Just because you don't fancy skydiving or swimming with sharks, it doesn't mean you shouldn't take any risk with your money. We take a closer look at investment risk and explain why not taking any chances could be the riskiest strategy of all

ARE YOU READY TO TAKE A RISK?

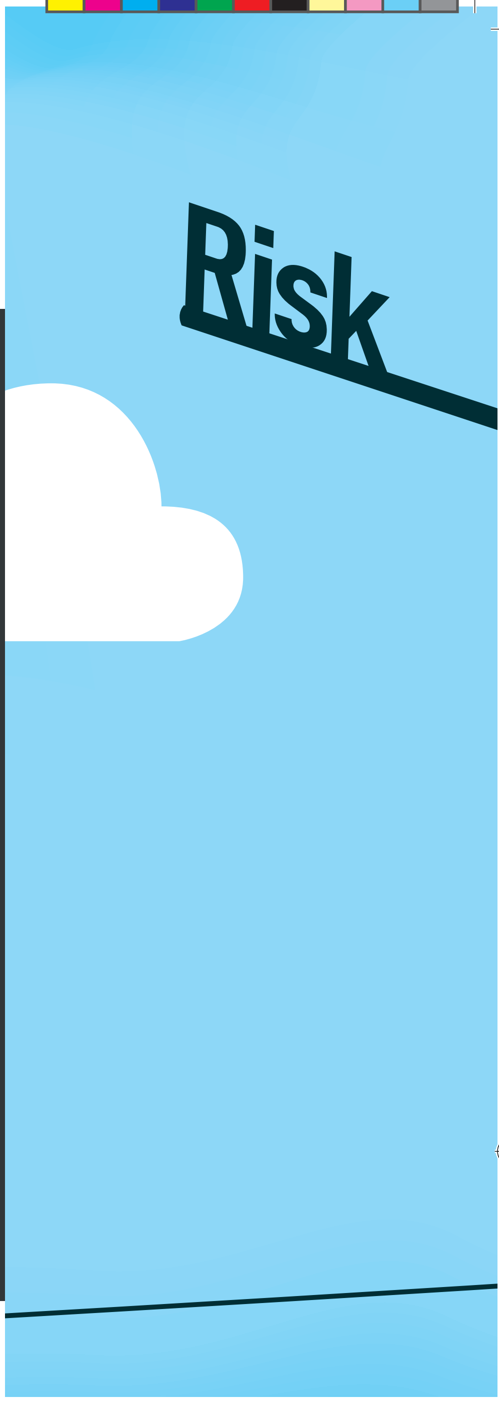
BY RUTH JACKSON

When it comes to savings, we all wish we could get a better return. But, despite more than a decade of relentlessly low interest rates, most of us still keep our money in traditional savings accounts where it stagnates. One reason for this is the fear that we will lose money by doing anything more risky with it.

This is in part why Premium Bonds are the nation's most popular savings product – they are perceived to be risk-free. Your money is held by NS&I, which is government backed so it is 100% safe. But in return for that safety, you will receive no interest on your cash. Your only chance of a return is if you win something in a monthly prize draw – and your chances of winning big are slim. Someone holding £5,000 worth of Premium Bonds, for example, has a one in 656,303 chance of winning the £1 million jackpot every month.

The story isn't any better when you look at the rest of the cash savings market. Rates on most savings accounts don't beat inflation. For example, if someone put £1,000 into the average easy-access account paying 0.7% in June 2009, they would have ended up with £1,072 a decade later. However, after inflation is taken into account it has the buying power of £789 in 2019, according to analysis by Hargreaves Lansdown.

It is all very depressing for savers, but there is a solution. If you took some of your money out of cash savings and took on some investment risk, you could boost your returns considerably. Hargreaves Lansdown gives the example of an investor who put £1,000 in the L&G UK Index Tracker in June 2009. Over a decade, their £1,000 would have turned into £2,450, which after inflation has the



ASSESS YOUR RISK PROFILE

Here are three questions that will start to give you an idea of your risk profile:

How would your friends describe you?

A A risk taker
B Steady Eddie
C A cautious soul

How long are you investing for?

A The long term – I won't need this money for 20 years.
B The medium term – this money will be left untouched for 10 years.
C The short term – I want to use this cash in five years' time

What are you investing for?

A I don't need this money for anything specific.
B This money is my pension.
C I am investing for a specific goal such as a house or to pay for my child's university fees.

If you answered mostly As – You are comfortable taking risks and are investing for the long term. You may be happy to take more risk with your money in order to maximise the gains. Over the long term, your money will have more chance to recover from any short-term losses.

If you answered mostly Bs – You are happy to take some risk with your money in order to improve your returns. But you have a plan for the cash and can't afford to risk it all on anything too adventurous.

If you answered mostly Cs – You have a very low appetite for risk and aren't prepared to put your capital on the line in order to chase big returns. You also probably aren't investing your money for long enough for it to be able to recover from a big dip. You may be safer sticking to cash.

buying power of £1,803 in 2019.

So why aren't we all putting our money into the stock market rather than Premium Bonds or savings accounts? Fear of losing our money puts millions of us off investing. But take the time to understand what investment risk is, assess your own appetite for risk, and invest accordingly, and you could enjoy bigger returns without losing sleep.

What is investment risk?

"Investment risk is the probability that you will lose money if you buy a particular stock or fund," explains Emma Wall, head of investment analysis at Hargreaves Lansdown.

"Different investments have different risk profiles. For example, it is considered more likely that you may lose money investing in companies listed in China or Turkey, known as emerging markets, rather than UK or US companies. Smaller company investments are considered riskier than shares in larger companies, as smaller firms tend to be less established, with less scope to turn fortunes around if they hit bad times."

> "Decide your own personal risk appetite: do you have nerves of steel?"

To put this in real terms, investing in a big established British company, such as BT, carries less risk than buying shares in a Turkish start-up business because it is a lot less likely that BT will collapse.

"If you can understand what risk is really about in respect to investing and can identify your own attitude to risk, then you will be in a better place to create a portfolio that includes risk at a level that is appropriate for you and you are comfortable with," says Patrick Connolly, a certified financial planner at Chase de Vere.

In order to work out your attitude to risk, you will also need to consider what you are saving for and when you will need the money. The longer you have to save, for example, the more risk you should be able to take as you will have more time to recoup any short-term losses.

"Your personal risk appetite, your financial goals, and – most importantly – the deadline for these goals, should determine the type of investments in your portfolio," says Ms Wall.

"Are you the type of person who worries about uncertainty or do you have nerves of steel? Are you looking to buy a house in the next five years or saving for retirement in 2053?"

You can work out your risk profile using online tools such as Standard Life's Risk Assessment calculator or Fidelity's Risk Assessor to help you understand how your personal investment goals and your own personality will affect how much risk you should take with your capital.

"It is important to be honest when completing these questionnaires,"

says Ms Wall. "We all like to think of ourselves as spontaneous and carefree, but there is a big difference between your appetite for skiing off-piste versus taking risks with your wealth."

Once you understand your risk profile, you can invest accordingly. Some investment firms will offer you a managed portfolio that matches your risk level. For example, Nutmeg offers portfolios with differing risk levels from 'cautious', which invests mainly in bonds, through 'steady', 'balanced' and 'growth' to 'high', which is almost entirely in equities.

Alternatively, you can go it alone and build your own investment portfolio containing a selection of asset types – for example, fixed-interest investments such as corporate bonds, alongside equity-based funds to reflect your own goals and the level of risk you are prepared to take on.

"Skiing off-piste is very different to taking risks with your wealth"

This can be achieved by opening a Stocks and Shares Isa that has an online platform, such as AJ Bell or interactive investor (*Moneywise*'s parent company).

How to minimise risk

"Moira O'Neill, head of personal finance at interactive investor, says: "The key to reducing risk is to have a balanced, diversified fund or investment trust that spreads your risk around the world. F&C Investment Trust, which has been delivering returns to shareholders for over 150 years, is an example.

"Another way to spread risk is to consider a multi-asset fund, which spreads risk across not just different countries, but assets classes too. There are three Vanguard LifeStrategy funds that we like, with different equity-to-bond weightings, that can suit a variety of risk profiles."

These include:

- Vanguard LifeStrategy 20% Equity (for shorter-term goals of three to five years – lower risk, but lower expected returns over the long term)
- Vanguard LifeStrategy 60% Equity (medium- to longer-term goals of five-plus years – a level of risk over the medium to long term to achieve potential for growth)
- Vanguard LifeStrategy 80% Equity (longer-term goals of 10 plus years – a higher level of risk in the pursuit of higher expected gains)

She adds: "You may think of yourself as a high-risk personality, but this doesn't necessarily translate to being comfortable taking high risks with your money. But even investors who consider themselves high risk

can rethink their definitions when they are challenged.

"Truly understanding risk as a concept is simply a cornerstone of successful long-term investment management," says Tom Kieldsen, a financial adviser at Nutmeg. No single asset class can be relied upon to produce safe, reliable and consistent returns."

Even cash carries an inflation risk – if your interest rate isn't higher than the inflation rate, your money is shrinking in real terms. It also carries the risk that your money will not grow fast enough to achieve your goals.

The answer is to diversify your investments. By spreading your money across different investment types, geographic regions and companies, you can minimise the chance of one event putting a huge dent in your capital.

"A diversified portfolio – with an appropriate proportion of cash, equities, bonds, commodities and alternative asset classes for your goals and risk tolerance – is a better way to maintain and build wealth over the long term," adds Mr Kieldsen.

Reassess your risk

You also need to keep an eye on your investments and remember to reassess your risk from time to time.

"You should rebalance your investments regularly to ensure you don't end up taking too much or too little risk," says Mr Connolly. This involves reallocating your gains in your most profitable holdings to return to your original asset allocation.

This is also a good time to review your attitude to risk. Think about whether your investment objectives have changed and whether you are on track to achieve them.

If your risk profile has changed, adjust your portfolio accordingly. For example, as you draw closer to the date that you will need your money, it may make sense to lock in your gains by lowering the risk of your overall portfolio. Alternatively, if time is on your side, you may decide to increase your overall risk a little.

If you are not meeting your current investment goals, consider increasing the sum you are investing or change your time frame, as well as whether to move some of your portfolio into higher-risk investments.

Check whether your funds are keeping pace with others in the sector. If you find that they are consistently underperforming, you may want to switch.

Understand investment risk and you could build a portfolio that won't keep you awake at night. mw

RUTH JACKSON is a personal finance writer for publications such as *The Times* and *MoneyWeek*, and website LoveMoney

"I am quite risk-averse by nature"

It was the risk of inflation eroding her savings that convinced Agnieszka Madurska, 30, (right) to start investing. As soon as she was earning enough in her career as a software engineer Agnieszka started saving.

"After some time, I noticed that most of the savings accounts offered interest rates below inflation. This meant that the money I was putting away was effectively losing value. This was a big problem as I was saving for a house. London house prices were rising quicker than I was able to save."

Agnieszka did her research and realised there were alternatives to keeping her money in the bank that offered bigger returns.

"I am well aware of investment risk and did my homework. I am quite risk-averse by nature, so I spend a lot of time researching before I ever invest in anything. I also do back-of-the envelope calculations to understand what the return might be in the best-case scenario, worst and on average."

By spreading her investments and diversifying her portfolio, Agnieska says that she is able to manage her risk.

"I invest in property, cash savings, managed portfolios, individual stocks and small start-ups. Typically, the higher the risk, the smaller the investment I make, to make sure I don't lose too big a proportion of my savings if anything goes wrong."