

Investment Risk management

Risk

SYSTEMATIC RISK AND UNSYSTEMATIC RISK

SYSTEMATIC RISK

Systematic Risk – also known as Market Risks are those risks which affect all companies within a market in one way or another.

For example:

- Inflation
- Recession
- Interest Rates
- Political Instability
- Exchange Rates
- War
- Confidence

Unsystematic Risk – also known as Specific Risk are risks which are unique to the company.

- Strength of Management (Marks & Spencer)
- Range of Products (Unilever)
- Geographic Location (McDonald's)
- Financial Position (B.P.)
- Innovational Factor (Apple)

UNSYSTEMATIC RISK

Total Risk = Unsystematic Risk + Systematic Risk

MODERN PORTFOLIO THEORY

Modern Portfolio theory developed by Harry Markowitz in 1952 indicates that much of the unsystematic risk can be factored out by spreading funds over more investments.

How many is deemed to be the minimum?

15-20

Modern Portfolio theory states that 95% of the unsystematic risk can be eliminated with 20 securities

BETA

One of key concepts of investment management and portfolio management is diversification.

You can diversify some of the portfolio risk away by investing in investments with different levels of risk measured by a company's Beta.

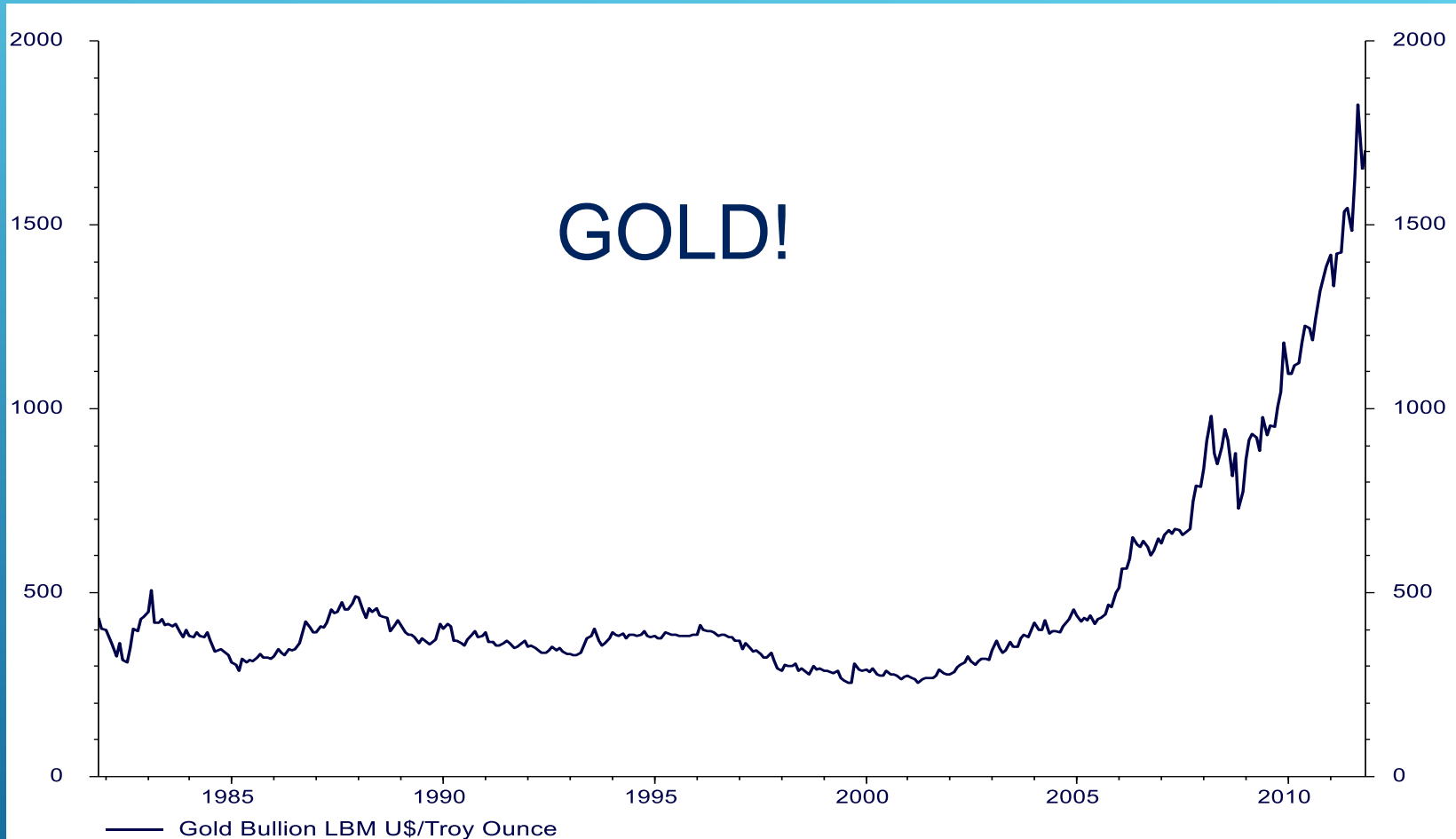
Beta is the measure of the average historic volatility of a security's return to the broader market risk and is stated as a proportion of the market risk. Beta for the whole market is deemed to be 1. A stock with a Beta of 1 is likely to move with the market. One with a Beta of 2 will move by twice the market – in both directions.

BETA

- Beta < 1 – Stock described as defensive (probably income producer)
- Beta > 1 – Stock aggressive & cyclical (probably growth stock)
- Beta can also be negative i.e. if market rises, investment likely to fall and vice-versa.

Example?

Guess what this is charting over last 30 years



Alpha is the risk adjusted measure of the active return on an investment.

It is basically a measure of a fund manager's stock-picking skill, with Alpha being used to measure individual securities, portfolios or funds.

A positive Alpha is good news and the higher the better.

Alpha = Annual Return - Expected Return

**Expected Return = Average Annual Risk Free Return + Beta
(Annual Market Return - Risk Free Return)**

ALPHA

Risk

INFLATION RISK

Inflation Risk

Inflation (RPI) over last 50 years

