

Understanding our recommendations

An explanation of our recommendations and of the ratings we use on shares.

Our recommendations are never made in isolation but in the context of a diversified portfolio. A cornerstone of our investment philosophy is that the most prudent and effective way of investing is to hold a diversified portfolio of assets, both across and within asset classes.

Stock recommendations – Portfolio view

We have a two-tier recommendation structure:

1) We firstly classify stocks under one of our three portfolio classification ratings: Core, Supplementary and Niche.

These classifications are based primarily on risk. Stocks that we believe are more defensive, less volatile and lower risk are classified as Core; the next tier is rated Supplementary; while the higher-risk stocks are classified as Niche.

The terms relate to our view on the role each stock should play in a portfolio and signal how much of a portfolio should be invested in a particular stock.

Stocks rated 'Core' should be core holdings in a portfolio while stocks rated Niche should represent a much smaller proportion.

In general terms, we recommend around 70% of a portfolio be invested in stocks rated Core, with Supplementary-rated stocks representing 20% to 30% and Niche no more than 10% of a portfolio.

2) We provide a portfolio view rating on each stock. We have three valuation based portfolio view ratings: Add, Hold, Reduce.

These portfolio view ratings reflect our current view of the attractiveness of the current share price of each stock. To determine these ratings, we take into account our estimate of fair value as well as broader factors, such as the outlook for the stock's sector and its possible performance relative to the broader market.

Stocks rated Add are those that we believe offer good relative value and should perform better than the market average over the coming two to three years. Stocks rated Hold are those we believe will perform in line with the broader market, while those rated Reduce are, in our view, expensive and/or likely to lag the market average over the coming two to three years.

Other issues

Analyst ratings: Overweight, Neutral, Underweight – We have a team of institutional analysts, each of whom research individual stocks. We draw on this research and it forms the basis of our ratings. We do not use their ratings directly because their recommendations are stock specific, have no portfolio context and they are written primarily for institutional investors, not private investors. As such, they are, at times, unsuitable for private investors.

Price targets – Price targets are calculated by our institutional analysts and are based on their discounted cash flow valuation model, along with any adjustments made to account for any other material issues. We believe it is important not to rely only on price targets as there are many other issues that need to be taken into consideration when selecting stocks for a long-term portfolio. Price targets are just one of the inputs we use to arrive at our portfolio views.

Fixed income recommendations – Portfolio view

We classify fixed income securities under one of our three portfolio positioning ratings; Core, Supplementary or Niche. These classifications are based primarily on risk. As a guideline we recommend at least 60% should be invested in Core securities, which are both high quality and relatively liquid senior bonds. We recommend Supplementary instruments represent no more than 40% of a bond portfolio and Niche no more than 20%. ©