ARC Private Client Indices Methodology

What are the ARC Private Client Indices ("PCI")?

ARC PCI is a set of risk-based indices designed to be used by private clients and their advisers in assessing the performance of any discretionary portfolio with a non-specialist mandate. There are four PCI series for each currency, designed specifically for investors with Sterling, US Dollar, Euro or Swiss Franc as their reference currency. These cover the following risk categories:

Private Client Index	Relative Risk to World Equities
ARC Cautious PCI	0 – 40%
ARC Balanced Asset PCI	40 – 60%
ARC Steady Growth PCI	60 – 80%
ARC Equity Risk PCI	80 – 110%

The PCI provide a unique insight into the actual returns being generated by investment managers for their discretionary private client portfolios. The indices are based on the real performance numbers delivered to discretionary private clients by participating investment managers.

There are no pre-set asset allocations; no asset class restrictions; no concentration limits; and no index performances used. Only actual performance numbers are included in the calculation of the indices.

The PCI are designed to provide an accurate reflection of the actual returns that a private client should expect from a discretionary portfolio manager for a given risk appetite. By comparing performance with the relevant PCI index, the investment manager is free to use any and all investment strategies, vehicles and structures in the pursuit of the maximum return per unit of realised volatility.

The indices are available free of charge to anyone through a web-based subscription service which can be found at www.suggestus.com. Participating investment managers can use the PCI performance series in private client reporting and marketing activities.

PCI Calculation Methodology

At the end of every month, using a defined control group of indices and funds, the PCI series are estimated for the previous month. These estimates are made available to both participating investment managers and subscribers a few working days after the end of each quarter. Actual performance data (**net of fees**) is then gathered from the participating investment managers over the month following quarter end. For each Data Contributor, a performance average in each of the four PCI risk categories is calculated as data becomes available. The deadline for all data submissions by Data Contributors is the middle of the following quarter.

The simple average of all the Data Contributor portfolios within each PCI category is then calculated with weightings applied to reduce the influence of larger managers and published as a performance series with a base of 100 as at the end of December 2003.

The aim is to finalise the PCI monthly performance numbers around 4 weeks after each relevant quarter end. Data Contributors and subscribers are informed when the finalised PCI performance data is available. No recalculations will be published, ensuring that historic PCI data remains unchanged.

Data Integrity

All Data Contributors have undertaken to ensure that data supplied by them for PCI accurately reflects the investment performance of their discretionary private client team.

However, ARC recognises that data integrity is critical to the acceptance of the PCI indices as suitable performance yardsticks. Thus, the data verification task is taken extremely seriously. Each quarter, data contributors are asked to sign off on their data submissions and a series of validation checks are made.

ARC reserves the right to exclude any data that it has reason to believe does not meet the required standard.

Monthly performance data **net of fees** is collected from participating investment managers (Data Contributors) on a quarterly basis. Managers are asked to provide actual performance numbers for all their unconstrained discretionary private client portfolios.

Only actual portfolio performance data goes into the PCI, **no model or synthetic figures are accepted for inclusion**. Other data that may be provided for comparison in the PCI reports, but not for inclusion in the indices, is as follows:

- GIPS Composite Numbers Those investment managers who have adopted the GIPS reporting standard supply the GIPS performance data for each of their performance categories.
- Fund Performance Data Investment managers that offer a unitised version of their discretionary private client investment solutions may choose to supply performance data for these funds as a proxy for that being delivered by their discretionary private client business as a whole.
- Audited Model Performance of model portfolios is not accepted for inclusion in the PCI calculation, but may be submitted by Associate PCI members for reporting purposes provided that ARC can verify that the performance numbers being submitted are representative of the performance of typical discretionary portfolios.

Data Validation

For those participating investment managers providing actual portfolio performance information (the preferred type of submission) the following guidelines are used:

- Discretionary mandates only
- Portfolios should be larger than £250,000 (or currency equivalent)
- Each portfolio should have been established at least 12 months
- Performance numbers are to be given net of all fees and charges
- Monthly performance numbers should be provided wherever possible
- Heavily constrained portfolios may be excluded
- Data Contributors should provide at least 20 portfolios per PCI risk category

Consistency of portfolio submission by each Data Contributor is carefully monitored by ARC to minimise the potential impact of survivorship bias.

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PCI Category Allocation

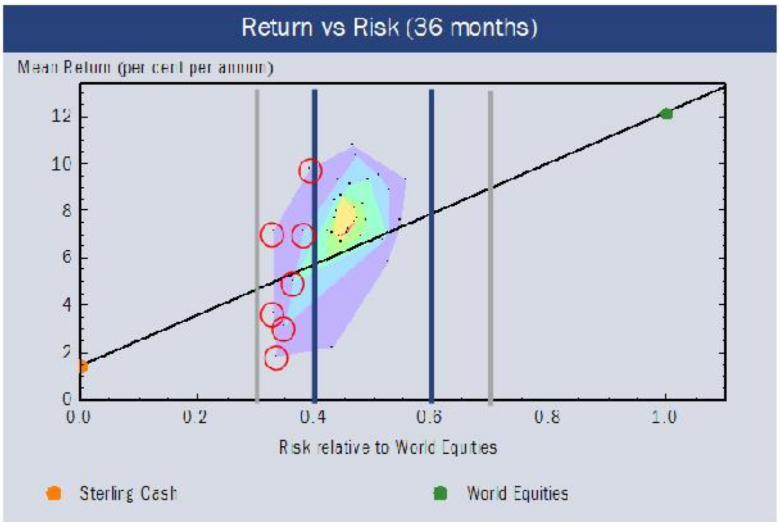
Each contributed data series is assigned to a PCI risk category by ARC according to its estimated historical relative risk to world equities. Where the historical relative risk profile is border-line between two PCI categories or where a data series has less than a three year track record, ARC may ask the Data Contributor for guidance as to which risk category would be most appropriate.

It is recognised that active asset allocation can cause the relative risk of a data series to change over time. In order to bring an element of stability to each of the PCI peer groups, once a data series has been allocated a PCI category, a 10 percentage point deviation in relative risk is tolerated.

Thus, the tolerance bands are as follows:

Private Client Index	Relative Risk to World Equities		
	Lower limit	Standard Band	Upper limit
ARC Cautious PCI	0%	0 – 40%	50%
ARC Balanced Asset PCI	30%	40 – 60%	70%
ARC Steady Growth PCI	50%	60 – 80%	90%
ARC Equity Risk PCI	70%	80 – 110%	120%

By way of example, the Sharpe chart below shows a (potential) distribution of contributed data within the Sterling Balanced Asset PCI category over a three year time frame. A line has been drawn around the outermost points, then the next set of points in and so on until all points have been incorporated on a colour contour. By shading the contours, the median risk-return profile can be identified as the darkest red shading. However, note that a few of the outlying data points are outside the defined risk band.



The blue lines show the official risk banding for the Balanced Asset PCI (0.4 to 0.6 relative risk).

The grey lines show the upper and lower relative risk thresholds for contributed data.

The portfolios highlighted with a red circle would not automatically move into the Cautious PCI category (0.0 to 0.4 relative risk).

They would remain in the Balanced Asset PCI category unless and until they breached the grey line. This approach ensures tactical asset allocation decisions are not treated as strategic changes.

By implementing this process of PCI category management, it is possible to differentiate between tactical (i.e. temporary) risk profile changes and strategic (i.e. permanent) alterations in investment objective.

For more information

Please get in touch with the PCI Team by emailing PCI@assetrisk.com

You can sign up to receive the monthly estimates, thought pieces and quarterly PCI reports at www.suggestus.com.