

A C EGGLETON & CO

RISK: A GUIDE AND OUR APPROACH TO IT

General

No savings are entirely risk free. Economic crises, currency collapses, inflation and increased taxation are all a threat to your savings. Most commonly brought about by economic mis-management they can also arise from other, less blameworthy factors, such as changes in international trade, investment and capital flows, terrorism and war. The UK is not noticeably more badly served in its economic management than most other western countries and the UK government has not defaulted on its debts for many centuries, if ever. In addition it has established and maintained itself as a major financial centre with regulatory regimes over institutions such as investment houses, insurance companies and banks and building societies designed to ensure that depositors funds are not stolen or recklessly lost. Nevertheless the risk of loss can never be entirely discounted: governments and companies do default on their debts; banks do collapse; insurance companies do go broke; investment houses do fail; regulators do neglect their responsibilities; lousy products are peddled and investors are defrauded. A recent development has seen employer-provided pension schemes fail to meet their obligations to their pensioners.

While some industry sectors have “lifeboat schemes” to protect investors and depositors to some extent, and the authorities also maintain limited investor compensation and pension protection schemes as a last resort, none can be relied upon to make good all losses in all circumstances; risk ultimately always lies with the investor.

As regards investments in equity shares and company loans (corporate bonds), both the share price and the prospect of the loans being repaid depend upon the competence of the management.

Risk is pervasive throughout our economy. Not all investments will prosper, nor will that necessarily be a cause for criticism of those responsible: ill-fortune can attend the most conscientious labour. Commonsense dictates therefore that it is not wise to “place all your eggs in one basket”.

Deposits versus Investments – Interest versus Growth

For our purposes mere cash deposits are not investments, they are merely sums of money upon which interest is paid. The underlying capital does not grow in value – only interest is paid upon it. Investment involves the purchase of securities, typically equity shares, which have the potential for capital growth, and loan stocks, in the trading of each of which fund managers may also accumulate profits on your behalf.

Non-Investment Savings Products

Bank and building society deposits, (including cash ISA’s), National Savings accounts, National Savings Certificates, UK government gilts. These are all considered to be very low risk homes for your money. They earn interest at varying rates, typically depending upon the period through which you are prepared to deposit

your funds. The chief risk is inflation, which may reduce the real value of your savings. The drawback is that there is no possibility of the asset increasing in value.

National Savings Index-linked Certificates are recommended for the protection against inflation in the medium and long term of core savings where maintenance of purchasing power is considered to be more important than either the rate of interest received or capital growth.

Investment Portfolio Components

Investments in property and equity shares, representing as they do live economic assets, also act to protect your savings against the general inflation which erodes the real purchasing power of simple money deposits.

The same or similar investment products may be found in each of the categories of risk profile: cautious, balanced and adventurous. It is the proportion of the whole portfolio in each of the products which determines its suitability for each of the profiles. For example, whilst the same UK equity income fund may be appropriate for both a cautious and an adventurous investor, the component of the overall portfolio for the cautious investor will be smaller than that deemed suitable for the adventurous investor.

We do not therefore rigidly allocate particular types of investment product to particular risk profile categories.

Risk and Reward

There is a link between the two. The lower the risk in the product or investment the lower the anticipated returns. That is because there are many potential investors seeking low risk investments and therefore the providers of such products need only offer the prospect of a low return to attract the investment. Equally, higher risk investments must offer the prospect of higher returns to attract the smaller pool of investors prepared to take greater risks.

Time Horizon

This is an essential consideration, particularly if there is a significant exposure to fluctuating assets such as equities since a reasonable amount of time may be necessary to make good falls in stock market valuations. For example where income is crucial, in general the older the investor the lower the equity element and the higher the proportion in lower volatility loan stocks i.e. investment grade corporate bonds and government gilts. Similarly if the funds are going to be required in say 3 years for a house purchase, then the time horizon is inadequate for equity share investment.

OUR APPROACH

Debt and Risk Reduction

We try to look at the overall level of financial risk to which you are exposed. Mortgage debt has an inherent risk to the roof over your head from redundancy, ill-

health and divorce. So can other commitments, typically personal loans and credit-card balances. Debt reduction minimises such risks, and by virtue of reducing interest paid over the long-term, can be a very valuable “investment”.

Diversification and Asset Allocation

This is a key risk reducer. Collective funds investing in a range of securities spread risk; a selection of funds spreads risk further still. But the degree of risk is determined by the investment policy followed by the fund manager. A collective fund is not low risk merely because it is a collective: a collective investment in a portfolio of high risk securities is still a high risk investment.

We focus on asset allocation i.e. we seek to select funds which invest in the securities we believe are suitable for you and is the correct proportions of equities, bonds and property as the case may be.

Making the Choice

We will establish your circumstances, concerns and intentions, and assist in determining your needs and assess your risk profile. Thereafter we will identify suitable investments and products with which you are comfortable and make recommendations suitable for you having regard to all those matters. Most of our clients fall within the cautious and balanced risk profile categories.

In choosing your funds we consider the findings of Independent Researchers who assess each fund having regard to such things as :-

Quality of Investment Process;
Continuity of investment personnel;
Consistent past performance record;
Clearly defined investment objectives.

Volatility ratings evaluate the fund’s sensitivity to interest rate movements, investment spread, liquidity and so on. It endeavours to indicate the volatility that can be expected of the fund. The lower the volatility, the lower the risk.

Financial Strength Ratings will be considered where appropriate. They are only relevant to with profits and life fund investments and products. They are a measure of the ability of the fund provider to meet its liabilities to its policy holders.

Description of Terms

For an explanation of any terms used in this document with which you may not be familiar, please read our **Description of Some Investment Products and Terms.**