Skandia
for the international investor

principles of investment

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Fidelity INTERNATIONAL

understanding diversification

This factsheet highlights the importance of spreading the risks associated with investing and how they can be reduced by creating a balanced investment portfolio.

reduce the risk: diversify

Risk is a necessary and constant feature of investing: shares fall; economic conditions fluctuate; companies can occasionally go bankrupt. Indeed the very returns these assets generate are typically there to compensate investors for the risk they take.

There are many different asset classes available to invest in, each possessing different risk characteristics. Whilst the risks attributable to each asset class cannot be avoided, when part of a diversified portfolio and managed collectively, risks can be diluted.

The key is not to put all your eggs in one basket.

The adage is the fundamental principle of diversification – spread an investment across a wide range of asset classes and sectors, and thereby avoid the risk that a portfolio will be overly reliant upon the performance of one single asset.

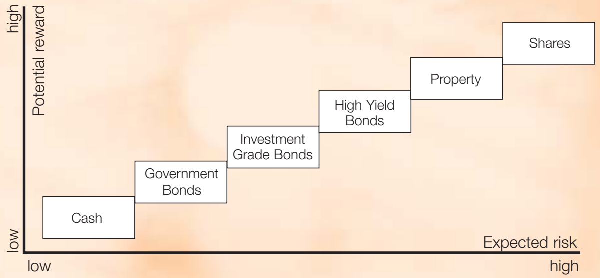
asset allocation

The best way to spread risk is to invest across several different asset classes. The principal choice is between shares, bonds, cash and perhaps other 'alternative investments' such as property.

The different 'risk/return' characteristics of each asset type are illustrated in this graph.

The aim is to select asset classes that behave in different ways; the theory being that when one asset class is underperforming, the other is outperforming. For example, bonds often behave differently to shares by offering lower but more consistent returns.

This provides a 'safety net' by reducing many of the risks associated with reliance upon one particular asset.

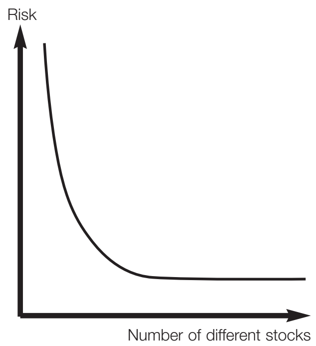


share-specific risk

The well-documented demise of what was once one of America's biggest companies, Enron, has illustrated the danger associated with investing in seemingly safe, large, multinational organisations. Whilst the impact would have been catastrophic to an individual with their life savings in the company, an investor holding Enron as part of a well-diversified portfolio would have seen the effect considerably diluted.

By investing in as little as 20 different stocks, the majority of share-specific risk can be reduced, as illustrated.

Also, it is wise to ensure that different shares do not represent a stake in companies very similar in size as the risks associated with, for example, smaller companies will span the breadth of a portfolio.



sector exposure

Depending on what they sell, produce, or what services they provide, companies can be classified by 'sector'. For example Wal-Mart resides in the 'Retail' sector and BP in the 'Oil and Gas' sector.

Just as it is important to spread an investment across different companies, it is also wise to select companies from different sectors.

For many reasons, companies within different sectors perform in very different ways. By diversifying across sectors, an investor can access stocks with high growth expectations, without overexposing their portfolio as a whole to undue risk.

Commodities or Technology shares are seen as having higher growth expectations, but stability can be achieved by holding stocks across sectors with lower growth expectations such as Pharmaceuticals or Insurance.

Picking the right balance of these depends upon your own risk profile.

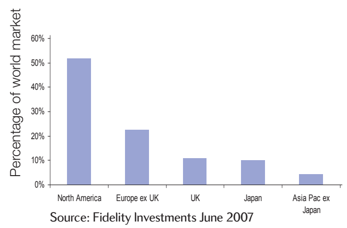
geographical location

You might feel better investing most of your portfolio in your home market – but is it the most sensible option? According to the MSCI World Index, the United States makes up more than half the world market and Europe (excluding the UK) 23.7%, as shown below.

This table shows the best and worst performing markets and asset classes over recent years. As you can see, to be able to invest in the 'winners' and avoid the 'losers' would indeed have led to a powerful performance, but look how hard it is to spot these.

The distribution is very wide, therefore it is wise to invest across a variety of global markets to dilute the risk.

it can pay to go global



Source: Fidelity Investments June 2007

make sure you have a global view

	US S&P 500 Composite	UK FTSE All share	Europe MSCI Europe (ex. UK)	Japan MSCI Japan	S.E. Asia MSCI Pacific	UK Bond ML UK Gilts All maturities	Intl. Bond CGBI WGBI All maturities	Cash JPM UK Cash 1M
1997	38.2	23.5	30.0	-20.5	*-28.0*	14.7	4.2	6.8
1998	26.8	13.8	32.5	4.1	*-7.3*	19.5	14.0	7.7
1999	24.6	24.2	21.6	67.0	47.8	*-1.2*	*-1.2*	5.7
2000	-2.1	-5.9	0.2	*-22.4*	-8.5	8.9	9.6	6.1
2001	-9.8	-13.3	-19.9	*-27.4*	-7.0	3.2	1.6	5.4
2002	*-29.8*	-22.7	-27.6	-18.7	-14.8	9.4	8.0	4.1
2003	15.3	20.8	29.2	22.4	32.2	*2.1*	3.3	3.8
2004	3.0	12.8	14.1	8.1	20.8	6.6	*2.9*	4.5
2005	16.9	22.0	24.5	40.5	28.4	7.9	*4.1*	4.8
2006	1.2	16.7	19.6	-6.7	16.8	0.6	*-6.9*	4.8

Blue = best performing *Red* = worst performing Source: Fidelity Investments June 2007

investment style

The final facet of diversification highlights the importance of ensuring that an overall portfolio has exposure to varying types of investment styles. Some shares are held as investors believe their value is likely to significantly grow over the long term, known as 'growth shares', others are held as they are regarded as being cheaper than the intrinsic worth of the companies in which they represent a stake, known as 'value shares'.

It is important to have a blend of styles to ensure that the portfolio as a whole is not overly vulnerable to the risk/return characteristics of each individual share type.

summary

The key benefit of diversification is the reduction of an investment portfolio's overall risk. This is achieved by reducing the reliance upon one particular asset class, share, sector or geographical region to generate returns.

The premise of diversification is a simple one; whilst one asset in an investment portfolio may be declining in price, another unrelated asset may be gaining; maintaining the balance required for a healthy portfolio.

In practice, it is difficult to create the perfect balance of assets, sectors, investment types and markets to suit a specific investment objective and risk profile. However, the innate diversification qualities of collective investment schemes, combined with the 'know-how' of a financial adviser, can present a sound, individually tailored diversification solution.

A financial adviser will be able to recommend investment funds to suit your individual investment objectives and risk profile.

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