Active Managed Portfolio Service

Consumer Duty Information December 2024

Summary

This document sets out the details required for distributors to undertake their Consumer Duty assessment on the Active Managed Portfolio Service (MPS). This document is intended for use by financial advisers as distributors of the service.

Target Market statement

The Active MPS seeks to provide clients (individuals, trusts, companies, and pension schemes) with an actively managed, discretionary portfolio through the adoption of one of a range of differing investment strategies, spanning from a low risk to 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 Active MPS strategies reference Distribution Technology's asset allocations to maintain a close alignment to the Dynamic Planner risk profiles.

The Active MPS strategies seek to achieve diversification both across, and within, various asset types, global regions and sectors, primarily using collective investments. Collective investments are pooled funds which themselves are diversified by holding many individual investments. To offer flexibility our Active MPS strategies are built using a range of investment tools including investment companies, open-ended funds (OEICs and Unit Trusts) as well as passively managed funds such as Exchange Traded Funds (ETFs).

Portfolios are available in GBP.

The Active MPS range 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. The Active MPS strategies are managed on a standardised basis where they cannot accommodate individual client preferences or investment restrictions.

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

Distribution and accessibility

The Active MPS is only available to investors 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 clients invested in the Active MPS. The service can be accessed via several external wrap platforms which are listed in **Appendix 1**.

Main features of the service

The Active MPS offers clients:

- A segregated discretionary portfolio containing direct holdings in the underlying funds which form the client's chosen 'model' portfolio;

- Access to a specialist MPS Investment Team with a proven process and track record of building portfolios which seek to maximise efficiency, limit unintended losses and diversification by investing primarily in collective investment vehicles, including open-ended funds (OEICS, unit trusts), investment companies and exchange traded funds (ETFs);

- Tactical rebalancing of portfolios 3-4x per year, subject to prevailing market conditions; and

- Flexibility of the tax wrapper being permissible within ISAs, SIPPs, and, where available, Onshore and Offshore Bonds. The client's financial adviser is responsible for advising on the tax wrapper and its suitability. Constituent funds of the Onshore and Offshore Bond models may differ from the general investment model due to wrapper provider restrictions. The financial adviser will need to ensure the Target Market of the Active MPS is suitable and check that an onshore or offshore bond version of the model is available.

Who is the Active MPS likely to be suitable for?

The Active MPS is **likely** suitable for clients who:

- Are advised by a regulated financial adviser on an ongoing basis;

- 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 risk profile consistent with one of the six investment strategies: (Refer to the **Appendix 2** for the investment strategy descriptions)

    - Defensive
    - Defensive Income
    - Balanced Income
    - Balanced Growth
    - Growth
    - Dynamic Growth

- Have no specific income requirement. The Active MPS models will generate some income, which can either be paid out to the client or reinvested within the portfolio, but no specific level of income can be guaranteed;

- Have a recommended minimum investment of around £20,000;

- Have a minimum investment horizon of two years and no immediate expectation of any requirement to withdraw capital;

- Do not require any CGT implications to be taken into consideration in investment decisions;

- Have no specific investment restrictions – i.e., no constraints as to the asset classes, industrial sectors or geographical exposure of the investments that can be included within the portfolio; and

- Accept that an Active MPS portfolio will not be managed on a bespoke basis and cannot be managed in conjunction with any other portfolio.

Conversely, who is the Active MPS unlikely to be suitable for?

The Active MPS is **unlikely** suitable for clients who:

- Do not have an appointed regulated financial adviser;
- Are not prepared to accept any capital loss;
- Have a combination of investment objective and attitude to risk that is not consistent with one of the investment strategies of the Active MPS;
- Do not meet the recommended minimum investment levels, typically £20,000;
- Have an investment time horizon of less than two years;
- Have specific investment requirements, restrictions and/or tax considerations which mean that they require a bespoke investment service – which may be likely for many clients with more than £250,000 to invest; and
- Have a specific income requirement which is higher than the income likely to be generated by the Income dedicated models.

Fair Value assessment

The Active MPS is considered to represent fair value now and for the foreseeable future. We have assessed the fair value of the Active MPS against several 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 such as the Lang Cat and Platforum. 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 MPS solutions 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 on an *agent as client* basis 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. The client accepts advice from their financial adviser that the Active MPS meets their needs and that portfolio values can increase or decrease.

Conflicts of interest

We have not identified any 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 3. We also explain the various asset classes that we might consider as suitable investments to be held within the Active MPS. 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.

Point of contact

Third Party 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.

Appendix 1 – External wrap platforms

- 7IM
- Abrdn Wrap
- Aviva
- M&G Wealth
- Quilter
- Transact
- Wealthtime

Appendix 2 – Active MPS Investment Strategies

Investment Strategy Descriptions

Defensive

The portfolio objective is to preserve the value of capital in real terms (i.e., so that it is not eroded by inflation). The portfolio invests mainly in funds providing exposure to defensive assets such as government bonds, corporate bonds and property, but with up to 35% invested in funds providing exposure to UK and International equities. The portfolio does not focus on income, which will vary. The portfolio is likely to be relevant for investors comfortable with variable levels of investment income to prioritise maintaining a lower degree of investment risk. The portfolio is aligned with Dynamic Planner's risk profiles and has been independently given a risk score of 3.

Defensive Income

The portfolio objective has a focus on providing higher income, whilst preserving the value of capital in real terms. The portfolio is diversified across funds providing exposure to relatively defensive asset classes such as government bonds, corporate bonds and property, but with between 30% and 60% also invested in funds providing exposure to UK and International equities. The portfolio is likely to be relevant for investors looking to receive a higher proportion of their total return as investment income and willing to accept a lower degree of investment risk. The portfolio is aligned with Dynamic Planner's risk profiles and has been independently given a risk score of 4.

Balanced Income

The portfolio objective has a focus on generating income, whilst also aiming to grow the capital value by more than inflation. The portfolio is diversified across major asset classes and may have between 55% and 70% invested in funds providing exposure to UK and International equities, subject to market conditions. The portfolio is likely to be relevant for investors looking to receive a higher proportion of their total returns as investment income and willing to accept a medium degree of investment risk. The portfolio is aligned with Dynamic Planner's risk profiles and has been independently given a risk score of 5.

Balanced Growth

The portfolio objective has a focus on delivering capital growth in real terms, whilst still producing some income. The portfolio invests actively across all major asset classes and may have between 65% and 85% invested in funds providing exposure to UK and International equities, with the remainder diversified across defensive asset classes. The portfolio is likely to be relevant for investors for whom ongoing investment income is less important and who are willing to accept a medium degree of investment risk. The portfolio is aligned with Dynamic Planner's risk profiles and has been independently given a risk score of 6.

Growth

The portfolio objective is to deliver long-term capital growth. The portfolio will normally invest more than 90% in funds providing exposure to UK and International equities across a wide range of geographical regions, but may include up to 15% exposure to defensive asset classes. The portfolio is likely to be relevant for investors willing to accept a higher degree of investment risk. The portfolio is aligned with Dynamic Planner's risk profiles and has been independently given a risk score of 7.

Dynamic Growth

The portfolio objective is to deliver long-term capital growth and will usually be fully invested in stock markets. The portfolio will usually retain a strong emphasis on developing markets with the flexibility to be as much as 50% invested in Asia and Emerging markets. The portfolio is likely to be relevant for investors willing to accept a higher degree of investment risk. The portfolio is aligned with Dynamic Planner's risk profiles and has been independently given a risk score of 8.

Appendix 3 – Key risks

1. The risks and rewards involved in investing

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.

The Appendix at the rear of this document has further information relating to the factors we consider in the management of portfolios.

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 factors 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 5.1.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 5.1.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 5.1.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.

Alternative Investment Market (AIM)

AIM is not classed as a 'regulated market' under UK law but is an 'exchange-regulated market' and is regulated by the London Stock Exchange. The following characteristics apply in addition to those of equities above.

Rewards

Shares in companies traded on the AIM market are not quoted investments so under current legislation may benefit from Business Relief (BR), which can provide 100% relief from UK Inheritance Tax (IHT) if the assets are held continuously for at least two years up to and on the date of death. Alternatively, BR will apply if qualifying securities have been held for a cumulative two years out of the five years immediately prior to an IHT transfer.

Risks

Shares in AIM companies are by their very nature higher risk than shares quoted on the main market of the London Stock Exchange or equivalent overseas markets, because AIM has lighter regulatory requirements and companies are not required to follow the same corporate governance standards and disclosure obligations as those applying in more regulated markets. The tax legislation is complex and there is a risk that some stocks may not qualify for BR.

Companies traded on AIM are often smaller and may be newly established with no trading history. Their management may have a more entrepreneurial approach to business and they may be partly owned by venture capitalists and others whose withdrawal of support may expose the business to significant change. The volumes of shares available for trading may be low. It may be difficult to buy or sell shares at the prevailing market price or indeed at any price at all. If trading is illiquid, price movements may be large, sudden and rapid.

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 supplement.

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 5.1.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 5.1.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.

vi. Long Term Asset Funds (LTAF)

A long term asset fund is a new category of UK authorised open ended fund specifically designed to facilitate investment in long term less liquid assets, including venture capital, private equity, private debt, real estate and infrastructure. Due to the majority of funds' assets being invested in these asset classes they deal less frequently compared to standard open-ended funds and require a period of notice to be given in advance of redemptions.

Rewards

The purpose of these funds is to provide access to illiquid assets, which can provide a useful alternative investment opportunity for investors with long term investment horizons.

Risks

LTAFs can invest in fixed assets, infrastructure, or complex financial products, all of which are relatively hard to sell. Investors who do not remain invested for the long term may not get back all their money. It may take many years to make a profit on the investment. The value of a redemption will not be known until the end of the notice period.

The Financial Conduct Authority have provided the following warning:

This is a high-risk investment, and you do not have protection against poor performance. Only invest if you're prepared to wait to get your money back. Assets in this fund take a long time to buy and sell. It will take several years to make any money on your investment.

We would reiterate that the points we have made in this supplement 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 Investment Manager or Financial Planner.

Appendix 4

Integration of sustainability risks in our investment process

Where a sustainability risk occurs, there may be a negative impact on the value of an investment. Sustainability risks can either represent a risk on their own, or impact and contribute significantly to other risks, such as market risks, operational risks, liquidity risks or counterparty risks.

Sustainability risks form part of our investment decision-making process, including the assessment of the likely impact of those risks on returns.

ESG data is received from third-party data providers and multiple ESG risk factors are considered when selecting equity investments within our monitored universe. These include:

Environmental	Climate Change Vulnerability, Biodiversity & Land Use, Carbon Emissions, Electronic Waste, Financing Environmental Impact, Packaging Materials & Waste, Product Carbon Footprint, Raw Material Sourcing, Toxic Emissions & Waste, Water Stress, Opportunities in Clean Tech, Opportunities in Green Building, and Opportunities in Renewable Energy.
Social	Chemical Safety, Controversial Sourcing, Health & Safety, Human Capital Development, Labour Management, Privacy & Data Security, Product Safety & Quality, Supply-Chain Labour Standards, Responsible Investment, Community Relations, Access to Finance, Access to Health Care and Opportunities in Nutrition & Health.
Governance	Corporate Governance (including Ownership & Control, Board, Pay and Accounting) and Corporate Behaviour (including Business Ethics and Tax Transparency).

Within our monitored universe of collective investment funds, due diligence is undertaken on each. We consider each provider's approach to sustainability risks and factors under the following subjects:

Industry bodies	Ideally the provider should be a signatory to the United Nations Principles for Responsible Investment (PRI) and/or the UK Stewardship Code, or another equivalent body.
Investment policy	A fund's investment policy should incorporate the principles of the PRI and/or the UK Stewardship Code, or another equivalent body, in their approach to responsible investment.
Investment process	The fund manager should be able to describe how ESG is integrated into the investment process.
ESG resource	Training should be available to all investment professionals. Additional note will be taken where there is dedicated resource and/or external ESG data providers.
Stewardship	Voting and engagement policies should cover ESG issues.
Principal adverse impacts (PAIs)	The provider should consider and disclose the PAIs of their investments on sustainability factors (defined as environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters).

In addition, we conduct regular screening of PAIs for our monitored universe across equities and collective investment funds.

Further details of our Sustainability Disclosure Policy and related disclosures are available at www.evelyn.com/legal-compliance-regulatory/legal-and-regulatory/

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