The Fry Group

Refreshingly individual financial planning from The Fry Group

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Investment Risk Today

Investment risk is a key consideration in the building of any portfolio and something that needs to be kept under constant review. Market conditions will fluctuate and from time to time trigger fresh consideration of the relative risk of various assets.

The traditional model of risk is straightforward enough, with low risk : low potential return investments sitting on one side of the scale and high risk : high return investments on the other. Risk increases incrementally through cash, gilts, corporate bonds and then equities.

The current economic backdrop is one of low interest rates, heavy tax burdens and stubborn inflation. This is not a favourable environment for assets traditionally seen as low risk. With UK interest rates close to zero and inflation running at approximately 4%, cash is guaranteed to lose real purchasing power. A UK higher rate taxpayer would need to earn in excess of 6% simply to stand still.

Government bonds are being propped up by the enforced buying of central banks through quantative easing, with an increased risk of default in some countries.

Corporate bonds will offer higher yields to compensate for the increased risk of default and managers of strategic bond funds have an opportunity to demonstrate their worth by optimising returns across all fixed income assets.

If these lower risk assets appear unattractive or run the risk of falling in value, investors may turn increasingly to more volatile and higher risk assets, such as equities. In a mildly inflationary economy with low interest rates, large “blue chip” companies have the capacity to borrow relatively cheaply and pass on to consumers the increased costs of production and are therefore able to maintain relatively attractive dividend distributions with the yield on the FTSE 100 Index running at approximately 4%. The corporate sector has gone through significant cost reduction over the last few years, removing inefficiencies and enabling companies to hoard cash.

In a well-balanced portfolio an argument could be made for reducing exposure to lower risk assets, such as fixed income, whilst building up exposure to higher risk assets, such as equities. Without overlooking the remaining asset classes of property and commodities, most clients recognise and understand cash, bonds and equities.

The inflation risk we see increasingly in cash and bonds argues strongly in favour of diversified portfolios containing good quality equities.

To review your investment portfolio or discuss your investment strategy, *click here* to get in touch with your usual Fry contact or call 01903 231545.

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