



WEALTH CREATION AND INVESTMENT

Investment Risk

All investments contain an element of risk and it is important for investors to have an understanding and awareness of the risks associated with any investment they may hold or that is being recommended. Risk can be defined as the potential for an investment to achieve a return lower than that which was expected at the time of investing. This 'unexpected return' can be due to numerous variables such as market changes, adverse economic conditions or specific risks.

Past investment results should not be relied upon as a guide to future performance.

The level of risk that investors are comfortable with can vary greatly. Some investors may be more comfortable investing in volatile investments, so it is critical that any recommendations made to investors are consistent with the level of risk that is acceptable to them.

Investors need to have a comprehensive understanding of risk to enable them to make informed decisions in relation to their investment portfolios. Risk, to some may mean the possibility of losing a portion of their capital, while for others, the main primary concern may be that assets produce sufficient income on which to live.

Risk and uncertainty cannot be eliminated, however they can be measured and managed within your portfolio. The key is to determine the appropriate level of risk

for you. Taking on greater uncertainty and short-term risk may be necessary for you to gain the long term returns needed to achieve your lifestyle goals and objectives. Any assessment of risk appetite should be in the context of your goals and the timeframe in which you wish to achieve your objectives.

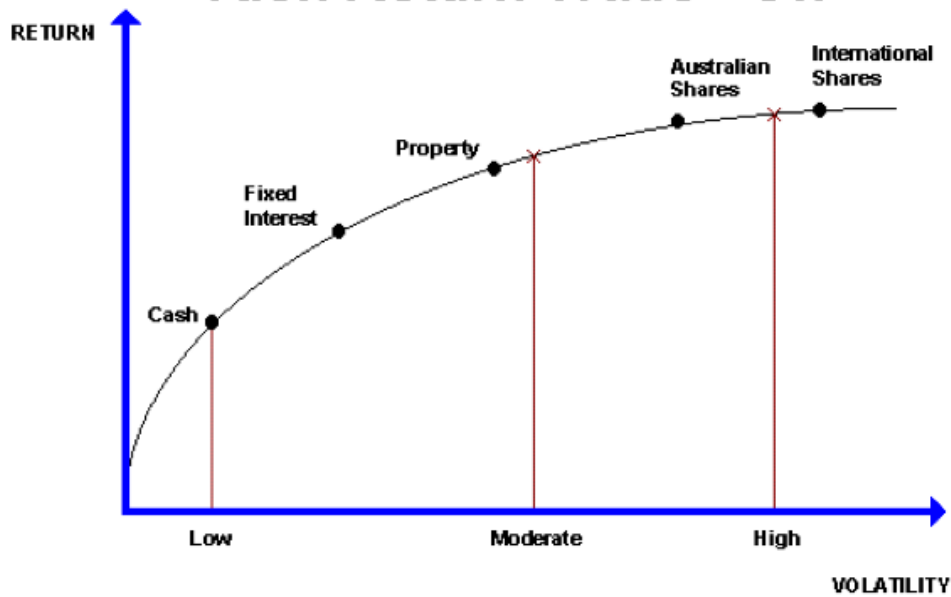
An integral part of the ongoing management of risk is to have your financial adviser review your risk profiles and current situation to assist in making investment decisions.

Risk and Return

The major asset classes (cash, fixed interest, shares and property) all have unique risk profiles based on their level of price volatility or instability. For example, cash and fixed interest investments are less exposed to market price fluctuations than investments in shares or property and as such have a lower risk profile. It is important to understand that in general the more volatile an investment is, the higher the possible returns will be from that investment. Investors will generally be comfortable with a higher level of risk if the expected return is proportionately higher than that of an investment with a low level of volatility.

The relationship between long term risk and return in different asset classes is illustrated in the following graph.

Risk Return Trade - Off



Risk (often referred to as Volatility) is a term that refers to the unpredictable upward and downward shifts of investment values over a period of time. The greater the volatility the more frequent the shifts.

Risk and Return are closely related. In general, the higher the degree of risk associated with an investment, the higher the return required by investors for acceptance of the risk. Low risk investments, such as cash deposits, offer relatively low returns as a reflection of their greater security, and are better suited to risk conservative investors. This is called the risk/return trade-off, and is used as a guide to selecting the appropriate asset allocation for your portfolio.

When investing it is important to acknowledge that all investments have associated risks and to understand the risks associated with the chosen investments. Government Bonds, which are often described as secure and 'risk-free', contain risk for the investor. For example, consider an investor who purchases a 10-year \$10,000 government bond yielding 6.5% p.a. (\$650 pa interest). Next year, the investor finds he needs the

money and decides to sell the bond. Since the initial purchase, assume the yields on 10-year bonds have risen to 9.5% p.a. Under these circumstances, a new investor could now buy a government bond returning \$650 p.a. for \$6,842 (instead of \$10,000 previously).

This reduces the value of the bond to approximately \$8,240, which represents a loss of 17.6% from the so-called "risk-free" investment. If the investor was able to wait the full 10-year term of the bond, he would receive the full \$10,000 (plus the \$650 each year).

Any investment decision you make means that you must take a risk of some sort. The decision will directly relate to the amount of money you invest, your circumstances at the time and your needs for the future. If you have a better understanding of risk, you can make a more informed investment decision, accepting some risks and rejecting others. The important point is that you understand the relationship between risk and reward, particularly over your investment time frame. Following is a summary of some of the risks that can affect investors.

Risk	Explanation
Inflation Risk	The real purchasing power of your money may not keep pace with inflation. Inflation is an important consideration for all investors. If the after tax return on your investments is less than the rate of inflation, then the real value of your money will decline.
Interest Rate Risk	For investors relying on fixed rate investments, maturing money may have to be reinvested at a significantly lower rate.
Market Risk	Movements in the market mean the value of your investment can go down as well as up, sometimes suddenly. Different types of investments experience different levels of volatility. Volatility becomes a problem if you do not have the time frame to withstand the rough patches. It is important to remember that markets go through regular ups and downs and that capital losses can occur if investments are redeemed when markets are down. While it is tempting to sell out of an investment after its value has fallen, history has taught us that investors who stick with their strategy generally go on to recover and prosper.
Risk of not Diversifying	All your capital will be affected if your single investment does badly. Diversification means spreading your money across different investments to reduce risk. The right asset allocation is an important driver for the long-term returns of your portfolio.
Market Timing Risk	Anticipating market rises and falls can be extremely difficult because no two economic cycles are the same. Market timing is not a good long term approach that tends to result in an overall poor return and high transaction costs. A sensibly balanced diversified portfolio will generally outperform a continually changing portfolio.
Credit Risk	This applies to debt type investments such as term deposits and debentures. The institution you have invested with may not be able to make the required interest payments or repay your capital.
Liquidity Risk	You may not be able to access your money quickly, or without cost, when it is required.
Legislative Risk	Your investment strategy could be affected by changes in the current laws and regulations.
Mismatch Risk	The investment you choose may not be suitable for your needs and circumstances. A perfectly sound investment choice for you now may not be best for you at another time.

Risk and volatility can be managed or minimised in various ways. A particularly risk averse investor may wish to invest only in cash or fixed interest and this may seem appropriate. It must be remembered, however, that a strategy of this type may reduce volatility but is risky in its own right as the investor is foregoing the potential for capital growth in the portfolio.

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