Welcome to the first article in a series of investment factsheets designed to give you a broader view on many aspects of the world of investment. These factsheets aim to give you an increased understanding of particular investment topics. Your financial adviser will be able to help you understand how these topics specifically relate to you.

We start with an introduction to investment, including a look at risk profiling – vital in formulating an investment objective.

how much risk can you handle?

Investing is not about gambling or speculation. It is about taking reasonable financial risks to achieve specific goals. There are many different reasons for investing and any two people will not have exactly the same objectives. For some it might be a way to pay off a mortgage, for others a way to build a retirement fund or safeguard their long-term savings.

The level of risk you might be willing to accept as an investor is an important consideration for your financial adviser, who will want to establish this with you in advance. For example, they may ask if you fit into a broad category like those below:

1. low risk
   You tend to prefer investments with low or no risks. You may be more interested in preserving the capital value of your investment than increasing its value.

2. medium risk
   You are willing to place reasonable emphasis on growth investments whilst being aware that these could go down in value as well as up. You can tolerate some fluctuations and volatility, but you tend to stay away from investments that may dramatically or frequently change in value (either increase or decrease).

3. high risk
   You are willing to accept a greater risk of a decline in value, in return for potentially higher returns. High risk investors are prepared for the possibility of losing a large proportion or all of the money invested.
different investments carry different levels of risk

**cash**
Cash or deposit accounts are often regarded as low risk, however, they are by no means risk-free. Inflation, for example, reduces the purchasing power of cash as it increases the value of goods and services over time. This means that the real value of investments into cash-like products could decrease over time. There is also an 'opportunity risk' of not being invested into other investment instruments - you lose opportunity to potentially receive more elsewhere.

**bonds**
Many low risk investors choose to invest in bonds or fixed interest securities. When investing in a bond you are essentially loaning money to either a Government or a company. In return for your loan, these entities pay a fixed rate of interest, usually at regular periods, and pay back the bond when it matures. The benefit of this type of investment is that the investor receives a fixed income. The risk is that the company may default and you may not get back all or any of your original investment.

**equities**
Historically, the best returns for a long-term investor have been from equity investment (stocks and shares), although past performance is not a guide to future performance. However, investing in individual stocks or shares does mean that the investor is taking on greater risk.

The price of company shares trading on a stock market is a reflection of their value as interpreted by supply and demand for the shares by investors. When investing in a company’s share, the investor is essentially buying a part of that company and its future profits. On the other hand, they also own any future losses. The risk can be high, especially if you own shares in only a handful of companies. If one company is not performing well you lose money as the share price goes down.

The potential exposure to risk can be reduced for your entire investment portfolio if you spread the risk amongst several equities in different sectors. This can be taken a step further by investing across a wide range of different asset classes, such as equities, bonds and cash. In this way, an investor is achieving diversification across their portfolio, lessening its overall vulnerability.

Investing in equities may be more suited to someone willing to accept medium or high risk investments - your adviser will be able to let you know how suitable they are for your investment needs.

**investment funds**
A way of investing in all these asset classes could be to invest in an investment fund. An investment fund offers a potentially less risky solution than holding a small number of equities directly. Under the supervision of a fund manager, an investment fund pools together money from many investors.

achieving diversification
Take a portfolio holding shares in an ice-cream company. If you add another ice-cream company to that portfolio it reduces the reliance on the performance of that one company. However, the portfolio is still dependent upon one factor: the demand for ice-cream. If this demand drops, your portfolio will suffer.

By adding a portfolio in another sector, for example a sun lotion company, you have a more diverse portfolio and reduce the risk of being in one market sector. However, you are exposed to the risk of a rainy summer. To solve this problem you could add an umbrella manufacturer to the portfolio - an asset that will appreciate during a rainy summer.
This combined pool of money is spread across a number of investments with the aim of reducing the risk of the overall portfolio. The concept is to enable investors to have a diversified portfolio with a stake in a wide range of assets.

Each fund has an objective which describes what it aims to accomplish for its investors and how it plans to achieve it. Some fund managers will aim to achieve high returns by investing in riskier stocks, which offer potentially higher returns but could also result in higher losses. Others are more defensive, seeking reasonable gains without the threat of big losses. However, no matter where they invest, the value of investment funds may go down as well as up.

The choice of funds today is enormous, with funds that invest in different countries, regions and industries - as well as a mixture of bonds and equities. Your financial adviser will provide you with the necessary guidance when selecting funds for your investment.

Whatever type of investment you are considering, it is important that you tailor it to the level of risk you are prepared to take. This is why Skandia consider it essential that you have the expertise of a financial adviser, who will be able to help you assess your risk profile and recommend suitable investments for you.

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market shocks

Why is assessing the amount of risk an investor is willing to accept such an integral part of formulating an investment objective?

A brief look at the history of the stock market highlights that the risks for investors are very real. We all know about The Great Depression, which started when the New York stock market crashed heavily in 1929. As a result the United States and the world were thrown into a decade of unemployment and economic downturn. Another example is 19 October 1987 - the largest one day stock market crash in history, referred to as ‘Black Monday’. More recent events that have affected global stock markets include global terrorism and the ‘dot.com’ crash. The latter occurred after predictions about the return potential from the so-called ‘dot.com revolution’ proved to be overly optimistic.

These are just some examples of the types of external influences that can have an impact upon stock markets. People that invested just prior to a stock market crash of this kind would have needed to remain calm and wait until share prices recovered. However, some investors will not be willing to accept this level of risk.

(continued)
It is very difficult to invest money at the absolute right time. It is also inevitable that uncertain events will occur and in the diagram below, you can see some of the recent crashes for the UK and American stock markets. This illustrates the importance of having a long-term perspective when investing in the stock market. Over the long term, ‘market shocks’ have, historically, had a relatively short-term effect. Although of course, past performance is not a guide to future performance.

The most important thing is to understand what you are investing in and why.

Stock market movements from 1 December 1969 to 31 December 2004, based in UK Sterling

The value of investments and the income from them can go down as well as up. You may not get back as much as you invested. Skandia does not provide advice on selecting investments - investors should consult their financial adviser on the merits of any particular investment or fund. Past performance is not a guide to future performance.