



Getting the balance between risk and reward

When you first meet a financial adviser, one of the key activities they will undertake will be an assessment of your attitude to risk. This will enable you and your financial adviser to identify what type of investment is right for you.

When you have review meetings with your financial adviser a reassessment of your investments and your attitude to risk should also be carried out.

Trying to understand and evaluate the level of risk you are willing to take with your investment is a difficult task. Understanding some of the risks that an investment could be exposed to can help you assess how much risk you are willing to take.

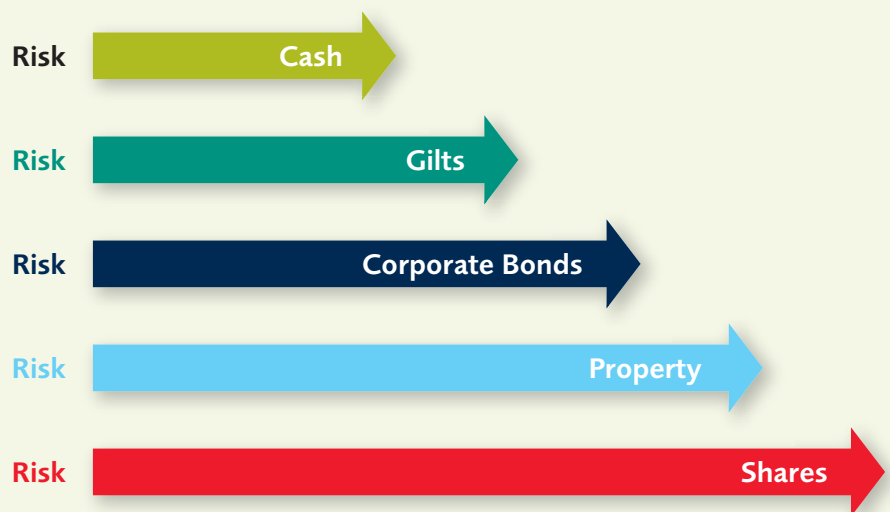
Growth from your investment can't usually be achieved without exposing your investment to some risk – being too cautious can also put your investment at risk, so getting the balance right is a key challenge to meeting your own investment objectives.

Investment risk:

When you choose to invest, there is always some risk of your investment falling in value. The extent of this risk will vary depending upon the nature of the investment. Some investments may offer guarantees, but there will usually be an additional charge for this extra security.

Let's look at investments simply – the risk profile for the five main asset classes.

Starting with cash (for example, deposit accounts), generally a low risk asset, up to shares which tend to be a high risk asset.



These risk evaluations are classified by Prudential and they therefore should not be viewed as generic descriptions across the fund management industry.

Generally, the lower the level of risk then the lower the potential level of return, and as you take on higher risk investments you can get higher returns but you should be prepared for the possibility of larger falls in the short term.

Over the long term, stockmarket investments have generally delivered strong investment performance relative to inflation and returns from Building Society deposit accounts.

It is important to remember that past performance is not a reliable indicator of future performance.

Since the launch of the FTSE All-Share Index in April 1962 until December 2009, shares have beaten cash in:

77.8% of all **5-year periods**
92.7% of all **10-year periods**
100% of all **15-year periods**
100% of all **20-year periods**

Over the same period, from April 1962 to December 2009:

the annualised growth returns, with net income reinvested, have been:

FTSE All-Share **10.6% a year**
Building Society **5.6% a year**

annualised inflation over the same period, based on the Retail Prices Index

Inflation **6.0% a year**

Source: Office for National Statistics (Financial Statistics) and M&G Statistics.

A stockmarket investment has a better chance of good relative performance by investing for the long term. Any investor should be prepared for periods where investments may fall in value, but remaining invested gives an opportunity for your investments to perform over the longer term, generally 5 years or more.

Please remember that the value of your investment may fluctuate and it is therefore not guaranteed. You may not get back the full amount of your original investment.

Question:
How long are you prepared to invest your money for?

Generally the longer you invest for, the less likely you are to experience significant falls in value even in stockmarket investments.

So if you're thinking about building a portfolio of savings and investments over the longer term you might consider investing a portion of your money in higher risk assets, such as property and shares, depending on your attitude to risk.

Question:
Are you willing to put your money at risk, in return for growth potential?

If you invest your money in some types of investment then your capital could be at risk, unlike a bank or building society deposit account which would normally return all your capital. You should consider a bank or building society deposit account for short term savings which is generally secure and accessible. However investing in other assets could offer greater growth potential over the longer term.

Diversification risk:

The desire to get maximum returns on your investment is hard in reality to achieve. Timing exactly when a certain type of asset is likely to rise or fall, selling at peaks and buying at troughs, is impossible to predict – even for investment specialists.

If you invest entirely in one asset area, then the value of your entire portfolio will be subject to the changes in the performance of that type of asset. To help manage this risk, you could consider spreading risk by investing in several assets or sectors. This protects your investment from feeling the full effects from a collapse in value of one asset area.

How can I help to manage this risk?

- › Spread your investment across different assets by selecting:
 - › Multi-asset funds – such as With-Profits Funds, which invest across many different asset classes,
 - › Portfolios – which include a number of different types of funds within a single Portfolio fund option.
- › Invest in several funds which focus on different types of asset or geographic areas.

The benefit of investing in a diverse range of assets is that when some asset values fall, the impact of the fall may be balanced or outweighed by other assets that rise in value.

Question:

What type of assets do you favour?

You can choose to spread your investment across assets to reflect your own attitude to risk. For example, more cautious investors are likely to have more exposure to gilts (Government Bonds) and corporate bonds – where your investment will receive interest from these bonds. More adventurous investors are likely to have a greater proportion of their investment in property and shares.

Question:

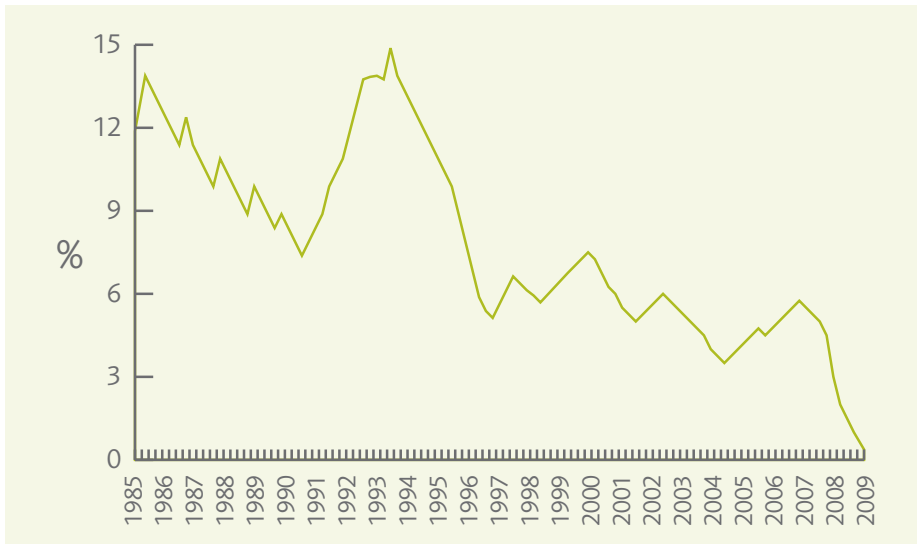
Consider your risk options within each asset class?

For example, within Bonds your options vary from Gilts (Government Bonds), Investment Grade Corporate Bonds which are Corporate Bonds from relatively secure companies, to High Yield Bonds from less secure companies which can offer higher rewards but with a higher risk of the company not being able to pay you back.

Within shares, are you willing to invest overseas in emerging markets where the potential returns may be higher but the risks are higher? Or do you prefer to choose mainly UK shares?

Interest rate risk:

Interest rates have recently fallen to historic lows. But in the late 1980s and early 1990s, interest rates were regularly over 10%. The graph below shows the changes in the UK base rate over the last 25 years.



Source: Bank of England

In times of low interest rates, alternatives to banks or building society deposit accounts may offer greater potential returns. Although if you choose to invest in stockmarket investments, the value of your investment can go down as well as up and there may be times when you may not get back the full amount of your original investment.

Inflation risk:

Keeping your money safe can also impact your future wealth. Even when inflation rates are low, if you do not invest for growth then your money will be worth less in real terms. This means that in the future, £100 will buy you less in years to come than it will today, due to the increase in prices and the general cost of living.

So to combat inflation and any costs or charges of investing, you should aim for levels of investment growth to cover inflation and charges to maintain the value of your money in real terms.

Question:

What returns are you getting on your savings? Are you willing to invest some of the funds for the longer term, generally 5 years or more, in other assets in search of better potential returns?

There are many investment options, such as retirement planning through pensions, investments using bonds or ISAs. Whilst you should keep some funds easily accessible for emergencies, for example in banks or building societies, – you should monitor and review balances and interest rates and ask your financial adviser if your money can work harder.

Question:

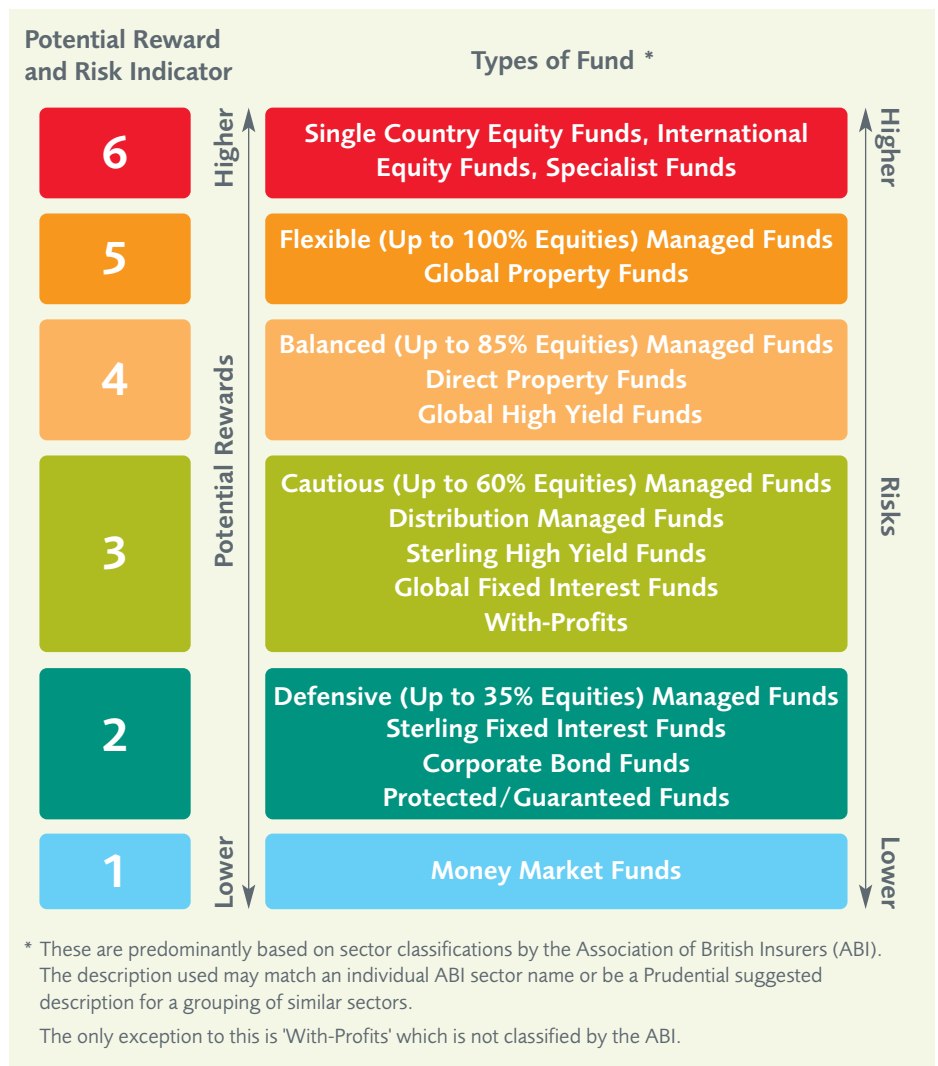
What are the charges on your investment?

Each investment product will have charges and the fund choices will have additional charges. Charges will vary depending on the degree of fund manager involvement in managing the fund, investment style or expertise. Tracker funds are usually cheaper, but aim to just follow an index, such as the FTSE 100, whether it rises or falls.

Prudential's investment options:

At Prudential we provide a range of investment options to suit different attitudes to risk:

- Multi-asset funds which are managed by our in house Portfolio Management Group (PMG) – such as With-Profits Funds and our PruFund range of funds, which invest across many different assets.
- Dynamic Portfolios – five Risk rated portfolios which select a number of independently managed funds within a single Portfolio fund option. Each portfolio is designed to meet different investment objectives and match different attitudes to risk.
- PruSelect range – A range of around 100 funds carefully selected and monitored by the independent research company Old Broad Street Research.
- Other additional Fund Choices.



These risk rating categories have been developed by Prudential to help provide an indication of the potential level of risk and reward that is attributable to a fund based on the type of assets which may be held within the fund. Other companies may use different descriptions and as such these risk rating categories should not be considered as generic to the fund management industry. Prudential will keep the risk rating categories under regular review and as such they may be subject to change in the future.

Reviewing your attitude to risk

You should review your attitude to risk regularly with your financial adviser. You should consider a review if your circumstances change – for example, a change in your job, change in your financial situation, such as receiving an inheritance, or a change in your marital status.

In any event, regular reviews of your investments with your financial adviser can help identify any changes required to keep your investments on track and in line with your investment objectives.

Getting the balance between risk and reward is very important in deciding the right investments. Ask your financial adviser to assess your individual needs and circumstances.

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