Helping you look after your family's future

INTRODUCTION TO INVESTMENT RISK

We want you to feel confident, secure, and inspired by your financial future.

The purpose of this document is to introduce some basic investment principles for our clients. We will explain different types of asset that could form part of a diversified investment portfolio that we might recommend for our clients to help them achieve their long term objectives.

A few concepts to define:

Asset: An item with value attaching, whether owned privately or by a business.

Asset Allocation: The process of categorising a portfolio's investments into its component asset classes.

Asset Class: A term to define the type and nature of an investment, based upon the characteristics of the underlying assets.

Bond: A loan that is a tradeable instrument, usually issued by a company or government, paying a rate of interest over a given time period and repayable at the end of the time period.

Capital Growth: An increase in the value of an investment, such that its current value exceeds the original amount invested.

Correlation: The extent to which different investments move simultaneously in a similar or opposite direction from each other.

Diversification: The process of investing in a range of different assets in order to spread risk on an overall portfolio, so that gains on some investments in a portfolio offset losses elsewhere in the portfolio.

Dividends: A share in a company's profits, paid out on predetermined dates to shareholders in the company.

Equities: Also known as shares; a stake in a company.

Fund: An investment vehicle that spreads an investor's money across bonds or equities from many different companies, sectors and/or regions, reducing risk since the fortunes of one entity are not paramount.

Liquidity: The ability or otherwise to buy or sell an asset when you want to.

Portfolio: A number of different investments held as a combination by an investor.

Return: What an investor might earn on their investment.

Risk: The possibility that the return on an investment or a portfolio might differ from that expected, including the possibility of losing some or all of the amount invested.

Volatility: The rate at which an investment or portfolio changes in value. Typically, a higher volatility is a sign of increased risk.

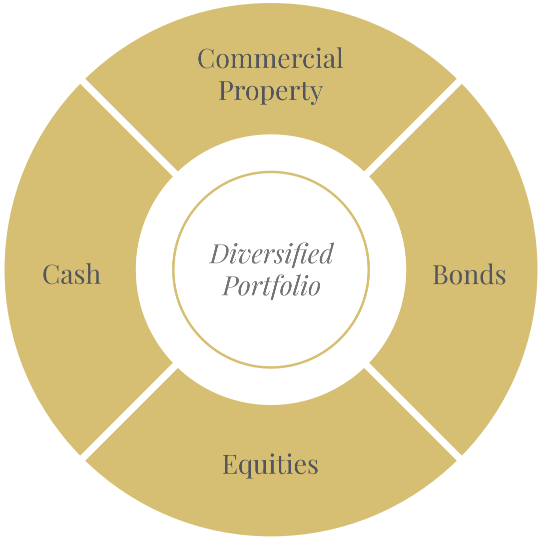
Asset Classes

There are four main asset classes that underpin all diversified portfolios:

Cash | Bonds | Commercial Property | Equities

Each individual portfolio's asset allocation will depend on the investor's own desired balance between potential return and potential risk, taking account of their time horizon and other factors.

The diagram shows each asset class. You should however always remember that there are ranges of risk within each asset class.



Cash
Returns are restricted to interest payments, the real value of your capital could actually fall if rates are below inflation. Capital is secure other than in the event of bank default.

Bonds
Returns tend to be in the form of interest and any growth potential is dependent on interest rate trends. Bonds usually carry less risk than equities and property.

Commercial Property
Offers the potential for a steady stream of rental income and some capital growth over the longer term, generally considered less volatile than equities.

Equities
Usually thought to offer the best returns in the long term, which combine dividend income with capital growth potential, but tend to carry the highest risk.

It is important not to overlook the risks caused by inflation and how it can erode the true value of your capital over time.

The following table shows the effect of inflation on £1,000 over various time periods.

Inflation	*5 years*	*10 years*	*15 years*	*25 years*
2%	£903.73	£820.35	£743.01	£609.53
4%	£821.93	£675.56	£555.26	£375.12
6%	£747.26	£558.39	£417.27	£233.00

This table is for illustration purposes only

In addition to the four traditional asset classes listed, many investment funds will now use additional asset classes such as commodities, managed futures, hedge funds, infrastructure and private equity and debt with the aim of increasing diversification and potential return without increasing the level of risk taken.

We classify these more esoteric investments under the asset class 'Alternative'.

This graph illustrates the historic performance of the four main asset classes over a ten year period.

Even over this comparatively short time period, it can clearly be seen just how differently the different asset classes may perform from each other as market conditions vary. It is also true to say that there may be time periods when assets do not perform as we would expect them to.

Through combining different asset classes that have low correlation with each other, it is possible to reduce a portfolio's overall volatility.

At Thorntons Investments we strongly believe in the need for a diversified approach to investing. Our view is that successful investment management most certainly includes an ability to select individual investments, be they shares or funds.

However, we believe that an appropriate understanding of the behaviour and potential returns and risks of the different asset classes in different market conditions will be of paramount importance to achieving each of our clients' investment objectives in accordance with their own risk profile.

Risk Groups

To establish the most appropriate level of risk for investments you hold we will ask you to answer questions about your Risk Tolerance, the level of ‘Risk Required’ for your portfolio and your Capacity for Loss. Your answers will, in conjunction with our discussions, help guide us towards an indication of your overall risk profile.

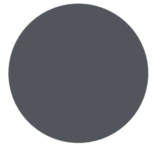
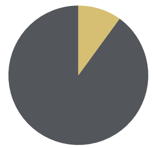
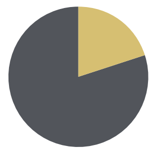
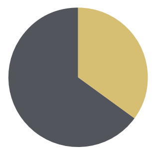
We will categorise your risk profile using a series of Risk Groups, which we define on the next two pages.

Which Risk Group is most suitable for you will, in turn, help us to determine a suitable shape for your portfolio. At the highest level, we are looking to determine how much of your portfolio should typically be held in investments linked to the stock market.

The Indicative Portfolio Splits on the next two pages are designed to give you a very broad overview of how we think a portfolio for an investor in each Risk Group might look. Your adviser will be able to provide you further details of the possible makeup and characteristics of portfolios we consider suitable for investors in each Risk Group, if you would find this helpful.

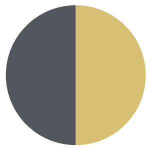
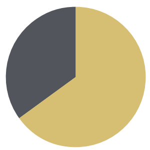
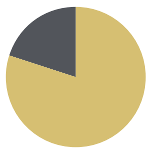
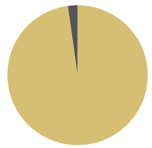
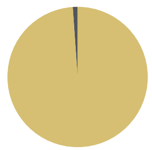
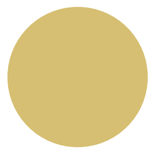
In the context of your overall circumstances, objectives, time horizon and your own feelings regarding your tolerance to investment risk, we will ask you to indicate which of our Risk Groups you feel most accurately summarises the approach you feel is suitable for the portfolio under consideration.

Higher Risk *Lower Risk*

Risk Group	Investor Characteristics	Indicative Portfolio Split
1 lowest risk	You are only concerned with the security of your savings. You do not expect to achieve a return in excess of that available from a savings account and recognise that inflation could erode the spending power of your savings.	
2 very low risk	You are very concerned with the possibility of losing your investment. You are not expecting your return to rise much more than if you had kept your money in a savings account. You recognise that inflation could erode the spending power of your savings but consider capital preservation to be a higher priority.	
3 low risk	You are looking for a better return than cash and are willing to take limited risk to achieve this. You are still concerned about the possibility of losing money and you seek a high level of certainty from your investments. While you understand that your investment can fluctuate in value, you would be uncomfortable if these fluctuations were more than modest.	
4 lowest medium risk	You are willing to take some risk to achieve better returns while still retaining a degree of certainty with your investments. Your emphasis is on the need to avoid losses rather than the potential to achieve better returns. While you understand that your investment can fluctuate in value, you would be uncomfortable if it fell or rose in value to any great extent.	

Higher Risk Lower Risk

Higher Risk Lower Risk

Risk Group	Investor Characteristics	Indicative Portfolio Split
5 low medium risk	You are looking for higher returns and recognise the need to take risk to achieve this. You seek a broadly equal balance between the need to avoid losses and the potential for higher returns. You understand that your investment can fluctuate in value but you would still prefer to avoid sharp fluctuations.	
6 high medium risk	You are willing to take a higher level of risk and accept some losses, particularly in the short term, to gain higher returns. You emphasise the potential to achieve higher returns over the need to avoid losses on your portfolio. You understand that your investment can fluctuate in value and accept that these can be sharp from time to time.	
7 highest medium risk	You seek a return approaching that traditionally available from equities over the medium to longer term. While not ignoring potential losses, you emphasise striving to achieve these returns over the need to avoid losses and you are comfortable with the fluctuations in value and risk of capital losses that will come as a result.	
8 high risk	You concentrate on getting higher returns on your investments. You expect your portfolio to behave broadly in line with an equity portfolio, both in terms of returns and losses and you are comfortable with the sharp fluctuations in value and risk of capital losses that come as result.	
9 very high risk	You are driven to achieve higher returns and are willing to accept higher losses. You accept a significant exposure to more speculative areas in your portfolio, seeking as you do to maximise the potential for higher returns while accepting a higher risk of loss.	
10 highest risk	You are focussed on obtaining very high returns and you are unlikely to be concerned with the potential larger losses. You seek equity investment in more speculative areas and will not want exposure to any lower-risk investments in your portfolio.	

The table details various investments we might include in portfolios, with some notes on the role they might play in a portfolio and the associated potential returns and risks.

The list is not designed to be exhaustive and other investments might be considered from time to time, please ask if you have any questions.

Investment	*Asset Class*	*Potential Returns*	*Potential Risks*
Cash Deposits	Cash	Variable or fixed rate of interest. Capital fully guaranteed up to £85,000 per account holder under Financial Services Compensation Scheme.	Inflation could erode the spending power of the interest and/or the underlying capital. No capital growth potential.
UK Government Gilts (conventional)	Bonds	Secure and stable source of fixed income to maturity, guaranteed by the UK government. Limited potential for capital growth in periods of falling or low interest rates and/or inflation.	Inflation in excess of the interest rate earned would erode value. Potential for capital erosion in periods of rising interest rates and/or inflation.
UK Government Gilts (index linked)	Bonds	Secure source of income to maturity, income and capital hedged against inflation, guaranteed by the UK government. Limited potential for additional capital growth in periods of falling or low interest rates.	Potential for capital erosion in periods of rising interest rates and/or inflation. No opportunity for capital growth in excess of inflation if held to maturity.
Corporate Bonds	Bonds	Similar to UK Government Gilts, guaranteed by issuing company rather than by UK government. Higher interest rates than on UK Gilts.	Similar to UK Government Gilts, price movements will tend to be more volatile. Issuing company may default on interest payments and/or capital repayments.

Investment	*Asset Class*	*Potential Returns*	*Potential Risks*
Corporate Bond Funds	Bonds	As for Corporate Bonds, diversification will mean income payable will vary depending on underlying bonds held.	As for Corporate Bonds, diversification will dampen potential for volatility and limit risk of default.
Commercial Property Funds	Property	Rental income from tenants of properties held within the fund. Potential for capital growth over the medium to longer term.	Rental income not guaranteed to be maintained. Potential for capital loss. Potential for restricted liquidity.
UK Equity Income Funds	Equities	Potential for a comparatively high and rising dividend income from shares in a diversified range of UK-listed companies. Potential for capital growth from rising share prices.	Dividends can be reduced or not declared by companies, share prices may not rise, although diversification through investment via a fund will reduce the impact of such eventualities.
UK Equity Growth Funds	Equities	Some potential for rising levels of dividend income, emphasis more on shares in a diversified range of UK-listed companies retaining a greater proportion of profit within the business to fund expansion/future profit growth.	Dividends can be reduced or not declared by companies, share prices may not rise, although diversification through investment via a fund will reduce the impact of such eventualities.
UK Equity Income Investment Trusts	Equities	As with UK Equity Income Funds, returns can be enhanced through the use of borrowing (known as gearing) and/or variation in relationship between quoted share prices and underlying Net Asset Values.	As with UK Equity Income Funds, risks can be increased through the use of borrowing (known as gearing) and/or variation in relationship between quoted share prices and underlying Net Asset Values.
UK Equity Growth Investment Trusts	Equities	As with UK Equity Growth Funds, returns can be enhanced through the use of borrowing (known as gearing) and/or variation in relationship between quoted share prices and underlying Net Asset Values.	As with UK Equity Growth Funds, risks can be increased through the use of borrowing (known as gearing) and/or variation in relationship between quoted share prices and underlying Net Asset Values.

Investment	*Asset Class*	*Potential Returns*	*Potential Risks*
Global Equity Funds	Equities	As with UK Equity Income/Growth Funds although will invest in a diverse range of companies listed in global equity markets rather than just the UK market. Typically dividend levels are lower than for UK-invested Funds. Additional potential for capital growth if currencies in which underlying holdings are denominated appreciate against the £.	As with UK Equity Income/Growth Funds. Additional potential for capital loss if currencies in which underlying holdings are denominated depreciate against the £.
Global Equity Investment Trusts	Equities	As with UK Equity Income/Growth Investment Trusts although will invest in a diverse range of companies listed in global equity markets rather than just the UK market. Typically dividend levels are lower than for UK-invested Trusts. Additional potential for capital growth if currencies in which underlying holdings are denominated appreciate against the £.	As with UK Equity Income/Growth Investment Trusts. Additional potential for capital loss if currencies in which underlying holdings are denominated depreciate against the £.
UK Listed Ordinary Shares (FTSE100)	Equities	As with UK Equity Funds/Investment Trusts. Greater potential for increase in dividend levels and for capital growth if successful companies are selected, as returns are not diluted through diversification.	As with UK Equity Funds/Investment Trusts. Greater potential for decrease in dividend level and for capital loss if unsuccessful companies are selected, as returns are not diluted through diversification.
UK Listed Ordinary Shares (FTSE250/Small Cap)	Equities	As with UK-listed Ordinary Shares (FTSE100). Greater potential for capital growth due to greater opportunity for such companies to become future market leaders.	As with UK-listed Ordinary Shares (FTSE100). Difference between buying and selling prices may be wider than with FTSE100 companies due to potential for reduced liquidity.

Investment	*Asset Class*	*Potential Returns*	*Potential Risks*
Specialist Funds/ Investment Trusts	Equities	As with Global Equity Funds/Investment Trusts. Potential for greater capital growth through successful identification of sectors/ areas/individual markets/emerging markets that outperform equity markets in general.	As with Global Equity Funds/Investment Trusts. Risk of greater capital loss if invested in sectors/areas/ individual markets/emerging markets that underperform equity markets in general. Likelihood of increased volatility.
AIM Listed Shares	Equities	Equity participation in the fortunes of new companies and companies without a full/main market listing in the form of dividends and capital growth. Opportunity for above average capital growth.	Risk of above average losses if the company(ies) selected do not trade profitably, individual companies may even go into liquidation and shareholders would lose their investment. Less well regulated, less well researched and with reduced liquidity than companies with full/main market listing, greater spreads between buying and selling prices.
Venture Capital Trusts	Equities	Equity participation in the fortunes of new companies in the form of dividends and capital growth. Opportunity for above average capital growth. Income and Capital Gains Tax advantages.	Risk of above average losses.
Exchange Traded Funds linked to commodity prices	Alternative	Participation in the increase in the value of commodities such as precious and industrial metals and agricultural and other 'soft' commodities through investment in listed open-ended investment vehicles that track the movement in commodity prices.	No dividend income. Risk of capital erosion in the event of falls in the value of commodities to which the investment vehicles are linked. Some structures for commodity investment can carry additional risks connected with price movement replication and default risk from associated counterparties.
Absolute Return Funds	Alternative	Utilise sophisticated techniques with a view to generating returns somewhere between those available from bonds & equities, with low volatility. Returns are in the form of capital growth.	Investment strategies may not generate the desired level of return, very dependent on skills and judgement of fund managers. Limited track record in many cases.

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