

Consumer guide to risk



What is risk?

Risk is another word for uncertainty. While all investments carry an element of risk, the amount of risk you take directly affects any potential returns and losses. Generally, if there is less risk to your investment, the lower the potential return you can expect; whereas the higher the risk, the greater the Potential return, but also the more likely your investment is to fluctuate in value and suffer potential losses.

Risk exists whenever you invest your money – even keeping money in the bank carries the risk of returns not keeping pace with inflation.



Types of investment risk

There are many different ways that risk that could affect an investment:

The risk that companies will be unable to meet their repayment commitments e.g. Lehmans and Landsbanki

The risk that an investment may be hard to sell e.g. property. This may mean you cannot sell the investment when needed or the property has to be sold below market value

The risk that an investment will fall in value (in real terms) as interest rates rise

The risk that equity investments will fall in value due to general falls in investment markets

The risk that investments or deposits in overseas companies will fall (in real terms) if Sterling becomes stronger

The risk that an investment will fall in value due to circumstances / events linked to a particular company / industry

The risk that the true value of savings will fall (in real terms) in times of high inflation

Depending on how you decide to invest your money, some of the above risks may apply, but your adviser will attempt to limit these risks by selecting products and funds that minimise the risk. However, the risks can never be completely removed.

Types of investment

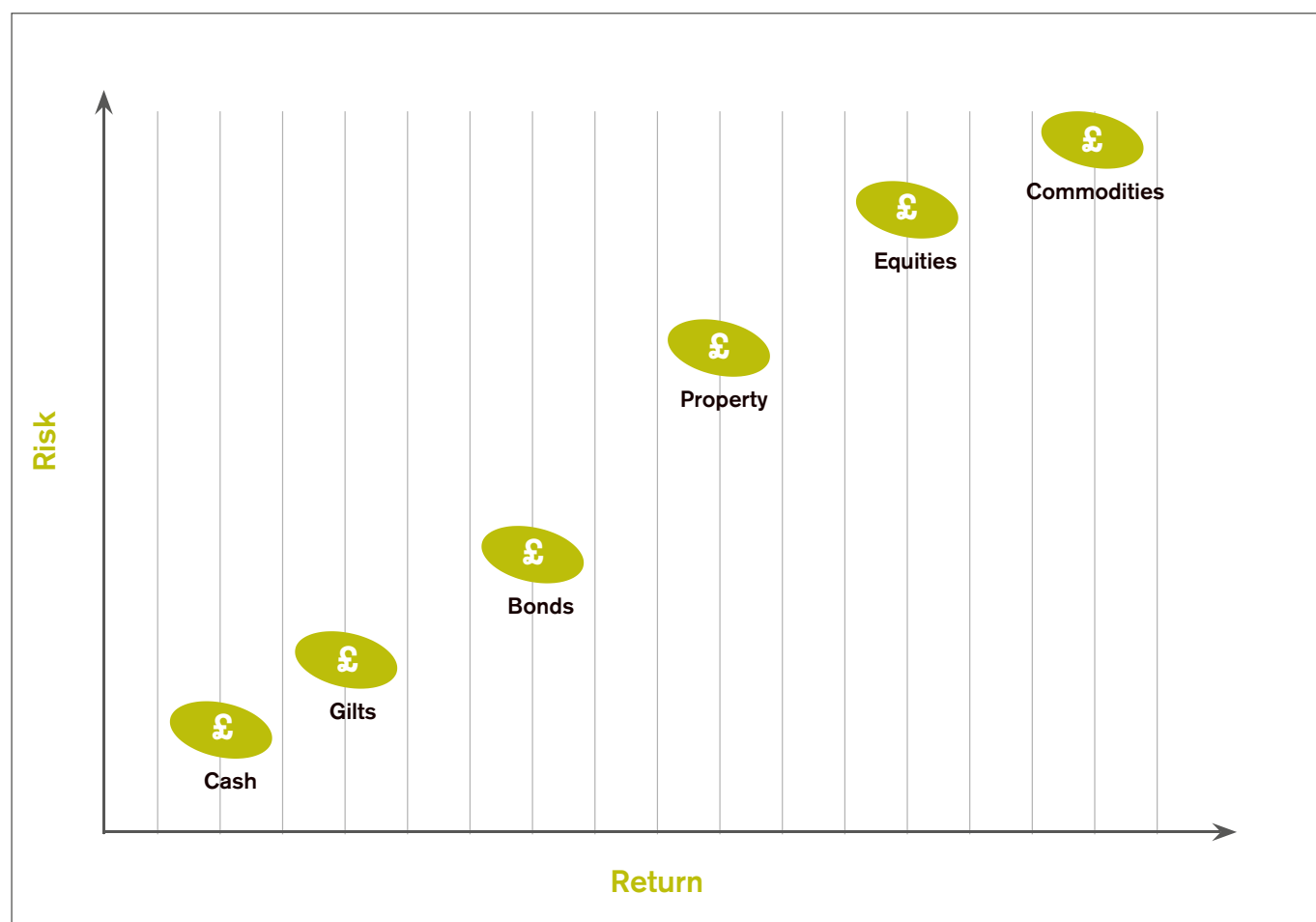
Different investment types and their risks

Different investments (known as asset classes) are commonly used to build a suitable investment solution. The asset classes tend to perform differently and carry different levels of risk, so using them together in different proportions aims to spread (and limit) the risk and achieve the desired investment returns. It is possible to invest in an appropriate range of asset classes through investing in one or more funds.

Some of the more common asset classes are explained below:

Asset Class	Description	Risks	Benefits
Cash	Usually held via bank or building society accounts, although cash can also be held in an ISA (Individual Savings Account) and in National Savings, which often offer fixed term savings accounts at better rates than instant access accounts.	<ul style="list-style-type: none"> Returns don't keep pace with inflation Bank goes 'bust' Little / no capital growth potential Returns affected by fluctuations in currency values (if held in overseas currency) 	<ul style="list-style-type: none"> Capital security Interest consistently paid (mostly variable, but could be fixed in some cases)
Fixed interest	<p>Usually held in the form of bonds or gilts.</p> <p>Government Bonds (such as UK 'gilts') are issued to raise funds for, for example, infrastructure investment. These are guaranteed by the issuing government.</p> <p>Corporate Bonds are issued by companies to raise funds for activities such as expansion or research and development. These may carry a higher level of risk than government bonds.</p> <p>In return for the loan, the investment provides a regular income from the interest until the loan is repaid.</p>	<ul style="list-style-type: none"> Returns are affected by changes in interest rates The issuer cannot meet the interest payments or repay the loan Returns affected by fluctuations in currency values (if held in overseas currency) Returns don't keep pace with inflation 	<ul style="list-style-type: none"> Opportunity to earn more than a deposit account and possibly match/beat inflation Regular income (often fixed) Loan from each bond is (usually) repaid in full at the end of its particular term
Property	Both residential and commercial property is often used for investment purposes – either through direct investment or via a property fund. Investing in property can provide income (rent from a tenant) as well as capital growth (when selling it for a profit in the future).	<ul style="list-style-type: none"> Property can be difficult to sell The inherent risk of losses within the property market Returns can be volatile Returns affected by fluctuations in currency values (if held overseas) 	<ul style="list-style-type: none"> Steady income potential Long-term capital growth potential
Shares	Also known as "equities" or "stocks" – the holder becomes a part-owner of the company (a shareholder). The aim is for the value of shares to grow over time as the value of the company increases in line with its profitability and growth. In addition, a dividend may also be paid, which is an income paid out of the company's profits. Individual company shares can be bought, but are more usually accessed via a fund that invests in a wide range of companies.	<ul style="list-style-type: none"> The inherent risk of losses within the equity market Losses linked to a particular sector/ geographic region Returns generally can be volatile Returns affected by fluctuations in currency values (if held overseas) 	<ul style="list-style-type: none"> Opportunity for high returns Inflation-proofing (as shares tend to outperform inflation over the long-term)
Commodities	<p>There are generally two types of commodities, 'hard commodities' and 'soft commodities'. Hard commodities include crude oil, iron ore, gold, and silver and have a long shelf life. Agricultural products such as soybean, rice or wheat, are considered 'soft commodities' since they have a limited shelf life.</p> <p>Commodities can either be held directly e.g. gold sovereigns, but are more usually held via a fund that invests in commodities.</p> <p>The aim is for the value of the underlying assets to increase over time.</p>	<ul style="list-style-type: none"> The inherent risk of losses generally within the commodity market Losses linked to a particular commodity Returns can be volatile Returns affected by fluctuations in currency values (if held in overseas currency) 	<ul style="list-style-type: none"> Opportunity for high returns Inflation-proofing (as tends to out-perform inflation over the long-term) Tends to be uncorrelated to the other asset classes

Expected returns

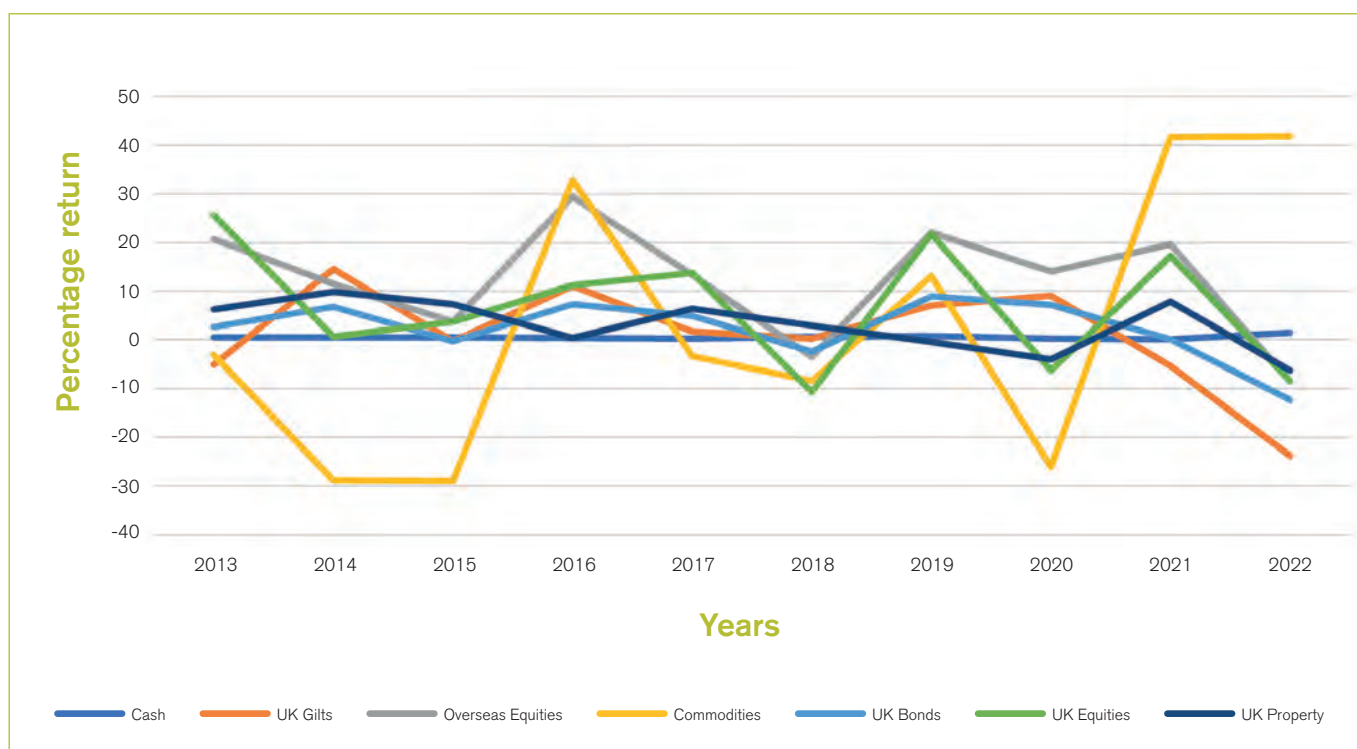


This graph demonstrates that high investment returns are possible, but in order to get better returns there is usually an increasing amount of risk. Often the agreed approach is a balance between risk and reward.

The aim of investing successfully is to achieve the best possible returns for the level of risk you are prepared to take.

Volatility

The graph below shows the percentage returns for the main asset classes over the calendar years 2013 to 2022.



Source

All of the following are sourced from FE Analytics.

Asset Class	Index/Measure
Cash	Bank Of England Base Rate TR in GB
UK Gilts	IA UK Gilts TR in GB
Overseas Equity	MSCI ACWI ex UK TR in GB
Commodities	S&P GSCI GTR in GB
UK Bonds	UT Sterling Strategic Bond TR in GB
UK Equity	UT UK All Companies TR in GB
UK Property	UT UK Direct Property Retail TR in GB

It's clear that none of the asset classes has performed consistently well in all years – the returns vary (sometimes significantly) from year to year. This variation from the average is what is known as 'volatility'.

If a fund value varies greatly from the 'average' returns, the volatility will be high; conversely a low variation indicates low volatility. Generally speaking you should avoid putting large proportions of your assets in volatile assets unless you are able to leave your investments in place for many years and can afford to accept the potential losses. Shares are the most volatile of the asset classes and their value can vary dramatically over a very short period of time; conversely cash and fixed interest don't tend to be volatile, but their returns are also generally lower.



Spreading the risk

As we've seen, not all assets perform equally and without a crystal ball it is not easy to guess which will provide good returns and which will not. Therefore, the main principle of efficient investing is diversification, which aims to ensure investors have a good spread of investments across the different asset classes, investment sectors, geographical areas and individual companies.

By achieving this, poor returns from one individual investment should not have a significant impact on the overall returns. By diversifying you can increase your potential returns whilst also reducing the level of overall risk you are taking.

Peter and James each have £5,000 to invest. Peter decides to invest all his money in Company A and buys 500 shares (worth £10 each). James also invests in Company A, but only buys 100 shares. He splits the remainder of his investment (£4000) equally between companies B, C and D. After 6 months Company A's shares suddenly drop to £5 each and Peter's investment is now only worth £2500. James's investment with Company A has also fallen in value and is now worth £500, however, his investments with Companies B, C and D have all risen in value and are now worth £1200 each. So by diversifying, the drop in share price did not affect James as much as it did Peter and his overall investment is now worth £5300. If Company A was subsequently to fail, Peter would potentially lose all of his investment, whereas James's overall loss would be limited to 20%.

Your risk approach

No-one can tell you how much risk you should be happy with – this is a personal decision likely to be affected by your personality, your circumstances, your investment goals and your personal experience. Identifying an appropriate risk approach involves considering a number of factors and you may agree to take a different approach for different investment goals. Your adviser's role is to help you agree the level of risk that is right for you and then recommend suitable investments for your needs.

There are five main areas that your adviser will help you consider:

1. Your “appetite” for risk

This can be described as your level of willingness to take risk, which can be difficult to quantify. To help with this, your adviser may ask you to complete a “risk questionnaire”. Your responses to the risk questionnaire will help your adviser understand how you feel about taking investment risk. The next consideration is whether you can afford to take that level of risk.

2. Your capacity for loss

In other words, how reliant you are on the money you are investing and how much of it could you potentially afford to lose?

In order to achieve returns beyond a minimal level, you need to be willing and able to accept the possibility of losing money.

You would be considered reliant on your capital if you need it to maintain a reasonable standard of living e.g. to pay for essential outgoings. Your adviser will talk to you about whether you would experience a significant reduction in your standard of living, either now or in the future, if you were to suffer a capital loss (or failed to achieve a level of capital), either because you are reliant on your total capital or the income derived from it. Your adviser will also talk to you about the potential consequences of any capital losses and how much capital you could afford to lose before suffering serious detriment.

You should never take more risk than you can afford.

3. Your need to take risk

Do you have a specific income or investment target in mind? Is this goal something you'd like to achieve (e.g. to pay for a cruise), or a need to achieve (e.g. to pay for private school fees)? Your adviser will help you understand the range of returns you could expect, for a given risk approach. Where there appears to be a shortfall, your adviser will discuss with you what would happen if you didn't meet this target and how it would impact on your standard of living.

However, as we saw earlier, large potential gains don't come without the risk of large potential losses; it's important to consider the balance between potential gains and losses and the likely impact of any losses. After discussing the potential risks, you may decide you are willing and able to increase the risk in order to increase your potential gains. However, in some cases, an investment target may not be realistic and you may need to consider reviewing your goal or considering how it could be achieved in other ways e.g. investing more and/or increasing the investment term. Increasing the level of risk in order to achieve a goal, should only be done with extreme caution.

4. Your investment timeframe

How long are you willing and able to leave your money invested? Short term investing can be more risky, as losses may not be regained quickly; therefore a less volatile approach may be best. When discussing your risk profile, your adviser will consider the likelihood of you needing to access your money earlier than anticipated, as you may need to avoid investing in volatile assets that may rise and fall significantly and frequently. Your adviser will also talk to you about putting in place an 'emergency' fund, if you don't already have one, as this will reduce the need for you to access your investments early.

5. Past experience and knowledge

In recommending a suitable investment approach, your adviser will consider if you have existing investments, or have held investments in the past, as this may be an indicator of the level of risk that you are willing and able to take with your money. Sometimes your past experiences (good and bad) may cloud your judgement and may influence your willingness to take risks in the future. If you haven't had previous investment experience, it may be difficult for you to know how you would actually feel if you lost any of your money. For clients with little or no investment experience, a lower risk approach may be appropriate initially.

What happens now?

Having read this guide, you should have a basic understanding of risk and how it relates to your investment decisions. In order to recommend a suitable investment approach for you, your adviser will need to consider the five main factors highlighted within this guide. Taking everything into account your adviser will then recommend a suitable investment solution to meet your needs.

Contact us

To find out more, contact Ecclesiastical Financial Advisory Service today, on

0800 107 0190

Lines are open 8:30am – 5:30pm Monday to Friday (excluding bank holidays). We may monitor or record calls to improve our service

You can email us at

getadvice@ecclesiastical.com

Or visit us at

www.ecclesiastical.com/getadvice

Other useful contacts

Ecclesiastical home insurance

0345 777 3322

www.ecclesiastical.com/homeinsurance

Ecclesiastical church insurance

0345 777 3322

www.ecclesiastical.com/churchmatters

If you would like this booklet in large print, braille or audio format please call us on 0800 107 0190. You can also tell us if you would like to always receive literature in another format.

Benefact House, 2000 Pioneer Avenue,
Gloucester Business Park, Brockworth,
Gloucester, GL3 4AW

 **ecclesiastical**
Financial Advisory Services

Ecclesiastical Financial Advisory Services Ltd (EFAS) Reg. No. 2046087. Registered in England at Benefact House, 2000 Pioneer Avenue, Gloucester Business Park, Brockworth, Gloucester, GL3 4AW, United Kingdom. EFAS is authorised and regulated by the Financial Conduct Authority. Firm Reference Number 126123.