# About Investing

## Risk matters: an introductory guide

**At the heart of investing is a simple concept that goes a long way in helping to understand what it's all about: the risk-return trade-off.**

## What is the risk-return trade-off?

There's no such thing as a risk-free investment. When you invest, you are taking the risk that the value of your investment may go down as well as up, meaning you might get back less than you put in. But in exchange for that risk you're getting the potential to make a profit over time.

The risk-return trade-off is this: the higher the level of risk you take, the higher the potential returns if things go your way and the higher the potential losses if they don't.[1] Conversely, the lower the level of risk you take, the lower the potential for both returns and losses.

## Understanding your risk profile

Finding the right risk-return trade-off for you starts with understanding your personal risk profile. There are two main elements to this. The first is to have a good idea of how much risk you're able to take in pursuit of your investment goals without putting your finances in jeopardy. This is known as your capacity for loss. The second is to be clear on how much risk you're willing to take. This is known as your tolerance for risk.

If the level of risk associated with a particular investment is likely to keep you awake at night, it may be too risky for you – that is, beyond your tolerance for risk. Yet there's also a risk in being too cautious - the risk-return trade-off means that if you need a certain amount of return to meet your goals, you may need to take a certain amount of risk to achieve this. If that level of risk feels uncomfortably high, then you may need to review your goals.

There is a whole science around building personal risk profiles. So if you seek support from a financial adviser or online investment service, they will often use a questionnaire that has been developed by specialists to help you understand your own level of risk tolerance and capacity for loss.

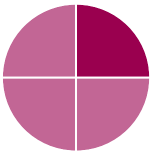
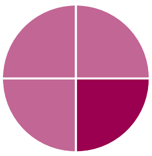
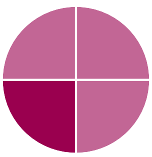
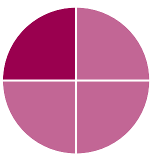
## Building a portfolio to match

Once you have that understanding you can put together a portfolio of investments with a risk-return trade-off that's suitable for you. There are a number of different routes for doing this from building your own portfolio of individual investments to using a multi-asset fund or model portfolio service. Again, a financial adviser can talk you through the options if you are not sure how to approach doing this yourself.

To be able to put together a suitable portfolio you need an understanding of the particular risks associated with different types of investment. Shares, bonds, property and cash are some of the most popular asset classes and tend to form the building blocks for most diversified portfolios.

It is possible to invest in all of these directly, but for shares, bonds and property, individual investors often choose to do so through collective investment funds, run by investment professionals like Santander Asset Management.

## A quick overview of the main risks:

| Investment type | | The main risks |
|---|---|---|
| **Shares**  | The value of a company is broken down into pieces called shares (also known as equities), which you can then buy. Shares can pay you an income (a dividend) although this is not guaranteed. | The value of your investment goes up and down in line with the fortunes of the company but also what the market view is of the company. The same goes for any dividend payments, which can also vary and may not be paid at all. There's also a risk of losing money if a company which you invest in goes bust. Companies come with different levels of risk, depending on the type of business they are in, how well established they are and how easy it is likely to be to buy or sell their shares when you need to (how 'liquid' they are). |
| **Bonds**  | These are a type of loan to a government or company over a fixed period which usually pays out a fixed amount of interest. | Bonds can be vulnerable to interest rate risk (where the fixed income you get doesn't keep pace with rising interest rates). There's also a risk of the issuer defaulting on its payments (credit risk) if it can't meet its financial obligations. Bonds are usually rated by independent rating agencies to help you assess their level of credit risk. This risk is typically seen as lower for government bonds (known as 'gilts' in the UK) and corporate bonds issued by more financially sound and stable companies, than it is for other types of bond. |
| **Property**  | Indirect investment in property by putting your money in companies which invest in physical buildings or own hotels, offices, retail shopping centres etc. | Both the value of property and rental income from it can fall as well as rise. The valuation of property can be more a matter of judgement than fact, and if there is high demand to take money out of a property investment it may be difficult to access your money at short notice, or when you need it, mainly because property takes time to sell (it is illiquid). |
| **Cash**  | Your money is held on deposit in bank and building society accounts. | Cash doesn't go down and up in value, but it isn't without risk. The interest you receive may not keep up with rising prices (inflation) meaning the buying power of your cash reduces over time. |

## Your time horizon matters

Shares usually have a big role to play for any investor seeking some degree of growth. But the exact proportion that's right for your risk profile is where the risk-return trade-off comes in.

How long you're investing for (your time-horizon) is an important consideration here. For example, if you're investing for a retirement that's still more than 10 years away, you may feel comfortable taking more risk with a higher proportion of shares because history shows that shares will typically grow over the long-term and smooth out any bumps along the way. The shorter your time-horizon, the less opportunity there is for that smoothing effect to occur.

## Doing research matters too

If you choose to invest through one or more collective investment funds, it's not enough to understand which asset class(es) these are invested in. Within each asset class some investments involve taking far more risk than others. It's the combined impact of all the risks involved across all the investments made by a fund that influences its overall risk-level.

Some types of funds are managed to stay within a target risk-level. This is a common approach with multi-asset funds for example, which blend a mix of asset classes to achieve an investment objective over time matched to an agreed risk appetite. Other funds have more specific aims, typically, when they concentrate on one asset class, for example, UK shares look to beat the performance of the FTSE All-Share Index. In practise, the level of risk they take may change over time depending on market conditions and the risks involved with each of the individual investments chosen by the fund manager.

Investment funds have to offer either a Key Investor Information Document (KIID) or a Key Information Document (KID), both of which provide standardised information. That includes the aims of a fund and its risk and reward profile (effectively, it's risk-return trade-off), on a standardised scale of 1 to 7. Level 1 is at the lowest risk end of the risk-return trade-off and 7 at the highest. It's always essential you read a fund's KIID or KID before investing to make sure you understand what you are buying into.

## Getting the balance right

In deciding how to invest and what fund or solution to use, you'll often find that it is the result of compromise. You may have a specific investment goal you either want or need to achieve over a certain timescale. However, when looking at how best to reach this target you may have to take more investment risk than you are comfortable taking to have any realistic chance of achieving this goal. In this case, you face a compromise. Either you reduce your expectations, lengthen your time horizon, or increase the level of investment risk – or a combination of all three. Striking the right balance therefore is crucial but ultimately a very individual decision. Clearly, attempting to agree such a compromise and invest appropriately often requires guidance and help from a financial adviser. They are able to discuss your options, measure your risk appetite, agree timescales and check whether your expectations are realistic. Seeking professional advice may turn out to be one of the best investments you make.

## Learn more!

Investing can feel complex and overwhelming, but our educational insights can help you cut through the noise. Learn more about the Principles of Investing **here**.

[1] Investopedia, 3 February 2020

Asset Management

# Let's be clear!

## Investment terms explained

**Asset class:** A group of investments with similar traits. Shares, bonds, property, cash and alternatives are all examples of asset classes.

**Bonds:** A bond is a loan issued by a government or a company. When you buy a bond, the issuer promises to pay a certain amount of income until the bond redeems and is repaid by the issuer. The strength of that promise varies by the issuer of the bond. This is known as creditworthiness.

**Credit risk:** The risk of default on a debt that may arise from a borrower failing to make required payments.

**Diversification:** Spreading your money across different investments to help manage risk.

**Dividend**: The income you can earn from equities.

**Fixed Income:** Also known as fixed interest. A group of asset classes that involve debt, this is usually in the form of bonds where an issuer will lend money for a predefined period and these can be issued by governments or companies. These will involve a regular coupon (interest) payment and the return of capital (original amount lent) at the maturity of the bond.

**Index:** A way of tracking the overall performance of a basket of individual investments of a similar type. For example, the FTSE 100 index tracks the performance of shares in the 100 largest companies by market value on the London Stock Exchange.

**Inflation:** Measures the increase in price of selected goods and services in an economy over a period of time.

**Portfolio:** A group of investments that are managed together to meet a particular objective.

**Property:** Property may be difficult to sell and can demonstrate significant declines in value due to changes in economic conditions and interest rates.

**Shares (often referred to as equities or stocks):** In investing, this is a share of ownership in a company. Investing in a fund gives exposure to underlying share prices without investors actually owning the shares themselves.

**Time horizon:** How long you expect to be investing for before you might need your capital back. Investing should usually be for a minimum of five years or more.