

## General Investment Risks

### Understanding investment risk and making appropriate investment decisions

Risk and return are the ‘yin’ and ‘yang’ of investing—a return can not be earned without taking some risk. But investors can sometimes forget that the two are inextricably linked.

Any investment decision you make means that you must take a risk of some sort. Investment risk is generally considered to be the possibility that your investments may not perform as expected. This includes situations in which your investment goals will not be met because the type of investments you chose did not provide the potential for adequate returns.

When making your investment decision, you should consider that investments in growth assets, such as shares and property, provide the potential for higher returns in the long term than investments in income producing assets such as fixed interest and cash. However, growth assets tend to produce more variability of returns in the short-term.

Investment risk as a broad topic is comprised of two main areas—namely General Investment Risks and Specific Investment Risks. Within this article we concentrate on providing an overview of General Investment Risks.

A General Investment Risk is considered to be a common risk factor that may cause the value of an investment to fluctuate. Not all risks apply to all funds.

### In this issue

The risk versus the rewards of investing

Asset Sector	Risk
<b>Mismatch Risk</b>	An investment opportunity may not be capable of meeting the needs and expectations of an investor within their preferred time span.
<b>Inflation Risk</b>	The value of investments may not keep pace with inflation. If the after tax return on investments is less than the rate of inflation, then the value of the investments will decline.
<b>Interest Rate Risk</b>	Changes in interest rates can have a positive or negative impact on the value of investments or returns. For example, many fixed interest investments invest in government bonds. If interest rates rise between the date of purchase and the date you need to sell it, you may have to sell the bond for less than you would have received if you held it to maturity. Alternatively, if there is a drop in interest rates you may be forced to reinvest at a lower rate (and receive less income) when your investment matures.
<b>Market Risk</b>	Market Risk is the risk derived from macro-economic factors and events that affect the market as a whole. Economic, technological, political or legal conditions, and even market sentiment change and this can mean that the value of investment markets change affecting the value of assets held. These factors include shocks to the economy such as a spike in the oil price, terrorist threats, political elections, environmental catastrophes and changes to monetary or fiscal policy.

Asset Sector	Risk
<b>Market Timing Risk</b>	Market timing relies heavily on the ability of the investor to predict market rises and falls which can be extremely difficult because no two economic cycles are the same. Market timing is not a good long term approach, it tends to result in an overall poor return and high transaction costs. A sensibly balanced portfolio will generally outperform a continually changing portfolio.
<b>Diversification Risk</b>	The risk associated with a portfolio that concentrates its investments on a limited variety of securities or asset classes. The value of such a portfolio tends to be more volatile than the value of a diverse portfolio.
<b>Currency Risk</b>	Currency risk is where underlying assets of a fund are denominated in currencies other than the Australian dollar. Changes in the Australian dollar exchange rate will create gains or losses. These assets are generally fully hedged back into Australian dollars with the aim of removing the currency risk. However, it may not be possible to perfectly hedge currency risk leaving the investment with a small foreign currency exposure from time to time.
<b>Liquidity Risk</b>	This risk arises when investments are made in securities which are traded on an infrequent basis. Should a fund hold less liquid securities it may take longer to sell these types of investments at an acceptable price, or the fund may not be able to sell these types of investments at an acceptable price at the time it may wish to do so.
<b>Credit Risk</b>	The risk that an issuer of credit (borrower) may not meet its obligations to make a payment of interest, a repayment of capital or some other financial obligation. Due to their nature fixed income securities are typically subject to credit risk.
<b>Legislative Risk</b>	The risk that the value of some investments may be adversely affected by changes in government policies, regulations and laws (including taxation legislation).
<b>Gearing Risk</b>	The risks involved in borrowing to invest. The risks involved in borrowing to invest can include, but are not limited to, increases in interest rates, loss of cash flow to meet borrowing expenses, magnified returns (both positive and negative) and the responsibility for capital repayment regardless of investment performance.

Investments are subject to many risks, not all of which can be predicted or foreseen. The important thing is that you, as an investor, understand the relationship between risk and reward, particularly over your investment time frame.

There are a number of ways to reduce the kinds of General Investment Risks discussed in this document. They include:

- Diversification
- Research
- Careful Strategy/Investment Selection
- Options and Hedging
- Market Timing
- Regular Reviews
- Contingency Planning

These strategies should be taken in to consideration when formulating your investment portfolio in order to ensure your overall risk levels are in line with your objectives. If you are in any doubt please consult your Managed client adviser before making a decision.

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