RETIREWELL
WEALTH MANAGEMENT SOLUTIONS

PROFESSIONAL PRACTICE
FINANCIAL PLANNING ASSOCIATION of AUSTRALIA

Risk and return: what you need to know

Achieving any goal in life usually involves starting out with a plan. Investing is no different. One of the most important things to understand before you embark on an investment plan is the relationship between risk and return.

Some investors focus only on maximising returns without considering the risk taken to achieve those returns. Others are so concerned about losing money that they seek to avoid risk altogether. Yet the single, most important lesson investors can learn is that risk and return cannot be separated.

Your appetite for risk changes over time

When it comes to investing, often the more risk you take, the higher your potential return. However, there are different types of risk and many change over time or have different implications depending on your time horizon, your attitude towards the volatility of investment returns and what stage of life you're in.

Because the sharemarket is volatile, the amount of investment risk you take on may change significantly depending on how long you are going to hold an investment for – this is termed your investment horizon.

Your life stage and investment horizon are vital to determining what type of risk you should take on. Different life stages come with different financial and family commitments – and this has implications for the risk you can bear.

Common risk profiles

There are many investments available with different levels of risk to cater for investors of different risk profiles. While the investment timeframe is naturally linked to life stage so risk profiles can be generalised among age groups (that is, the younger you are, the longer investment timeframe you have and the more aggressive you can be), there is no 'one size fits all' approach to risk profiling among age groups.

Here are the main risk profiles:

Conservative

Conservative investors are generally prepared to accept lower returns with lower levels of risk in order to preserve their capital. Their portfolios tend to be allocated predominantly in defensive assets, such as cash and fixed interest, with the remainder in growth assets.

For this reason, people in retirement (in the wealth protection phase of their investment path) may adopt a more conservative attitude to risk. They have less time to ride out the ups and downs of the sharemarket and tend to have less of their portfolios allocated to shares and other high risk asset classes.

Balanced

Balanced investors generally have more of an equal mix of growth and defensive assets, and are comfortable with taking calculated risks to achieve good returns.

Growth

Growth investors are more comfortable with a higher level of risk in order to achieve potentially higher returns. Their prime objective is to accumulate assets over the medium to long-term and capital security is secondary to potential wealth accumulation.

Investors in this category can therefore expect to have around 85% of their portfolio allocated to growth assets, although still diversified across shares, property and alternative assets.

Whichever risk profile you may fit into, the most important consideration when it comes to investing is that your investment plan needs to be tailored to your individual needs and goals.

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