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WHY IT'S IMPORTANT TO UNDERSTAND YOUR RISK TOLERANCE WHEN INVESTING

By Renee Eagar, Certified Financial Planner®, Brenthurst Wealth Management

Many people think they can remain rational when markets are volatile and when investment values are going through a dip. The truth, however, is quite the opposite. People become overly emotional when markets behave badly to the point of selling off valuable stakes of their portfolio. But selling shares when values decline is never a good idea.

History has proven that panic-selling for long-term investors almost always ends poorly. Investors who kept their wits during a financial slump ended up recouping not only all their losses but were also still around to benefit from a market recovery.

Often, it's hard to really know what you're comfortable with until you've experienced losses. It is therefore important to make an honest assessment of your own risk tolerance.

Any financial planner worth his/her salt will tell you that a proper assessment of your risk profile is the first step in the creation of a robust financial plan. If you're not aware of your own risk profile, chances are you'll end up taking regrettable investment decisions at least a few times in your life.

Risk tolerance is a measure of willingness to accept higher risk or volatility in exchange for higher potential returns in portfolio selection.

Risk profiling helps you invest in the optimum and diversified asset allocation to reach your investment goals. It also aims to simplify the process of understanding your underlying attitudes towards investing and hence predicting your probable reactions to future events. It is an important part of the financial planning process.

All types of investments require that you take on some degree of risk. Cash, for example, carries an inflationary risk, property carries the risk of not being occupied and equities the risk of capital loss through corporate failure or devastating economic factors.

Investment risk measures how sure you can be of achieving your investment objectives. The relationship between risk and return is fundamental to all investments. The more risk you're willing to take on, based on market performance over long periods, the greater the potential return should be.

Your financial planner will assist you in understanding your risk profile by way of a questionnaire. Based on your requirements, a decision can be made on asset allocation. The more detailed it is, the more it's likely to capture your risk profile accurately. It will test the investor's responses to his/her limitations in taking financial risk, past decisions in financial situations, and his/her attitude towards investing in various risk/return scenarios.

Once you know how much spread is to be maintained between risk assets like equity and low-risk assets like cash, you can identify the funds and products where you would like to invest. You will also realise your preference for consistent growth and a slow uptick, and the level of volatility you can withstand to get a better result.

The rate of return that an investment is going to generate is generally the first thing that is discussed at the time of investment. While this is definitely a very important aspect to be noted, it is equally important to consider the risks associated with that particular investment.

Once you are better versed in the products and assets you are invested in and what percentage is invested either locally or offshore, you will be less likely to be panicked into a decision when the market turns.

Proper risk profiling ensures that your asset allocation is in alignment with your attitudes and current situation. This will allow you to take wiser decisions with your money – not panic and sell out or invest out of greed. In the long run, you'll be happy with the returns you've earned.

Investors must understand the dangers of changing strategy in a portfolio, just to chase last year's performance, and how getting the timing wrong can have a detrimental effect on a portfolio. It is very important to leave emotion out of it and ignore the noise, as an overreaction will only lead to losses.

A better understanding of your risk profile will also make it easier for you to adapt your financial plan. It will hone your focus on future events that matter, like retirement or the death of a family member, which are the real determinants of a risk profile.

**PROPER RISK PROFILING ENSURES
THAT YOUR ASSET ALLOCATION IS IN
ALIGNMENT WITH YOUR ATTITUDES
AND CURRENT SITUATION**



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INTRODUCING: RENEE EAGAR, CERTIFIED FINANCIAL PLANNER®



Renee Eagar is a CERTIFIED FINANCIAL PLANNER® professional, a member of the Financial Planning Institute of South Africa and is fully qualified to give advice on all investment matters.

Renee has been in the financial services industry for 18 years since 1998 and has worked for institutions namely TMA and Investec Asset Management.

Renee obtained her Higher Certificate in Financial Markets in 2004 and was awarded the CERTIFIED FINANCIAL PLANNER® designation in 2006.

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