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# Attitude to Risk

Every investment that you make carries some risk. Usually, the higher risk you are prepared to accept, the more you will be rewarded for taking that risk. However, this also means there is more chance you could lose more.

Taking less risk is the opposite; your investments may be safer, but the reward may be less. For example, if you invest your money in a bank, it is usually considered ‘safe’ as it is very rare that you will lose the initial capital that you invested. There have been instances of banks failing over the years, but this is rare. The Financial Services Compensation Scheme (FSCS) also provides a guarantee of up to £85,000 per eligible person, per bank.

## Risk vs Reward

Investing in a bank may be considered ‘safe’, but you should consider that inflation, or the general increase in the cost of living, can erode the ‘real’ value of your investment. As an example, if inflation is 6% and the bank pay you 2% interest, the real value of that capital is not keeping pace with inflation, albeit the capital is relatively safe.

On the other end of the scale, investing in high-risk, stock-market based company shares means you are taking a risk with the capital that you invest. If the shares increase in value, you will increase the value of your investment, but you should consider that values will fluctuate and there have been examples in history of stock market crashes and investors losing the value of their investments.

## Timescales

Unfortunately, no one, not even investment experts are able to beat the markets all the time. Each individual investor is different, and your attitude towards investment risk may be very different to another person’s. Some people may be happy to take a risk and leave the money invested for a long period, such as 20 years, others may wish to invest for a shorter term. For a shorter-term investment, you may want to take less risk to minimise the risk of longer-term market fluctuations.

Therefore, the time period of investment is important, because if the market falls, you need to ensure you have time to recoup any losses before encashing the investment. However, it is impossible to time when you make the investment and later encash it, because no-one knows when the markets will rise and fall. The key principle that is applicable to all investors is time in the market.

The number of years, or decades, that you choose to invest for to achieve a particular financial goal can make a significant difference to the assets that you choose to invest in. An investor with a longer time horizon may feel more comfortable taking on a riskier, or more volatile investment because they can ride out the inevitable ups and downs in the markets.

## Why not just invest in cash

Cash can provide a safe home for your capital, meaning that the value of your capital will not fluctuate or be less than the amount you invested. The interest rates paid can vary.

Cash normally forms the first layer of an investment portfolio, having done that investors will generally build their portfolio further by spreading their capital across other asset classes. Equities are known as asset- backed investments, i.e., the company's assets, both physical and intellectual underpin a company's shares. Over the long term, asset values should grow in line with the growth in the general economy.

There is a considerable volume of research that suggests that equity-based investments can outperform cash over the longer term. Over other periods of time, fixed interest and property have also performed well.

By investing in asset classes other than cash, you're taking a calculated risk that in doing so you're increasing the chances of achieving higher returns, especially over the longer term.

However, there is no guarantee that these asset classes will ever outperform a deposit account or will return the capital you invested. Whilst in the past equities have outperformed cash, there have also been long periods of underperformance, and there is no guarantee that markets will perform the same way in the future. Ultimately, you must understand the risks involved with such investments and be prepared to take the risk.

## Modern Portfolio Theory (MPT)

Modern Portfolio Theory is a term covering the development and management of investment portfolios. Research in this theory originated from Professor Markowitz in the 1950s and was later further advanced by academics Fama and French.

The key principle of MPT is an understanding of the characteristics of each asset class, and how to blend them to create a portfolio that minimises risk whilst maximising return for a given level of risk. It is a method that can be used by risk-averse investors to construct diversified portfolios that maximise their returns without unacceptable levels of risk.

A key component of the MPT theory is diversification. Most investments are either high risk and high return or low risk and low return. Markowitz claimed that investors could achieve their best results by choosing an optimal mix of the two based on an assessment of their individual tolerance to risk.

The MPT argues that any given investment's risk and return characteristic should not be viewed alone but should be evaluated by how it affects the overall portfolio's risk and return. In other words, an investor can construct a portfolio of multiple assets that will result in greater returns without a higher level of risk.

## Risk Tolerance

Risk tolerance is the assumed level of risk that an investor is willing to accept. Through gaining an accurate assessment of your risk profile, 2plan can develop a tailored financial plan that reflects your perception of an acceptable balance between risk and the financial compensation required for bearing this risk.

At 2plan we use a scientifically developed measure of risk tolerance within a structured process. We feel that this provides us with the best approach to determine the risk tolerance of clients. A risk tolerance profile provides us with a good basis upon which to explore the type of investments that are most suitable.

## Attitude to Risk Questionnaire

The 2plan attitude to risk questionnaire has six outcomes. These are as follows:

1. **Secure**
2. **Defensive**
3. **Cautious**
4. **Moderately Cautious**
5. **Balanced**
6. **Adventurous**

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| You do not have to accept the outcome of the risk profile questionnaire. You can complete the questionnaire again if you feel the outcome does not describe your attitude to risk.<br><br>Alternatively, you can simply discuss the outcome with your adviser and if necessary, choose another outcome that fits better with your views. |

## Asset Allocation

Asset allocation is a commonly adopted investment strategy used by financial advisers. It considers the use of multiple or mixed asset classes in attempt to balance risk versus reward. This is achieved by adjusting the percentages held in an investment portfolio according to the investor's risk tolerance, goals and investment time frame. Asset allocation is based on the principle that different asset classes can perform differently during identical market and economic conditions.

Your adviser will select and explain a fund or combination of funds that they believe are suitable for you, based on the information you have provided. For certain products, it may be appropriate for us to recommend that up to 4% of an investment amount is held in a separate cash account to cover fees and charges.

Over time, the asset allocation of your investment will change, and we would recommend that you undertake regular reviews to ensure it remains suitable for your investment needs.

Once invested in a portfolio, the asset allocation at any given point in time will differ from the starting asset allocation, because of market movements.

By including assets with investment returns that move up and down under different market conditions, this can help to protect your investment against significant losses. Historically, the returns from the major asset classes have not moved up and down at the same time, so by investing in more than one asset type, you reduce the risk of losing money and your portfolio's overall investment returns should suffer from less fluctuation.

## Strategic Asset Allocation (SAA)

Strategic asset allocation seeks to create an overall asset mix that will provide the optimal balance between expected risk and return for a long-term investment horizon.  Various studies over the years have identified that approximately 80% of returns is derived from the strategic asset allocation, so getting it right is very important.

Strategic asset allocation establishes a framework for an investor’s portfolio by properly aligning their asset mix with their long-term investment goals and objectives.  Countless studies have shown that investors’ asset allocation is the primary driver of portfolio returns. Maintaining an appropriate strategic asset allocation is what keeps investors pointed in the right direction for the long-term.

The primary focus of strategic asset allocation is constructing “efficient” portfolios.  Efficient portfolios maintain the optimal mix between different asset classes such as stocks, bonds and cash with the goal of maximising returns for a given level of risk.  The goal of efficient portfolios could also be described as achieving the lowest level of risk or volatility for a given level of expected return.  While each investor’s specific risk tolerance, time horizon and investment objectives may result in a different strategic mix of assets, the goal is always the efficient allocation of portfolio investments.

The strategic asset allocation approach involves sticking with your original allocation over long periods of time, typically spanning a decade or more.  Advocates of this approach would argue that the long-term strategic focus helps investors avoid making short-term, emotional decisions based on current market events.

To this end, 2plan utilises specialists to ensure the correct mix of asset classes are used, and this is annually refreshed to ensure the mix of assets is kept up to date and in line with global economic and political events.

## Maximum drawdown

Maximum drawdown is the maximum loss from peak to valley of an investment before a new peak is attained. Maximum drawdown is an indicator of downside risk over a specified time period and is represented as a negative percentage.

The numbers in the table below give an indication of the historic maximum drawdown of an investment based on the various investment risk profiles. These losses are not an indication of what you will achieve should you invest today; they are purely to explain that over the given time period what the maximum losses could have been.

The maximum drawdown figures illustrated include the Covid stock market crash of March 2020 which saw one of the largest single day stock market drops in history. The charts used within the investment risk profile tool also show the maximum gain over the relevant periods for comparison purposes.

As our analysis is based upon historic information, it is important to remember that past performance is not a reliable indicator of future results. If you have any concerns, you should not proceed until you are comfortable with and fully understand the nature of the risks that you are taking.

Maximum drawdown and performance figures used in the investment risk profile tool have been calculated using data sourced by Figure Out Ltd to show returns based on a back-tested portfolio.

## 2plan Risk Profiles

| Risk Profile | Attitude to Risk Description | Asset Class & Allocation | Maximum Drawdown since 2018 |
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| **1 Secure** | Knowing your money is safe matters more than high returns. You would rather keep it in the bank than invest it in the stock market.<br><br>You did not want to take any type of investment risk with your money and therefore you did not complete the risk profile questionnaire. This means a bank or building society investment could be more appropriate for your needs as you will not see any fluctuation caused by the stock market.<br><br>Whilst your capital will be safe, please bear in mind that inflation can reduce the buying power of your money over time. You are protected by the Financial Services Compensation Scheme up to £85,000 should your bank or building society fail. | Cash 100% | N/A |
| **2 Defensive** | You don't like taking big risks with your investments but you are prepared to make an investment but with a lower proportion invested within equities.<br><br>You are willing to invest a small proportion of your capital into stock market-based investments, this is in an attempt to achieve returns that are slightly above inflation.<br><br>The majority of your capital will be invested within fixed interest securities which are less volatile than stocks and shares but you should remember that there are still circumstances where you could get back less than you invested.<br><br>Whilst you are prepared to take a small amount of risk in order to achieve more growth over the medium to long term, you would be uncomfortable if you saw losses in any one year in excess of 15%. | Fixed Interest 57.5%<br><br>Alternatives 22.5%<br><br>Developed Equities 18.0%<br><br>Emerging Equities 2.0% | -10.30% |
| **3 Cautious** | You are usually uncomfortable taking large risks with your investments. You are willing to take limited risks because you know that could bring potentially better returns in the long run.<br><br>You are willing to invest around a third of your capital into stock market-based investments, this is in an attempt to achieve returns that are above inflation.<br><br>Most of your capital will be invested within fixed interest securities, which are less volatile than stocks and shares but you should remember that there are still circumstances where you could get back less than you invested. We will keep the majority of your equity investments in developed economies (e.g. UK, US, Europe) but a small portion of your capital will be invested into less developed overseas equities which brings additional volatility.<br><br>Whilst you are prepared to take some risk in order to achieve more growth over the medium to long term, you would be uncomfortable if you saw losses in any one year in excess of 20%. | Fixed Interest 52.5%<br><br>Alternatives 7.5%<br><br>Developed Equities 37.8%<br><br>Emerging Equities 2.2% | -14.70% |

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| **4 Moderately Cautious** | You know that reaching your investment goals means taking risk. You confirmed that you are ready to do that with at least some of your investments.<br><br>You accept that in order to achieve a potentially higher return over the medium to long term, around half of your capital will be invested in stocks and shares.<br><br>These equities will be both developed and emerging economies and you accept the additional volatility that this may bring. You understand that the remainder of your investment is distributed across other less volatile asset classes.<br><br>Although you would be prepared to accept some falls in value, you would be uncomfortable if you saw losses in any one year in excess of 25%. Remember that there are still circumstances where you could get back less than you invested. | Fixed Interest 39.5%<br><br>Alternatives 5.5%<br><br>Developed Equities 46.4%<br><br>Emerging Equities 8.6% | -19.90% |
| **5 Balanced** | You are ready to take a risk with a substantial proportion of your investments because you know it could result in better returns in the long run.<br><br>You accept that in order to achieve a potentially higher return over the medium to long term, the majority of your capital will be invested in stocks and shares. These equities will be both developed and emerging economies and you accept the additional volatility that this may bring.<br><br>You understand that a smaller amount of your investment is distributed across other less volatile asset classes. Although you would be prepared to accept some falls in value, you would be uncomfortable if you saw losses in any one year in excess of 30%.<br><br>In the event of a stock market crash you are prepared to wait until the returns improve rather than surrendering your investment to protect the remaining capital. Remember that there are still circumstances where you could get back less than you invested. | Fixed Interest 26.25%<br><br>Alternatives 3.75%<br><br>Developed Equities 55.2%<br><br>Emerging Equities 14.8% | -23.60% |
| **6 Adventurous** | You are ready to take considerable risks with all your investments to get the potential highest returns you can.<br><br>You accept that in order to achieve a potentially higher return over the medium to long term, the vast majority of your capital will be invested in stocks and shares.<br><br>Most of these equities will be overseas and you accept the high volatility that this may bring. Although you would be prepared to accept some falls in value, you would be uncomfortable if you saw losses in any one year in excess of 35%.<br><br>In the event of a stock market crash you are prepared to wait until the returns improve rather than surrendering your investment to protect the remaining capital. You may even see this as an opportunity to invest further capital. This is the highest risk profile available, and you are aware that by taking on the highest levels of risk with your investment, you could get back significantly less than you invested. | Fixed Interest 5%<br><br>Alternatives 0%<br><br>Developed Equities 72.0%<br><br>Emerging Equities 23.0% | -26.50% |

The descriptions above apply to the way that certain asset classes and investments have performed in the past, and you should remember that they may not perform the same way in the future.

The future performance cannot be guaranteed and will depend on how the selected investments perform, their tax treatment and the impact of charges.

## Capacity for loss

Capacity for loss looks at whether you have enough income and assets to cover your expenditure and liabilities and maintain a comfortable standard of living. It also looks at whether you can afford to take risk, and what you can afford to lose if an investment performs poorly.

It focuses on your ability to absorb falls in the value of your investment.

Your capacity for loss will be recorded and confirmed as part of the advice process to you.

**Please take time to read the definitions below to ensure you have been categorised correctly**

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| **None** | This means that you are an investor who cannot bear any loss of capital. The investment would be fully guaranteed, and the full value of the investment protected. There may be some losses however due to product and adviser charges. |
| **Limited** | This means that you are an investor seeking capital growth and can bear limited/small loss of the capital amount invested. |
| **Moderate** | This means that you are an investor with the ability to accept moderate loss of the capital amount invested and will not be adversely affected if investments did fall as you have other investments and income in place. |
| **High** | This means that you are an investor with the ability to accept high loss of the capital amount invested and will not be adversely affected if investments did fall as you have other investments and income in place. No capital guarantees are required. |
| **Beyond** | This means that you are an investor willing to bear losses of the whole capital amount invested as well as lose any potential gains from this capital. |

## Investment knowledge and experience

As part of our information gathering process, your adviser will also discuss with you your investment knowledge and experience.

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| **First time** | This means that you do not have any previous financial knowledge or experience and you have not invested before into a stock market-based investment. |
| **Basic** | This means that you have a basic and limited knowledge of financial products and can make an informed investment decision based on the help of the documentation and information provided to you. |
| **Informed** | This means that you have an average knowledge of financial products and can make an informed investment decision based on the documentation and information provided to you, together with knowledge and understanding of the specific factors and risks highlighted within them. |
| **Advanced** | This means that you have a good knowledge of financial products and transactions and the ability to understand and bear risk. |