Capacity For Loss Guide

On our client application form is a section regarding "capacity for loss". This question helps us to assess your capacity for loss and the appropriateness of holding investments for you that may, due to markets and aspects such as economic conditions, be volatile and at sometimes illiquid (i.e. they could be difficult to sell). It is not an undertaking that we can formally protect you against losses, but we will at all times guide you, as circumstances in and around your portfolio of investments evolve.

This document is designed therefore to guide you through the process of determining your capacity for loss (CFL) and it should be read in conjunction with our Risk Investment Guide.

What is capacity for loss (CFL)

Investments can move up and down in value, and volatility will sometimes be a daily characteristic of financial markets. Financial professionals often say that you should not invest unless you are able to weather a financial downturn. Your CFL can be expressed as a monetary figure or as a percentage value of your portfolio or on the amount of money that you are looking to invest. This figure represents the value that your portfolio could fall in value before it would materially impact either your view of your total portfolio value or the value of your portfolio relative to your overall standard of living.

Factors for you to consider

You may already have a figure in mind with respect to your CFL. However, it is sensible to make a realistic assessment on your dependence on either the capital or the income derived from your investments. Ultimately you have to ask yourself what would be the effect on your lifestyle if there was a significant adverse fall in either. Some typical questions that you might ask yourself would be:

- **Are you likely to need access to some or all of your funds in the short to medium term?**
- **By how much would your investments need to fall in value before you felt concerned?**
- **Could you afford to lose a proportion of the value of your investments or the income generated from them?**
- **Are you setting aside your portfolio for a set purpose such as school fees or to fund your retirement?**
- **In the overall context of your wealth does your portfolio represent a significant proportion of that wealth?**
- **Do you have access to liquid assets (cash) to fund unexpected expenditure or will you have to raise funds from your portfolio?**

This is by no means an exhaustive list of questions and we would be happy to discuss specific situations or risks with you that are relevant to your circumstances.

Financial History

Although the past is no guide to future market performance it is useful in the sense that it allows us to see how investments have performed in the past. In particular it allows us to see how a monetary amount has performed and the risk of capital loss that may be involved in the management of a portfolio or when making an investment choice.

As a firm we use for certain investment strategies the industry recognised MSCI WMA Private Investor Indices to report alongside the performance of client portfolios which we manage. This is done on a total return basis which represents income and capital. Typically in the main we use three of these indices. However, it should be noted that the bespoke nature of our client relationships and our prevailing views on markets means that portfolios are at any time unlikely to exactly reflect these indices which are:

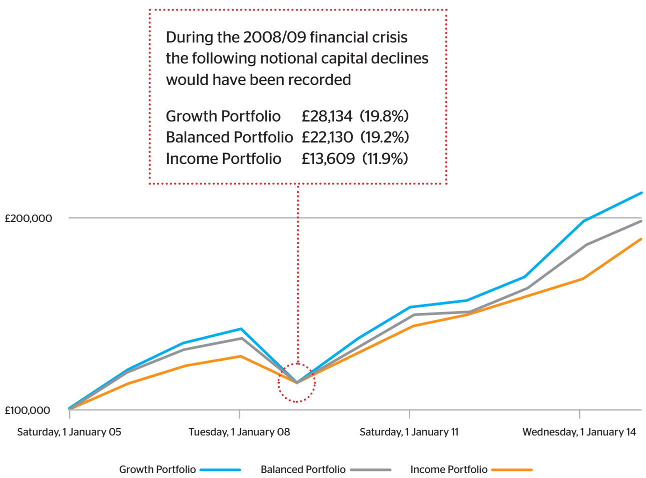
MSCI/WMA Private Investor Income Total Return Index
– This is a benchmark for portfolios seeking an income return.

MSCI/WMA Private Investor Balanced Total Return Index
– This is a benchmark for portfolios seeking a combination of income and capital growth.

MSCI/WMA Private Investor Growth Total Return Index
– This is a benchmark for portfolios seeking capital growth.

Sometimes it helps to represent things graphically. The chart below shows the movement of the WMA indices rebased to reflect the investment of a notional sum of £100,000 back in 2005. The chart is designed to give you an idea of the capital losses that may be incurred and to provide further information in helping you to determine your CPL.

Performance of MSCI/WMA



A practical example

A fictitious example is a good way of seeing how CFL can be determined and how it may work in practice. Let us consider Mr & Mrs Lee who are both retired medical professionals. They primarily rely upon their share portfolio to generate an income to supplement their combined pension income. From time to time they plan to take capital from their portfolio to finance holidays, undertake repairs to their property and to make occasional payment of school fees for the grandchildren. Overall they have a risk profile of lower medium risk and a strategy of seeking a balanced return. As Mr & Mrs Lee are both no longer working they cannot add new cash to their portfolio and if they needed emergency funds they would consider taking them from their investments. They both recognise that markets can move up and down and based upon the initial value of their combined portfolios they have established that their CFL is at a rate of 20% or the monetary equivalent of £100,000. This represents the amount of capital that they could potentially lose before impacting their standard of living.

The following investments are managed by Vartan Ravenscroft on a combined discretionary basis:

Mr Lee NISA Portfolio	£87,000
Mrs Lee NISA Portfolio	£105,000
Mr & Mrs Lee Joint Portfolio	£308,000
Total Discretionary Portfolio Value	£500,000

Several years have now passed since the commencement of the discretionary agreement when news breaks in the market of a surprise increase in US interest rates at a time of heightened geo-political volatility in the Middle East. This causes the stock market investors to take fright and the value of investments around the world register significant declines. Some six months after this event the benchmark against which Mr & Mrs Lees portfolio is compared has fallen in value by 22%. Their portfolio has fallen in value by slightly more than this figure registering a decline over this period of 23% In monetary returns this means that the total value of their portfolio has fallen by £115,000 and is now valued as follows:

Mr Lee NISA Portfolio	£77,000
Mrs Lee NISA Portfolio	£82,000
Mr & Mrs Lee Joint Portfolio	£226,000
Total Discretionary Portfolio Value	£385,000

As the fall in value of their total portfolio is more than their stated CFL, their portfolio manager at Vartan Ravenscroft contacts Mr & Mrs Lee. This is to establish if this fall in the value of their investments now means that they need to re-assess their standard of living. This may of course mean that stock market based investments are no longer appropriate for them. In the event Mr & Mrs Lee decide that no action should be taken on their portfolio and believe that over the next 12 to 24 months their portfolios are likely to rise.

The next steps

Hopefully the information in this document makes it easier for you to understand what CFL means and provides you with guidance on how you might determine what figure is right for you. If you do have any concerns or questions relating to your CFL we would be more than happy to discuss matters with you to ensure that you arrive at an appropriate and realistic figure.

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