

Investment Risk management

Risk

GEARING

What constitutes gearing?

RISK

Gearing

Type of risk which involves either borrowing funds to increase the amount available for investment or buying an investment such as an investment trust warrant which will react by a greater percentage than the underlying investment. Options, CFDs and other derivatives have the same geared risk elements.

1. Investor has £2500 to invest
2. Sure investment is going to rise so borrows £2500 and invests £5000
3. Shares rise 50% so sell for £7500 and repays loan
4. Percentage profit 100% less loan costs.

However, if shares fall 50% investment wiped out plus costs of loan.

Risk

KEY POINTS ON RISK

- Systematic Risk is market risk whereas unsystematic risk refers to specific risk, or investment specific risk.
- Inflation is a major risk for investors particularly those invested in cash deposits or fixed interest securities which are not index-linked. Real assets such as property and equities can provide some inflation protection.
- Interest Rate risk is measured by duration, fixed interest securities will lose value when rates rise and vice versa. Fixed interest investments are also subject to credit risk.
- Investors buying outside their base currency are taking on currency risk.
- Other main risks are political, event, liquidity and operational risk.

Diversification

KEY POINTS ON DIVERSIFICATION

- Diversification refers to combining risky investments in a way that reduces the overall risk of a portfolio.
- Diversification can be carried out at the asset class or geographical level or by holding a diversified portfolio of securities within a single market.

Gearing

KEY POINTS ON GEARING

- Gearing or leverage will increase risk as it magnifies the losses or gains made by an investment when the price of the underlying asset moves.

'The investor of today does not profit from yesterday's growth'

Warren Buffet

RISK



QUESTION TIME

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