framework financial

latest word

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Are you exposing your money to unnecessary Risk?

"Risk varies inversely with knowledge"

Risk & Return

One of the fundamental principals in investing is that we must expect a higher return for higher levels of risk.

So, for example, if we take a look at what has been happening in bond markets today (20th Sept 2011), the credit rating of Italy has been downgraded, which means lending to Italy is considered more risky and therefore an investor in an Italian bond (i.e. lending to the Italian Government) would require a higher return for the higher level of risk. The significant feature of the current financial crisis is the huge change in the risk profile of the different European countries.

Looking at the two extremes in Europe at present, if we were to lend money today to Germany for two years, we would receive approximately a 0.5% return whereas if we lend to Greece today for two years we would receive approximately a 61.5% return, reflecting the huge differences in risk.

If we compare lending to Germany and Ireland, lending to Germany for 10 years would currently yield a return of approximately 1.8% whereas lending to Ireland would yield a return of approximately 8.6%.

So we know about risk and its relationship to return, now what does that mean for you and your money?

Your Life, Your Choices

The starting point is your life. Where are you now and what would you like to do in the future? What age would you like to be able to retire? What quality of life would you like to have? Would you like to travel? Would you like to be able to offer some support to your children? This is a very important part of our work with our clients. You need to be very clear about what you are looking to achieve.

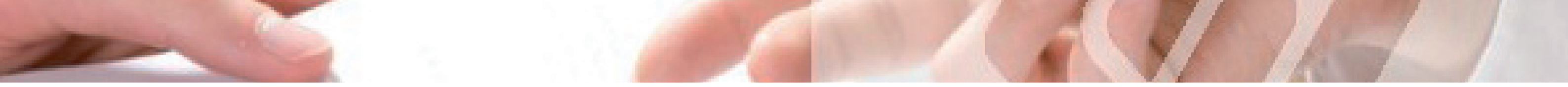
Choices need to be financed and that requires a financial plan (or map) to get you there.

Key factors are your level of income, your level of savings, and the return you can generate year after year to grow your money.

So what average return do you require? 4%? 6%? 8%? 10%? You need the average return that is going to grow your money to the amount you need to make your life choices. You do not need more than that and consequently, you do not need to take any greater level of risk than that required to earn the return you need.

Baskets & Eggs

Now that old cliché is true, we don't want to put all our eggs in the one basket, and in fact the more eggs and baskets we have the better, generally speaking. Taking into account our clients attitude to risk and the return they require, we carefully construct an investment plan that is most likely to



generate the clients required return for the minimum level of risk. We say likely because we have not yet developed the ability to predict the future but we do have the ability to predict what is very likely to happen over the longer term. If you do happen to meet someone who says they can predict the future, our advice is to run a mile and as fast as you can. Anyway if they could truly predict the future, they would probably been on some exotic beach somewhere and not trying to sell you on their big idea.

Reckless Decisions & Broken Eggs

Now, as silly as that last statement may sound, we have met people and you probably have too that did meet these gifted seers who predicted the future, and worse still, they gave them their hard earned money or as Dragons Den, Theo Paphitis, likes to put it, their children's inheritance.

There are many business owners and professionals out there, with good businesses and careers, that thrived during the Celtic years, and are now working, in difficult economic conditions, to make payments on a reckless ad hoc investment.

For example, a feature in recent years was for many individuals to make selective investments, particularly in property, often on the advice of someone that this was an excellent investment in a 'retail park in Croydon with blue chip tenants' or some other wonderful opportunity etc etc. The advice came from many quarters, friends, banks and the media. We are not debating the merits of these investments in themselves but, when you look at the big picture, the result of this, for most people, was to take a significant amount of their eggs and throw them into the one basket (a retail park in Croydon), hugely increasing their risk without any regard or consideration for their long term financial goals and required return. For many, those risks materialised with poor consequences for their wealth and children's inheritance.

If you have (or have had in the past), an ad hoc investment, like in the example above, the likelihood is that you are exposing yourself to more risk than is necessary to achieve your financial goals.

Questions for you

So to bring this in for a landing, let me ask you;

- Do you have things you want to do with your life now and in the future?
- Are you clear about what those things are and when you would like to do them?
- Will you be able to afford to do these things?
- Do you have a number you need to achieve?
- Do you have a financial plan or map to get there?
- What return on your existing and future savings do you require, to do the things you want to do, when you want to do them? What is that number?
- Are you taking more risk than you need to? How do you know?

These are questions that we, at **framework financial**, help our clients to answer every day.

Last word

Thanks for taking the time to read our "latest word" We welcome any feeback you wish to give.

framework financial:
Unit Ab1, Centrepoint House, Rosemount Business Park, Blanchardstown, Dublin 15
Phone: 01 - 8829938 Fax: 01 - 8829772 Email:info@fwf.ie
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