GIBRALTAR ASSET MANAGEMENT LIMITED

STOCKBROKERS & INVESTMENT MANAGERS

# Investment Risk Guide

## Acceptable Risk

All clients and prospective clients should remember that by their very nature, investments involve a degree of risk over and above that of cash. The vagaries of the economic cycle and political factors can act to produce significant price movements in either direction. Money should only be invested on a medium to long-term view, although we shall act in a way we believe to be in accordance with your willingness to accept risk.

For your guidance we classify the three major risk categories as follows:

### Low Risk

Clients whose primary objective is the preservation of their real wealth should consider opting for a low risk approach. Low risk securities include:

i cash and cash equivalents
ii AAA-rated government and supranational bonds

Note, however, that the effects of high inflation can still erode the present purchasing power of cash.

### Medium Risk

A portfolio designed around a medium risk stance will offer substantially greater opportunities for longer term growth than a low risk portfolio, although there is likely to be a higher degree of volatility in the investment's performance. Medium-risk securities include:

i investment grade (BBB- & above) fixed interest securities
ii FTSE 350 stocks as well as large cap companies in major western markets (Europe & North America)
iii broadly diversified collective investment schemes
iv hard & soft commodities (no more than 20% of portfolio)
vi hedge funds (no more than 20% of portfolio)

### High Risk

A high-risk portfolio is suitable for those clients who wish to maximise their long term returns and are prepared to accept a significant degree of volatility in performance, over and above the levels of the investment markets as a whole. High-risk portfolios are likely to see a more active management style in order to capitalise on short-term opportunities as and when they arise. High risk investments cover all other investments not mentioned above and can incorporate:

i smaller capitalisation shares
ii AIM-traded shares
iii new issues (IPOs)
iv hard & soft commodities
v hedge funds
vi venture capital

## Investment Objectives

Investment returns come in two guises, income or capital growth. Most investors wish to see some combination of the two, but often with a particular bias towards one or the other depending on the investor's circumstances. The greatest determinant of long term performance is whether income is withdrawn or reinvested. If income is not required we recommend that clients elect any income that their portfolio generates to be retained on their account.

Where there is a requirement for a particular degree of income we will seek to manage the portfolio to produce such a level, though investors who require very high levels of income should realise that this can be achieved either through sacrificing capital by purchasing a wasting asset or through the assumption of a high degree of risk. We set out below some guidance as to how portfolios with differing income requirements might be managed, dependent of course upon the level of risk deemed to be acceptable.

### Income

To achieve income there must inevitably be a surrendering of long-term capital growth potential. Income can be maximised through holdings of corporate bonds, plus a selection of high yielding equities to give the potential for income growth. Overseas markets are unlikely to account for a significant part of the portfolio, since the level of income offered is normally low.

### Growth

Primarily, this will be for investors whose income needs are not important and are willing to accept a lower than average yield in order to focus on capital appreciation. Portfolios are likely to involve investments such as low yielding "growth stock" equities and overseas collective investment schemes.

### Balanced

This is for investors seeking both income and capital growth. Such a portfolio would incorporate a selection of income-producing assets plus a number of capital growth orientated investments. A broad selection of equities is likely to be recommended to provide a degree of rising income, whilst corporate bonds are also likely to be included in order to produce income. Some overseas investments may also be included.

## Risk Types

This guide is intended to give you information on the different types of securities available in the market and a warning of the risks associated with them so that you may take investment decisions on an informed basis. You should not deal in these or other products unless you understand the nature of the contract you are entering into and the extent of your exposure to risk. You should also be satisfied that the product and/or service is suitable for you in light of your circumstances and financial position and, where necessary, you should seek appropriate independent advice in advance of any investment decisions.

## Generic Risk types

### General

The price or value of an investment will depend on fluctuations in the financial markets outside of anyone's control. Past performance is no indicator of future performance.

### Liquidity

Under certain trading conditions it may be difficult or impossible to liquidate or acquire a position. This may occur at times of rapid price movement if the price rises or falls to such an extent that under the rules of the relevant stock exchange trading is suspended or restricted.

### Credit Risk

Credit risk is the risk of loss caused by borrowers, bond obligors, or counterparties failing to fulfil their obligations or the risk of such parties credit quality deteriorating.

### Market Risk

*General:*

The price of investments goes up and down depending on market supply and demand, investor perception and the prices of any underlying or allied investments or, indeed, sector and economic factors. These can be totally unpredictable.

*Overseas Markets:*

Any overseas investment or investment with an overseas element can be subject to the risks of overseas markets which may involve different risks from your home market. In some cases the risks will be greater. The potential for profit or loss from transactions on foreign markets or in overseas denominated contracts will be affected by fluctuations in overseas exchange rates.

*Emerging Markets:*

Price volatility in emerging markets, in particular, can be extreme. Emerging markets generally lack the level of transparency, liquidity, efficiency, market infrastructure, and regulation found in more developed markets. They may also be affected by political risk.

### Insolvency

The insolvency or default of the firm with whom you are dealing, or of any brokers involved with your transaction, may lead to positions being liquidated or closed out without your consent or, indeed, investments not being returned to you. There is also insolvency risk in relation to the investment itself, for example of the company that issued the bond or of the counterparty to the off-exchange derivatives (where the risk relates to the derivative itself and to any collateral or margin held by the counterparty).

### Operational Risk

Operational risk, such as breakdowns or malfunctioning of essential systems and controls, including IT systems, can impact on all financial products. Business risk, especially the risk that the business is run incompetently or poorly, could also impact on shareholders of, or investors in, such a business. Personnel and organisational changes can severely affect such risks and, in general, operational risk may not be apparent from outside the organisation.

## Specific Risk Types

### Ordinary Shares

A share is an instrument representing a shareholder's rights in a company. One share represents a fraction of a corporation's share capital. The issuer has no obligation to repay the original cost, or the capital, to the shareholder until the issuer is wound up. Dividend payments and an increase in the value of the security are both possible, although not guaranteed. Ordinary shares usually carry a right to vote at general meetings of the issuer. In the event of a liquidation of the company, ordinary shareholders are amongst the last who have a right to repayment of their capital and any surplus funds of the issuer, which could lead to a loss of a substantial proportion, or all, of the original investment. Purchase of partly paid shares may also result in the shareholder being forced to subscribe further.

Dealing in shares may involve risks including but not limited to the following:

*Company Risk:*

A share purchaser does not lend funds to the company, but becomes a co-owner of the corporation. They participate in its development as well as in chances for profits or losses, which makes it difficult to forecast the precise yield on such an investment. An extreme case would be if the company went bankrupt, thereby wiping out the total sums invested.

*Price Risk:*

Share prices may undergo unforeseeable price fluctuations causing risks of loss. Price increases and decreases in the short-, medium- and long-term alternate without it being possible to determine the duration of those cycles. General market risk must be distinguished from the specific risk attached to the company itself. Both risks, jointly or in aggregate, influence share prices.

*Dividend Risk:*

The dividend per share mainly depends on the issuing company's earnings and on its dividend policy. In case of low profits, dividend payments may be reduced or not made at all.

The market in ordinary shares can be very illiquid for small companies. This will make it difficult to either acquire meaningful sizes or sell substantial holdings.

Volatility can be very high for ordinary shares, particularly in fast markets. Withdrawal of liquidity in times of stress can result in huge moves to the downside.

### Preference Shares

Unlike ordinary shares, preference shares give shareholders the right to a fixed dividend, the calculation of which is not based on the success of the issuer company. They therefore tend to be a less risky form of investment than ordinary shares. Preference shares do not usually give shareholders the right to vote at general meetings of the issuer, but shareholders will have a greater preference to any surplus funds of the issuer than ordinary shareholders, should the issuer go into liquidation.

The market in preference shares can be relatively illiquid. This will make it difficult to either acquire large sizes or sell substantial holdings. There is a statistical positive correlation to the equity market, meaning that a fall in equities will lead to a fall (though not as large a fall) in preference shares. Volatility tends to be lower than that exhibited by ordinary shares due to the nature of the instrument.

### Depository Receipts

Depository Receipts (ADRs, GDRs etc.) are negotiable certificates typically issued by a bank, which represents a specific number of shares in a company, traded on a stock exchange, which is local or overseas to the issuer of the Receipt. They may facilitate investment in the companies due to the widespread availability of price information, lower transaction costs and timely dividend distributions. The risks involved relate to both the underlying shares (as above) and to the bank issuing the Receipt.

### Bonds

Bonds are negotiable debt instruments issued by a company or a government body to creditors and whose par value at issuance represents a fraction of the total amount of the debt. The duration of the debt as well as the terms and conditions of repayment are determined in advance. Unless stipulated otherwise, the bond is repaid either at the maturity date, or by means of annual payments, or at different rates determined by drawing lots. The interest payments on bonds may be either (i) fixed for the entire duration or (ii) variable and often linked to reference rates (e.g. LIBOR). The purchaser of a bond (the creditor) has a claim against the issuer (the debtor).

Dealing in bonds may involve risks including but not limited to the following:

*Insolvency risk:*

The issuer may become temporarily or permanently insolvent, resulting in its incapacity to repay the interest or redeem the bond. The solvency of an issuer may change due to one or more of a range of factors including the issuing company, the issuer's economic sector and/or the political and economic status of the countries concerned. The deterioration of the issuer's solvency will influence the price of the securities that it issues.

*Interest rate risk:*

Uncertainty concerning interest rate movements means that purchasers of fixed-rate securities carry the risk of a fall in the prices of the securities if interest rates rise. The longer the duration of the loan and the lower the interest, the higher a bond's sensitivity to a rise in the market rates.

*Credit risk:*

The value of a bond will fall in the event of a default or reduced credit rating of the issuer. Generally, the higher the relative rate of interest (that is, relative to the interest rate on a risk-free security of similar maturity and interest rate structure), the higher the perceived credit risk of the issuer.

*Early redemption risk:*

The issuer of a bond may include a provision allowing early redemption of the bond if market interest rates fall. Such early redemption may result in a change to the expected yield.

*Risks specific to bonds redeemable by drawing:*

Bonds redeemable by drawing have a maturity that is difficult to determine, so unexpected changes in the yield on these bonds may occur.

*Risks specific to certain types of bond:*

Additional risks may be associated with certain types of bond, for example floating rate notes, reverse floating rate notes, zero coupon bonds, foreign currency bonds, convertible bonds, reverse convertible notes, indexed bonds and subordinated bonds. For such bonds, you are advised to make enquiries about the risks referred to in the issuance prospectus and not to purchase such securities before being certain that all risks are fully understood. In the case of subordinated bonds, you are advised to enquire about the ranking of the debenture compared to the issuer's other debentures. Indeed, if the issuer becomes bankrupt, those bonds will only be redeemed after repayment of all higher ranked creditors and as such there is a risk that you will not be reimbursed. In the case of reverse convertible notes, there is a risk that you will not be entirely reimbursed, but will receive only an amount equivalent to the underlying securities at maturity.

The market in certain corporate bonds can be relatively illiquid. This will make it difficult to either acquire large sizes or sell substantial holdings. There is a statistical positive correlation to the equity market, meaning that a fall in equities will lead to a fall (though not as large a fall) in corporate bonds. Volatility in corporate bonds tends to be lower than that exhibited by ordinary shares due to the nature of the instrument.

The market in major government bonds is very liquid, making it easy to either acquire large sizes or sell substantial holdings. There is a statistical negative correlation to the equity market, meaning government bonds should rise as equities fall (and vice versa).

### Penny Shares

There is an additional risk of losing money when shares are bought in some smaller companies including penny shares. Usually there is a big difference between the buying price and the selling price of these shares. If they have to be sold immediately, you may get back much less than you paid for them.

### Money-Market Instruments

A money-market instrument is a borrowing of cash for a period, generally no longer than six months, but occasionally up to one year, in which the lender takes a deposit from the money markets in order to lend it to the borrower. Unlike in an overdraft, the borrower must specify the exact amount and the period for which he wishes to borrow. Like other debt instruments (see above), money-market instruments may be exposed in credit and interest rate risk.

The market in money market instruments is very liquid, making it easy to either acquire large sizes or sell substantial holdings. There is a statistical negative correlation to the equity market, meaning money market instruments should not fall as equities fall.

### Units in Collective Investment Schemes

There are many different types of collective investment schemes. Generally, a collective investment scheme will involve an arrangement that enables a number of investors to "pool" their assets and have these professionally managed by an independent manager. Investments may typically include gilts, corporate bonds and quoted equities, but depending on the type of scheme may go wider into derivatives, real estate or any other asset. There may be risks on the underlying assets held by the scheme and investors are advised, therefore, to check whether the scheme holds a number of different assets, thus spreading its risk. Subject to this, investment in such schemes may reduce risk by spreading the investor's investment more widely than may have been possible if they were to invest in the assets directly.

The reduction in risk may be achieved because the wide range of investments held in a collective investment scheme can reduce the effect that a change in the value of any one investment may have on the overall performance of the portfolio. Although, therefore, seen as a way to spread risks, the fund's price can fall as well as rise and, depending on the investment decisions made, a collective investment scheme may be exposed to many different major risk types.

The market in collective investment schemes is predominantly very liquid, making it easy to either acquire large sizes or sell substantial holdings. There is a statistical positive correlation to the equity market (using equity-based funds as an example), meaning collective investment schemes should rise as equities fall (and vice versa). Volatility in collective investment schemes tends to be lower than that exhibited by ordinary shares due to the nature of the diversified portfolios. It should be stressed however, that liquidity can suffer in various funds (predominantly hedge funds and property-based funds) where during times of market turbulence there are so many sellers that the fund cannot raise the funds quickly enough from the portfolio. In this instance, it is not uncommon to see such funds suspended at the discretion of their directors.

### Non-Readily Realisable Investments

From time to time we may recommend an investment we believe is suitable for you although it is illiquid or not readily realisable. This means the market is or could become illiquid, the investment difficult to resell and its proper price difficult to assess. We will always use reasonable care to execute such a transaction on terms that are fair and reasonable to you, including price. We are always available to explain how a price is calculated, how it compares to the prices in any previous arm's length transactions we have acted in as agent for buyer or seller and whether the firm or its associates previously held a position in the investment. Please inform us if you do not wish to be advised in respect of such investments.

### Exchange Traded Funds

Exchange Traded Funds ("ETFs") trade on a stock exchange. They tend to be very liquid with tight spreads. There is a statistical positive correlation to the equity market (using equity-based ETFs as an example), meaning ETFs should rise as equities fall (and vice versa). Volatility in ETFs tends to be lower than that exhibited by ordinary shares due to the nature of the underlying index.

Short and leveraged ETFs are also available. Short ETFs rise as the underlying market it tracks falls and vice versa. The returns of Leveraged ETFs are magnified (typically 2-3 times) to the long side or the short side. It should be noted that both these can suffer from tracking error due to the effect of the daily rebalancing. They are designed for holding for a short period of time. Investors should note that over a long timeframe, their price will naturally gravitate downwards, which is why reverse stock splits are so prevalent in these products. You cannot, however, lose more than you invest.

### Hedge Funds

A hedge fund is an actively managed portfolio which aims to exploit market inefficiencies using a variety of sophisticated investment strategies in order to achieve a positive return in most market conditions. The managers may buy and sell a wide variety of financial securities including bonds, equities, options and derivatives. The techniques employed may include selling securities not already owned with a view to buying them back at a lower price in the future (a technique known as "short selling"). Managers will also borrow in order to facilitate transactions and/or to generate improved returns (known as gearing or leverage). These and other techniques introduce additional financial risks, which are not normally present in conventional funds. Sophisticated monitoring of the current investment positions by the hedge fund managers aims to limit the risk involved but unforeseen circumstances may result in part or total loss of your investment. A fund of funds hedge fund may invest in a portfolio of hedge funds and/or accounts managed by third party managers utilising a variety of strategies.

Hedge funds are subject to certain risk factors including, but not limited to, the following:

*Gearing effect:*

They use a variety of financial instruments, loans and short selling which can result in a substantial gearing effect. This gives rise to the possibility that small price movements can have a disproportionate effect on the fund value and sometimes a total loss of capital to the investor.

*Dealing:*

Purchases & sales are usually made through the fund's Administrator. Dealing dates for these funds are typically monthly or quarterly and in extreme market conditions, the dealing frequency may be extended. You may not be able to realise your investment at short notice. Hedge funds are long-term investments but under certain circumstances may be closed to new investment or may be redeemed.

*Pricing and valuations:*

Hedge fund managers generally provide calculations of the net asset value on a monthly basis. Orders are placed in advance of the publication of the dealing price.

*Regulatory framework:*

Hedge funds are often domiciled in countries with minimal or no legal or regulatory framework. The legal risks involved in enforcing possible claims may also need to be taken into account.

*Potential conflicts of interest:*

A substantial proportion of the manager's remuneration is based on a performance fee. Managers can hold a substantial stake in the funds they manage and may have a direct or indirect interest in the underlying investments.

*Tax:*

The tax treatment of hedge funds may differ from your other investments and we recommend that investors get specialist tax advice where they have a concern.

### Stabilisation

Stabilisation is a price supporting process that may take place in context of new issues. The effect of stabilisation can be to make the market price of the new issue temporarily higher than it would otherwise be. The market price of investments of the same class already in issue, and of other investments, whose price affects the price of the new issue, may also be affected.

This process is undertaken in order to ensure that the issue of investments is introduced to the market in an orderly fashion, and that the issue price or the price of the associated investments is not artificially depressed because of the increase in supply caused by the new issue. Stabilisation is carried out by a "stabilisation manager" (normally the firm chiefly responsible for bringing a new issue to market).

Stabilisation may only take place for a limited period, and there are limits on the price at which shares, warrants and depository receipts may be stabilised (although they are not limited in respect of loan stocks or bonds). The stabilisation rules also require the stabilisation manager to disclose that they are stabilising, but not that the manager is actually doing so.

The fact that a new issue or a related security is being stabilised should not be taken as any indication of the level of interest from investors, nor of the price at which they are prepared to buy the securities.

### Structured Capital-At-Risk Products (SCARPS)

SCARPs are usually share-based investments from banking, insurance or investment management firms, and can offer attractive returns. But if your investment does not perform as planned, you could lose some or all of the capital that you put in. SCARPs usually invest in a variety of stock market investments such as shares or debt securities.

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