

# Standard Life MyFolio Pension Funds

## Fund Information – December 2010



### Standard Life MyFolio II Pension Fund (Fund Code – AAMI)

**This document is intended for use by individuals who are familiar with investment terminology. Please contact your financial adviser if you need an explanation of the terms used.**

#### Fund Description

The fund is invested in the Standard Life Investments MyFolio II Fund which aims to provide a total return from a combination of income and capital appreciation over the longer term. Investing mainly in a range of collective investment schemes managed or operated within the Standard Life group of companies, the fund achieves a broad exposure to diversified investments, including equities, absolute returns, fixed and variable rate interest bearing securities and immovable property. The fund may also invest in transferable securities, money-market instruments, deposits and cash. Typically, the fund will have a preference towards lower risk assets, such as bonds.

The value of investments within the fund can fall as well as rise and is not guaranteed – you may get back less than you pay in.

The fund may use derivatives for the purposes of efficient portfolio management, reduction of risk or to meet its investment objective if this is permitted and appropriate.

The sterling value of overseas assets held in the fund may rise and fall as a result of exchange rate fluctuations.

#### Composition by Fund Exposure

Source: Standard Life Investments, effective 31/12/2010

SLI UK Corporate Bond	32.7%
SLI Global Index Linked Bond	13.5%
SLI UK Gilt	12.1%
SLI UK Equity Growth	11.3%
SLI Global Absolute Return Strategies	8.4%
SLI American Equity Unconstrained	7.7%
SLI UK Property	5.0%
SLI Higher Income	4.7%
SLI AAA Income	2.9%
Aberdeen Emerging Markets	2.0%
SLI Asian Pacific Growth	1.5%
SLI UK Smaller Companies	0.4%
Cash and Other	-2.2%

Cash and Other - may include bank and building society deposits, other money market instruments such as Certificates of Deposits (CDs), Floating Rate Notes (FRNs) including Asset Backed Securities (ABSs) and allowances for tax, dividends and interest due if appropriate.

## General Risks

**As all the MyFolio funds are multi-asset investments the relevance of these general risks will depend on the specific MyFolio fund and associated risk level chosen.**

Prospective investors in the fund should be aware that there are risks inherent in the holding of securities within the funds

The price of stocks, shares and other securities on financial markets can move unpredictably. Many factors affect prices, including announcements by the issuer of a security, economic and political events and views of prospective events. Investment in a fund should be regarded as medium to long-term. There is no guarantee that the objective of a fund will be achieved.

The capital value from shares in a fund can go down as well as up, and are not guaranteed. On realisation of a unit holding an investor may receive back less than the original investment.

Past performance is not a guide to the future.

Investments may be made in assets denominated in various currencies, and movements in exchange rates may have a separate effect on the value of and the returns from such investments.

The yields offered by funds investing in fixed interest securities reflect, in part, the risk rating of the issuers of these securities.

A fund can invest in collective investment schemes which can themselves invest in a diverse range of other assets. These underlying assets may vary from time to time but each category of asset (which may include equities, bonds or immovable property) has individual risks associated with them. The fund may not have any control over the activities of any collective investment scheme invested in by the fund.

If the value of a fund falls significantly, it may not be possible to maintain the same diversification of risk as the fund may hold a narrower range of assets.

## Risk Factors

There are a number of risks that are caused by different factors or which affect different investments to varying extents. Some risks affect most investments and some are pertinent to particular types of investments.

Detailed below are some specific risks which are pertinent to the MyFolio fund range.

**1. Market risk** is the risk that market conditions can negatively impact investment returns. For instance, the prices of securities are dependent on general supply and demand that fluctuates independently of any security in particular. Market risk is generally dependent on economic conditions, such as inflation, consumer sentiment, or credit availability.

**2. Emerging markets** Emerging markets tend to be more volatile than more established stock markets and therefore your investment may be subject to greater risk. Political and economic conditions should also be taken into account.

The reliability of trading and settlement systems in some emerging markets may not be equal to that available in more developed markets, which may result in delays in realising investments within the funds.

**3. Financial risk or default/credit risk** is the risk that a business will not be able to make payments due to its debt load. Interest and principal must be paid on borrowed money—failure to make payments can force the business into bankruptcy. A business with large amounts of debt relative to income does not have much reserve for unexpected expenses or lower income, and can fail if the economy sours or if it encounters some other factor that lowers income or increases expenses.

Funds investing in corporate bonds are therefore subject to default on the interest owed and/or the ability of the bond issuer to return capital on the redemption date.

The risk of this happening is usually higher with bonds classified as 'sub-investment grade'. These may produce a higher level of income but at a higher risk than investments in 'investment grade' bonds. In turn, this may have an adverse impact on funds that invest in such bonds.

**4. Interest rate risk** is a risk that lowers yields or returns due to changes in the prevailing interest rate. Interest rate risk can affect different securities in different ways. The price of bonds in the secondary market, for instance, varies inversely to interest rates i.e. when interest rates rise, the price of bonds drops, and vice versa.

**5. Inflation risk** is a risk that lessens real returns due to the decreasing purchasing power of the returns.

**6. Liquidity risk**, which is the risk that an investment cannot be sold quickly for a reasonable price. Real estate or property, for instance, is an illiquid investment because it can take considerable time to sell unless it is sold below market value. Other markets can also be less liquid and therefore can be more volatile such as smaller companies securities or emerging markets.

**7. Property** The valuation of property is a matter of judgment by an independent valuer. The value of capital and income will fluctuate as property values and rental incomes rise and fall.

Where investment in property is made, either directly or indirectly, it should be noted that due to the nature of these assets, significant volatility may be experienced during times of extreme market turmoil.

The underlying investments of property funds can generally be less liquid than equities or bonds and, as such, purchases and sales may be a long and uncertain process. At times, cash may remain uninvested if it proves difficult to make purchases. Equally, there may be times when property has to be sold quickly and for less than expected.

**8. Business risk** is any risk that can lower a business's net assets or net income that could, in turn, lower the return of any security based on it. Some business risks are sector risks that can affect every company in a particular sector, while some business risks affect only a particular company. Higher mortgage rates can increase the business risk for real estate or construction companies, for instance. However, even similar businesses can have widely different risks depending on the quality of management and the resources that are available to the business.

**9. Event risk** is the risk of an event that can have an impact on the potential return of an investment. Generally, event risk is risk that affects a single company and its securities, such as the loss of a major lawsuit or an accounting scandal. Sometimes event risk can affect a number of securities, such as the political risk that a country will do something that will drive down the prices of any securities issued by companies located in there, such as increasing taxes, discouraging foreign investment, or in extreme cases, nationalizing the companies without proper compensation.

**10. Tax risk** is the risk that a taxing authority will change tax laws which could have a negative impact on investment. Higher taxes on investment income reduce real returns and can lower the prices of investments in the secondary markets. Higher taxes on businesses will lower their net income, which will usually lower the stock price, and may lower its bond prices in the secondary market if their credit rating is lower as a result of the lower income.

**As all the MyFolio funds are multi-asset investments the relevance of these specific risks will depend on the specific MyFolio fund and associated risk level chosen.**

### **Absolute return risks**

These risks are specifically applicable to MyFolio funds which may invest in absolute return funds (currently MyFolio I, II, III, IV & V and MyFolio Multi-Manager I, II, III, IV & V).

It is important when considering absolute return funds or absolute return investing not to confuse this with guaranteed funds or products which guarantee a positive nominal return over any period.

### **Intangible risks and volatility**

The risks of a fund can be measured in different ways. Volatility (a measure of how much a fund's price has varied in the past) will not necessarily always provide a complete picture of a fund's risk. Some risks are not represented in the movement of the unit price until they emerge and only then will they have a significant effect on a portfolio.

Absolute return funds can invest in a wide variety of investment strategies and assets. Below we document the specific heightened risks applicable to these types of funds rather than an exhaustive list of risks for potential strategies or asset classes.

### **Extensive use of derivatives**

In order to achieve its objectives an absolute return fund utilises a combination of traditional investments (such as equities, bonds and foreign exchange) and advanced techniques where it can use derivatives extensively. Derivatives are financial instruments which derive their value from an underlying asset, such as a share or bond, and are used routinely in global financial markets. Used carefully, derivatives offer an effective and cost-efficient way of investing in markets. However, derivatives can lead to increased volatility of returns in a fund, thus requiring a robust and extensive risk management process. While the fund will not borrow cash for investment purposes, the total value of exposures to markets will routinely exceed the fund's net asset value. Derivatives may be Exchange Traded or Over the Counter (OTC).

### **Use of 'short' positions**

Typically, UK authorised collective investment schemes invest on a 'long only' basis. Absolute Return funds, by employing certain derivative techniques, will establish both 'long' and 'short' positions in individual markets and sectors. Investing on a 'long' basis means that the value of the derivative will rise or fall in the same direction as the underlying market value of the asset from which it is derived. If investments are made on a 'short' basis the value of the derivative will rise and fall in the opposite direction to the underlying market value of the asset from which it is derived.

### **Counterparty risk**

The Investment Manager may use one or more separate counterparties to undertake derivative transactions on behalf of a fund. From time to time a fund may be required to pledge collateral, and when this is required it will be paid from within the assets of a fund. When a derivatives contract moves in favour of a fund there is a risk that the counterparty may wholly or partially fail to honour their contractual obligations under the arrangement. The Investment Manager usually assesses the creditworthiness of counterparties as part of the risk management process and will ordinarily hold collateral to mitigate this.

### **Active Fund Management**

The majority of risks within traditional investment funds are driven by the type of investments held (i.e. equities, fixed interest or property, etc). The risks that fund management decisions add are generally of a smaller magnitude than those of the asset types themselves. Funds which employ an absolute return strategy may not have a structure where most of the returns are generated from traditional asset types. Rather, they may derive most of their returns from very specific strategies. As a result of this, the risks of the fund may be driven primarily by these fund management decisions, and less by the characteristics of the underlying traditional asset types.

### **Correlation**

The fund will invest in a diverse set of investment strategies. While the breadth of the strategies is significant, should they start to exhibit closer correlation i.e. move in the same direction as one another, the fund may be subject to a higher level of risk and volatility than anticipated.