



Information Risk and Reward

We contend with risk every day of our lives, from crossing the road to playing sport. We accept these risks as we are aware of the possible outcomes, both good and bad. Risk is also a fact of life for any investor. Markets rise and fall. There is even risk in doing nothing! The highest rewards usually have the highest associated risk.

Conversely, to minimise exposure to the perils of investing, you may have to accept lower returns.

All asset classes offer investors a degree of risk. Risk is often measured by the volatility of the underlying assets. Using this measure we know that equities (shares) are riskier than gilts (government loans) because prices suffer greater fluctuations. We also know that gilts are riskier than cash for the same reason.

However this method is not infallible. Gilts are one of the safest forms of investment. If the Government is unable to pay its loans, it can print more money to compensate the investor.

Cash too can offer a risk, not to the capital, but to the spending power of the money. Due to inflation, £100 left under the bed will have a real value of around £77 in 10 years (based on inflation at 2.5%). According to a study by Credit Suisse, even deposit accounts paying interest do not escape the effects of inflation. £100 invested in 1945 would only have been worth £62 in real terms in 2001 (based on net interest being reinvested).

There is no way an investor can fully eliminate risk. The easiest way to reduce the risk of investing in equities, and improve the gain, is to increase the time you retain your portfolio. It is worth remembering that had you invested in the FTSE All Share index on any day in the past 30 years and remained invested for 10 years, you would never have lost money (source: Barclays Capital & Gilt Study). However, not everyone is comfortable exposing their savings fully to volatile equities, but they are still looking for the potential to beat the effects of inflation.

The value of your investments and any income from them can fall as well as rise and investors may not get back the amount invested.

Some investors prefer to guess which market will provide the greatest returns with an "all eggs in one basket" approach. Barton Lyle believes that diversification is the most sensible strategy. Diversification holds the key to maximising returns at a level of risk you are comfortable with.

Spreading investments across a number of asset classes works to reduce risk and therefore, by understanding how asset classes behave in relation to each other, it is possible to arrange investments that meet specified levels of risk. This 'asset allocation' method contributes to over 90% of investment performance according to research by *Brinson, Singer, Beehower* in 1991.

For more information on investment risk, contact your Barton Lyle consultant. □

