UNDERSTANDING INVESTMENT RISK

AND WHY IT MATTERS

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WEALTH SOLUTIONS

Taking expert investment advice is probably the main reason for clients to consult an adviser. Clients naturally want an investment portfolio that gives them the best chance of reaching their goals.

It is important you explain to your clients that their attitude to risk can be measured; and can be matched with an investment portfolio that has a balance between risk and reward suitable for them. Helping to give your clients greater confidence when making investment decisions demonstrates the value of your advice.

HOW DO WE MAKE INVESTMENT DECISIONS?

Research into the psychology that drives financial decision making indicates that investors suffer from loss aversion; that is they dislike losses more than they like equivalent gains. A misunderstanding of risk is likely to lead to irrational investment decisions that may result in poor outcomes relative to the investor's goals.

If clients understand how investment risk can be monitored and managed then they will be in a better position to make informed decisions; to help ensure that the risks involved are appropriate for the returns they hope to achieve.

WHAT DO WE MEAN BY INVESTMENT RISK?

THE TIME HORIZON

Time is a critical factor. It is vital to consider when clients will need to access their investments.

A client who does not need to access their money for a long time may choose to take on higher-risk investments, at least in the early years. A longer time horizon will potentially allow any falls in value to recover. Someone close to retirement, however, may be looking for current income and may be more concerned to keep risk lower, because there will be less time available for recovery.

VOLATILITY

One of the key ways to assess investment risk is by measuring how an asset rises and falls in value over time. This can be done by targeting risk through a broad measure - volatility. This is a statistical measurement of how widely a range of returns produced by an asset varies from its average over a particular period. The overall volatility of an investment portfolio is dependent on the volatility of each of its assets, as well as how they correlate with each other.

BALANCING RISK AND REWARD

The risks associated with investments vary from low to high. Typically, there is a higher potential for greater returns when investors take on higher levels of risk, alongside an increased chance of significant losses. Neither of these outcomes is guaranteed.

EXTERNAL FACTORS

Within investments, there are different types of risk. These include the impact of changes in interest rates; when borrowing costs rise and fall, and the threat of inflation; with the risk that the rising price of goods and services could outpace returns. Some high level risks are hard to predict or mitigate; such as changes in legislation or unforeseen geo-political events. The latter can often lead to market turbulence, which in turn tends to make investors nervous. In such an environment, the way clients react can depend on how well they understand the extent of their own exposure to risk, and whether their investment portfolio is being managed so that it can respond and adapt to meet changing circumstances.

Making sure your clients understand what investment risk is and managing their expectations around risk can help them maintain confidence both in their investments and in you as their adviser, encouraging a long-term relationship.

To find out more or to contact our Technical team, please visit our uTech site at
www.utmostinternational.com/wealth-solutions/our-wealth-solutions/united-kingdom/utech/

The value of investments can fall as well as rise and investors may not get back what they have invested.

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