AMP Capital Investors Limited
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Methodology and assumptions

Standard risk level

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Understanding your fund's risk level

Under new regulations which came into effect on 22 June 2012, shorter product disclosure statements (PDS) were introduced for simple managed investment schemes (funds). These PDSs are required to describe the risk level of the fund in the form of a summary.

A standard risk level is based on the expected frequency of negative annual returns over a 20-year period. This frequency then translates to a 'risk band' with an associated 'risk label', based on the following table:

Risk band	Risk label	Estimated number of negative annual returns over any 20 year period
1	Very low	Less than 0.5
2	Low	0.5 to less than 1
3	Low to medium	1 to less than 2
4	Medium	2 to less than 3
5	Medium to high	3 to less than 4
6	High	4 to less than 6
7	Very high	6 or Greater

For example, if your fund has a risk band of 4, you could expect between 2 and 3 negative annual returns over your 20-year investment period, as a normal reflection of the impact of economic cycles on your fund's performance.

In determining the risk labels, a wide range of possible economic scenarios and investment returns for different asset classes are projected. In order to generate these projections, assumptions are made about the future levels of expected return from investing each asset class, as well as the fact that investment returns are uncertain (i.e. there is a range of possible outcomes, the risk of investing).

Each of the main economic regions (i.e. the US, UK, Japan, Europe, Asian ex-Japan, emerging markets, and other individual countries, such as Australia) are considered separately and then combined into blocks in the appropriate weights to form the desired asset class combination for each fund.

By projecting a large number of possible economic outcomes and asset class returns, it is possible to estimate the frequency of negative returns expected over a 20 year period for a given fund with a particular asset allocation.

This includes the following considerations:

1. The strategic asset allocation weights for the fund;
2. The use of forward looking asset class assumptions, rather than historical returns;
3. Gross of tax (ignoring the impact of franking credits);
4. Gross of administration fees, but net of investment management fees; and
5. Any excess return (above benchmark) is offset by investment management fees.

In summary, the risk level for a fund is based on industry guidance to allow investors to compare different funds, using a common basis of comparison (the number of negative annual returns expected over a 20-year period, based on the fund's strategic asset allocation). The risk level is not a complete assessment of all forms of investment risk associated with the fund. For example, it does not detail what the size of a negative return could be, or the potential for a positive return to be less than you may require to meet your objectives. Further, it does not take into account the impact of administration fees and tax on the likelihood of a negative return. Investors should still ensure they are comfortable with the range of risks and potential losses and gains associated with their chosen investment fund.

Contact us

If you would like to know more about how AMP Capital can help you, please visit www.ampcapital.com.au, or contact one of the following:

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