

Jones Financial Planning Limited, Investment Process

This document details the full Investment Process of Jones Financial Planning Limited (The Company). The process is reviewed on a regular basis.

The five key parts to the Investment Process

1. Risk Profiling
2. Asset Allocation
3. Fund Selection Process
4. Ongoing Monitoring and Review of Funds
5. Client Reviews

Risk Profiling and Asset Allocation Tool

It's inevitable clients and advisers will have widely varying interpretations of risk. It is vital from the perspective of consistency the business and all advisers within the business adopt the same interpretation of risk.

Furthermore, it's a key obligation under the Financial Services Authority's requirement for 'treating customers fairly' that all of our clients assessed to be of equal attitude to risk should receive the same investment portfolio.

The only way to achieve these outcomes is to establish a consistent measure across the business for establishing attitude to risk.

The basis we have adopted for the consistent assessment of attitude to risk is to encourage all clients to complete an attitude to risk questionnaire. To ensure a consistent basis for assessing clients' attitude to risk, we will use the same tool for each client of the business.

We recognise risk is a relative measure and it's therefore important we educate clients about the relationship between risk and return. We demonstrate for any given potential upside to a portfolio, there is a potential downside. We establish that in order to achieve the potential for higher upside, the client must also accept the potential for larger downside.

To this end, the questionnaire forces a client to focus on what they can afford to lose, rather than what they wish to gain.

Finally, risk is a relative measure and therefore an individual's attitude to risk will vary according to that individual's expectation of the likelihood of a negative outcome. It's therefore imperative that as a business, we assess each client's attitude to risk on a regular basis.

The completion of a new attitude to risk questionnaire will be a function of each annual client review.

Asset Allocation Theory

We recognise that efficient asset allocation is the key determinant in the variation of returns in a client's portfolio.

In 1952 Professor Harry Markowitz published his doctoral thesis "Portfolio Selection", marking the introduction of what is now known as Modern Portfolio Theory.

Professor Markowitz established that for any given level of risk, it was possible to construct an investment portfolio that mathematically delivers the maximum possible investment returns. That portfolio is said to sit on the "efficient frontier".

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Modern Portfolio Theory states any portfolio that does not sit on the efficient frontier is inefficient, as the portfolio is not maximising the returns for that given level of risk.

As a conclusion of this, we use the attitude to risk questionnaire to first establish a client's acceptance of risk before we then find the portfolio on the efficient frontier for that level of risk.

More recent research by Brinson, Singer and Beebower (Brinson, Singer and Beebower; "Determinants of Portfolio Performance II: An Update"; 1991) indicates that asset allocation is by far the dominant determinant (91.5%) in the variability of returns in a portfolio. Market timing represents 1.8% and Stock Selection 4.6%.

Furthermore, the Myners report of 2001 clearly states the significance of asset allocation and goes so far as to state clients should pay more in order to receive advice on asset allocation.

Choice of Asset Allocation Tool

Having carried out a thorough review of the risk profiling and asset allocation tools on the market, we've selected the asset allocation tool provided by Skandia/Watson Wyatt to build our clients portfolios. As a result, we've concluded it's important we use the same company's attitude to risk questionnaire as the output of this feeds directly into the asset allocation models.

One of the key reasons for choosing this tool is that it does not amend the economic output in anyway. We believe providers who amend the output of their models are creating a conflict of interest. In addition, our research indicates it's the only model that takes into account the impact of the different tax wrappers: ie. the impact of a gross or net yielding environment on the performance of the underlying asset classes.

Modelling of Asset Classes

The asset allocation tool models the following asset classes:

- Cash / Money Markets
- UK Fixed Interest
- International Fixed Interest
- Property
- UK Equity
- International Equity

Although International Equity is modeled together, it's further sub-divided into North America, Japan, Europe, Far East, Emerging Markets and Global specialist. The proportion for each of these sectors is determined by Watson Wyatt and is based primarily on the size of each market and the respective economies.

Asset Class Assumptions as at 18th June 2010

The following table provides the figures.

	Return Assumptions %	Volatility Assumptions %
Cash / Money Markets	3.54	1.62
UK Fixed Interest	4.74	5.20
International Fixed Interest	3.80	9.20
Property	7.39	10.42

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UK Equity	7.63	19.22
International Equity	8.14	19.12

Gross versus Net Yielding Wrappers

The asset allocation tool takes account of the tax status of the investment wrapper.

Gross Yielding – Pension / ISA and PEP

Net Yielding – Investment Bond / Unwrapped Collectives

For any given attitude to risk, there may be a difference in the asset allocation recommended for an investment into a gross yielding wrapper and a net yielding wrapper. Specifically the differences arise because of the different tax treatment of the underlying asset classes within the different wrappers.

UK Equity Dividends suffer the 10% tax credit regardless of the tax status of the wrapper in which they are held.

Similar to UK Equity, the yield on UK property is taxed regardless of the tax status of the wrapper within which it is held. UK Fixed interest suffers savings tax within a net yielding wrapper, but is untaxed within a gross yielding wrapper.

The tax advantaged position of fixed interest over property with Pensions / ISA and PEP increases the assumed return for the fixed interest within these wrappers. Within a gross yielding environment, fixed interest is assumed to produce similar returns to property, but to do so for a lower assumed rate of volatility. It therefore becomes preferable to hold fixed interest over property in a gross yielding environment. However, the advantage is marginal compared to benefit of spreading assets across all sectors. As a result, the business has chosen to include Property within pension portfolios.

Asset allocating within Sectors

The asset allocation tool provides us with the recommended asset allocations into the following sectors.

- UK Equity
- UK Fixed Interest
- Property
- International Fixed Interest
- European Equity
- US Equity
- Global Specialist
- Global Emerging Markets
- Far East Excl Japan
- Japan

Fund Selection Process

Although asset allocation is core to our investment process, we don't believe markets are 100% efficient. There are likely to be inefficiencies in the distribution of information in any market.

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That said, we believe a number of fund managers and fund houses have the ability to outperform the market over the long term. Our fund selection process aims to select those managers that have the ability to exploit these inefficiencies and deliver long term out performance of a given sector.

In short, we're aiming for active rather than passive fund management.

Criteria for Selection

The Company recognises past performance is not a guide to future performance and as such, performance plays only a small role in our selection. We pay much more attention to the following five criteria.

1. Ratings agencies
2. Risk adjusted returns
3. Relative risk
4. Consistency of performance (rather than specific past performance)
5. Representativeness of the asset class (ensuring it fits our model)

The following paragraphs provide information on each of these criteria.

1. Ratings Agencies

As a small IFA practice, we recognise we're limited in our ability to perform detailed due diligence on the whole market of investment funds. A key part of our investment process is therefore studying the output of the ratings agencies. These organisations have huge research resources and high levels of access to fund groups and fund managers.

The two ratings agencies we use are OBSR and Citywire. Full details on OBSR and Citywire can be found in the appendix. In addition we will at times use reference from Rayner Spencer Mills.

2. Risk Adjusted Returns

We use a measure called the Information Ratio. The Information Ratio is used to help put the returns a fund manager generates into context, given the level of risk they take on. We're able to gauge what level of added value the manager has historically achieved and how this ranks relative to the manager's peers in the same sector. A higher Information Ratio indicates a higher rate of active risk adjusted return.

3. Relative risk

Volatility is a statistical method that measures how much a series of values move up and down around its average.

The higher the volatility number, the less consistent historical performance has been. We're therefore looking for funds that have performed with as little volatility as possible.

4. Consistency of Performance

As we have already established, past performance is not a guide to future performance. What is useful however, is to establish which funds have generated consistent performance. To assess this, we look at discrete quartile rankings over the following time periods:

1 year from 12 Months ago

1 year from 24 months ago

1 year from 36 months ago

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Rankings 1 and 2 are above average, and rankings 3 and 4 are below average.

5. Representativeness of the asset class

For the asset allocation to maintain its validity, it's important we choose funds that fit the sector reasonably closely. If they fit the sector exactly, they effectively track the performance of the sector. In effect, these are passive funds. We look for funds that closely fit the sector, for with a little variance comes the opportunity to out-perform the sector. Clearly, we are not looking for funds that vary widely from the sector, for this would upset the asset allocation principles.

The measure we use to assess this is called R^2 .

Ongoing Monitoring and Review of Funds

The Company will on a quarterly (Jan, Apr, July and Oct) basis perform two functions:

1. Decide whether to apply any changes made necessary by a change in the underlying asset allocation recommendations provided by Watson Wyatt
2. Review the fund selection

The outcome of the review meetings and any portfolio recommendations will be published on the Jones Financial Planning Limited website. We will email clients (post to clients without email) a newsletter giving the information, inviting them to consider the conclusions and to notify us if they wish to accept our recommendations and make appropriate changes to their portfolios. We do not currently hold discretionary adviser status and therefore any changes to a client's portfolio must first be authorised by the client.

Client Reviews

Every client will be offered at least an annual review, unless they are on the "Transactional On Demand" service. Part of the review will be focused on re-assessing the client's attitude to risk. Where this results in a change in attitude to risk, the client's portfolio will need to be amended in line with the correct asset allocation for the new attitude to risk.

Appendix – Old Broad Street Research (OBSR) Detail

OBSR AAA Rating

This is the highest rating awarded. It's given to funds which demonstrate very powerful investment processes and disciplines which we believe will translate into exceptional long term performance. It's an indication of excellence.

OBSR AA Rating

This is determined using the same methodology as for the OBSR AAA Rating. The OBSR AA Rating is an indication of highly superior quality based on process and track record.

OBSR A Rating

This is again determined using a methodology consistent with that applied for the OBSR AAA and the OBSR AA Ratings. A fund which achieves the OBSR A Rating status is a highly commendable one.

Ratings are formally reviewed on a quarterly basis but may be changed intra-quarter should the judgment alter about the future prospects for a fund. Changes of this type are likely to be predicated by a significant 'event' such as a change in fund manager or a fundamental change in the investment process applied in the management of a fund.

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The OBSR Fund Ratings Service aims to identify funds which will achieve their objectives. The award of a OBSR Rating does not imply, however, that a fund will achieve positive returns, nor is the award an indication of the prospective returns from any particular asset class or asset allocation strategy.

OBSR Ratings are intended to be 'predictive' in nature. The aim is to identify the winning funds of tomorrow.

How ratings are determined

OBSR Fund Ratings are determined on the premise the fund selection process should, whilst taking past performance into consideration, ascribe greater weight to identifying the factors which will affect future performance.

This process demands a much stronger emphasis on a qualitative examination of funds.

There are several key factors that lead to the final OBSR Rating determination. These are:

- Strength of investment process and length of time it has been in place
- Continuity of investment personnel
- Investment style that has proven durable over time
- Clearly defined investment objectives
- Strong and consistent past performance record
- Favourable risk adjusted returns

The OBSR Ratings are determined following in-depth qualitative and quantitative analysis with the emphasis more focused towards qualitative appraisals. Clearly defined routines are followed for consistency.

Discrete Time Period Analysis

The OBSR Fund Ratings Service analyses historical fund performance by looking at results over discrete time periods. It places greater emphasis on short to medium term trends in performance than on long term trends. Examination of performance over long time horizons can severely distort and disguise more recent movements. As the focus is to define the winners of tomorrow, it's believed that placing the emphasis on the short to medium term provides a more valid guide. This contention is supported by the many fund management company takeovers and mergers and fund manager moves which are a feature of the global financial services industry today. Changes to investment processes and/or the appointment of new fund managers can clearly, in many instances, bring into question the relevance of long term historical performance.

Proprietary Classification System

The OBSR Fund Ratings Service uses a proprietary classification system across all regions and asset classes to group funds together by style. This ensures the "like-for-like" comparison of funds that, in turn, enables OBSR to remain agnostic about the type of fund chosen and to focus purely on the best managers. The extensive knowledge of funds, achieved through the rigorous qualitative analysis that is undertaken, allows OBSR to build up a sample group of funds representative of different investment styles. From this, quantitative models are constructed that describe the behaviour of particular styles over specific time periods. The aim is to clearly identify groups of funds that exhibit similar characteristics.

Funds are ranked over discrete time periods according to their performance relative to what are termed their true peer group - the OBSR defined universe. Funds can be moved between these universes at any time, as and when

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changes in style are identified through qualitative analysis. The process also takes into account fund manager changes. Those funds that achieve the highest rankings in terms of consistency within the OBSR defined universe are then analysed under the Capital Asset Pricing Model, to assess their risk/return characteristics. The objective is to determine whether a fund is justifying its fees relative to its systematic risk. This sounds rather technical. In simple terms, the aim is to measure the added value from any given fund. This process highlights funds worthy of further analysis and, thus, the possible consideration of a OBSR Rating.

Qualitative Analysis

There are certain key areas that are focused upon, including an analysis of the strength of the investment team, the quality of its individuals and their experience, the level of research undertaken by the fund manager or the reliance placed on third party information. Also considered are the merits and demerits of funds being managed locally or at head office. The reliance on individual or so-called 'star' fund managers, as opposed to the adoption of a team approach, is also considered. OBSR needs to assess how vulnerable an organisation is to the departure of a specific fund manager, which may result in the OBSR Rating being revised.

OBSR attempts to identify particular strengths which enable it to assess whether an organisation is likely to be better than its competitors at managing specific types of funds. For example, strong asset allocation disciplines are more important in a fund management company which is heavily involved in the management of global or regional funds.

To give further instance, when examining bond funds, consideration is given to the quality of the organisation's skills in the interpretation of macroeconomic data, as well as its ability and resource in the evaluation of credit risk.

Fund Manager Interviews

In-depth interviewing of fund managers is the cornerstone of this aspect of the process. The aim is to gain a thorough understanding of the investment process applied in the management of a fund. This part of the analysis is ongoing. OBSR carry out around 5000 fund manager interviews each year for the OBSR Fund Ratings Service and other research services.

There are a number of areas that are examined as part of the due diligence. OBSR has deliberately avoided the production and completion of questionnaires for fund managers. It's recognised there are great differences in style and OBSR does not wish to be constrained by the need to 'straitjacket' fund managers with its own definitions and questions. Anyone can fill in 'boxes' but there is more required to gain real insight into a fund. Assessment is made based on detailed discussion and, whilst knowing what questions need to be answered, fund managers are encouraged to describe their (and their team's) investment process and approach in their own way.

Ongoing Monitoring

The OBSR Rated funds are monitored continuously and their managers may be contacted or re-interviewed as frequently as quarterly. The objective of regular follow up is to enable the research teams to revalidate the understanding of a fund. Managers of other funds which may aspire to the OBSR Rated status are also interviewed regularly.

Considerable time is spent developing understanding of how different investment management houses operate. Real insight is gained into investment style and to identify areas of expertise (and possibly, weakness).

Contrasting Investment Approaches

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Analysis of investment groups, fund managers and individual funds points to the fact that, at times, very different approaches are taken in managing money in similar areas. Once the strengths of a particular management group have been defined, focus is turned to specifics. A clear picture needs to be gained as to how an individual fund is to be managed and how a company's overall methodology translates into practical day-to-day management.

The most important issue here is to obtain a clear definition of a fund's objective. Examination of attitudes towards managing an investment portfolio actively or passively is undertaken. Growth and value are looked at. The degree of aggression and attitudes towards trading are assessed, including the blend of these in the portfolio. The degree of diversification or concentration in the portfolio is understood. Followed closely is the pursuit or otherwise of the sector themes. Portfolio commitment is looked at in relation to individual sectors and stocks either as core holdings or as temporary features.

Summary

As noted earlier, the award of a OBSR Rating to a fund is intended to be a predictive indication of its quality. While past performance can be an important factor, the essence of the approach is to emphasise this qualitative aspect and the judgment and experience of the teams is critical in the OBSR Rating determination. This is the real added value of the OBSR Fund Ratings Service.

Appendix - Citywire Ratings Detail

Citywire tracks the individual fund managers, the people, rather than the funds. The problem is that fund managers switch jobs so frequently – they might move from one firm to another, or they may simply take on new funds or drop others. Therefore it becomes very important, as these people move around so much, to produce regular and reliable information, which highlights how they perform.

Rankings

Fund managers are ranked compared to their peers. Assessed is how well – or badly – they have done and the results are published in league tables.

Ratings

Also assessed is how much risk managers have taken to produce their returns. A manager who takes lots of risk to produce good returns would be in greater danger of failing to deliver those results in the future. Conversely, a manager who is able to deliver good results without taking too much risk, is perhaps more reliable for the future.

When analysing the risks managers have taken, how they perform compared with the benchmark index of the markets that they invest in is considered. A UK fund manager who invests in large and mid-cap shares should be judged against the FTSE 350 Index; a fund manager investing in the US could be judged against the S&P500 index. Combined is analysis of how risky fund managers are with how well they do compared with their relevant benchmark over a three year period to produce a Citywire Rating.

The very best – fewer than 5% of all UK fund managers - achieve an AAA rating from Citywire. If they do it means that they have performed very well and are among an elite.

Managers who achieve an A or AA rating are still well above average performers. Less than one in five fund managers get any rating at all from Citywire.

Other fund managers will get no rating at all – because they are not good enough or because they have not been running funds long enough to qualify.

One important point is that all this is a mathematical process, which is approved by outside experts, AKG Actuaries.

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Who comes out on top is entirely down to how they perform; not whether they spin a good story, are charismatic or forceful personalities or pay a fee.

Appendix – Investment Managers Association Sectors and Definitions

Sector Definitions and Classification

There are about 2000 investment funds to choose from. But to help identify funds with similar characteristics, they are categorised within a fund classification system of over thirty sectors. The sector categories are broadly divided into funds that aim to provide an 'income' and those designed to provide 'growth'. Each sector is made up of funds investing in similar assets, or the same stockmarket sectors, or in the same geographical region.

Funds are classified in this way to make it easier to find those that meet the investment objectives. This ensures that when comparing one fund with another, we are comparing funds with similar objectives or with similar underlying assets.

Funds principally targeting income

UK Gilts

Funds that invest at least 95% of their assets in Sterling denominated (or hedged back to Sterling) Triple AAA rated, government backed securities, with at least 75% invested in UK government securities (Gilts).

UK Index Linked Gilts

Funds that invest at least 90% of their assets in UK Index Linked Government securities (Gilts).

UK Corporate Bond

Funds that invest at least 80% of their assets in Sterling-denominated (or hedged back to Sterling), Triple BBB minus or above bonds (as measured by Standard & Poors or an equivalent external rating agency – (Moody's Baa or above)). This excludes convertibles.

UK Other Bond

Funds investing at least 80% of their assets in Sterling denominated (or hedged back to Sterling), and at least 20% of their assets in below BBB minus bonds (as measured by Standard and Poor's or an equivalent external rating agency), convertibles and income producing preference shares.

Global Bonds

Funds that invest at least 80% of their assets in fixed interest stocks. All funds which contain more than 80% fixed interest investments are to be classified under this heading regardless of the fact that they may have more than 80% in a particular geographic sector, unless that geographic area is the UK, when the fund should be classified under the relevant UK heading.

UK Equity & Bond Income

Funds which invest at least 80% of their assets in the UK, between 20% and 80% in UK fixed interest securities and between 20% and 80% in UK equities. These funds aim to have a yield in excess of 120% of the FTSE All Share Index.

Funds principally targeting income

UK Equity Income

Funds which invest at least 80% in UK equities and which aim to achieve a yield on the distributable income in excess of 110% of the FTSE All Share yield.

Funds principally targeting capital

UK Zeros

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Funds investing at least 80% of their assets in Sterling denominated (or hedged back to Sterling), and at least 80% of their assets in zero dividend preference shares or equivalent instruments (i.e. not income producing). This excludes preference shares that produce an income.

UK All Companies

Funds that invest at least 80% of their assets in UK equities which have a primary objective of achieving capital growth.

UK Smaller Companies

Funds that invest at least 80% of their assets in UK equities of companies which form the bottom 10% by market capitalisation.

Japan

Funds that invest at least 80% of their assets in Japanese equities.

Japanese Smaller Companies

Funds that invest at least 80% of their assets in Japanese equities of companies which form the bottom 30% by market capitalisation.

Asia Pacific including Japan

Funds that invest at least 80% of their assets in Asia Pacific equities including a Japanese content. The Japanese content must make up less than 80% of assets.

Asia Pacific excluding Japan

Funds that invest at least 80% of their assets in Asia Pacific equities and exclude Japanese securities.

North America

Funds that invest at least 80% of their assets in North American equities.

North American Smaller Companies

Funds that invest at least 80% of their assets in North American equities of companies which form the bottom 20% by market capitalisation.

Europe including UK

Funds that invest at least 80% of their assets in European equities. They may include UK equities, but these must not exceed 80% of the fund's assets.

Europe excluding UK

Funds that invest at least 80% of their assets in European equities and exclude UK securities.

European Smaller Companies

Funds that invest at least 80% of their assets in European equities of companies which form the bottom 20% by market capitalisation in the European market. They may include UK equities, but these must not exceed 80% of the fund's assets. ('Europe' includes all countries in the MSCI/FTSE pan European indices.)

Cautious Managed

Funds investing in a range of assets with the maximum equity exposure restricted to 60% of the fund and with at least 30% invested in fixed interest and cash. There is no specific requirement to hold a minimum % of non-UK equity within the equity limits. Assets must be at least 50% in Sterling/Euro and equities are deemed to include convertibles.

Balanced Managed

Funds would offer investment in a range of assets, with the maximum equity exposure restricted to 85% of the Fund. At least 10% must be held in non-UK equities. Assets must be at least 50% in Sterling/Euro and equities are deemed to include convertibles.

Active Managed

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Funds would offer investment in a range of assets, with the Manager being able to invest up to 100% in equities at their discretion. At least 10% must be held in non-UK equities. There is no minimum Sterling/Euro balance and equities are deemed to include convertibles. At any one time the asset allocation of these funds may hold a high proportion of non-equity assets such that the asset allocation would by default place the fund in either the Balanced or Cautious sector. These funds would remain in this sector on these occasions since it is the Manager's stated intention to retain the right to invest up to 100% in equities.

Global Growth

Funds which invest at least 80% of their assets in equities (but not more than 80% in UK assets) and which have the prime objective of achieving growth of capital.

Global Emerging Markets

Funds which invest 80% or more of their assets directly or indirectly in emerging markets as defined by the World Bank, without geographical restriction. Indirect investment e.g. China shares listed in Hong Kong, should not exceed 50% of the portfolio.

The above sectors also require funds to be broadly diversified within the relevant country/region/asset class. Funds that concentrate solely on a specialist theme, sector or single market size (or a single country in a multi-currency region) would be incorporated in the Specialist sector (see below), or in the case of tech funds, in the Technology & Telecommunications sector.

Funds principally targeting capital protection

Money Market

Funds that invest at least 95% of their assets in money market instruments (i.e. cash and near cash, such as bank deposits, certificates of deposit, very short term fixed interest securities or floating rate notes).

Protected/Guaranteed Funds

Funds, other than money market funds that principally aim to provide a return of a set amount of capital back to the investor (either explicitly guaranteed or via an investment strategy highly likely to achieve this objective) plus some market upside.

Specialist Sectors

Specialist

Funds that have an investment universe that is not accommodated by the mainstream sectors. Performance ranking of funds within the sector as a whole is inappropriate, given the diverse nature of its constituents.

Technology & Telecommunications

Funds that invest at least 80% of their assets in technology and telecommunications sectors as defined by major index providers.

Appendix - Sources of Information

Bloomberg Financial Glossary (www.bloomberg.com)

FTSE The Index Company

Skandia

Investment Managers Association

Rayner Spencer Mills

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