Fidelity Fund Risk Ratings

Fidelity Fund Risk Ratings explained

Effective 31st Oct 2016

Fidelity believes it is important for our customers to consider the risk characteristics of funds before making any investment decision and on-going monitoring of the risk after investment. To assist you to make better informed decisions in today's investment environment, Fidelity has enhanced the way risk ratings are calculated. A rating are still in the familiar 1-5 format as described below but uses a more comprehensive calculation, taking into account multiple factors to provide a better picture of a fund's potential risk.

Fund risk rating description

The fund risk rating is sourced from a methodology developed for Fidelity by Morningstar (Asia) Limited ("Morningstar"). The fund risk rating is provided to investor(s) for reference purposes only. Risk ratings are:

1 = Low risk, 2 = Low to Medium risk, 3 = Medium risk, 4 = Medium to High risk, 5 = High risk.

1 Low Risk: Lowest possibility of losing capital over the term of the investment. Return volatility is expected to be low.

This investment is suitable for investors who are usually willing to accept a lower return in order to minimize possibility of losing capital. It involves relatively little risk to investors' capital, in terms of both magnitudes of loss and return fluctuations.

2 Low to Medium Risk: Low possibility of losing capital over the term of the investment. Return volatility is expected to be moderately low.

This investment is suitable for investors who are willing to accept more risk than Low Risk investment. Investors' capital is relatively less exposed to market fluctuations than higher risk investments but the magnitude of loss can be apparent at times.

3 Medium Risk: Moderate possibility of losing capital over the term of the investment. Return volatility is expected to be moderate.

This investment is suitable for investors who are willing to accept more risk than conservative investors, but are probably not willing to accept the short-term risk associated with achieving a long-term return substantially above the inflation rate.

4 Medium to High Risk: Moderately high possibility of losing capital over the term of the investment. Return volatility is expected to be moderately high.

This investment is suitable for investors with higher risk tolerance. Investors' capital is not secured and can fluctuate at times. Magnitude of loss can be great sometimes.

5 High Risk: High possibility of losing capital over the term of the investment. Return volatility is expected to be high.

This investment is only suitable for investors with high risk tolerance. Investors' capital is not secured and may fluctuate significantly. Magnitude of loss can be considerable. Conservative investors who are particularly sensitive to short-term losses should limit their exposure to this investment.

Fund risk ratings are reviewed on a semi-annual basis.

Fidelity Fund Risk Ratings

Fund risk rating methodology

Risk can be measured in a multitude of ways, but it all comes down to quantifying the probability of losing money. In Hong Kong, standard deviation has been widely used as the sole risk measure by fund distributors. However, it cannot differentiate between gains and losses or quantify the probability of losing money. While standard deviation is useful, no single measure is able to capture all facets of risk.

To address this Morningstar developed for Fidelity a risk rating methodology that includes two components – a quantitative model using multiple metrics with a qualitative overlay. Fund risk rating scores are expressed numerically from 1-5 (1 being the lowest potential risk and 5 being the highest potential risk).

The quantitative model remains the core of the fund risk rating methodology to uphold objectivity. The qualitative overlay is used to identify potential risks that may not be reflected in the quantitative results. Morningstar implements the concept of floor rating, which gives the lowest risk rating of funds that belongs to the same fund or asset class category, to provide a more structured and consistent framework to apply the qualitative overlay. Additional qualitative adjustments are made only in a limited number of defined circumstances to avoid ungrounded subjective influence.

Quantitative Measurement

The risk rating methodology uses three metrics, each with a weighting relative to their importance in determining fund risk level:

- 3-year Conditional Value-at-Risk (30% weighting)
- Maximum Drawdown (30% weighting) and
- 3-year Standard Deviation (40% weighting)

Results are standarised with their quintile percentile rank against the universe of funds available for sale in Hong Kong. The above risk metrics are calculated based upon total monthly returns of the fund in USD terms. These standardised values are added together to calculate the final 1-5 risk rating.

Conditional Value-at-Risk (CVaR): Estimates the loss that is expected to be exceeded with a given level of probability over a specified time period. It is a meaningful risk measurement for investors since it does not account for a fund's upside potential (i.e. it's solely focused on the probability of losing money). Moreover, CVaR is a well-recognized measure of tail risk, an essential dimension of risk. In this methodology 3-year CVaR is used.

Maximum drawdown: Measures the peak-to-trough decline during a specific record period for an investment. It measures the greatest actual loss during the record period. Maximum drawdown is the most straightforward risk measure since it reflects the actual loss investors would have experienced during the record period. Maximum drawdown gives investors a picture of the worst-case scenario over any period in the investment's history.

Standard Deviation: Standard deviation is a statistical measurement of dispersion about an average, which depicts how widely an investment's returns have varied over a certain period of time. In this methodology the common 3-year standard deviation measure is used. Investors use the standard deviation of historical performance to understand the range of returns that are most likely for an investment. When an investment has a high standard deviation, the range of performance was wide, implying greater volatility.

Fidelity Fund Risk Ratings

Qualitative Considerations

A qualitative overlay is added to the fund risk rating methodology to address potential risks that may not be effectively reflected by quantitative only risk measures. Floor rating will address the scenarios where Morningstar believes that the quantitative only risk measure may materially under-estimate the risk of the fund. If the fund risk rating implied by the quantitative score is lower than the floor rating, the floor risk rating will apply. For example, the floor rating of Global Bond Fund is 2 and if the fund risk rating implied by the quantitative only risk measure is 1, the Global Bond Fund will be assigned a floor rating of 2. Additional qualitative assessment is done by trained professionals at Morningstar and only in defined exception circumstances:

Use of Derivatives: Intensive use of derivatives might increase risk of funds. Funds with greater than 10% derivative holdings have their risk rating reviewed.

Use of Leverage: Funds with flexibility to use leverage may bring additional risks to investors. Funds allowed to go beyond 100% exposure have their risk rating reviewed.

Liquidity Risk and Credit Risk: Where extreme market events occur that significantly affect the credit market or if liquidity changes dramatically and the market is likely heading into a crisis, the fund may have their risk rating reviewed.

In such cases the fund risk rating may be increased unless already rated as 5 - High risk.