AWFM Fact File

"Understanding Risk"

V2

AW Financial Management LLP

Financial Planning
Independent Financial Advice
Investment & Wealth Management

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Whether you keep money in the Bank or under the bed, whether in a Pension fund or an investment portfolio the one constant is risk, although the risk your money is exposed to is different depending on what you do with it. Our job is to help you manage the different levels of risk to help you gain the best possible outcome.

Risk Process

When you seek investment advice from us, one of the first things we do is ask you about your financial position and also what it is you want to achieve (your goals and objectives). We then ask you to complete an Attitude to Risk Questionnaire (ATRQ) which helps determine the extent to which you are prepared to take risks with your money. Our ATRQ is an essential part of our advice process because the more accurate our understanding of your attitude to risk, the greater the chance of building an investment that will behave as you might expect it to.

Risk Score

There are 14 questions to answer in our ATRQ. They aim to determine your *attitude* to investment risk. Once completed, the ATRQ will deliver us a score on a scale of 1-5.

Investment Time Frame

The last question you come to when you complete the ATRQ is the time frame over which you intend to invest. Time is a critical factor in any risk assessment process and investment management process. If relevant, you need to think through when you are likely to need your investment monies back. This will be relatively simple for say a pension fund when you have a good idea of when you are likely to retire and you are sure you wish to purchase an Annuity. However, for most clients there is no clear investment time frame in mind and the investment monies are likely to remain invested over the remainder of their lives. This is particularly common for Income Drawdown pensions and Investment Portfolios (including ISAs). In this scenario, a specific investment time frame is not particularly relevant and so we would suggest selecting the longest investment term offered in the ATRQ.

If you are looking to invest over a specific shorter investment term, we will usually recommend taking an overall lower level of risk. This is because with shorter time frames there is usually not sufficient time for investments to recover from any possible market falls. Conversely, if there is no specific point in time at which the majority of the investment capital is required, there is no need to take an investment term into account. We will help you consider this issue as part of our investment process.

Capacity for risk

What the risk score will not tell you is your capacity for risk which is the amount and type of risk that you are realistically likely to be able to bear. You might for example be very happy to take greater risks at first sight. However, if the nature of your investment goals requires greater certainty of the result (say - school fees or planning a project or indeed planning for retirement) then it may be more prudent to take less risk than is being indicated in the "ATRQ" in order for you to achieve your desired outcome.

Conversely, when there is no specific goal or target to be achieved, your “time horizons” and “capacity for risk” may increase. We will therefore always discuss the results of the Questionnaire with you before we adopt a specific Risk strategy for your investments or pension funds.

The 4 main Investment Classes

When considering investments managed by this firm, there are 4 main ways to invest and we provide a brief description of each for you:

Cash/Money Market Sector

This is usually the most secure type of investment where returns are likely to be broadly in line with prevailing Interest Rates. Cash funds can be held in your own name in a Current Account or Deposit Account with a Bank or Building Society or it can be invested into a Money Market fund or Cash fund. A Money Market fund will typically expose an investor to slightly higher risk than funds held in one’s own name because of the use of near cash instruments. Money Market funds would have a unitised price which brings both an additional element of risk and cost. This is the lowest risk area as far as capital is concerned but over the longer term, funds could start to lose value against inflation.

Fixed Interest Sector

Funds will invest in Corporate Bonds and Gilts which are basically trade-able loans. Gilts are issued by the UK Government to raise finance in addition to taxation. Companies issue “bonds” to raise money normally for expansion. The investor (or ‘creditor’) receives a fixed level of interest until the capital is repaid much like a normal loan. However these ‘loans’ are traded on the stock market so their capital values can rise and fall according to demand. If you are investing solely for income, bonds and gilts can be highly appropriate and even when capital values fall, the income yield may often rise. However if capital values rise significantly, yields will probably fall, affecting your income. Over a long period of time capital values should remain relatively stable giving a return from the yield that is hopefully higher than the prevailing interest rates available from bank deposits. This asset class on its own would usually be described as a Low risk investment.

Property Sector

Most Property funds are Commercial Property funds although certain Property funds can include both Residential Property as well as investing in the shares of Property companies rather than directly holding the property asset. Property funds usually enjoy relatively low volatility (unless they are heavily invested in the shares of property companies) and provide good, reasonably stable returns over the mid to long-term. They also provide good diversification from Equities. Because of the potential that property prices can and do fall, they usually described as a Low to Medium risk investments but could certainly be classified as higher risk depending on the way the fund is constituted. The main problem with all Property funds is the lack of liquidity which can be a problem if funds need to be released quickly or indeed to benefit from a strategic investment switch. Sometimes, restrictions can be placed on withdrawing funds from a Property fund, for either economic or fund specific issues.

Equity Sector

Equities are the generic name for shares. Equities have historically provided high returns over the mid to long-term. However equities tend to be volatile and the uncertainty over the future movements of their prices make them a riskier investment than some other asset classes. The share price of a company will be determined by general market factors, such as the state of the economy, but it will also be determined by the way the company is doing in the market-place and amongst its peers. If a company’s profits are down, this will probably push the share value lower. If however the company is subject to a takeover bid, this may well push the share price up. As well as movement in the share price, shares can produce Dividends which are a distribution of the profits of the company. This is an important part of the reason for investing in Equities. Equities must be deemed to be at least a Medium risk investment fund, because the value of the fund can go down as well as up, in some cases sharply. In some cases, smaller companies, and shares in companies within less stable economies (known as Emerging Markets usually) would be classed as one of the highest risk investment classes.

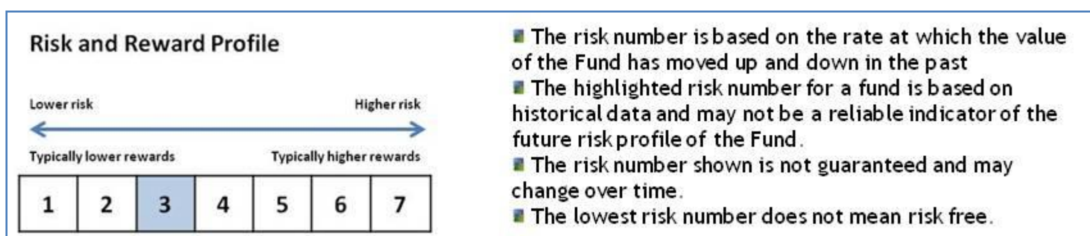
There are other peripheral investment classes and methods but most use these 4 main underlying assets.

Product and Fund Risk Factors

Every investment product and each fund have different risk factors. We therefore highly recommend that you refer to the Fund Factsheets/KiiD to provide you with detailed information about the contract and/or funds recommended. We will provide these to you at the appropriate time.

Key Investor Information Document (KiiD)

From the 1st July 2012 EU regulations mean that asset/fund management companies will be required to produce a KiiD for each of their funds which are subject to this legislation. This will be a 2 page document describing all the key information you need to know about a fund before you invest. It will detail the nature of the fund, its charges and the risk associated with investing into it. Every OEIC (Open Ended Investment Company) fund will have a KiiD. Each document will show the Fund's underlying "Risk and Reward Profile" (as shown below).



General Product and Fund Risks

- Past performance is no guarantee of future returns.
- The price of assets and the income from them can fall as well as rise.
- The value of most investments cannot be guaranteed and on encashment you may not get back the full amount invested.
- If withdrawals are made at a rate which exceeds the net growth of the fund, capital will be eroded.

Other Important Risk factors

- Inflation – when there is a broad rise in the cost of goods and services, different investment assets will cope with this in different ways – some better than others. Cash tends to be the most vulnerable to loss of value as rising interest rates will only come into effect after inflation has taken effect. Many Bonds are also sensitive to inflation risk as they rely on a series of fixed cash payments.
- Currency – For funds that invest overseas, exchange rate variations may cause an investment to increase or decrease.
- Global economy risks -Where funds are invested in parts of the world where there are less well established economies their value might be subject to considerable price variations.
- Commercial Property - Some investments into Property can be more difficult to sell or switch out of in difficult market conditions.
- Ethical funds - have a restrictive investment mandate and as such these funds could be more volatile than funds which do not have such investment constraints.

More Information

More information on our approach to handling client's investments can be found in our Fact- File "Our Investment Management Process".

Information given in this document should not be taken as advice as it is intended for guidance only.
If you wish to have an assessment of your own situation, you should contact the office for advice.

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AWFM Risk Profiles

Cautious

You are prepared to take only a very small amount of investment risk and it is important to you that your capital is protected. This means that your portfolio will concentrate on investments which provide low returns in the long term but present no risk to your capital. Only a small amount of riskier assets will be included in your portfolio in order to increase the chance of obtaining better long term returns. A typical Cautious investor will be invested mostly in fixed interest and cash with a small element up to about one third in equities and property which can boost longer term returns but are associated with more risk. The range of assets provides diversification benefits which also help to reduce the overall risk.

Cautious to Moderate

You are prepared to take a small investment risk in order to increase the chances of achieving a positive return but you only want to risk a small part of your capital to achieve this. A typical Cautious to Moderate portfolio will have up to half invested in fixed interest products which are low risk but have low returns. The larger part of the portfolio will be invested in equities and property which can boost longer term returns but are associated with more risk. The range of assets provides diversification benefits which also help to reduce the overall risk.

Moderate

You are prepared to take a moderate amount of investment risk in order to increase the chance of achieving a positive return. Capital protection is less important to you than achieving a better return on the investment. A typical moderate investor will usually invest in a variety of assets to obtain diversification. There would be a substantially higher proportion of equities and property compared to fixed interest and cash. The range of asset types helps reduce the overall risks as well as increasing the chance of better returns.

Moderate to Adventurous

You are prepared to take a medium degree of risk with your investment in return for the prospect of improving longer term investment performance. Short term capital protection is not important to you and you are willing to sacrifice some long term protection for the likelihood of greater returns. A typical Moderate to Adventurous investor will be invested mainly in equities but with other assets included to provide some diversification. There may be a small amount of specialised equity within the portfolio.

Adventurous

You are prepared to take a substantial degree of risk with your investment in return for the prospect of the highest possible longer term investment performance. You appreciate that over some periods of time there can be significant falls, as well as rises, in the value of your investment and you may get back less than you invest. This strategy holds significant risk in the shorter term. A typical Adventurous investor will be invested entirely in equities, both in the UK and overseas. There may be a significant proportion of the investment in specialised equities.

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