Information on risk

The financial industry talks a lot about investor risk tolerance, as it should. But investors and their advisers need to have a more comprehensive conversation about risk, because risk tolerance is only one of several elements that make up risk. We can break down risk into the following facets: risk required, risk perception, risk capacity and risk tolerance.

Risk required is the **amount of risk you need to accept** to reach your goals. You can't eliminate risk, even with cash. When investing, you are seeking a return. How much return you require will depend on where you are now and where you need to end up. But with the potential for returns comes risk.

Risk perception is **what you think about the risks** regarding a particular investment. If you don't have a full understanding of an investment, your perception of its risks will be incorrect, as many investors found out with sub-prime mortgage investments.

Risk capacity is the **risk you can afford to take** and is a financial characteristic. It refers to how able your portfolio is to withstand adverse events. For example, if your goal is to use a sum of money for a big holiday beginning in two weeks time, your risk capacity for that sum of money is very low. You could not afford for the value of it to drop by 10% or even 5%, otherwise you'd have to cut your holiday short.

Risk tolerance differs from risk perception in that tolerance refers to **how you feel emotionally** about taking risk. For example, if you portfolio drops in value by 20%, how would you feel? Would you feel panicked, slightly nervous or calm?

Types of risk

In addition to the various aspects of risk itself, investment risk comes in many forms. They include, but are not limited, to the following:

Market risk refers to the volatility in a market. Fluctuations in the value of markets mean that you can't determine the exact value of your investments at any point in the future.

Purchasing power risk is the risk that a given amount of money today won't buy the same goods and services at a later stage due to inflation.

Interest rate risk could cause the value of an investment to alter due to changes in interest rates.

Credit risk is the possibility that a business, government, investment or individual will fail to repay what is owed on your investment.

Political risk is the risk that political events and government policies will negatively affect investments in a country or region.

Foreign exchange risk is the risk that currency rates will move in directions unfavourable to your intended currency exchanges.

Managing risk

First, there is no way to ever completely eliminate risk. Essentially, managing risk requires trade-offs.

For example, if you have a savings goal that looks like it will be difficult to reach in the allotted timeframe, you have several options. You might take more risk and invest aggressively to reach the goal. But if losing 15% of your portfolio means you will then no longer be able to achieve your goal, then you are not financially able to take that risk.

Your other options might include saving more towards that goal, finding or diverting other investment resources to apply to your goal, delaying when you will achieve your goal, or even adjusting the nature and extent of your goal.

At Collinson & Co we have the experience to help you manage risk. We will work with you to explore your options and explain the risks involved in different investment strategies so that you can make informed decisions about how best to reach your goals.

More information

At Collinson & Co we have the experience to help you invest wisely. To learn more about risk and how we can help you manage your risk, contact us today for a no-cost, no-obligation discussion on **(09) 300 5237 or** wealth@collinsonco.com.