05. Risks to consider

Understanding the risk side to investing and how that plays a part in my**super**.

Welcome to an insider's guide to investing with my**super**. As a member, it's worth knowing the ins and outs of how your money is working for you. Not that you have to do anything, but to achieve your goals it helps to understand how your investment lives and breathes.

Guide 05. Reveals the risks of investing.

Here we gain an understanding of how with high reward comes high risk, and that to benefit from change means also accepting its volatility.

What is the risk of investing?

Investing is not static, but rather lives and breathes with the changes of the world. The positive side is that there are times when the world is flourishing. The negative side is that there are times it is not. These changes affect many aspects which come with risk.

What are the risks of investing with my**super**?

Like any investment product, the my**super** superannuation scheme comes with risk. Understanding and determining what level of risk you are comfortable with are important parts of the investment decision. This includes selecting your investment fund type; Growth, Balanced, Conservative or Cash.

The following are some of these risks, and what our expert investment managers do to minimise them.

Inflation risks

Inflation is the rising prices of goods and services eroding the spending power of your savings.

Best practice is to invest in assets that have earnings that grow as inflation grows, such as shares and property.

Deflation risks

Deflation is the falling of prices leading to interest rates falling to almost zero. This in turn means the falling of company earnings, as well as share prices.

Best practice is to invest in shares that pay dividends as they generate cash, which increases in value under deflation.

Market volatility and capital loss risks

Market volatility is the rise and fall of share prices, which can fluctuate rapidly in a day. If a company is performing poorly, it may be difficult to sell the shares and the price will drop due to lack of demand. Some cyclical shares such as Fletcher Building and United Technologies may be more volatile due to links to the overall economy.

Best practice is to include cash and fixed interest in your portfolio, to act as a buffer to volatility in share and property markets. Having the correct asset allocation for risk is the key.

Credit risks

Credit risk refers to the risk that an issuer of deposits, bonds or other fixed interest securities falls into financial difficulty and is unable to repay your capital.

Best practice is to focus on high grade issuers even if it means lower returns, and have a range of securities from a range of issuers.

Currency movement risks

Currencies can be extremely volatile. A rising New Zealand dollar can impact returns on overseas assets for investors but avoiding foreign currencies can be even worse for your long-term financial health.

Best practice is diversifying into global currencies, especially for New Zealand investors who live in a small country with a fragile economy. Short-term volatility can be limited by holding a range of currencies.

Liquidity risks

Liquidity is how easily an investment can be bought or sold. If something is a non-liquid investment, this is a risk. Selling a house, for example, during a property downturn can take months or years.

Best practice is to be aware that shares are a liquid investment, however they also have the highest degree of volatility (can rapidly change), followed by bonds.

Interest rate risks

Interest rates are a risk as they constantly move. A significant change can catch you out, if your portfolio is positioned incorrectly. If you have too much cash, falling interest rates will reduce the value of your income, whilst rising rates will reduce the value of longer-term bonds.

Best practice is to have a laddered portfolio of fixed interest securities (varying maturity dates) to avoid a large portion maturing in the same year. In the past, growth shares have handled periods of rising interest rates better than other shares.

Bubble risks

Bubbles are when too many investors invest in the same area, such as shares of an investment company, tech shares, houses and hedge funds. The result is chaos as the inevitable happens and the bubble bursts.

Best practice is having an asset allocation strategy and sticking to it. Keep disciplined, diversify, and reduce exposure to markets and sectors that look over exuberant.

Regulatory risks

Regulatory risks are the risks of future changes to tax or general investment legislation, which could affect your interest or the way the investment is managed.

Best practice is to invest in countries that have stable governments, companies that operate in mature and regulated markets, or industries that have mature and clear/precise regulations.

Counterparty risks

Counterparty refers to the risk associated with a third-party defaulting (not being able to pay you back) on their obligations.

Best practice is to invest in companies that have a proven track record of repaying debt, or who have a spread of clients so any one defaulting client will not expose the company to liquidity issues. It is also best to invest in companies who operate in countries with structured debt recovery (where there is clarity on the processes for recovering unpaid bills).

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