becomes insolvent. Quoted equities are listed on a regulated public market, such as the London Stock Exchange and can usually be freely traded.

Rewards
Shares entitle the shareholder to a share of the profits that a company makes. This can take the form of dividends (income payments to shareholders, often on a regular basis) or the return of capital.

Listed (or quoted) equities have the added convenience of usually being easy to buy and sell. An equity portfolio can provide a diversified stake in the world economy. Investors will usually demand higher returns than from debt to reflect the additional risk of equities. Shares have historically produced higher returns than cash or bonds, though this is not in any way guaranteed. Shares are also valued for the ability of good companies to grow their profits and dividends by more than the rate of inflation over time.

Risks
Share prices are volatile. They reflect both the varying fortunes of companies and the fluctuating risk appetite of investors at any point in time. Equities are therefore exposed to many different kinds of risk. As the lowest ranking forms of capital in a company, shares can lose all their value in the event of company insolvency. Weakening economic conditions, the strength of competitors, ineffective regulation and management errors are some of the factors which can depress share prices. Changes in investor sentiment and periods of market turbulence can also lead to sharp fluctuations in prices. These risks can be moderated, but not eliminated, by holding a diversified portfolio of shares over a suitably long timescale. Equities in smaller quoted and unquoted companies can suffer from additional liquidity risk (see section 1.1.i) and so may be difficult to buy or sell at reasonable prices. A company's quotation on a Stock Exchange can be suspended and/or terminated, which is likely to make it much more difficult for investors to sell its shares.

Stabilisation
Transactions may take place in newly issued securities, the price of which may have been influenced by measures taken to stabilise it. Regulators allow stabilisation in order to help counter the fact that, when a new issue comes onto the market for the first time, the price can sometimes drop before buyers are found. Stabilisation may affect not only the price of the new issue but also the price of other securities relating to it.

Stabilisation is carried out by a 'stabilisation manager' (normally the firm responsible for bringing a new issue to market). As long as the stabilisation manager follows a strict set of rules, it is entitled to buy back shares that were previously sold to

investors or allocated to institutions which have decided not to keep them. The effect of this may be to keep the price at a higher level than it would otherwise be during the period of stabilisation.

1.3 Collective investment schemes/funds

Collective investment schemes, or funds, are arrangements that enable a number of investors to pool their assets and have them professionally managed. Collectives can invest in the asset classes discussed in this Appendix.

There is an important distinction between open ended funds and closed ended funds. Open-ended funds such as unit trusts and Open-Ended Investment Companies (OEICs) issue and redeem units at a price based on net asset value. The manager provides a dealing facility. The number of units in issue rises and falls in response to investor demand. There are important distinctions between regulated and unregulated funds:

• Regulated funds are subject to rules about (and limits on) the types of underlying assets in which they can invest and the frequency and price at which the units can be redeemed. In particular, the rules limit the extent to which such schemes can borrow, or invest in derivatives.

• Unregulated funds are subject to few or no rules about the types of assets they can own, the amounts they can borrow, or the frequency at which they can be redeemed. Many private equity funds and hedge funds are unregulated. Unregulated funds are niche products and it is usually inappropriate for most retail investors to invest in these schemes. We will consider your personal circumstances very carefully before investing in or advising you to purchase these investments.

Closed-ended funds (such as investment trusts) have a fixed share capital which is traded in the secondary market, often at a discount or premium to the underlying value of the investments depending on demand.

Rewards

Collectives give investors the benefits of scale and diversification across a wide range of potential investments. They provide a convenient and often cost-effective way to gain exposure to assets and markets which may be difficult to deal in directly. They can reduce holding and transaction charges for relatively small portfolios. Another advantage is that gains are not usually taxed as long as they remain within the fund. Most investors are only liable to tax on gains if they sell the fund itself. Foreign tax reclaims can be processed by the fund. The offshore status of some funds can also be an important consideration for tax planning purposes.

Risks

The funds are subject to the same risks as the assets in which they have invested, although the risks can be moderated, but not eliminated, by diversification. In the case of closed-ended funds, their ability to use debt finance and the tendency of discounts to fluctuate can create more price volatility than open-ended funds. Open-ended funds have no control over cash flows in and out of the funds which can disrupt the investment strategy. For investors, another risk is that the fees charged by the managers of funds may outweigh the benefits of diversification and professional management. Regulation may also be less effective in some jurisdictions and transparency poorer.

i. Actively managed collectives

In actively managed collectives the manager seeks to match or beat the fund's stated objective with adept investment management.

Rewards

A successful actively managed fund can produce returns that are superior, over one or more designated periods of time, to its stated objective. They may also be superior to the returns which in hindsight could have been achieved by investing in a passively managed fund with the same objective.

Risks

Whether funds that do outperform over any given period of time owe this success to the manager's skill, or are simply the product of chance, or some other factor, is hard to establish and much debated. On average, while many do well over shorter periods, the majority of actively managed funds fail to meet their objective or match a given benchmark over periods of several years.

ii. Passively managed collectives

These are constructed to mirror an index or market sector. They are often structured as index tracker funds (which are normally unit trusts or OEICs) or Exchange Traded Funds (ETFs), which are companies whose shares are publicly traded.

Both index (or tracker) funds and ETFs aim to deliver the performance (both capital and income) of a specified market index or commodity, e.g. the FTSE 100 or gold. In its simplest form, the fund will buy a holding in each constituent in the given index (this is known as 'full replication'). As the value of a unit in the fund will rise or fall in line with the value of the underlying stocks, the performance of the fund should mirror that of the index. As constituents drop out of the index and are replaced, the fund will replace its holdings so that its performance continues to mirror that of the index.

This exposure to an underlying index can also be created through use of derivatives ('synthetic replication'). Here, the fund does not invest directly in the index constituents; instead its primary assets will be contracts with external counterparties which provide the fund with exposure to the performance of the underlying index.

Funds which fully replicate an index aim to keep pace with their underlying indices, not to outperform them. Synthetic funds may include weighting or other proprietary methodologies which aim but do not necessarily succeed in making the fund outperform the index.

Rewards

By purchasing an index tracker fund or an ETF an investor can produce strong returns in a rising market. As they are not actively managed, they often have lower than average management costs and expense ratios. There are hundreds of indices with associated tracker funds, providing a liquid and relatively low cost means of diversifying a portfolio. These funds have historically outperformed the majority of actively managed funds in their sector, but invariably lag behind the best of them.

Risks

Index trackers and ETFs will lose value if the underlying index they are tracking declines. Most tracker funds underperform their index by a small margin after deduction of the management fee. The market conditions or other events may mean that the fund may not be able to match exactly the performance of the index it is tracking (so called 'tracking error').

Fully replicated funds can engage in stock lending which exposes them to counterparty default risk.

Synthetic replicated funds do not necessarily own any interest in the constituents of the underlying index; exposure to index constituents is notional and created via the use of the derivative contracts with various counterparties. This means that the fund is reliant upon its counterparties to provide payments which mirror the returns of the index. If a counterparty (see section 1.1.iii) becomes insolvent it may not be in a position to honour any payments due to the fund and this will affect the returns to unit holders. It is not unusual for a synthetic fund to achieve its index exposure via a single derivative contract. In addition, synthetic funds may pay a fee to their counterparties for the provision and hedging of the derivative contracts.

1.4. Alternative asset classes

Alternative investment is a term commonly used to describe non-mainstream asset classes, although they can still include elements of cash, bonds or equities. Alternative investments include private asset funds, hedge funds, property and commodity funds and defined return products. Alternative investments may be used to provide a degree of diversification from mainstream asset classes (cash, bonds and equities), aiming particularly for returns which are uncorrelated to those markets.

i. Private asset funds

Private asset funds are typically collective schemes which invest in enterprises beyond quoted markets. The underlying assets will often be in particular industries that are intrinsically illiquid or may benefit from specialist management. These schemes can be structured in a variety of forms, ranging from having a listing on a regulated market to being illiquid and unregulated partnerships.

Rewards

Private asset funds provide investors with access to industries, assets and management techniques that are less available through conventional public investments, enabling investors to capture the associated benefits. The lack of direct correlation with mainstream asset classes also has potential diversification advantages. Managers often take significant control of their investments, seeking to increase returns by improving the management team and changing the strategy. This greater degree of control and visibility over the business means that private asset funds can potentially add more value than is possible by buying shares in a public company. The managers are typically highly incentivised with a share of future returns and operate with fewer regulatory and legislative requirements. The potential for higher levels of leverage can significantly enhance returns.

Risks

The consequence of higher potential returns comes in the form of higher risks and less liquidity than quoted investments. Private asset funds are subject to fewer regulatory and legislative requirements. They often rely on leverage to boost returns, which can amplify the risks if the value of the underlying investments fails to increase by more than the cost of

borrowing. The ability to sell investments can be constrained by market conditions. Underlying valuations can lack transparency and robustness as well as being less frequently published. Private asset funds often have high fees and transaction costs. Quoted private assets funds can trade at large discounts to their net asset values because of these and other uncertainties.

ii. Hedge funds

A hedge fund is a collective employing a wide range of trading and investment strategies and typically investing in a broader range of financial instruments (including derivatives) and assets than traditional funds.

Rewards

Many hedge fund strategies have the objective of generating positive returns in both rising and falling equity and bond markets, a valuable attribute for risk-averse investors. The return from hedge funds can be less volatile than those from equities and bonds. If uncorrelated with broad market movements, the inclusion of hedge funds in a balanced portfolio can reduce overall portfolio risk and volatility.

Risks

There is no guarantee that hedge funds will meet their return and volatility targets. Many funds also make extensive use of borrowing and trading in derivatives to boost returns, adding an additional layer of risk. Hedge funds tend to be less transparent and less liquid than conventional funds, making them harder to value. Managers can restrict or suspend dealing, making it difficult to realise your investment. Hedge funds typically charge high management fees and include additional performance fees, such as a share of any profits made, which reduce the investor's return. Many hedge funds are unregulated collectives (see above) and therefore unsuitable for most retail investors.

iii. Property

Property is investment in real estate in the UK and overseas. Investment strategies may involve purchasing or leasing many different types of property (e.g. residential or commercial), either as finished buildings or as development projects. Exposure to this asset class may be through listed property companies, Real Estate Investment Trusts (REITs), that have certain tax privileges, or via other open-ended collective structures.

Rewards

Investors can benefit from both the capital growth of properties within the portfolio and the rental income which they produce. Rents on commercial property tend to rise over time, providing some inflation protection. Funds allow smaller investors to gain professionally managed and diversified exposure to the returns available from large-scale property enterprises.

Risks

Returns can be reduced or negative in a weak property market, especially when interest rates rise. Investors can suffer when there are no tenants or rents are not paid. Closed-ended funds can trade at a discount to the value of the underlying assets, particularly in times of market stress. Property is an illiquid investment and managing property in an open-ended structure poses particular liquidity issues. This can negatively impact returns and means that redemption rights may be delayed or suspended.

iv. Commodities

A commodity is a basic good or raw material used in the production of goods or services. Commodities are bought and sold on the cash market and can also be traded as futures contracts. Buyers and sellers include commodity producers, traders and investors. We would normally gain exposure here by investing in collectives, some of which track a specific commodity price.

Rewards

Returns are largely independent of stock and bond markets, so can help diversify an investment portfolio. Commodity funds give investors professionally managed exposure to a varied asset class that typically requires some specialist knowledge. Commodities may provide protection against inflation.

Risks

Commodity prices and futures contracts can be highly volatile. Values are sensitive to worsening political and economic conditions. Investors in futures contracts can lose more than their initial investment, which is not the case with shares and bonds. Commodities typically produce no income, and physical delivery or storage can involve costs.

v. Defined return products

A defined return product, often described as a structured product, is an instrument designed to offer a defined return from a particular asset or asset class over a set period. This will often include some form of capital protection. The term 'structured product' covers an extremely wide range of structures and a broad array of asset classes. Structured products can be influenced by the pricing of derivative instruments.

Rewards

The defined return nature of structured products can assist in planning, although the benefits are often contingent upon the performance of the underlying assets. Risk averse investors with a sufficient time horizon can use structured products to gain exposure to certain asset classes while still benefiting from an element of capital protection embedded in the product.

Risks

A risk of investing in structured products is counterparty (see section 1.1.iii) risk, the risk that the issuer or the guarantor providing capital protection does not meet their obligations. The myriad of factors involved in pricing these instruments including movements in interest rates, the perceived credit worthiness of the issuing bank, shifts in expected duration, and time to maturity are amongst factors that can all have a significant impact on the value of a structured product. Investors seeking to realise their investment prematurely may not be able to do so at a price that reflects the underlying value.

We would reiterate that the points we have made in this Appendix are designed for simplicity and clarity and are not a definitive discussion of all the issues. If you have queries as a result of reading this document, please raise them with your Evelyn Partners representative.

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