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financial planning

A Perspective on Risk

Investment Risk is one of those concepts which, from an academic perspective, most people can understand, but the reality of risk and what happens to one's investments can stretch and stress people to the extreme.

One of the "stock phrases" in relation to risk is that "investment values can fall as well as rise".

As a concept it is something which we can all accept. If you put your money into a bank account then you expect to be able to go back a year later and find that the money is still there. It won't have increased by a great deal, given deposit rates are these days, but unless you have taken any out it will not have fallen.

Alternatively, if you invest your money into something other than cash, whether it be shares, property, or corporate bonds, what you could get back if you were to sell the investments will go up and down. Depending on what you are investing into, some things would go up and down more than others and change more often. The value of a quoted share you would expect might change daily, unlike the value of a house.

This is a standard concept in investment and will often be accompanied by graphs which look much like this:

This looks fine and we can all understand the logic of investments falling as well as rising and, given two lines representing different investments, we can see the difference between the "less risky" line which falls and rises less than the "more risky" line.

Despite this logic being apparent and easy to grasp, a lot of people still end up with unhappy investment experiences, feeling that they have been let down by the investment industry or advisory community and that what they had is not what they wanted or expected.

Some of this can be explained by people not understanding what they are investing in or being given false assurances of what the likely outcome of their investment is. However, even if an investor understands the basics and the likely outcomes, they can still seem surprised when the investments don't grow.

What if there is an inherent flaw in this picture which contributes towards the likelihood of disappointment?

With these types of graphs, the first thing that any of the investments displayed does is rise. Where there are falls, these are always following a period of investment growth and for the person looking at them, this generates a false sense of security. It is far easier to accept the logic of investments falling as well as rising, where this only ever occurs after you have achieved growth in your investment. If risk is the risk of losing some of what you have gained, this is vastly different from if risk is the risk of you losing some of what you have invested.

If investments can fall as well as rise, how easy is it to accept the logic of this and take the risk of investing outside cash if the graph actually looks like this?

The likelihood of disappointment is much less if you assume that the first thing which might happen to your investment is that it falls in value? Not just by the odd percent because of charges, choosing to have advisory fees paid from the investment and a bit of short term fluctuation, but by 10%,15% or more? If it does then you are prepared for it and if it doesn't then you are pleasantly surprised.

Why would I invest if I am going to assume that the first thing that happens is that the investment will fall in value?

The answer to this is exactly the same as the answer to someone who invests because they expect that the first thing which will happen to their investment is that it will grow – because there is no certainty that the investment will fall nor that it will rise. In the long run we expect that the investment will grow because the only way to get true growth is to invest in real assets such as stocks, shares and property. All have the potential to grow, rather than cash which only ever generates an Income and runs the risk of losing value in real terms against inflation.

Nothing is guaranteed when you invest. If you cannot cope if your investment falls first then should you really be investing? It is said that a pessimist can be pleasantly surprised whereas an optimist will invariably be disappointed.

For more information on risk or investments, please contact **Ed Gibson** at **Ed.Gibson@shawgibbs.com** or call **01865 292197**.

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