Transcript

Why understanding risk matters

When you invest, it's to make money on your investment or, as we say, to get a return. So it's tempting just to focus on the return you want.

But did you know your return is not the only thing you should be thinking about? The other side of investing is the potential risk – the chance that your investment won't give you the return you want.

And every type of investment has some risk, because to make a return, you have to take risk.

So understanding risk is a big part of choosing the investment that's right for you.

Different types of investments have different levels of return and risk. Investments that are expected to have higher returns also come with higher risk.

For example, shares are a higher risk investment. Investing in shares means buying a stake in individual companies. In the short term, these share prices may fluctuate as the business goes through good and bad patches due to changing economic conditions or things like technological innovations. These fluctuations mean shares in companies are higher risk in the short term than some other types of investments, like term deposits. But if you hold on to shares for a number of years, the ups and downs tend to smooth out and they may give you a higher long-term return than many other investments.

On the other hand, a term deposit with a major bank is a low risk investment – there's very little chance you'll lose your money. But the return you get is just interest, and interest rates are low at the moment. Low return, low risk.

Understanding risk can give you peace of mind. You'll have a clearer idea of what to expect from your investments. For example, if share prices move around a lot in the short term, you know this is normal. You're less likely to panic, sell and miss out on potential long-term returns.

One good way to help manage risk is diversification – this means investing in a range of investments to spread your risk. Investments can go up and down at different times: when some are making good returns, others may not be. In extreme cases, some may lose all of their value and some may double in value. Over a number of years, diversifying can smooth out the ups and downs in your overall returns. You can diversify across types of investments, industries and countries.

Remember:

- Every investment has some risk. You need to be comfortable with the level of risk you're taking.
- Diversifying your investments can help reduce the fluctuations in the value of your overall portfolio. Once you've got an investment plan, stick with it to get the potential long-term benefits.

A financial adviser can help you figure out an investment strategy that has the right return and risk levels to help you meet your financial goals.

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