Investment Risk

HOW TO MANAGE IT

With deposit rates at historically low levels, more clients are looking for savings and investment vehicles that have the potential to offer a better return for their hard-earned cash. While no one wants to lose money, you do need to consider the level of investment risk you are prepared to accept in looking for better returns. A high investment return requires a high level of investment risk. If you are not prepared to accept risk, you cannot expect high or even moderate growth on your investments.

There are many factors contributing to investment risk such as:

- Term of investment
- Asset class – equities, commodities, property etc.
- Geographical investment location – Europe, USA, Asia, Emerging Markets etc.

Mitigating risk requires diversification between asset classes, regions and investment terms.

In most scenarios, the level of risk you should take on an investment will correlate with the duration of the investment.

For example:

- No risk should be taken with funds that may be required in an emergency or certainly within the next year or two. These should be lodged to a bank account where they can be easily accessed at short notice. Ideally you would have 3-6 month's salary in savings accounts to cope with emergencies.

- Some increased risk can be taken where funds are not needed for 5 to 7 years. These funds might be required for the provision of school fees or to build up a deposit for a home. The increased risk will generate potentially higher returns but also exposes you to the possibility of losing some or all of your investment. You should ensure that you fully understand the level of risk you are taking.
- Investments beyond 5-7 years are considered long term investments. These include long term savings plans and pensions. If you have 15 years plus to retirement, you can afford to take medium to high levels of risk, certainly in the early years, to generate a return and benefit from growth assets such as equities and to a lesser extent, property.

Equities, or stocks and shares, are growth assets and tend to provide better returns than any other asset class in the medium to long term.

Unfortunately, stock market crashes and corrections do happen, and this volatility can severely impact on the value of your investment in the short term. However, longer term investments, with the benefit of time, have the capacity to absorb and recover from such crashes. Although US stock markets, which make up well over 50% of global indices, crashed in 2008 (the S&P 500 Index lost 37%), they are at or near all-time highs in 2017.

Diversification is vital in any asset class and between asset classes. Being invested in a fund exposed to 100 different stocks is preferable to investing in one individual stock, as you are not reliant on the success of one company for your investment to grow. Being exposed to 1,000+ stocks is better again because you have automatically spread your risk over several different industrial sectors and regions. Including government or corporate bonds, commercial property and commodities further spreads and reduces the risk of significant falls in the value of your investment.

At MoneyCoach, we discuss these issues at length with our clients. We gauge your capacity for loss through our needs analysis process and the use of specialist software, before explaining and recommending suitable investment options.

Finally, the ultimate arbitrator of risk will be yourself. Life is short so don’t take risks which keep you awake at night. If you do not have the capacity to accept a loss on an investment, the investment is not for you.