Looking beyond the glossy brochures

BY GORDON WILSON

THE rollercoaster ride experienced by stock markets this month will have left most of us feeling nervous about money we have put away for the future.

Investing need not be complex, but the financial industry insists on dressing up the key ingredients in ways which disguise what hides behind the glossy brochure.

The key to understanding how much risk you are taking is to first establish what you are invested in; you need to look beyond the veneer of pension, Isa or investment bond.

You will be invested largely in a combination of cash, fixed interest, property and shares and it is the extent to which you are invested in each of these categories which determines how much risk you are exposed to and the returns you can expect to receive (having also deducted charges).

Risk and return are related. The more risk you take, the greater your potential returns, but also the greater the potential losses – you cannot break this link. Anything which can generate high returns involves high risk.

Fortunately it is possible to quantify risk.

Our research shows the range of returns you would have experienced over the past 23 years for a given level of risk.

Avoiding shares completely – investing solely in UK one-month Treasury bills, which is as close to risk free as you can get – would have generated an average gross return of 6.5% a year. The best year was 15.6% and the worst 0.5%, before charges.

At the other extreme – investing 100% of your money in a portfolio of UK, international and emerging-market shares – the average annual return is much higher at 13.2% with a best year of 40.1% and worst of -30.8% in a single year.

RIGHT BALANCE: Gordon Wilson . . . Risk and return are related

This demonstrates that risk and return are related.

Most people we see are in between these extremes, but once you understand where your investments are on this simple spectrum of risk then you can establish whether you are taking more or less risk than you need to in order to deliver the return required to achieve your financial goals.

Most investors are taking far too much risk, often without realising it, and we typically recommend this be scaled back. Costs also play a big part and most investors are paying more than is necessary and this can have a huge negative impact on the returns received.

So how do you protect yourself from the next downturn? You consciously take less risk by moving yourself down the risk spectrum.

In doing this you accept that you are likely to receive less of an investment return over the long term but perhaps capital preservation is more important than achieving a higher return.

Principle number one of investing is that you should take the minimum amount of risk to achieve your required or desired return. If you do this, then the chances are you can rest easy through any storm in financial markets.

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