

What's your appetite for risk?



When most people think of 'risk' they often think of something threatening or undesirable, something that should be avoided particularly when it comes to their investments or their super.

Australians generally do not have a good understanding of risk but if you want to maximise your retirement savings it pays to understand what risk means and how it affects the rate of return on your super investment.

Every investment decision involves an element of risk. Risk is the possibility that the actual return from an investment may end up to be different from the expected return. Risk also includes the possibility that the actual return ends up to be higher than what was expected.

The relationship between risk and return

Whenever you make an investment there is a fundamental relationship between the rate of return you receive and the risk you take to achieve that rate of return.

In general, any investments which theoretically generate higher long-term returns, such as shares or property, carry a higher risk in the short term. This means that the rate of return may vary and the value of the investment may rise and fall more sharply than other more conservative investments such as cash or bonds.

Your appetite for risk

Everyone has a different attitude to taking risks and this determines your personal risk profile or your appetite for risk.

A recent Citibank survey revealed that when it comes to investment risk, Australians tend to be risk averse. In fact 70% of people over 25 years of age don't believe in taking risks to achieve higher investment returns.

This suggests that many Australians may not understand the relationship between risk and return and what investment strategies they should employ to achieve their investment goals.

When considering an investment strategy it is important to be aware of your own appetite for risk. Some people become anxious if their investments lose just a fraction of their value while others are not concerned about short-term fluctuations.

If you take on a level of risk which makes you feel uncomfortable or keeps you awake at night, we would recommend that you review your investment strategy.

Other risks you may need to consider

In recent years many investors have become increasingly aware of the impact their investments have on the environment and the community. While some investments such as tobacco companies may provide a healthy return in the short term, they may have an unhealthy impact on society. These companies may also face legislative risks which will affect their long-term future.

Every investor needs to weigh up any external risks such as the environmental or social impacts when considering their investment strategy.

Impact of the global financial crisis

In the wake of the global financial crisis people found that their super balances had fallen and they became very sensitive to risk. Media reports of a global economic recession only added to the confusion, creating more uncertainty and

convincing many people to change to a less risky investment strategy.

Unfortunately by switching to a conservative strategy, such as cash, these people missed out on the subsequent market recovery and crystallised their losses.

Moving in and out of investment strategies based on short-term events may appear sensible but in reality most investors get their 'timing' wrong and generally end up reacting too late to capture any financial benefits.

Super is a long-term investment so it is essential that you choose a strategy which balances your long-term financial objectives with your appetite for risk.

Get some good advice

If you are considering a change to your investment strategy, the best advice is to get the best advice.

A qualified financial planner can help you better understand your investment risks and determine the right investment strategy; a strategy which will help you achieve your long-term financial goals and not keep you awake at night.

If you are a member of Local Government Super you can access quality financial planning advice no extra cost.

If you would like to speak with a financial planner, just call 1300 369 901.



Reference:

Citibank Australian Wealth Survey Report, November 2009

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