Insights, Tacit Thought | Weekly Investment Insights

Focus on Your Objective

Published on: 18 August, 2017 **|** Author: Investment Team

Many in our industry focus on volatility of returns rather than the returns themselves and this can have a detrimental effect on client outcomes.

Every investor should assess their risk appetite and their capacity for loss before making an investment. This helps them understand the risk they are willing to tolerate when trying to achieve their objective. The objective, however, should never be forgotten; whether it be to preserve your wealth or grow it without constraint, your objective must remain a focal point of discussion. Now, objectives can change over time. An event in your life may shorten your time horizon for that objective to be reached for example, and at Tacit, we understand that an investor can change their objective at any time.

Typically, when an investor completes a risk profiling questionnaire they receive a score which will then place that investor into one of 5-10 ‘risk buckets’; 1 being for a low risk investor and 10 being for a high risk investor. A high risk investor will be told that they should invest 100% of their assets into equities as their appetite for risk allows this. Whether equities are expensive or cheap at that point does not matter because over the longer term equities provide the best positive returns for investors. All very straightforward right? We would disagree.

With equity valuations high at present, achieving a higher return from an equity portfolio than from other risk buckets is not guaranteed over the coming five years. Any meaningful correction in equities in the first two years could leave an investor at risk of not achieving their longer term objective.

Not achieving their objective is very different to losing money however. The statistics show, that even accounting for 2008, holding an equity portfolio for 7 years has historically resulted in positive returns. You may not achieve your objective but you will get your money back as markets normalise. The key is to stay the distance and not alter your investment approach following a fall in markets. Most people however get very nervous at this stage and generally make the wrong decision.

This is why most investors tend to end up in risk bucket 3-7. They either don’t have the appetite for large market losses or, and this is interesting to us, just do not need to take the risk to achieve their longer term objective.