



MANAGING RISK IN THE GOVERNED PORTFOLIOS

Our Governed Portfolios are a risk-managed Centralised Investment proposition (CIP) that targets an annual level of risk defined as volatility. This leaflet aims to explain what volatility is and how we manage this risk.

WHAT IS VOLATILITY?

Volatility, or standard deviation, quantifies how much a series of numbers varies around its mean, or average return. It provides a precise measure of how varied a fund's returns have been over a particular time frame both on the upside and the downside.

With this information, you can judge the range of returns a fund is likely to generate in the future. The more a fund's returns fluctuate from month to month, the greater its standard deviation.

VOLATILITY IN ACTION

A fund that gained 1% each and every month would have a standard deviation of zero, because its monthly returns didn't change from one month to the next. At the opposite end of the extreme, a fund that gained 5% one month, 25% the next, and that lost 7% the next would have a much higher standard deviation because its returns have been more varied.

Calculating volatility allows a fund's performance swings to be captured into a single number. For most funds, future returns will fall within one standard deviation of its average return 68% of the time and within two standard deviations 95% of the time.

Let's use an example of a fund with a standard deviation of four and an average return of 10%. Most of the time (or, more precisely, 68% of the time), we can expect the fund's future returns to range between 6% and 14% or its 10% average plus or minus its standard deviation of four. Almost all of the time (95% to be exact), its returns will fall between 2% and 18%, or within two standard deviations of its mean.

TARGETING VOLATILITY IN THE GOVERNED PORTFOLIOS

All nine of the Governed Portfolios are forward-looking and target a specific level of annual volatility.

Investment choice	Target volatility range	
	Min	Max
Governed Portfolio 1	9.5%	11.6%
Governed Portfolio 2	7.7%	9.4%
Governed Portfolio 3	4.1%	5.0%
Governed Portfolio 4	11.3%	13.8%
Governed Portfolio 5	9.5%	11.6%
Governed Portfolio 6	5.9%	7.2%
Governed Portfolio 7	13.1%	16.0%
Governed Portfolio 8	11.3%	13.8%
Governed Portfolio 9	7.7%	9.4%

Each quarter, we ask Moody's Analytics to use their stochastic modelling expertise to estimate the annual volatility of each of the portfolios in current market conditions. In the event that a portfolio's volatility is out-with its target range, the Investment Advisory Committee (IAC) would review the strategic asset allocation to bring it back within the target range.

It's important to remember that prices can fall as well as rise meaning you may not get back the value of your original investment.



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