Investment principles

by Barry O'Neill, Carbon Financial Partners Limited

The road map to a successful investment experience starts with having the destination firmly in mind before you set out.

Before investing in anything, I would recommend having a clear set of guiding principles to follow. This will help to screen out those investment propositions that appear too good to be true, regardless of how compelling the opportunity may seem.

In my experience, investors generally want the highest possible return for the least possible risk. Understanding the inextricable link between risk and reward is one of the secrets of successful investing.

Avoiding risk means that you cannot reasonably expect to be rewarded by any more than the return from risk-free assets such as Treasury bills.

Investing for a specific goal within a known timeframe, such as providing an inflation-proofed income in retirement, means that the rate of return required to achieve that goal can be calculated.

It is this required rate of return that should be the driver for the level of risk taken. The maxim being to take as little risk as is practical to achieve the required return by investing in an "efficient" portfolio; one where taking additional risk is likely to be rewarded accordingly.

When investing in the stock market, look to diversify away the risk of one company's shares falling in value by spreading your investment across as many firms as possible with different risk characteristics.

Portfolio risk can be further reduced by diversifying across more than one asset class – such as investing in bonds as well as shares.

Many investors routinely start off on their investment journey taking much more risk than is necessary. We regularly see portfolios with 80% invested in equities where the investor's goals could be delivered by a much more modest strategy. This initial exuberance can lead to disillusionment and sometimes panic when equity markets are falling. Such panic can lead investors to retreat to the safety of cash at exactly the wrong time and then feel too scared to get back in to risk assets, thus missing out on the good days.

A far more scientific strategy is to set your course for the smoothest route possible to your intended destination and to stay disciplined.

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