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fundstalk-bulletin

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SafetyPlus® Fund changes

From January 2010, we're changing the fund's objective and policy to clarify that it can use alternative strategies, when necessary, to achieve the fund's protection.

Key points

- The SafetyPlus® Fund is designed to provide the potential for long-term UK stockmarket growth while protecting against large stockmarket falls, and it has been performing in line with this. While the FTSE 100 Index has **fallen** by 3.39% over three years (to 30 November 2009), the fund has **risen** by 5.81%. And over five years to 30 November 2009, it has returned 29.09% against a return of 32.94% for the FTSE 100.*
- In 2008, market volatility pushed up the price of the investment instruments (put options) used to protect the fund against large stockmarket falls. As a result, the fund manager decided that the most cost-efficient way of meeting the fund's aim was to hold the majority of the portfolio in cash to provide the protection, with a small proportion invested in options linked to the FTSE 100 to provide potential growth.
- From 9 January 2010, we're changing the fund's objective and policy to clarify that it can use alternative investment strategies in times of market volatility.

*Performance information is for the SafetyPlus® Pension Fund. Source: Lipper Hindsight, as at 30 November 2009, on a bid-to-bid basis, total return, tax default, in £s.

Past performance is not a reliable indicator of future results.

A reminder about the fund

The SafetyPlus® Fund is managed by Scottish Widows Investment Partnership (SWIP) and is available through Scottish Widows as a pension fund. It's a popular choice with investors, with the pension fund having assets of approximately £117.2 million (as at 30 November 2009).

The fund is designed to give long-term capital growth and a level of protection against major stockmarket falls through the use of a Safety Price. By 'Safety Price' we mean the lowest possible selling price, which is guaranteed not to fall for a period of time, the 'Safety Period', normally 12 months. The Safety Price is set at 95% of the share price at the start of each Safety Period. The SafetyPlus® Fund isn't a guaranteed fund, although it does offer limited risk as well as growth potential.

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Standard investment approach

To help meet the fund's aim of providing protection against large stockmarket falls, the fund manager ordinarily buys 'protection' for the fund in the form of a put option. By doing this, they can limit how far the value of the fund can fall if the UK stockmarket falls. Typically, the cost of buying the protection is met by selling some of the growth of the fund if the FTSE 100 exceeds a certain level. It does this by selling a call option – the right to buy the asset.

The strike price of the option will be determined by the price at which the options trade. For instance, if the manager buys a 100% FTSE 100 put option when the FTSE is at 5,000 then the fund is protected at a market level of 5,000. If the market rises, this protection will fall in value but the fund value will increase from the rise in value of the equity holdings. Similarly, if the market falls below this level, the equities will fall in value but the value of the put option will increase to offset the fall in equity value. This will help to maintain the value of the fund at or above the Safety Price.

When determining which option approach to put in place, the fund manager considers a range of different option strikes. If necessary, a combination of puts and calls are reviewed to achieve the most efficient and cost-effective way of obtaining protection for shareholders.

The protection is normally renewed on an annual basis, and the Safety Price re-set at this time. The most recent re-set was on 21 December 2009.

Alternative investment approach

In times of economic uncertainty, as we experienced in 2008, the cost of buying the fund's protection significantly increases. This is because at times like this investors flock to buy put options (protection against market falls) rather than call options (the upside potential). As a result, the demand for, and cost of, buying the protection rises significantly, and can't be economically offset by selling some of the growth via a call option.

An alternative approach, which the fund manager used during 2009, is 'cash and call'. This approach is made up of two parts; first, the majority of the portfolio is held in cash to provide the protection, while a small proportion is invested in an option strategy to provide potential growth.

From a customer's perspective, this alternative approach has very little impact. Using this approach, the fund continues to have a Safety Price that ensures the maximum fall in the value of the fund's shares during the associated Safety Period is limited to 5%, whatever happens to the FTSE 100. The fund also retains the potential for long-term growth. It is only how the fund's aims and objectives are achieved which changes.

What is an option?

An option is a financial contract between two parties. It gives the right, but not the obligation, to the holder to buy or sell an asset at some point in the future.

Here's an example. You own a call option on Company A shares that expires on 30 June 2010, with an 'exercise' price of £1.00. This means that before 30 June 2010 you can 'buy' a Company A share at £1.00, although you would probably only exercise this contract if the price of the share was above £1.00. In the UK, there's a large and established market where financial companies buy and sell options with the aim of generating profit.

Call options give the right to buy the asset.

Put options give the right to sell the asset.

Changes to investment policy and objective

From 9 January 2010, we're changing the fund's objective and the first two paragraphs of the fund's policy to clarify that the manager can use alternative approaches in times of economic uncertainty, and that providing protection against stock market falls forms part of the objective. The changes don't affect the fund's aim or its risk approach.

For full details on the fund's objective and policy, have a look at the addendum to the prospectus, which you can access at **www.scottishwidows.co.uk/prospectus**

Change of manager

From January 2010, Caroline Silander will take over management of the SafetyPlus® Fund from Tony Whalley.

Caroline joined SWIP in 2000 as a Derivatives Analyst. She manages tracker funds and derivative-based funds. In addition, she is involved in coordinating SWIP's equity derivative activity and solutions provision.

Before joining SWIP, Caroline worked within the Scottish Widows actuarial department.

Caroline holds a BSc in mathematics from Heriot-Watt University, and the Investment Management Certificate.

More information on the SafetyPlus® Fund

We have also produced a short sales aid on how the SafetyPlus® Fund works. This will shortly be available to download from the Fund Information section of the Literature Library:
http://scottishwidows.becomeinteractive.co.uk/index.php?page=1&cat_id=7

Please remember that the SafetyPlus® Fund is not a guaranteed fund although it does offer limited risk as well as growth potential. The value of the shares may change on a daily basis and can fall as well as rise. The techniques used to provide the Safety Price incur a cost. The effect of this is that the long-term growth is likely to be lower than would be achieved without the Safety Price. The Safety Price is guaranteed currently by a small number of major financial institutions and is dependent on each of these third parties meeting its obligations.

SafetyPlus® is a registered trademark of Scottish Widows plc.

Views, opinions and forecasts expressed in this document are those of Scottish Widows and Scottish Widows Investment Partnership as at December 2009. Investment markets and conditions can change rapidly and, as such, should not be taken as statement of fact, nor should reliance be placed on these views when making investment decisions.

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