Atkins Bland

Investments • Pensions • Financial Planning

Brief Guide to: Investment Risk

Introduction to Investment Risk

Understanding the issue of risk is a pivotal part of the investment decision making process because:

If you take investment risks beyond your capacity to cope with the possible consequences, you can jeopardize your financial security, and that of any dependents.

If you take too little investment risk, there is a chance that you may find yourself in the same mess, with inadequate resources accumulated and insufficient income to live on when your working life has finished.

Investment risk is, therefore, a topic to be taken very seriously, as getting your approach to it right can make a big difference, as can getting the approach wrong.

This guide is designed to help you understand the nature of investment risk but with as much brevity as we believe is appropriate. If you are interested in delving deeper into this important and interesting subject, our Comprehensive Guide to Investment Risk is available on request.

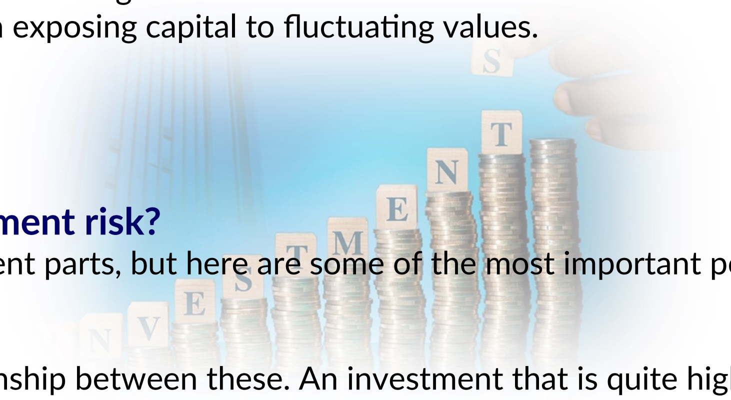
What is investment risk?

Investment risk can come in many guises, some obvious and some not so. However, in its simplest form, it is the risk of losing the capital you have, or the income it can generate, or both.

It is often defined as “volatility” which refers to the degree to which an investment might go up and down in value.

Why accept investment risk?

To seek a better medium to long term return than available with no risk. Without the prospect of that, there is no point in exposing capital to fluctuating values.



What causes investment risk?

Risk has many constituent parts, but here are some of the most important points to focus on:

Risk and time horizon

There is a direct relationship between these. An investment that is quite high risk over a very short term might be a lot less risky if held for a longer period.

This is because, if your investments take a tumble in value for one reason or another, a short time frame gives less potential for a recovery to come along.

Risk and investor discretion

If you can choose when to sell investments based on relevant market conditions and wait if needed, the risk of loss is much less than it is if such flexibility is absent. This discretion can often be created by holding enough in cash deposits to fund shorter term spending needs.

Risk and investor behaviour
Investor behaviour has a big impact on investment risk.

If you invest in something where the value fluctuates, you must be prepared for the fact that values will sometimes fall, possibly dramatically.

If you will not panic when they do, but stay invested to allow a recovery to come along, the risks caused by short term volatility are greatly reduced.

However, if you might panic and sell after markets have fallen, that creates a lot of risk of experiencing a real loss.

Only those willing and able to ride through a crisis and await a recovery should invest in assets where values might fall.

Risk and market conditions
Risk is greatly influenced by market conditions. Something out of favour may have already fallen in value, so the risk of a further fall is reduced. Something in favour may already have risen strongly, so the risk of a setback is increased.

It is easy to forget this and buy into what's been doing best and avoid what's being doing worse, but that can sometimes prove a very poor strategy.

Risk and the economic climate
Investment risks shift over time as global or local economic conditions change.

Risk is not a stable thing, but dynamic. This means it is important to keep everything under review. Our ***Guide to the Risks of Static Risk Classifications*** has more on this important issue.

Deconstructing investment risk
Here are some of the main risks you might face when investing capital.

Losing your capital completely
This can happen if you invest in the shares of a single company, which subsequently goes bankrupt.

The risk can be reduced or increased depending on the nature of the company. However, even huge household name companies occasionally fail, with a total loss for their shareholders.

The value falling
This is a far more common situation. It can arise with most investments other than cash deposits or guaranteed products. Most assets will fall and rise in value as part of the normal pattern of their markets.

The scale of a potential fall varies from one asset type to another, as well as between investments within the same broad asset type. It also changes with the passage of time.

In the vast majority of cases, if an investment falls in value but does not become completely worthless, the value will eventually recover, although this is not always the case.

Loss of purchasing power
When prices rise due to inflation, the real value of money falls.

Many investments offer the potential for your capital, and the income it produces, to rise to combat inflation but those which do not, will carry a risk of loss created by inflation.

Failing to achieve what you need from your savings
Often overlooked, this can be a bigger risk than others in terms of damaging your financial security.

A common example is failing to achieve enough real growth on a pension fund or other investment earmarked for retirement.

If you land up without enough to generate the income you need, you may be forced to spend the capital itself. In turn, that runs a risk of the money running out and a truly miserable time in later retirement.

Event risks
There are plenty of unpredictable events which can derail even the best constructed investment planning, such as poor health forcing you to spend resources earmarked for retirement much earlier than expected, and possibly seeing them dwindle away to nothing.

Classifying Investment Risk

This is how we describe the five broad risk categories we use.

Risk Category	Description	The benchmarks we use to compare results	
		IA (Investment Association)	ARC Private Client Indices
Low (deposit linked)	No risk to capital values Low income No potential capital growth High risk from inflation	N/A	N/A
Below average	Modest risk to capital values Reasonable income Modest potential for capital growth Fair potential to combat inflation	IA Sector Mixed Investment (0-35% Shares)	ARC Sterling Cautious PCI TR
Average	Larger but not excessive risk to capital values High income Good potential for capital growth Good prospect of combating inflation	IA Sector Mixed Investment (20-60% Shares)	ARC Sterling Balanced Managed Asset PCI TR
Above average	Larger risk to capital values High income Potentially enhanced capital growth Even better prospect of beating inflation	IA Sector Mixed Investment (40-85% Shares)	ARC Sterling Steady Growth PCI TR*
High	High risk to capital values Not well suited to income generation Potentially high growth Very good prospect of beating inflation	IA Sector Flexible Investment	ARC Sterling Equity Risk PCI TR

**Please note that we consider the ARC title "Steady Growth" to be misleading. This is an above average risk portfolio strategy so is expected to experience a bumpy ride, rather than the smooth and steady progress implied by the title.*

For information on our use of benchmarks, our ***Guide to Atkins Bland's Use of Benchmarks*** is available on request.

Risks associated with individual investments

Table A, below, shows what we estimate as the maximum potential loss over 1 and 5 years from an *individual* investment in each of the broad risk categories we use.

Table A:

Our risk classification	Estimated maximum potential loss over a 12-month *OR* 5 year period.	
	Percentage	***Example based on £10,000 invested***
Low (deposit based)	Nil	Nil
Below average	25%	£2,500
Average	40%	£4,000
Above average	75%	£7,500
High	100%	£10,000

To explain the above, our estimated maximum loss for a single investment over a 5-year period is the same as over a 12-month period. This is because we feel that, over a 5-year period, it is very unlikely the overall result could be worse than in a single year during a market crisis.

Please note it is always possible for an investment to fall in value by a larger percentage than the figures we show.

Risks associated with a portfolio of investments

Table B, below, shows the same data but based on a diversified portfolio in each risk classification, rather than a single investment, and also shows estimates based on 10 years.

Table B:

Our risk classification	Estimated maximum potential loss over 12 months Example based on £100,000 portfolio	Estimated maximum potential loss over 5 years Example based on £100,000 portfolio	Estimated maximum potential loss over 10 years Example based on £100,000 portfolio
Low (deposit based)	Nil	Nil	Nil
Below average	20% or £20,000	15% or £15,000	Nil
Average	30% or £30,000	20% or £20,000	5% or £5,000
Above average	40% or £40,000	30% or £30,000	10% or £10,000
High	60% or £60,000	50% or £50,000	15% or £15,000

As time passes, the risk of loss decreases because markets are more affected by extreme events in the short term. Over 10 years, a loss is unlikely but possible, especially with higher-risk investments. Less diversified portfolios may face higher losses. Note that portfolio values can fluctuate more than the figures shown.

Potential Gains

The risk of loss and your willingness and ability to accept it should be the main driver behind your selection of investment risk strategy. However, a lower return than needed to achieve objectives also poses a risk, so it can still be important to consider how much extra gain you could enjoy if you accept more risk.

No one can possibly know future returns in advance, but there is a rational expectation, supported by past data, that longer term investment returns should increase as you move up the risk ladder.

Any attempt to quantify that will almost certainly prove inaccurate, but the figures in Table C below, shows what we feel is a realistic expectation of average yearly total returns over a period of 5 year or longer, using the same gaps as the Financial Conduct Authority (FCA) applies, of 3% between low and average and 3% between average and high.

The estimates in the table are based on total returns (income as well as possible capital growth) on a yearly basis from a portfolio in our different risk classifications and do not take account of inflation, but assume it averages the Bank of England target of 2% pa.

The suggested total returns below are before portfolio administration and advice costs, but after internal fund management costs.

Table C:

Risk category	Fair assumption for average returns 5 year annualised	Realistic range for deviation 5 years annualised
Below average risk	2.5%	1.5% to 3.5% yearly
Average risk	4%	3% to 5% yearly
Above average risk	5.5%	4.5% to 6.5% yearly
High risk	7%	5.5% to 7.5% yearly

These figures are before adjustment for inflation and are annualised, which means they are an average of what an investment portfolio may earn over a period of time.

To keep things straightforward and avoid pretending we can predict the future, when we are projecting future values in today's terms, so after adjusting for inflation, we generally assume the total return from a suitably invested portfolio matches inflation but achieves nothing more than that.

We emphasise that this is much less likely to be achieved from a low-risk strategy, while the potential to achieve or exceed this over the medium to long term increases as you move up the risk ladder .

More information on how we approach this important topic will be found in following guides, available on request.

- ***Atkins Bland Guide to Our Assumptions for Future Investment Values***
- ***Atkins Bland Guide to Forecasting Future Retirement Income***

Volatility

Volatility in pictures

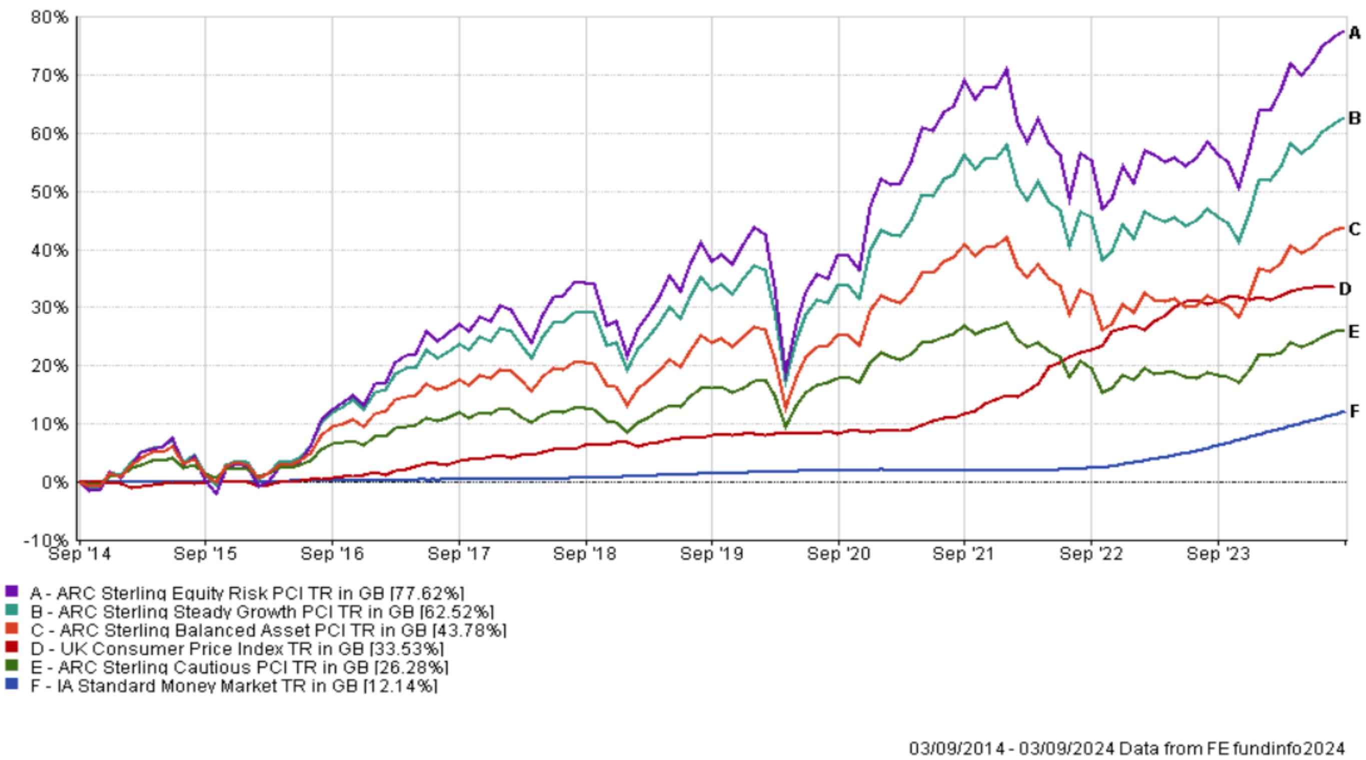
The past is definitely not an accurate guide to the future. However, the graphs below are still helpful in showing the actual past behaviour of the risk graded benchmarks we use. We have used the ARC benchmarks for this, but the same general pattern applies with the IA benchmarks.

As a reminder, the risk categories they represent are:

Below average risk	ARC Sterling Cautious PCI TR
Average risk	ARC Sterling Balanced Managed Asset PCI TR
Above average risk	ARC Sterling Steady Growth PCI TR
High risk	ARC Sterling Equity Risk PCI TR

We have also included the UK Consumer Prices Index as a representation of inflation.

Cumulative 10-year total return to September 2024 (in GBP)



Volatility

Does volatility matter?

Only when you are buying or selling.

At any other time, it should make no real difference to you, unless you let it.

If volatility influences your decisions, such as leading you to sell in a panic after markets have fallen and the media is scaring the pants off everybody, then volatility certainly does matter.

If you are investing for the longer term and prepared to sit tight through the inevitable bad patches, then short-term volatility in capital values should not be a problem.

However, it is important to invest in assets where such volatility should remain within your comfort zone, otherwise the stress of a sharp fall might overcome your resolve and force a decision to sell, thereby missing the recovery and creating a loss you could have avoided.

Some guidance on core points to consider

When selecting your risk strategy, give careful thought to the following questions:

- How long can my money be invested before I'll need it for expenditure?
- Do I have enough on deposit or through insurance cover to cope with emergencies?
- Will I be patient during a crisis, or might I panic and sell after values have fallen?

Keep your answers to these questions under review as a change to any of them could imply you should adjust your investment risk strategy.

Always be aware that your personal capacity for risk may alter, perhaps because of a shift in your circumstances.

If you do need to adjust your risk strategy, you should do so at a sensible time, not during an investment market crisis.

Try to plan your money to make sure your short-term needs are covered. Keep some cash on easy access deposit and take out insurance if your financial security or that of your family is at risk if you suffer a health problem or pass away. If you do this, you or your family should always have a choice over the timing of the sale of your investments

Getting your investment risk strategy right

For some the right strategy is simply what suits their preferences, as their circumstances are such that they are safe with no risk, high risk, or anything in between.

For these lucky souls, it's all about working out personal priorities and what makes them feel good.

However, for most of us it's more complex than that, as we do need our capital to achieve something, be it security now or resources for later or a mixture of both.

For many, the low return associated with zero risk investments means they are unsuited to their primary objectives and longer terms needs.

For others, their financial position is too precarious and uncertain to tolerate a risk of their capital falling, even if that means they must put up with a very low return.

The degree of investment risk you are comfortable with, and can tolerate, will depend on your specific circumstances and priorities.

Your Atkins Bland adviser will discuss all of this with you and help you assess what is best for you.

How do we assess what's best for you?

There are two core issues to consider. One is your capacity to accept risk, and the other your willingness to.

Capacity to accept investment risk
This can be influenced by a wide range of factors, and these can differ substantially between one person and another. However, it is a measure of someone's ability to cope with the consequences of their capital, or the income it generates, falling in value.

Atkins Bland will assess all relevant factors to ensure that the agreed risk strategy fits comfortably with your personal capacity for risk.

Willingness to accept investment risk
For most people (but by no means all) this will be influenced strongly by their capacity to accept risk. However, within any given capacity to accept risk there can be a significant difference between one person and another in terms of their willingness to do so.

This is because we have different personalities, priorities and preferences. Some are by nature extremely cautious while others are risk takers. Most people fall somewhere in between these two ends of the spectrum.

At Atkins Bland, we will help you assess and consider both of these elements, and so all we can to ensure that whatever investment risk strategy we agree with you, it is ideally suited to your circumstances, preferences and needs.

As a reminder, our more detailed "***Comprehensive Guide to Investment Risk***" is available on request.

Important notes

Any opinions expressed on the merits or disadvantages of any options are intended as a general comment only and not as specific advice to the reader.

This document is intended as a supplement to full independent advice and not as a replacement for it and should be read in conjunction with any personalised recommendations provided by Atkins Bland Ltd and with any product brochures supplied.

The value of most investments will fall as well as rise, as can any income produced or generated. An investor may, therefore, get back less than invested.

Inflation can reduce the real value of capital and the income it generates

Past investment performance is not a reliable guide to the future

Any reference to taxation, regulation or legislation is based on our current understanding and details should be checked before any reliance is placed upon its accuracy.

The impact of taxation and tax planning depends on individual circumstances and may be subject to change, which can be retrospective.

Errors and omission excepted.

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Atkins Bland

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