Parmenion

Investing with Parmenion

The power of our 20-year Risk Framework

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Parmenion's Golden Rule: Risk First

One enduring philosophy underpins everything that Parmenion Investment Management (PIM) do: risk first.

When your clients invest in a PIM solution, our Risk Framework provides the appropriate boundaries within which to invest, across 10 Risk Grades, so you can be confident in the suitability of your recommendations to clients.

How does the Risk Framework work?

Our Risk Framework provides guidance on the expected volatility that we're able to introduce to client portfolios at every Risk Grade.

By calculating the historical maximum loss for each Risk Grade over the past 20 years, it also gives you an indication of realistic experiences for investors.

It makes sure that those volatility levels, and capital falls, are in sequential order through the risk grades.

In other words, your Risk Grade 6 clients should return more than Risk Grade 5 clients over the long term, as a reward for the extra risk taken, while your Risk Grade 4 clients should have better protection in falling markets than Risk Grade 5 clients, in recognition of their greater caution.

This risk-centric approach applies to all PIM solutions, whether your client's focus is on accumulation, decumulation or expressing ethical values through their investment choices.

“Our risk framework has been used since we first formed as a business and continues to be at the heart of our portfolio construction”

Peter Dalgliesh, Managing Director, PIM

Looking back to look forward

No investment manager can control what markets do - or what volatility and market falls might be experienced in the near term.

But by looking back at the risk and return characteristics of asset classes over the long term, through a wide range of market conditions and using established benchmark indices, Parmenion’s Investment Management team can build realistic expectations of volatility parameters and potential losses.

We use a 20-year data set: long enough to capture many market events and social, political and economic changes; short enough to be relevant to investors now.

Alongside benchmark indices, we consider a collection of broader indices that reflect our investible universe (25 in total) to capture the granularity of potential risk and return.

Setting realistic expectations

When we look at risk, we consider volatility and the maximum loss experienced by asset classes in any given 12-month period, over the past 20 years.

This tells us how we can realistically expect each asset class to behave over the long term. We use that information to decide our allocation for each asset class, at each Risk Grade, in each solution, to form our long-term Strategic Asset Allocation.

Establishing the boundaries

We base our Risk Framework's limits on what we believe a rational investor's tolerance to be.

This allows for a historic maximum loss in any 12-month period ranging from 4% at Risk Grade 1 to 35% at Risk Grade 10.

We also create volatility boundaries ranging from a floor of the volatility exhibited by a theoretical 100% Managed Liquidity portfolio (effectively, Risk Grade 0), to a ceiling of the volatility of an efficient portfolio with no more than 35% in Emerging Markets (our most risk-on investible asset class). Within that, we allow no more than 15% in Property, given its liquidity profile.

Finding the efficient frontier

The efficient frontier is a term to describe theoretical portfolios which have historically offered the best return per unit of risk taken.

There is a maximum return achievable for any given amount of risk. That's why cash in the bank, easily accessible and relatively protected (though not against inflation), offers a very low return, while more complex investments offer higher returns.

There comes a point, though, where more return for a single point of risk is impossible. On the flip side, portfolios delivering less return for the risk taken are not using the risk at their disposal effectively - we describe these portfolios as "inefficient".

Efficient portfolios sit at the optimal point of returns for risk taken. The spread of these points across different Risk Grades is called the "efficient frontier" – our basis for maximising risk-adjusted returns, and structuring asset allocation to fit your clients' risk profiles. We monitor our performance and adherence to the risk parameters set in the Risk Framework on an ongoing basis.

Supporting suitability

We update the Risk Framework annually to run on the most recent 20 calendar years of index data.

The underlying asset allocation for every Risk Grade, in every solution, is compared against the strict risk boundaries set by the framework.

By looking at how each portfolio's asset allocation would have behaved over the 20-year period, we can see if the volatility and 12 month rolling maximum loss are appropriately aligned.

Using long-term indices gives a big picture view on this, irrespective of fund selection which may change over time.

We assign independent Risk Grades to the two risk measures of volatility and maximum loss, then take the average to determine the overall Risk Grade.

We apply a tolerance, so in a given year, we will allow a portfolio to behave in line with either a risk grade above or below the designated Risk Grade. If the differences are more significant, or we see sustained outlying behaviour, a Strategic Asset Allocation review is triggered.

Consistent mapping of each solution and Risk Grade means we can compare every portfolio we run, regardless of the mandate, on a standardised basis.

Regular reporting

We assess the portfolios monthly to make sure they're behaving in line with expected volatility, given the parameters of each Risk Grade, determined by our Risk Framework.

Every quarter, portfolio data is formally published, in our Investment Quarterly (IQ) and Quarterly Investment Review (QIR) reports.

When we update the Risk Framework each calendar year, the indicative volatility and maximum drawdown figures for each Risk Grade on our solution reports are updated too, so you see the most up-to-date information at all times.

Further resources

Investment Quarterly

For the quarterly performance and volatility of each solution on a risk grade basis.

Quarterly Investment Review

For a breakdown of each solution including asset allocations and portfolio holdings.

Get in touch

If you'd like to chat to us about our risk framework or wider investment philosophy, please get in touch.

Phone:
03300 945 900

Email:
mail@parmenion.co.uk

Parmenion

Registered office: Aurora, Counterslip, Bristol BS1 6BX.
Website: www.parmenion.co.uk

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