



P-Solve

RISK MANAGEMENT SOLUTIONS

# Briefing Note – Equity

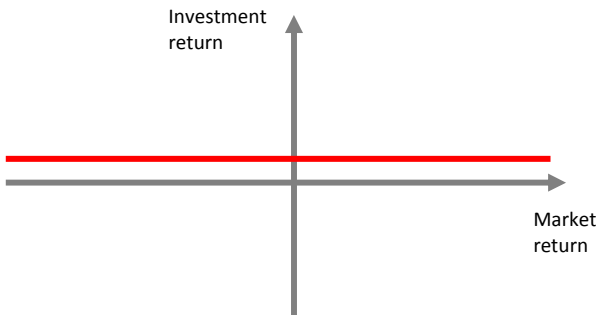
## “I agree with Nick...”

April 2010

Labour are the new Conservatives, the Conservatives are the new New Labour and everyone loves Nick Clegg. Understanding politics is difficult at the best of times but fundamentally it is about understanding what you want and finding the people that best meet your needs. Equity investing is, strangely, quite similar – there are many choices but how do you know which is best for you? This note explores equity investing and how it can be tailored to different needs.

### The conservative approach (or is that Labour?)

A vote for the Labour party, we are told, is a safe vote. So what is the equivalent in equity investment? Well, for the purposes of this note, let us assume that a vote for Labour is equivalent to putting the money under the mattress – you will not suffer any bust if markets fall but equally the price you pay for that is very little potential return. The graph below shows the return on this investment for different equity market movements.

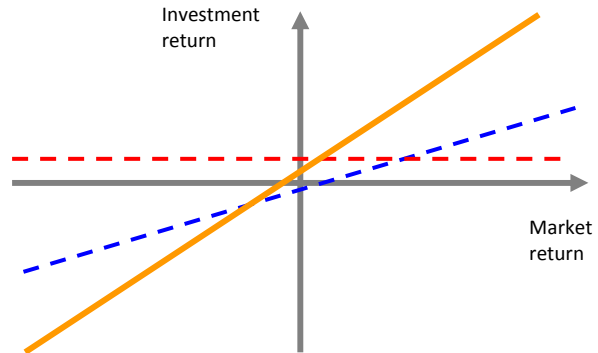


### In brief:

- Equity investing is similar to politics – choose a route that best meets your needs
- It is different to politics in that you are able to choose different pieces of different approaches
- Shaped equity solutions allow investors to better meet their needs by tailoring their exposure to equity markets whether this means protection from falls or exposure to gains

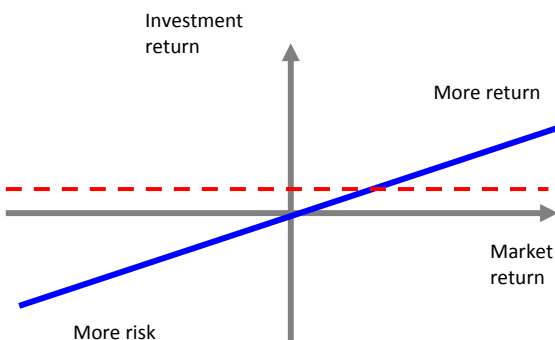
### The Clegg Effect

The Lib Dems have had a fantastic election campaign so far. They are painting themselves as the only party representing “real change”. So in our parallel equity world how could this look? Well, being agents of change could mean that the potential return is far more significant than any of the other two parties. However, the Lib Dems have not been in power for many years and are an unknown so the price of this return could be more potential risk.



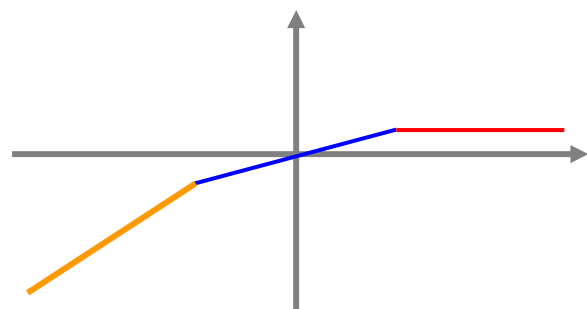
### The “New Conservative” approach

According to Nick, all the main parties are the same these days, aren't they? Whilst everyone would like to agree with Nick, David would argue that the Conservatives offer more potential return. At the same time Gordon argues that there are questions to be raised over the Conservatives' potential performance owing to them not having been in power for over a decade, thus resulting in greater risk. For the purposes of this note we could represent this as below:



### Hung Parliament – The worst of all worlds

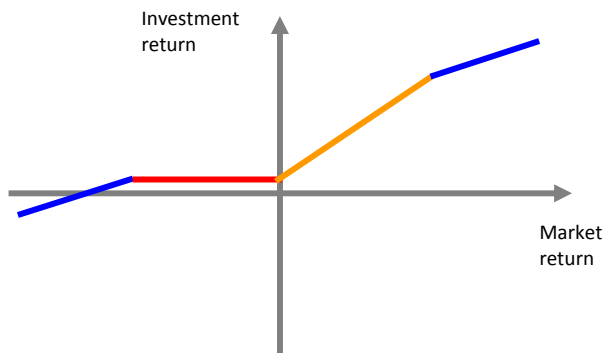
The concept of a hung parliament is something that the British people have had to understand and get used to. There is a fear that with a hung parliament the outcome will be generally negative and not what people voted for because of the ensuing political wrangling and negotiation. For example, current polling is predicting that each party will receive approximately 33% of the vote so we can assume that a hung parliament means that the outcome has to be an equal combination of the above three lines – the issue is that the negotiation means that the outcome may not be the best of each line as shown below:



## Shaping Equity – The perfect combination

This is where our equity market parallel diverges: equity investment is not subject to the same wrangling and negotiation – the equity investor can pick and choose the best parts of each potential outcome in order to meet their needs.

If we had to pick 33% of each line then one possibility could be the following:



In this example the investor is aiming to get the immediate benefit of a Lib Dem change, with the protection of Labour. However a third of the vote has to be allocated to the conservative approach which means accepting a slightly lower return for large positive or negative market moves.

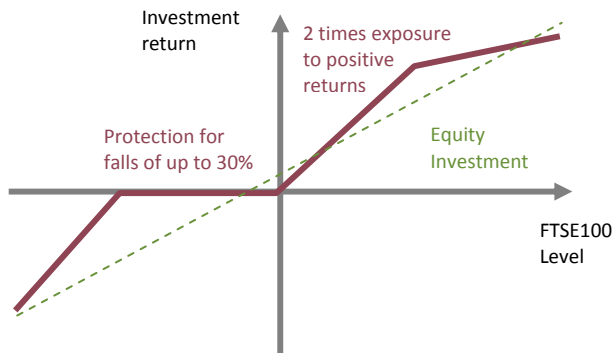
## Back to the real world – Know your needs

As we have said before, the key thing with equity investing, as with politics, is to do what is best for your needs. For an equity investor, understanding what you need is the key to success. The questions below touch upon some of the things you may want to consider in assessing your needs:

<b>How much return do you need?</b>	Your investment objective will define your return requirements
<b>How quickly do you need your return?</b>	Some investors want maximum exposure to markets in order to meet their objective, others are more comfortable with a slow and steady approach
<b>Is there a maximum return?</b>	Sometimes we don't need a return in excess of a set level
<b>How much pain can you take?</b>	How much can you afford your equity portfolio to lose before it hurts?

## Meeting your needs – Shaped equity

Modern equity investment tools mean that you don't have to settle for a traditional investment that makes money if things go up and loses money if things go down. Shaped equity solutions allow investors to tailor their exposure to equity markets to suit their needs. We give an illustration below of a shape that is achievable in current market conditions. This shape is for an investor with a target return of Cash + 6% per annum over a three year term (based on exposure to the FTSE100 Index) who has worries about equity market falls:



The shape shown provides an enhanced return (2 times equity market returns) up to the point where the investor achieves their objective. The investor does not need any returns above the Cash + 6% level and so the returns increase at a slower rate above this level. For equity market falls the investor is protected for falls of up to 30%. Below that level the investor will still be better off than in a traditional equity investment.

The solution shown above is a passive investment that, like most passive investments, can be liquidated prior to the three year maturity. It enjoys the benefits of passive type fees yet has the added advantage of being tailored to your exact needs.

## Summary

Equity investing, as with politics, is all about choosing something that best meets your needs. Where politics has the uncertainty of hung parliaments and political infighting, shaped equity solutions allow investors to take control and shape their exposure to markets in a way that meets their needs (and not the needs of the average population).

If you are interested to learn more about shaping equity returns, please visit our website at [www.psolve.com](http://www.psolve.com) to watch our bite-size training videos on the subject. Alternatively, please talk to your usual P-Solve contact who shall be happy to explain to you how a shaped equity solution could form a fundamental part of your strategy.

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