

A Consumer Guide to Investment Risk

Risk exists whenever you invest your money. Even when investing with a bank or building society, there is a risk that your money won't keep up with inflation and may be worth less in real terms in the future. Saving or investing successfully is about balancing the risk that you are prepared to take with your money to try and achieve the return you want, whilst at the same time feeling comfortable with what you are doing.

A good start is to look at this chart of the four main investment asset types, in ascending order of the risk involved with each.



The diagram above illustrates that the greater the potential reward from an investment, the greater the risk that its value could fall. It also provides an indication of the relative risk and reward of the main asset types in which you can invest in.

Investments which have a very low risk that you will lose some or all of the money you have invested, often also tend to give a very low return on your investment; for example, if you have money in a bank or building society account, your money is safe, but usually it is not earning high rates of interest. This can be tiered from instant access cash to notice accounts or term accounts. Conversely, investments with potentially higher returns are often also higher risk; for example, investing in the stockmarket through equities could reward you with a high return, but the stockmarket could also fall and you could lose a large part or even all of your investment.

Bonds are generally lower risk than equities and property, although the risk of investing in bonds depends on what specific type of bond you invest in.

A brief guide to different types of investment

<p>Cash</p>	<p>Cash investments (sometimes called deposit-based investments), receive interest. These include bank or building society accounts. Cash investments generally give you easy access to your money. The interest rates payable may be fixed or variable.</p> <p>The risk may be low; however the returns may be low too. Cash investments generally give lower medium to long term returns than other asset classes. Therefore a cash based investment might not be appropriate for medium to long-term pension planning.</p>
<p>Bonds</p>	<p>Bonds (also known as fixed-interest and index-linked securities) usually have a fixed term. There are two main types:</p> <p>Government Bonds (such as UK 'gilts') - these are issued to raise funds for, for example, infrastructure investment. These are guaranteed by the issuing government.</p> <p>Corporate Bonds - these are issued by companies to raise funds for activities such as expansion or research and development. These may carry a higher level of risk as there is no guarantee that the company will make the interest payments or pay back the original investment.</p> <p>In general bonds are lower risk than equities although the risk of investing in bonds depends on which specific bond you invest in. Bonds also have the potential to earn a higher income than would be achievable in a bank or building society account, although with a bank or building society account your money is more secure.</p>
<p>Property</p>	<p>There are two main types of property investment:</p> <p>Direct property purchase - either buying to let, or to develop and sell for a capital gain.</p> <p>Property funds - these allow investors to pool their money, which can spread risk. Returns are determined by changes in the market value of the properties held, as well as rental income.</p> <p>The fluctuating state of the property market provides an element of risk. The main risks involved in investing in property are that property is not easy to sell which means you may not be able to cash in your investment when you want, and there may be a delay. The value of property is generally a matter of valuer's' opinion rather than fact. Properties may fall in price, and the rental market may decline.</p>

Equities

*Also known as **stocks or securities**, equities are shares listed on a stock exchange. They may offer a share in the profits of the issuing company (referred to as 'dividends').*

Dividend income isn't the only potential benefit of an equity holding. The value of shares may increase as company profits increase, or as a result of market expectation.

Historically, over the medium to long term, equities have been the best performing asset over cash, bonds and property. However, past performance isn't a guide to future performance.

*You can buy equities directly from a stockbroker or trader, or invest in **a pooled fund**, which allows a fund manager to buy shares in many more companies than most individuals would be able to invest in. Although this spreads the risk, you are of course still exposed to the risk of the stock market falling in value. Any dividend income is not guaranteed.*

Equity prices can fluctuate suddenly, and sometimes very sharply, making equities the riskiest asset class compared to cash, bonds and property. Equities ought to be considered for medium to long-term investment. The risk of fluctuation generally makes them unsuitable for shorter terms.

***Past performance is not a guide to future performance.
The value of investments may fall as well as rise.***

While there are a number of ways to evaluate risk, we use the following definitions to help you decide on the appropriate risk and investment approach for you. Please note, we categorise investment periods as follows:

short-term - up to 5 years

medium-term - between 5 and 10 years

long-term - over 10 years.

Please note that our risk categorisations below are based on the medium to long term investment periods.

Investment approaches categorised by risk

Investment Category	Characteristics
<p style="text-align: center;">(1)</p> <p><i>These investments provide safety to the amount invested and can be expected to offer relatively low growth over the medium to long-term. They cannot fall in actual value but can fall in 'real' value due to the effects of inflation.</i></p>	<p><i>Investments are generally cash based. They provide a return, normally in the form of interest, which may be modest. The future 'real value' or 'purchasing power' of the investment could be greatly affected by inflation. Assets may be easily withdrawn, but early withdrawal or cashing in may result in a penalty (normally loss of interest).</i></p> <p>Examples: <i>Though not exhaustive, these could include instant access/notice accounts, fixed term deposit accounts, Cash ISA's and National Savings Accounts & Certificates.</i></p> <p>'I dislike Risk. I prefer guaranteed benefits or benefits known in advance wherever possible. I accept that this may result in higher costs and/or lower returns but consider this a price worth paying. Security of capital is important to me and I accept that this may mean low rates of return being earned and that I might not be protected from inflation.'</p>
<p style="text-align: center;">(2)</p> <p><i>These investments are expected to have minimal risk to the capital value and/or income over the medium to long term. They have the potential to provide income and/or capital growth marginally above cash deposit returns over this time period. Although the capital value may fluctuate in the short-term, some products may offer some guarantee of capital protection.</i></p>	<p><i>Investments are typically in corporate and Government bonds (Gilts), but may have some equity exposure. Some investments may offer an element of capital guarantee to the capital invested.</i></p> <p>Examples: <i>Though not exhaustive, these could include Corporate Bonds, Gilts, Defensive Managed, and other mixed asset funds weighted towards bonds, together with certain 'With Profits' and 'guaranteed' returns funds</i></p> <p>'I am prudent in my outlook. I am attracted to the security of returns but I am willing to accept exposure to variable or non-guaranteed benefits where I can see a clear advantage in doing so. In terms of investment funds, I am prepared to tolerate a minimal degree of risk that the value of my capital may fall in the hope of meeting my objectives over the medium to long term. I will accept a diversified approach to different investment areas, including exposure to equities but with limited allocations overseas.'</p>

(3)

These investments carry a small risk of loss to capital value and/or income over the medium to long term. They have the potential to provide modest income and/or capital growth above cash deposit returns over this time period. The capital value may fluctuate in the short-term and they do not have any guarantees.

Investments are typically split between equity related investments balanced with other investments such as corporate bonds, gilts and property. Some mitigation against the effect of fluctuations in returns is achieved by spreading the investment across different asset types.

Examples: *Though not exhaustive, these could include Cautious Managed, Direct Property and Distribution Funds. Other mixed assets funds weighted towards equities and certain With Profits funds. (Direct Property Funds reserve the right to defer withdrawal for up to 12 months)*

'I regard myself as having a relatively cautious approach to risk. However, I am prepared to accept the risk that the value of my capital may fall in the short term, in return for potentially good medium to long term rewards. I require a broad-based approach for medium to long term investment, including exposure to equity based funds investing in the UK and major overseas markets.'

(4)

These investments carry a risk of loss to capital value and/or income over the medium to long term. They have the potential to provide attractive income and/or capital growth above cash deposit returns over this time period. The capital value is likely to fluctuate sharply in the short-term and they do not have any guarantees.

Investments contain a significant proportion of UK and overseas equity or equity related investments. The bonds portion of an investment is used to provide portfolio diversification.

Examples: *Though not exhaustive, these could include managed funds, UK Tracker funds, UK Equity and Equity Income funds, UK smaller companies funds, major overseas markets funds and mixed asset funds weighted significantly towards equities.*

'I am prepared to accept a balanced approach to risk. Security of benefits is a secondary consideration and I can tolerate a higher than average degree of risk in order to take advantage of the opportunities available. I prefer any investment strategy to offer a high degree of exposure to equities including specialist and overseas funds. I understand that the performance of such funds may be volatile.'

(5)

These investments carry a significant risk of loss to capital value over the medium to long term. They have the potential to provide significant income and/or capital growth above cash deposit returns over this time period. The capital value is likely to fluctuate significantly in the short-term and they do not have any guarantees.

Investments have a greater potential to be affected by other risks not directly related to the investment (e.g. currency fluctuations in overseas markets and political uncertainty). All or most funds will be in equity or equity related investments.

Examples: *Though not exhaustive, these could include Emerging Markets funds, overseas smaller companies funds, technology and healthcare funds. Other higher risk investments may be Venture Capital Trusts, hedge funds and specialist funds*

'I am willing to adopt a risk strategy that is highly speculative in approach and I am looking to maximise possible benefits rather than secure those already accrued. I am therefore willing to accept a high level of risk. I realise that such an approach may include holdings in specialist funds and products whose performance will be highly volatile. I also appreciate that certain high risk investment funds may not be readily realisable and that access to reliable data for valuing such funds may be restricted.'