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Financial Planning Association

1800 626 393

www.fpa.asn.au

Macquarie

Financial Advisers 1800 808 508

Investors 1800 806 310

www.macquarie.com.au/personal

Macquarie Investment Management Limited
PO Box 192
Australia Square NSW 1215

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FORWARD thinking

BKL0006 03/04

Macquarie Investment Funds

The trade-off

Understanding investment risk

FORWARD thinking

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Need to know, afraid to ask?

Why you need to understand risk.

There are a number of ways of looking at risk.

The chance of loss

The Cambridge dictionary defines risk with elegant simplicity as "the possibility of something bad happening." Many investors define it by asking the question: "What are the chances of losing my money?" Neither of these two definitions is exactly correct in an investment sense. However they may define your attitude to risk – and that's just as important.

Variability and volatility

Australian investment magazine, Moneymanager[1], defines risk as "the variability of returns." This definition is closer to that used by investment professionals. Fund managers and professional investors see risk as the **difference** between expectations and results.

A commonsense definition

Risk is the **price** you pay for returns. Just as the more work you do the more you should be paid, so the more risk you take, the higher the return you should receive. This is "the risk/reward trade-off". It is one of the key concepts of investment – and one we shall apply throughout this booklet.

Any investment decision implies some risk. This booklet outlines many of the risks you should be aware of when making an investment. With a better understanding, you can make a more informed investment decision – accepting some risks and rejecting others. In other words – you can **manage** risk.

Risk is not knowing what you are doing.

– Warren Buffett

[1] Source: www.moneymanager.smh.com.au/tools/glossary/dict_r.html

Types of Risk

This table highlights some of the risks you could encounter.

Risk type	What it means
1. Mismatch risk	The investment you choose may not suit your needs and circumstances.
2. Inflation risk	That the purchasing power of your money will be eroded by inflation.
3. Interest rate risk	The risk that changing interest rates will reduce your returns or cause you to lose money.
4. Market risk	The risk that movements in asset markets (share markets, bond markets, etc) reduce the value of your investment or returns.
5. Market timing risk	That the timing of your investment decision will expose you to lower returns or capital loss.
6. Risk of poor diversification	The poor performance of a small number of assets significantly affects your total portfolio.
7. Currency risk	The risk that currency movements will affect your investment.
8. Liquidity risk	The risk that you may not be able to access your money quickly or cheaply when you need to.
9. Credit risk	The risk that the institution you invest with may not meet its obligations (ie, default on interest payments).
10. Legislative risk	You lose capital or suffer reduced returns due to changes in laws and regulations.
11. Gearing Risk	The added risk involved in borrowing to invest.

Tug of war

Mismatch risk.

To invest successfully you need patience, skill and some good advice. But the first thing you must have is a plan – an understanding of exactly what you want your investments to achieve.

It's easy to invest emotionally. A conservative investment may make us feel safer. The prospect of fantastic returns makes us feel richer. It's harder to invest rationally – ignoring our feelings to make sure the investments you choose achieve your goals. You do that by focusing on your objectives and timeframe.

Your objectives

What are you seeking to achieve by investing? To save a deposit for a home? Pay for the education of your children? Fund your retirement? Are you investing for income, capital growth or a combination of the two?

You need to choose investments that will help you achieve those goals.

Your timeframe

Sometimes you will have a specific goal and invest for a short time only. At other times you may want to take a long term view, aiming to grow your capital (eg in preparing for retirement). One way to help you avoid mismatch risk is to match your timeframe, objectives and investments – as in the following table.

Objective	Timeframe	Investment
Short term (eg a holiday, appliance purchase)	Less than 12 months	Cash
Medium term (eg a home deposit)	At least 3 years	Emphasis on fixed interest with some cash and growth assets
Long term (eg children's education, retirement)	More than 5 years	Emphasis on growth assets (shares and property) with some access to cash

Our lives improve only when we take chances – and the first and most difficult risk we can take is to be honest with ourselves. – Walter Anderson

"The Confidence Course – Seven steps to self fulfilment"
Published January 1998, Harper Collins Publishers Inc

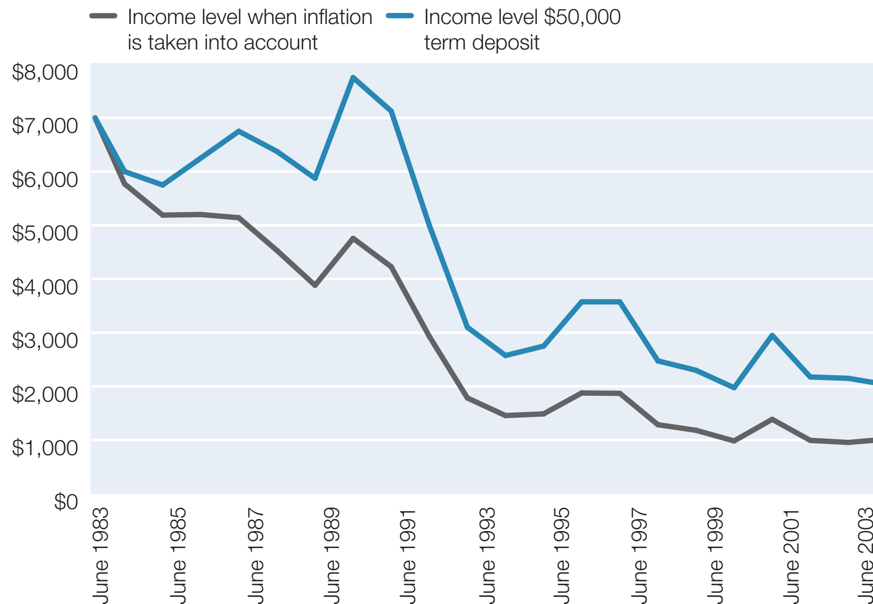
Bubble trouble

Inflation risk.

Inflation is an increase in the price we pay for goods and services. Because of inflation, $1.00 today will buy you more now than it will in the future. Even if the rate of inflation remained at a relatively low 3% pa, a $1.00 purchase will cost $1.56 in 15 years time.

Inflation is investors' great enemy. It eats away at your returns, pushes up interest rates and, if excessive, can lead to poor investment decisions.

It's the return after inflation that really counts



Graph prepared by Macquarie Investment Management Limited (MIML). Term deposit rates are from June 1982 to June 2003 as per the RBA Bulletin (Table F4) one year fixed deposits $5,000 to $100,000. Inflation adjustments are based on the Consumer Price Index (CPI). Source: ABS. Past inflation rates are not indicative of future inflation rates.

When deciding on the return you want from your investments – and therefore what investment strategy to pursue – it is vital you take the effect of inflation into account. If the after-tax return is less than the rate of inflation, the real value of your money will decline.

The graph opposite shows the level of income produced by one year term deposits, from June 1983 to June 2003. As you can see, inflation over this period has reduced the purchasing power of your income by more than half.

To protect your investments from inflation over time you need some capital growth. While fixed term deposits and savings accounts generate a regular income, your capital value remains the same. Many people choose these investments because they seem safer. However, if they do not keep pace with inflation they can lose money!

That's why most medium to long-term investment strategies include at least some growth investments like shares and property. They have a better chance of beating inflation than cash or fixed income investments.

This is particularly important for retirement investing. Many retirees focus on 'protecting' their capital. Yet longer life expectancy and the effects of inflation mean retirees can easily outlive their capital if they do not use growth assets to boost the value of their portfolio over time.

A not-so-great rate?

Interest rate risk.

Fixed income investments are highly attractive to investors whose main priorities are income and security. Many fixed interest investments invest in government bonds. They offer excellent security because a government (Australian or foreign) guarantees to repay the capital value when the bonds mature.

However, fixed interest investments do have their own risks.

Quality risk

Firstly, all bonds are not equal. The bonds issued by a government like Australia, the US, France or Japan are considered much more secure than those offered by countries with weak economies or those suffering political instability (eg Zimbabwe). That's why those countries' bonds generally pay higher rates than bonds from more stable economies. That's the risk/reward trade-off again.

Not all bonds are government bonds. Semi-government bodies like water boards or electricity utilities can issue bonds. Others are issued by companies. Once again you will generally find that bonds from high quality organisations pay a lower rate of return.

Reinvestment Risk

Interest rates go up and down depending on the economic climate. If you're invested in bonds and there is a drop in interest rates, you may be forced to reinvest at a lower rate (and receive less income) when your investment matures.

Because fixed rate investments generate no capital growth, there's no extra capital available to bolster your income. And as you can see from the graph displaying inflation risk on page 4, the income produced by fixed rate investments has fluctuated significantly over the period 1983 – 2003.

The policy of being too cautious is the greatest risk of all.

– Jawaharlal Nehru (1889 – 1964)

Capital risk

Fixed interest investments such as bonds generally pay a fixed income (known as the coupon payment) which is set on issue.

However, it's important to remember that while the coupon payment (the regular income you receive) is fixed, movements in market interest rates can affect bond prices.

Typically, you can buy and sell bonds before their maturity. Their price is affected by how attractive their coupon payment is at a given time. The following table shows the inverse relationship between interest rates and bond prices – a rise in interest rates leads to a fall in bond prices and vice versa.

Impact of movements in interest rates on bond prices

So if you needed to sell your bond in an emergency, the price at which it sells will depend on interest rates at the time.

If interest rates rose between the date of purchase and the date you sell it, you may have to sell the bond for less than you would have received if you waited until it matured. You will have lost money.

Consider an example. A 5 year bond worth $100,000* when interest rates are 5% pa would be worth approximately $96,000 if interest rates were to rise to 6% pa. Fluctuating interest rates don't only affect your income; they can also affect your capital value if you need to sell before maturity.

This concept of capital risk is also applicable to bond funds – managed funds which buy, hold and trade a wide variety of bonds with the aim of generating better income returns. Bond funds are highly attractive to income investors – they offer wider diversification, good flexibility, the potential for capital gain and professional management. They are generally more secure than share or property funds. However, they can suffer occasional capital losses if interest rates move against the expectations of the manager.

*5% pa coupons payable half-yearly assumed.

Case Study – Sylvia

Sylvia is a 72-year old retiree who relies on her investments for income. "I always used term deposits, because I knew exactly what my income would be and I could plan my expenses around it," she says.

In the early 1990s, Sylvia could earn about 10% from fixed rate investments. "I thought I could go on like that forever, rolling over my investments as they matured," she said

But by 2003, after more than a decade of falling inflation and declining interest rates, Sylvia was earning only 3.55% on her term deposits. Because there was no growth in her investment value, there was no capital to top-up her income.

This is a fictional case study. It is an illustration only and any similarities to any reader's circumstances are purely coincidental.

Bazaar Behavior

Market risk.

The essence of a market is that it allows prices to change – if they didn't you would never go to the local markets looking for a bargain. The same is true of prices in investment markets. Driven by supply and demand, prices must fluctuate – and that creates volatility.

At your local market, you will notice that the price of different goods moves more than others. Fruit prices move up and down with the seasons, clothes prices change with fashion. Furniture prices may change more slowly over time.

The same is true in investment markets. Different investments have different levels of volatility. Investments expected to generate higher long-term returns (such as shares) generally show greater volatility in the short term.

If you accept that the volatility is a characteristic of higher returning assets, it becomes a problem only if you don't have the time to ride it out. (see 'Mismatch risk', page 3).

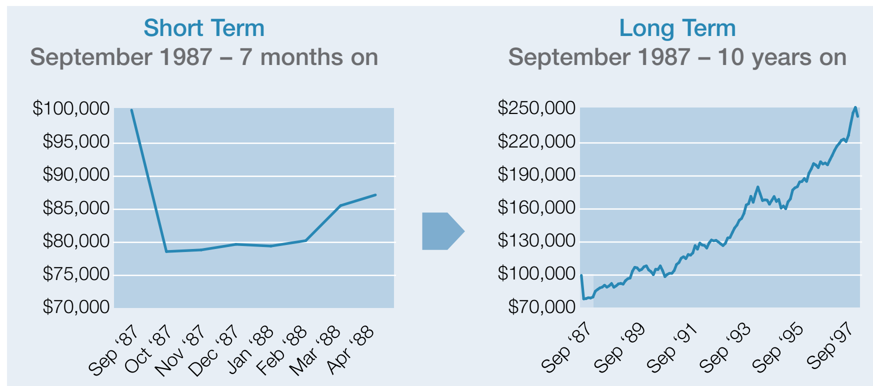
It's important to remember that markets must go through ups and downs. It's tempting to sell an investment if its value falls. However, history proves that having the discipline to stick with quality assets is generally a more successful strategy over time.

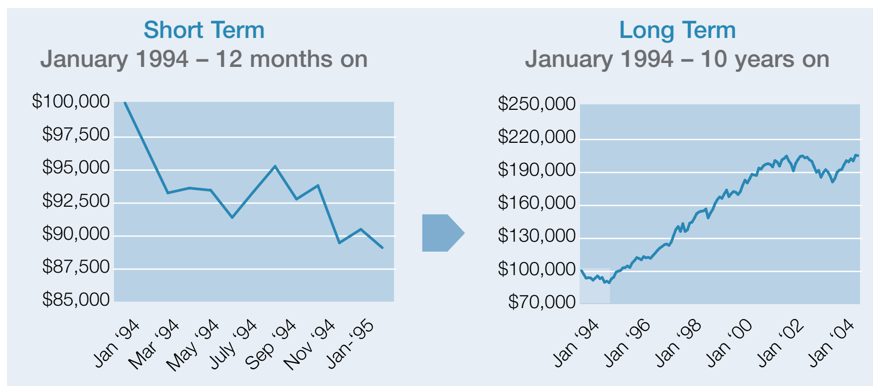
Research from the Australian Stock Exchange (ASX) bears this out. Between 1980 and 2003, there were eight calendar years when the All Ordinaries Index (or its equivalent) generated a negative return. But the All Ordinaries is yet to produce a single negative ten-year return.

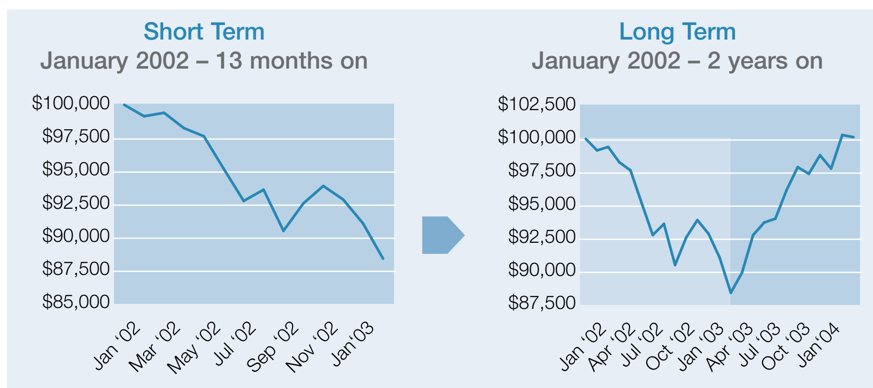
The graphs on page 10 cover some of history's major market downturns. They show how an investor in a balanced fund would have fared if they held onto their investment rather than crystalising their losses when market prices dropped. The long-term results all prove the value of staying the course through the market ups and downs.

"It will fluctuate."

– J.P Morgan, Founder of one America's first great investment banks, when asked what the stock market would do.







Graphs prepared by MIML and are based on the following assumptions. Initial investment is $100,000. Investment is in a balanced fund made up of: Australian shares 45%, International shares 20%, Bonds 30%, Cash 5%, rebalanced monthly. All income is reinvested. No fees are taken into account. Performance is based on indices we commonly use to measure the performance and risk of the relevant investment markets. All income is reinvested. Past performance is not a reliable indication of future performance.

Of time and timing

The risks of market timing.

Many people believe investing is about ‘timing the market’ – getting in before prices rise, enjoying the ride up and then getting out before prices fall.

Yet anticipating these market moves can be extremely difficult because no two market cycles are the same. Investors’ emotions make successful market timing even harder. While logic suggests the best time to buy is when asset prices are cheap or falling, many investors tend to buy when prices are rising and sell when they are falling. The emotions of fear and greed can lead us to buy and sell at exactly the wrong times.

A lot of long-term research suggests that market timing is difficult, even for professionals.

This is why using a financial planner often leads to better investment returns. It’s not just that expert advice helps you pick better investments; it’s that it stops you chopping and changing.

As an investor, you must allow time for the rises and falls of the market to take their course. The main message from investment experts is that it is better to buy and hold rather than trying to time the market. As the cliché says “It’s time; not timing that counts”.

> Look at stocks as businesses. Look for businesses you understand, run by people you trust and are comfortable with, and leave them alone for a long time.
>
> – Warren Buffett

The time difference

The graph on the following page shows the result a long-term investor can achieve over a period of 20 years if they invested at the same time each year, the market high or the market low each year. As you can see, regular, disciplined investing can pay off handsomely and can be a much better investment strategy.

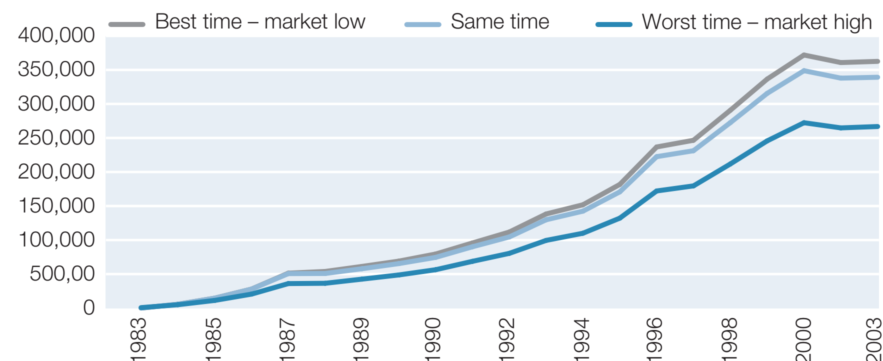
The price of trading

Investors who try to time the market often find that trading is expensive – and not just because of the added transaction costs. Research from Yale University[2] by academics, Nicolosi, Peng and Zhu concluded – "investors trade excessively: investors who trade the most earn the lowest average returns after transaction costs. Interestingly, on average, men trade more actively yet perform worse than women. Investors who switch from phone-based trading to online trading also trade more and earn lower returns."

Market timing is expensive and risky – it means you have to get more decisions right – and that's hard to do.

[2] Source: Yale ICF Working Paper No. 03-32, November 2003. "Do individual investors learn from their trading experience?"

Result of investing $5,000 each year



Graph prepared by MIML. Based on S&P/ASX All Ordinaries Accumulation Index. Assumes an investment of $5,000 (as a proportionate replication of the S&P/ASX All Ordinaries Index) each financial year at the market high, the market low and on 30 June between June 1983 and June 2003. Past market returns are not necessarily an indication of future market returns.

Handling volatility

So how do you cope with the stresses that come with volatility?

1. **Stick with your long-term goal.** Make sure you write it down – it will help you focus on your goal and make it easier to manage emotions like fear, anxiety and greed.
2. **Protect yourself** by spreading your portfolio across a range of investments that behave differently under different market conditions.
3. **Match your objectives with realistic timeframes.** If you're saving for a retirement that is 30 years away you can easily ride out a five year market slump.

Remember, a financial planner can help you understand your investment objectives and associated risks. **To find a financial planner in your area,** contact the Financial Planning Association on 1800 626 393, or visit the website at www.fpa.asn.au

The lessons of history

The past is not necessarily an indication of future performance, however, history does have things to teach us. This table shows the yearly rate of return for various asset classes over the past 20 years. The dark shaded figures represent the best performing asset each year, while the lightly shaded figures represent the worst performing asset sector.

Historical returns from the major asset sectors

End of year	Australian Shares	International Shares	Australian Property	Fixed Interest	Cash	Balanced
Dec-84	-2%	14%	10%	12%	11%	7%
Dec-85	44%	71%	5%	8%	16%	33%
Dec-86	52%	46%	35%	19%	17%	40%
Dec-87	-8%	7%	6%	19%	15%	7%
Dec-88	18%	4%	16%	10%	13%	13%
Dec-89	17%	26%	2%	15%	18%	17%
Dec-90	-18%	-15%	9%	19%	16%	-4%
Dec-91	34%	20%	20%	25%	11%	27%
Dec-92	-2%	5%	7%	10%	7%	4%
Dec-93	45%	24%	30%	16%	5%	31%
Dec-94	-9%	-8%	-6%	-5%	5%	-7%
Dec-95	20%	26%	13%	19%	8%	20%
Dec-96	15%	6%	14%	12%	8%	12%
Dec-97	12%	42%	20%	12%	6%	19%
Dec-98	12%	32%	18%	10%	5%	16%
Dec-99	16%	17%	-5%	-1%	5%	9%
Dec-00	5%	2%	18%	12%	6%	8%
Dec-01	10%	-10%	15%	5%	5%	5%
Dec-02	-9%	-27%	12%	9%	5%	-6%
Dec-03	15%	-1%	9%	3%	5%	8%

Last year's winner?

The complex relationships between different asset types mean that if one asset class is doing well, another may be performing poorly. If, for example, the government is raising interest rates to slow down the economy, the sharemarket usually weakens. Rising rates make it more expensive for companies to do business and therefore reduce profits. Yet higher interest rates are good news for cash investors.

It's tempting to try and ride these cycles – to switch your money into the latest "hot" investment. This is rarely a wise strategy because all sorts of factors – economics, politics, market sentiment and international events impact the markets. Proof that it's hard to make those judgements is illustrated in the table – the best performing asset often changes from year to year.

In other words, chasing last year's top asset is a risky strategy. A diversified portfolio can generate consistent long-term returns with less volatility than chasing last years best returning assets.

Sticking with your strategy

Despite ups and downs, most assets have done well over the long term. The chart below shows the returns you would have received from long-term investments in the major asset classes.

Value of $10,000 if you invested in December 1983

	Australian Shares	International Shares	Australian Property	Fixed Interest	Cash	Balanced
Value $ at 31/12/03	95,621	94,737	96,647	83,796	59,633	104,889
Real value $ (adjusted for inflation)	43,860	43,454	44,330	38,436	27,353	48,111
Return % pa	12.0	11.9	12.0	11.2	9.3	12.5
Real return (adjusted for inflation)	7.7	7.6	7.7	7.0	5.2	8.2

Table prepared by MIML. All figures are based on indices we commonly use to measure the performance and risk of the relevant investment markets. All indices assume reinvestment of dividends and/or income. Returns from the balanced fund returns are based on an asset allocation of 40% Australian equity, 10% property, 20% international equity, 0% cash & 30% fixed interest. Past performance is not necessarily an indication of future performance.

Eggs and baskets

The importance of diversification.

Diversification means spreading your money across different investments to reduce risk. It is perhaps the most important of all investment disciplines. That's why it has become the world's most used and most valuable piece of investment advice – "don't put all your eggs in one basket".

The better you diversify your investments, the less likely you are to suffer from the poor performance of one investment. Spreading your investments reduces your overall volatility, whether you invest in a managed investment or directly into assets (such as shares).

Unfortunately, too many people are poorly diversified – and that can be expensive. A study by W N Goetzmann and A Kumar[3] called "Diversification Decisions of Individual Investors and Asset Prices" followed the results of 60,000 individual share investors.

Their report showed that a vast majority of individual investors were under-diversified, taking too much risk and losing money as a result. On a risk-adjusted basis, the least diversified group of investors earned 2.4% less each year than the most diversified investors.

According to their report, over 25% of portfolios contained just one stock. Fifty percent contained fewer than three stocks and only 5-10% of portfolios contained more than ten stocks. As a result, investor portfolios were extremely volatile.

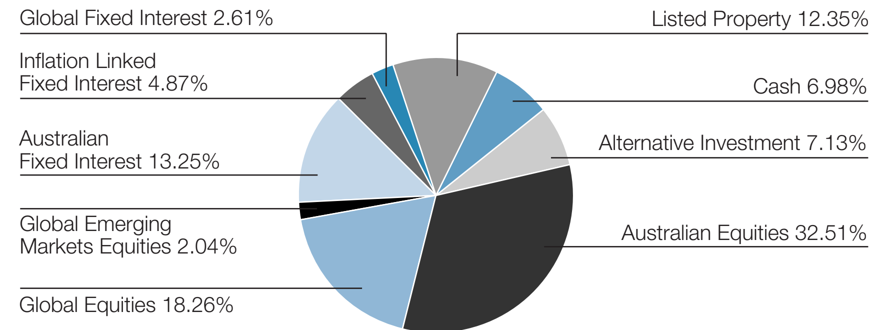
The pie chart on the next page gives an example of the level of diversification achieved by investing in a diversified portfolio – such as a balanced fund.

More than one kind of diversification

Professional investment managers normally produce better returns than individual investors. Yet it is equally important to diversify across managers as well as assets classes. Different managers have different skills and perform well under different conditions. Your financial planner can help you choose a mix of fund managers that suit your needs and have complementary investment styles.

Diversifying across shares, cash, bonds and property potentially reduces your risk. It also plays a crucial role in tailoring your investment portfolio to your needs. Just as no two investors are the same, no two diversification strategies need be the same. You can work with your adviser to ensure your mix of assets meets your needs for both for risk and return. This **asset allocation** process is one of the crucial parts of investment strategy.

Diversification of a Balanced Fund investment



[3] Goetzmann, William N. and Kumar, Alok, "Diversification Decisions of Individual Investors and Asset Prices" (January 14, 2004). Yale ICF Working Paper No 03-31.

Graph prepared by MIML. The pie chart indicates asset allocations of the Macquarie Balanced Fund at 31 December 2003. The composition of this chart may change and at the time of reading differ from the above allocations.

Flight risk

Managing currency risk.

Today we can invest almost anywhere in the world. Australians can profit from the performance of Microsoft (US), Vodafone (UK) and Samsung (South Korea). And investors as far apart as Bangkok and Birmingham can invest in successful Australian companies like Cochlear and Westfield.

International investing doesn't just give us exposure to bigger and better companies. It also increases diversification – expanding, literally, the universe of stocks you have to invest in. That's why investing overseas can increase returns **and** reduce risk.

Different countries, different currencies

Investing internationally has its own risks. By buying overseas assets, you are taking a risk on the relative value of the Australian dollar against other currencies.

As we have seen recently, relative value moves dramatically. In 2003, the Australian dollar rose 33% against the US dollar and finished the year valued at around 75 cents US. As a result, any gains received from investing in US shares were reduced by the worsening value of the US dollar against the Australian dollar. In 2001, it was worth just 48 cents.

Currency moves of that type can wipe out any return you generate from the overseas assets. Alternatively, they could generate a currency-related profit.

Hedging for protection

To control this risk many fund managers hedge their international investments. Hedging is complex, but essentially means managing the risks of a movement in the value of your international assets and therefore helps to protect these assets from currency movements.

A fund manager's currency management process can be a major influence on returns from international funds. It's an important issue to look at when you're working with your adviser to choose an international fund.

> Take calculated risks. That is quite different from being rash.
>
> – General George S. Patton

Rainy-day money

Liquidity risk.

> There are risks and costs to a program of action. But they are far less than the long-range risks and costs of comfortable inaction.
>
> – John F. Kennedy

Sometimes, unforeseen circumstances force us to draw on the money in our long-term investments. This can result in a loss, either because there are transaction fees or because we have to sell investments when their market price is down.

That's why it's wise to keep some 'rainy-day' funds in an accessible, short term investment (such as a cash management trust).

It's equally important you understand the **liquidity profile** of your investments. How long will it take you to redeem money from your cash management trust or managed funds? Remember, for all its advantages, direct property is likely to be your least liquid investment as it will typically take longer to sell.

Once you have your short-term needs taken care of, you can be confident your long term investments can remain just that! Good planning means you can handle emergencies without affecting your long-term goals.

Case Study – Joan, 53

Joan's financial planner always stressed the need for liquidity. "It never really made sense to me," says Joan. "I wanted the best possible return from my money and knew that meant investing in shares and property. I had a good income and didn't need to use my savings so it seemed a bit silly to keep money sitting in cash.

Nonetheless, I took my planner's advice. Then my daughter, who was living in London, had a car accident. She had to have emergency surgery and weeks of follow-up treatment. Thanks to my separate cash fund, I was able to get on a plane almost straight away.

If I had to, I would have sold investments to be with my daughter. But that might have taken a week – and I could have lost money selling my shares when the market was down. At a really stressful time, it was an enormous relief to have emergency funds to call on."

This is a fictional case study. It is an illustration only and any similarities to any reader's circumstances are purely coincidental.

Trust issues

Credit risk.

Do not trust all men, but trust men of worth; the former course is silly, the latter a mark of prudence.

– Democritus (460-370 BC)

Credit risk applies to investments such as term deposits, debentures and bonds. It is the risk that the company you have entrusted your money to will become insolvent – unable to meet interest payments or to repay your funds.

Information is the key to managing credit risk. If you're considering an investment, ask for information about the company's credit rating, past performance, ownership etc. This should give a good indication of the quality of the organisation.

Once again understanding the risk/return trade-off is important. Bonds or debentures that are riskier have to pay a greater return to attract investors. That's why government bonds generally pay less than corporate bonds, and why bonds issued by blue-chip companies generally pay less than those issued by new or smaller companies.

Diversification will also help you manage credit risk. By spreading your money amongst a number of institutions, you can reduce the effect a credit problem in one investment could have on your portfolio.

Credit ratings

Ratings agencies like Standard & Poor's (S&P) rate investments such as bonds, cash management trusts, investment bonds and approved deposit funds.

The highest rating available is 'AAA'. S&P considers funds rated from 'AAA' to 'BBB' to be 'investment grade', that is, to have the capacity to pay income and repay funds in a timely manner.

Changing rules

Legislative risk.

When you map out a particular investment strategy, you naturally make decisions based on the laws and regulations at the time.

There is always a risk that the rules could change. This is especially important in superannuation and Social Security where governments of both major parties have made many major legislative changes over the years.

A financial planner can explain the legislative risks of a particular investment and help make sure you will not be locked into an unsatisfactory strategy should the laws change.

Loopholes and legislation

Governments don't like changing investment laws that are well-established and trusted by large numbers of voters eg, negative gearing.

Indeed, much of the complexity of today's super legislation is the result of governments changing the super laws, and at the same time, trying to make sure people who invested under the old laws will not be disadvantaged.

Where legislative risk becomes a real problem is if investors try to take advantage of short-term loopholes or weaknesses in government regulation. Governments are much more likely to amend those regulations without warning or compensation.

That's why it's so important to judge each investment on its investment merits… not on the chances of special, one-off tax advantages.

Government's view of the economy could be summed up in a few short phrases:
If it moves, tax it.
If it keeps moving, regulate it. And
if it stops moving, subsidise it.

– Ronald Reagan

Doubling up

Gearing risk.

Gearing is simply borrowing to invest.

Investors "gear" if they borrow to buy shares, property, or other assets so that they can increase their returns. Obviously, the more money you invest, the greater the cash return you receive for every percentage point of growth or income your investment generates.

However, the more you invest, the greater the loss you can make if the market turns against you. So gearing can have substantial risks – and these risks increase the more volatile the underlying investment.

There are many ways to manage gearing risk. You can limit the amount you borrow, buy only quality investments and make sure you are investing for a suitable time. You can also take out insurances (such as life, trauma and income protection) to protect the income that pays the loan.

Your financial planner can fully explain how any gearing will change the risks in your investment portfolio and help you devise a strategy to manage those risks.

Different assets, different risks

Each of these four major asset classes – cash, fixed interest, shares and property – has unique characteristics.

Cash

Includes cash management trusts and on-call deposits with banks, building societies and credit unions.

Fixed Interest

You receive an income in return for the loan of your money over a fixed term. See pg 6 for more information on fixed interest investments.

Shares

Shares are traded on a stock exchange and are generally liquid. They represent part ownership of a business and entitle you to share in a company's income and any growth in its value. Historically, shares have delivered the best long-term returns of the major asset classes.

Property

Can be residential, commercial, retail, industrial or rural. Direct property is relatively illiquid. By investing in listed property securities traded on a stock exchange you can enjoy better liquidity though you will need to manage many of the risks associated with share investing.

> There is good news. The financial tools that will allow ordinary folk to cope with increased uncertainty, and to insure against adverse economic events, are already being developed.
>
> – Robert Shiller
>
> US economist and author of *"Irrational Exuberance"*

A suitable choice

The table below shows some of the potential risks associated with each asset class.

With careful **asset allocation,** you can mix the different asset classes, each with different levels of return, liquidity and volatility, into a portfolio that is tailored to your needs.

Asset	Features	What do I need to know?
Cash	The capital is safe relative to other asset classes. You have quick access to your money.	No protection from inflation or taxation. Returns tend to be lower than for other assets over time.
Fixed Interest	Generally secure – if held to maturity. Certainty of income.	Interest rates can vary and may not keep pace with inflation. Can be expensive to convert into cash in an emergency.
Shares	Tend to generate superior long-term returns and growing income. Potential tax benefits. Highly liquid – in most cases.	Volatility could lead to losses if forced to sell. Market slumps can be prolonged. Skill, experience and/or good advice is often required to make right selections. Can be difficult for the direct investor to achieve sufficient diversification.
Property	Capital value and income should rise with inflation. Potential for tax benefits. Emotional security of “bricks and mortar”.	Illiquid. Managing tenants can be difficult and costly. Often involves large sums of capital, significant debt and numerous costs such as legal fees and maintenance expenses.

And now what?

You now understand some of the risks involved in investing. As you can see, risk is not something to be scared of. Rather it needs to be understood, accounted for and managed. A financial planner can help you do this.

To find a financial planner in your area, contact the FPA on 1800 626 393, or visit the website at www.fpa.asn.au

The Financial Planning Association (FPA)

The Financial Planning Association of Australia (FPA) is the peak professional body for Australia’s financial planners, representing both individuals and businesses. Over 8,000 of its 14,500 members are practising financial planners.

The FPA provides a range of services to its members, to the financial planning profession and to individual investors. These include member education and training; support for members in maintaining and enhancing professional standards; representing members’ views to government, regulators, the media and other stakeholders; input into policy and regulatory decision-making; and raising the awareness of Australians about the benefits of good financial planning.

Macquarie Investment Management Limited

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Macquarie Bank was established in 1969 and is an Australian listed company specialising in investment banking and financial services. The company employs more than 4,700 staff in Australia. Its market capitalisation exceeds $5 billion.