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asset management



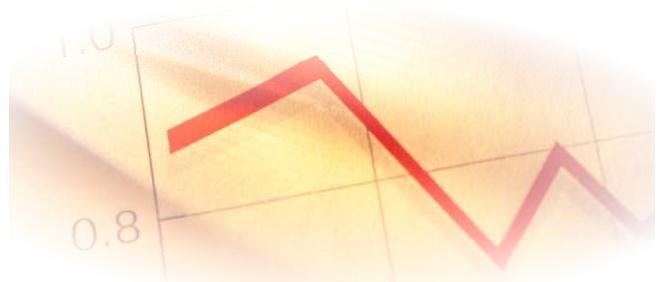
Understanding Investment Risk

Independent Financial Advisers

Understanding Investment Risk

With very few exceptions, investing money involves the risk that you may get back less than you put in. No one however enters into a transaction with the intention of incurring a loss and to this extent virtually any investment is a calculated gamble. Where an individual has made an informed decision on whether that wager is worthwhile, he is usually prepared to take losses in his stride but problems occur when investors do not believe they will make a loss or do not understand the odds involved. The purpose of this supplement is to explain the background to investment risk and to assist you in deciding the level of risk you are prepared to take with your money.

Your Adviser will recommend a choice of investments that will reflect the views you have expressed in your discussions as well as your responses he has obtained from you. If you are in doubt as to the level of risk the recommended investment involves do not proceed until you have resolved any queries you have.



The Role of the Adviser

One of your Adviser's duties is to ensure that you are placed in a position from which you can make an informed decision as to whether the degree of risk involved in an investment is acceptable to you. He will not provide any guarantees as to how an investment *will* perform because future results are dependant on the outcome of numerous events that are not as yet known. Advisers, like fund managers, analysts, economists and stockbrokers can only voice an educated opinion as to what the future might bring and for this reason they cannot promise that you will make a profit on your investment or that you will not make a loss. If you lose capital they will not therefore compensate you unless:

- they have misinformed you as to the nature of the product
- they have made a recommendation that is unsuitable based on your personal circumstances described to them or the broad level of risk you have stated that you are prepared to accept

An Adviser provides guidance as to a suitable course of action based on your circumstances and known facts. The final decision as to whether to take out an investment remains in your hands and it is important to understand that you are taking on any associated risks, not the Adviser.



Risk & Reward

The reason that most people will decide to accept investment risk is in the hope of a reward. For example if a building society account offered a guaranteed return of 10% p.a. then the stockmarket would have few takers. Likewise a product that offered very low returns but involved immense risk to capital would prove unpopular. As a rule of thumb the higher the risk the greater the potential for growth or income and the greater potential for loss of capital and reduced income.

Much the same applies to any form of a gamble – a horse that is very likely to win a race will provide a small return for one's stake compared with an outsider. At the end of the day investment is a gamble even when it is based on an educated assessment of the market.

Degrees of Risk

Your Adviser will usually explain the risk involved in an investment in terms of 'Cautious', 'Moderate' and 'Adventurous' or somewhere in between, such as 'Cautious to Low Moderate'.

They may also use numerical categories (for example from 1 being lowest risk to 10 being highest) or even use colours ('red means danger' and so on). Any category system is, however, broad brush because it involves guesses as to the future and depends on opinion.

Regardless of the way in which your Adviser labels an investment you should also therefore make a personal assessment of whether the level of risk involved is acceptable to you. Remember your Adviser is there to help you but they do not take on the risks involved on your behalf.

Low Risk does not mean that you will not suffer a loss or even that if you incur a loss it will be of a small amount. It merely means that the likelihood of you losing capital is small and if you do make a loss it is probable that the loss will be of low magnitude.

Moderate Risk & Adventurous are just further benchmarks upon a continuous path from the safest investment through to the most speculative. Like any feature of life, investments do not conveniently group into neat pigeonholes and your Adviser will only be providing you with a general label as to the degree of risk you are likely to face.

Through discussion your Adviser will also assess your 'attitude to risk'. That is to say they will try to determine the extent to which you are prepared to risk your capital in exchange for the *potential* to gain a higher return. This will depend partly on your circumstances (for example how much you depend on the money involved to underpin your standard of living) but also on your feelings. Some individuals for example are very cautious in the way they approach a proposition. At the other extreme are those who enjoy the excitement involved in taking considerable risks in exchange for the potential of equally high rewards.

Your Adviser will then match your preferences in terms of risk and reward with a suitable product based on his understanding of your personal and financial circumstances.

Duration of An Investment

Most investments other than cash are intended for the medium to long term and are recommended on the basis that you hold them for at least five years. This is because it takes time for potential growth to emerge over short term price changes. In addition some products carry discontinuance penalties to enable the provider to recoup set up costs if the investment is not held long enough for these to be taken out over time.

As a result if you need to cash in the investment in the short term you are more likely to suffer a loss. Your Adviser will discuss the extent to which you can afford to commit capital to long term investment however you must make the final decision as to whether the investment is affordable because you will have to accept any loss on early encashment.

Your Own Views

There is no standard benchmark against which to measure the risk of a product and this is partly due to the fact that assessment of risk is very subjective and depends on the standpoint of the investor. An individual who has always kept their capital in a Building Society may regard any investment that involves any risk to capital as higher risk.

Conversely an experienced stockmarket investor may consider a broadly based share portfolio of large company shares as only medium risk. Perception of risk depends on the view of the individual and you should assess the risk from your personal standpoint as well as considering what the Adviser has to say.

Over the coming decade there are likely to be periods of strong growth for investments as well as further downturns. It is difficult to grasp when investments are going up that they might ever plummet and equally hard in bleak conditions to understand that markets generally recover in the long term.

Your Adviser will assist you in arriving at a balanced decision but he cannot guarantee results. He will describe the level of risk involved in broad terms. Risk is not an exact science and your personal views are more important than any generalised categorisation of risk provided.

You are therefore urged to carefully read the Adviser's report and the 'key features' brochure describing the investment you are buying before finally committing yourself. Do not merely rely on your understanding of discussions. The Adviser's recommendation may meet needs that he has identified but it is equally important that you are happy with and understand the advice that is given.

Virtually all investments involve the risk that you may receive back less than you put in. Even low risk investments can involve a significant loss of capital in untoward market conditions. If you are in any doubt as to how the recommended investment works or the risks it involves seek further clarification from your Adviser.

Different Types of Investments

One of the reasons you are likely to have consulted an Adviser is because you are seeking guidance as to how to achieve the best return for your money with the least risk. Although your Adviser can choose from a variety of different products, all may contain one or more of the basic types of asset such as cash, shares, property, government gilts and Bond funds.

Cash

Placing money in the Building Society is perceived as free of risk but even a deposit account can erode your capital in real terms if the interest you receive is less than inflation.

Gilts & Corporate Bonds

These are respectively loans to the government and to companies. They usually pay a fixed amount of interest with the nominal value of capital being returned in full after a pre-determined length of time. Gilts are as safe as the government however, but will only return capital at the end of the agreed term.

If cash is needed beforehand the Gilt has to be sold on the open market and the price paid will reflect demand, which varies according to interest rates.

Corporate Bonds are as safe as the company to which the money is being lent and even the most solid company can go to the wall. The same rules apply as for Gilts if cash is required before the end of the term.

Any investment our Advisers recommend may involve one or more of the above assets and it is the overall mix of assets and the way that these are structured that is important in balancing risk and reward.

We are covered by the FSCS. You may be entitled to compensation from the scheme if we cannot meet our obligations.

Most types of investment business are covered up to a maximum limit of £50,000.

Property

Bricks and mortar usually retain some value whatever the future. However demand for property fluctuates in line with rental demand and interest rates.

In addition the value of property depends on a valuer's opinion and can be affected by market sentiment. Property can also be hard to sell in poor market conditions and this can affect its value and/or delay encashment.

Shares

Shares represent part ownership of a company and they are traded on the stock exchange, where their price varies according to demand. Demand depends on the current and perceived future profitability of a company. Shares pay a 'dividend' representing part of the profits made by the company. Ultimately if a company becomes insolvent, a share can become valueless.

Derivatives

Are complex contracts related to the likely future value of shares or commodity prices. Although 'futures and options' have received bad press as a result of scandals such as the failure of Barings Bank, derivatives act as an important structural balance within the financial system and enable providers to offer products with safety features such

Appendix A

Scale of Investment Risk

Safety First

A Safety First Investor is looking for an investment where the probability of any fall, and the size of any fall, in the value of their capital over a relatively short time period is low or non-existent. The return is likely to be similar to that available from a high street deposit account and as a result, over the long term, the Safety First Investor runs the risk that inflation may reduce its real value.

Cautious

A Cautious Investor is looking for an investment where the return should be slightly better than that available from a high street deposit account and accept that the value of the investment could fall as well as rise. They would feel uncomfortable however if their investments were to rise and fall in value very rapidly.

Balanced Investor

A Balanced Investor is looking for a balance of risk and reward, seeking higher returns than those available from a high street deposit account and willing to accept a certain amount of fluctuation in the value of their investments as a result. However, they would feel uncomfortable if their investments were to fall in value significantly in one year.

Motivated Investor

A Motivated Investor is willing to accept a higher level of risk on their investment, in return for, higher returns in the long run. They are willing to accept a good amount of fluctuation in the value of their investments as a result. They would feel comfortable if their investments fell in value more than one quarter in one year and would see this as a time to ride out the storm rather than a time to purchase more.

Acquisitive Investor

An Acquisitive Investor is willing to accept a much higher level of risk on their investment in return for higher returns in the long run. They are willing to accept a good amount of short-term fluctuation in the value of their investments as a result. They would feel comfortable if their investments were to fall in value more than one quarter in one year and may well see this as an ideal time to purchase investments because of their cheaper asset values.

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