Identifying your comfort level with investment risk

Separating facts and feelings to create the right portfolio for you

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Does the fluctuating value of your investment portfolio cause you great discomfort? Are you confident the value of your investment will be sufficient when you need it? These are but a few questions you may want to consider as you look towards your financial future.

Investing for the future can be a tricky business as there are so many things to consider — and who better understands the amount of investment risk you are comfortable with than you? But with so many different types of investment products, different asset classes, different industries and countries, determining the right strategy becomes a daunting task. Taking the time to make the right decisions is imperative, as this will determine the manner in which your investment portfolio is constructed.

For instance if you are uncomfortable with investment risk, an appropriate investment portfolio would be comprised mainly of the more stable fixed-income type investments. The focus is on capital preservation and income generation. As equities are added to a portfolio the potential for a higher rate of return increases, but so too does the volatility of your investment.

One of the best tools to assist you through the process of identifying how comfortable you are with investment risk is our investment questionnaire to get you thinking about how much potential investment risk you are prepared to assume. Answers in the questionnaire help us to create a framework that we use to construct a sound, well-diversified strategy for you.

Completing the questionnaire with your Consultant tends to be the best approach. Regardless of your own personal investment experiences or investment knowledge many investors feel they benefit from having the opportunity to further discuss certain points or have a professional expand on some of the questions. Although the questions are vital, the discussion around them is just as important as you develop solutions on how best to achieve an investment goal.

Another approach is to complete a questionnaire on your own. There are some who see this as an advantage as they would otherwise feel a sense of urgency to complete the questionnaire without having ample time to reflect on a question or consult with other family members. The downside is if you are an inexperienced investor with limited investment knowledge then you may have questions. Should you choose this latter approach, it is highly recommended that you seek answers before proceeding.

The type of questions that appear on the questionnaire are both factual and feeling based. Fact based questions are used to gauge the period of time you are expecting to be invested and the length of time you expect to be withdrawing your assets. If your investment time frame is less than four years, you really should not be invested in any asset riskier than a T-Bill. That is because market volatility can be quite severe in the short term and an investment portfolio requires sufficient time to recover from that short-term volatility.

Some experts believe that if you have a long investment time horizon — beyond ten years — you should invest in a more aggressive portfolio. The logic stems from historical trends that have shown over the long term you will benefit from a higher rate of return because you will have ample time to recover from short-term volatility.

While this may be true, the fact remains that a lengthy time frame will not change the way you feel in the short term when the markets go through a severe decline.

That is why the feeling based questions make up such a large portion of a questionnaire. The purpose of these questions is twofold. First, they serve as a tool to prepare you for what you should expect. Second, they focus on your logic and emotions specifically designed to identify a consistent pattern of how you perceive investment risk and what you are capable of realistically withstanding.

Often risk is measured by your ability to withstand investment losses. This is such an important indicator because it does not matter if you are a conservative investor or an aggressive investor, it takes time for an investment strategy to work. The biggest mistake you can make is to overstate your comfort level with risk, as this is often a precursor to abandoning your investment strategy at the first sign of market volatility. Choose the right strategy from the start and stick with it. Over the long term you will be rewarded.

continued on next page

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Perhaps you completed a questionnaire some time ago but are uncomfortable with how the market is behaving. This is not an uncommon reaction to the market volatility that has been prevalent in recent years. As a result of this volatility many investors now have a far better understanding of what to expect from their investment and what they are comfortable with. It is human nature to assume more risk when things are moving along quite well. The late 90s were a prime example where investment markets were steadily moving upwards and more investors were willing to assume greater risk by investing in a more aggressive portfolio. This was because the concept of risk seemed so far removed. Now that we are coming out of a bear market, many investors have had time to reflect on what investment risk means to them. Situations such as these certainly warrant a review of your investment goals as well as the completion of a new investment questionnaire.

For new investors, it is highly recommended that you take adequate time to complete an investment questionnaire. If you have been invested for some time but are uncomfortable with the behavior of the markets there is no time like the present to work through a questionnaire and realign your investment portfolio with your investment goals. Many valuable lessons have been learned through experience and many investors have come to learn they are actually more risk averse than they once thought.

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