A sensible approach

to risk

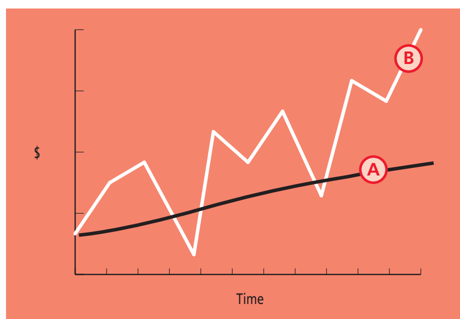
"High returns with no risk"

That's what we'd all like but it's just not realistic. Higher returns do mean accepting more risk, so it's important to understand the nature of different investments before investing. It's all a question of keeping risk in perspective.

Don't be put off by the word "risk"

Risk means different things to different people – loss, change, uncertainty, opportunity, excitement. In investments, risk is the possibility that there may be fluctuation in or loss of capital. There are fundamental reasons why this might happen and this allows us to understand the various types of risk.

In investment terms, a low risk investment is one whose returns are fairly predictable, at least over the short term. An investment that is less predictable, like shares or property, is described as higher risk.



What we're really talking about, then, is ***volatility*** – the ups and downs that are quite normal for property and share investments. It's important not to confuse that volatility with the risk of permanently losing your money. That's what happens to speculators, not investors.

In this diagram investment A is an example of low risk – it increases steadily but at a fairly low rate. Investment B is higher risk, with returns going up and down quite sharply over the short term, but over the longer term it produces a much higher return.

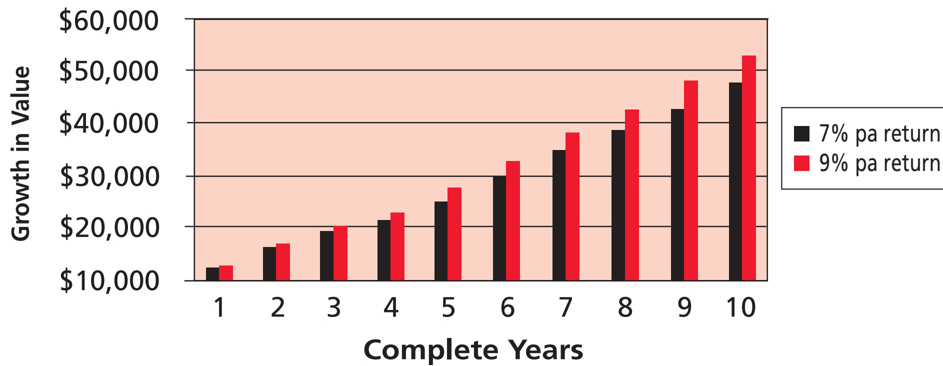
What's important is to determine the trade-off between volatility and performance that suits you. The idea is not so much volatility that you lose sleep, but not such low returns that you fall short of your goals.

As you can see on the graph overleaf, even a small difference in returns can make a difference in the final result over a period of years.

Consider an intial investment of $10,000 and a regular contribution of $200 per month for a 10 year period.

At the end of 10 years an accumulation at an annual earning rate of 9% pa will be $53,557, some 14% higher than an accumulation at 7% pa.

Note: This accumulation allows for an on-going management fee of 1.95%pa.



NB: These projections allow for an ongoing management fee of 1.95% and are exclusive of tax.

Know your own investment personality

To help you understand your investment personality a little better, here are a few questions that may help.

1. Which of the following best describes you?

A	You wish to accumulate wealth for the longer-term – you don't need to spend your savings short term	❑
B	Debts are paid off or under control – and your spare savings are to be invested mainly for capital growth	❑
C	Your priorities are balanced between meeting family commitments and medium to longer term goals	❑
D	You are retiring or already retired or have a short to medium term timeframe	❑
E	You are dependent on regular income from your investments	❑

2. Which of the following best describes your attitude?

A	You're willing to take substantial risks for substantial potential rewards	❑
B	Short-term losses are acceptable as long as there's a reasonable probability of long term gain	❑
C	You wouldn't be comfortable investing in something you know little about	❑
D	You prefer steady returns without sharp up and down movements, even if those returns are lower over time	❑
E	You don't want to risk the value of your capital falling at all, even if it means a low return	❑

3. How would you feel if a short time after making an investment it fell by 20%?

A	You'd consider investing more to take advantage of the price drop	❑
B	This was a calculated risk so you'd wait, expecting te price to recover	❑
C	You'd be concerned and keep a close eye on the investment	❑
D	You'd think about getting out of the investment and seek advice	❑
E	You'd get out before it could fall any further	❑

4. Considering that cash investments offer no capital growth and that inflation can reduce their purchasing power, which is more important to you?

A	Preserving the purchasing power is more important than security	❑
B	Important to preserve purchasing power but need to consider risk	❑
C	Look for a balance between security and preserving purchasing power	❑
D	More important to have security than worry about inflation	❑
E	Protecting capital at all costs is the main priority	❑

How did you go? If your answers were all As and Bs, you'd probably have no problem with capital growth funds, perhaps including specialist share funds.

All Ds and Es? An income fund or conservative balanced fund is more likely to suit you.

Somewhere in between? That's not uncommon. You may be well suited to a balanced fund, or you could create your own balance by investing in a mix of specialised funds.

Please note, however, that this is only a guide and you should talk to a financial adviser who can help you clarify your risk profile.

What to consider when investing

Few, if any, investments are completely risk free. Risk, in a financial sense, may generally be considered to be:

- The risk that income will fail to meet your expectations; and
- The risk that the capital value of your investment will fall from time to time.

When you invest in a managed fund, your investment's value will rise and fall with the changes in the value of the Fund's underlying investments. As such, the value of your investment is not guaranteed and it is possible that you could get back less than you invested.

Some risks associated with the underlying investments are:

Market risk: the risk of loss of capital, due to the effects of economic and political factors on all securities within a market.

Company risk: which refers to the risk of loss of capital from the failure of individual companies due to specific characteristics such as management caliber, financial stability and competitive position.

Interest Rate risk: which refers to the risk of loss of capital value from interest rate rises. This primarily applies to fixed term investments.

Inflation risk: which refers to the situation whereby investment returns fail to keep pace with inflation.

Currency risk: which generally refers to the situation where investments held in foreign currency fall as a result of an appreciation in the Australian Dollar.

Liquidity risk: where the Fund becomes illiquid, and cannot sell assets to provide for liquidity.

Risk is a fundamental investment consideration, but it is essential to place it in the perspective of your overall financial objectives and we encourage you to discuss the issue further with a financial adviser.