

## Risk and Diversification

### What is Risk?

Risk is defined as the chance that an investment's actual return will be different than expected. It is therefore important to understand the relationship and trade-off between risk and return and the main factors that influence different investments.

Virtually all investment involves some degree of risk so it is crucial that you acknowledge and accept this and find a level of risk that you are comfortable with.

### How much risk are you willing to take?

Your risk capacity relates to your ability to take risk. Generally an investor who has a high proportion of capital and income wealth relative to their liabilities, and who has a long investment time horizon, will be able to take a greater level of risk than someone with more limited wealth or a shorter time horizon.

Your attitude to risk relates to your ability to tolerate market swings (volatility) as well as the chances of suffering a complete loss. The prospect of losing money will be very distressing for some whilst others will be more relaxed. Both your ability to take risk and your attitude to risk may be influenced by your age and financial circumstances as well as other factors.

### If you are planning to invest in the stockmarket you should:



### The principle forms of investment risk faced by investors are:

- Systematic Risk - the risk that the overall stockmarket will rise or fall, as economic and other market factors change. This may affect returns over a period of time or have a more immediate impact if an investor buys at the top of the market or sells at the bottom i.e. bad timing. Systematic risk causes similar movements in all investment returns.
- Unsystematic Risk – whereby different factors cause unrelated movements in the returns of different investments. Examples include industry risk caused by factors specific to a business sector rather than general to the market, and stock specific risk affecting one particular company.

### Risk/return trade-off of the various asset classes



**No asset class, including cash, is considered to be absolutely risk free**

**Attitude to Risk** is personal to each investor. The following descriptions may help you to define your own attitude to risk.



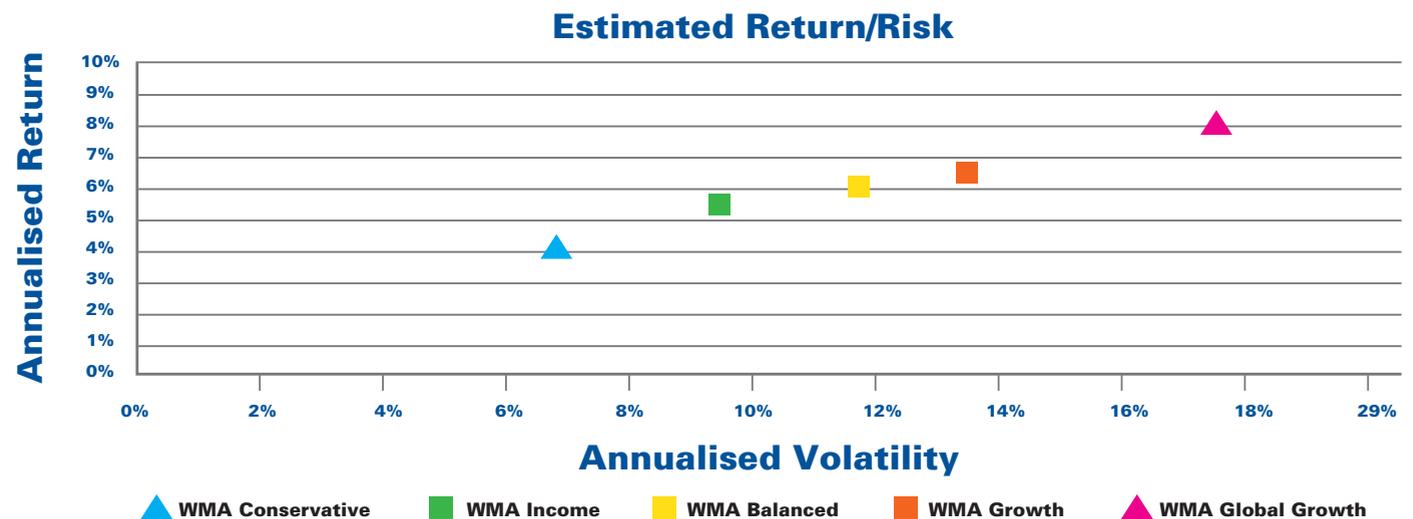
### What is diversification?

Diversification of risk can be simply described as “don't put all your eggs in one basket”. Diversification can be used to moderate risk within a portfolio as individual investment variables may offset one another and this can be achieved in the following ways:

- Diversification of asset class (e.g. cash, fixed interest, equities, property, commodities)
- Diversification within the asset class (e.g. by sector, region or market)
- Diversification by product type (e.g. shares, investment trusts, unit trusts, OEICs or Exchange Traded Funds)
- Diversification by fund manager, product provider or investment strategy.

### Risk/return of the Wealth Management Association (WMA) Private Investor Indices

These indices can give a useful perspective on the world of stocks and shares and the potential returns from mixed asset portfolios.



**Over the years as your circumstances change it is likely that your investment objectives will alter and this in turn is likely to affect your attitude to risk. Please always let us know if your circumstances alter as it may affect the way we manage or advise you on your investments.**