Outside the Flags

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Risks Worth Taking

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A wise man once said that to profit without risk and to experience life without danger is as impossible as it is to live without being born. That all may be true, but which risks are worth taking and which are not?

The fact is even the most self-declared risk-averse people take risks every day. There are routine risks to our safety in crossing the road, in riding public transport, in exercising at the gym, in choosing lunch and in using electrical equipment.

Then there are the "big decisions" like selecting a degree course, choosing a career, finding a life partner, buying a house and having children. These are all risky decisions, all uncertain, all involving an element of fate.

In making these decisions, we seek to ameliorate risk by carefully weighing up alternatives, researching the market, judging possible consequences and balancing what feels right emotionally and intellectually, both in the short term and in the long.

Sometimes, we ask an independent outsider to guide us in making our decision. They do this by providing an objective assessment of the potential risks and rewards of various alternatives, by taking a holistic view of our circumstances and by keeping us free of distraction and focused on our original goals.

In investment, this is the value that a good financial advisor can bring – not only in understanding risk and return and how to build a portfolio but in knowing the specific needs, circumstances and aspirations of his or her individual client.

Quite simply, many people who invest without the help of an advisor take risks they do not need to take. They gamble on individual stocks, they rely on forecasts, they chase past returns, they fail to rebalance their portfolios to take account of changing risks and they run up unnecessary costs and tax liabilities.

To use an analogy, this is like trying to cross an eight-lane highway in the face of heavy traffic when there is a pedestrian bridge a little way down the road. You may well get to your destination safely through the traffic, but it will be despite your actions rather than because of them.

Understanding risk in investment begins with accepting that the market itself has already done a lot of the worrying for you. Markets are highly competitive, which means that new information is quickly built into prices. Instead of trying to second guess the market, you work with it and take the rewards that are on offer.

Your biggest investment is in spending time with an advisor building a diversified portfolio designed to meet your long-term requirements, then meeting them periodically as your needs change and to ensure you are still on course.

In considering all of this, it is important to understand that risk can never be totally eliminated. If there were no risk, there would be no return. But your chances of a good outcome are far greater if you use the accumulated knowledge of financial science and the guiding hand of an advisor who knows you.

To sum up, risk and return are related. But not all risks are worth taking. The process of working this out starts with not trying to do it all alone.