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West Riding Personal Financial Solutions Ltd

Risk Realities

Helping our Clients Understand Investment Risk

Risk Realities - Contents

Understanding Risk and Attitude to Risk

We want our clients to be very clear about what we can and cannot do; what 'risk' means and the many different forms risk takes.

As this guide evidences, we go to great pains to explain to clients what 'risk' mean in reality. If you are very nervous about investing money, you probably should <u>not</u> invest but should instead keep your money on deposit in the bank or building society, or in National Savings. An investor who 'panics out' of the market at the bottom after a sudden fall can self-inflict a severe financial wound and suffer an irrecoverable loss. The real-life case studies set out in the 'Risk ***in*** Reality' section of this guide illustrate, amongst other examples, pone such investor who did precisely that after the 1987 crash. For this reason, we do not invest money for individuals whom in our judgment are incapable of coping with investment risks.

We cannot offer <u>any</u> totally risk-free investment. Bank deposits are not investments; they are savings. They are generally regarded as very low risk but, as experience has taught us, even they are not totally risk-free. Inflation erodes their real value even if the banks do not go bust. Textbooks class UK government gilts as low risk but when interest rates are very low, they are potentially very risky indeed. When interest rates rise gilts fall in price with all other bonds. Even 'guaranteed' National Savings products are not truly risk free. If a fixed-rate fixed-term investment is bought and the rate of inflation then ends up outstripping the rate of return it provides, the investor will lose money in real terms because the buying power of the capital plus interest returned at maturity will be less than that of the capital invested at inception.

Inflation is a risk. Currency depreciation is a risk. The fact that interest rates might rise is a risk. There are many other risks. This guide spells them out.

Forget, then, the idea that there are totally risk-free investments to be had. Totally risk-free investments do not exist and we do not do purport to be able to provide such.

<u>What We Can and Will Do</u>

We <u>**do not**</u> guarantee returns at all but we **do** guarantee:

1. To do our best, to work hard for our clients and to tell the truth.
2. To choose investments objectively given the parameters clients set because we believe them to be the best choice for the client, not because they earn us the most. We guarantee that by having fixed charges. We re not paid by commission.
3. To spread risk by diversifying your investment between dozens of different underlying securities, different types of securities such as bonds, shares and property, and different market sectors such as retail, pharmaceuticals, manufacturing, heavy and light industry, technology, consumer goods, commodities and all the rest.
4. To be as 'available' as we reasonably can be. All clients have our home and mobile numbers. We do not 'hide' from our clients.
5. **Never** to knowingly invest in anything which we in any way believe or even suspect can go to zero. Some investments can go to zero – futures and options for example. Similarly, investments in individual shares can suffer a total loss as happened to shareholders in Northern Rock and Bradford & Bingley.

Attitude to Risk

The phrase 'Attitude to Risk' describes an individual's approach to the level of investment risk that he or she considers acceptable. Each person's attitude to risk is unique. It will depend on his or her circumstances, investment experience and objectives. It is possible to measure attitudes to risk using risk profiles ranging from cautious to adventurous. At the lowest-risk end of the scale will be investors with little or no tolerance for loss who are prepared to accept low but secure returns. At the other end of the scale are investors who can afford to risk large and sudden losses and who are prepared to accept such a risk to enjoy the potential for higher returns.

We undertake an attitude to risk assessment with every investment client. This takes the form of a thorough verbal explanation by the adviser as to what risk means followed by a questionnaire that both assists the client in understanding risk whilst helping us to understand how much risk the client can tolerate. All this is summarised in a 'Risk Reality' report - this report - so the client has time to digest it and reconsider his or her answers. There is no rush from our point of view; clients can take as long as they want and can change their minds if they wish. We want to get it right and we try our best.

Once we have agreed the risk tolerance, we finalise our recommendations in a personal report. The personal report sets out both general and specific risk warnings. We emphasise that clients should take these warnings seriously, they are there for their benefit. The general warning is italicised below but it is important to understand the different types of risk that affect individual asset classes. With that in mind, we have expanded on the subject in this document. We hope you find it helpful and if you would like a more detailed discussion of any of the points covered, we will be happy to oblige.

Due to charges and the nature of investment markets, you should consider any investment you make to be for the medium term at least; i.e. five years' plus. If any right to cancel is exercised during the cancellation period you may not get back the full investment if the value of units falls in the meantime. Please remember that savings in bank or building society accounts are relatively secure, whereas investments (e.g. unit trusts, OEICs, investment trusts or life company funds) involve stock market risk. This means that the value of your investments and the income from them can go down as well as up and, particularly if you withdraw in the early years, you may not get back the full amount invested. This may be partly due to exchange rate fluctuations in investments having an exposure to foreign currencies, and interest rate movements. Similarly, interest rate movements and inflation expectations will affect the value of fixed-interest bond investments. Past performance is not necessarily a guide to future performance and cannot provide a guarantee of the future returns of a fund.

Fund Specific Risks

This section deals with the specific types of risk applying to the various investment fund types.

With-Profits Funds

With-profit funds depend for their growth on the underlying assets, which traditionally consisted of a mixture of equities, property and fixed interest stocks. More latterly many companies have had to scale down the equity content in favour of increasing the proportion of fixed interest stocks. Bonuses representing the growth in underlying assets are declared at the discretion of the company's actuaries and are not guaranteed. Market Value Adjustment factors ('MVAs' - sometimes called Market Value Reducers) may be applied where underlying asset values have fallen to a level insufficient to justify the face value of a policy to which bonuses have been added. This will usually have the effect of reducing the realisable value of the investment, meaning that you cannot cash it in for its full 'theoretical' value. The policy conditions state the circumstances under which MVAs may be applied but in general MVAs are most likely to be applied after serious and/or sustained falls in the underlying stockmarkets.

Fixed Interest Funds

Bonds come in many different varieties and are used by companies and governments to raise capital from the stockmarkets rather than by borrowing from banks. Bonds represent a promise by the issuing company or government to pay interest at regular intervals and to repay capital on a fixed date in the future. Corporate Bond funds invest largely in fixed-interest loan stocks issued by companies (hence corporate bonds as the name suggests). The risk factors applicable to corporate bond funds concern the ability of the bond issuer to meet its commitments, the risk of inflation increasing and the possibility of interest rate increases.

The capital values of Corporate and government Bonds are affected most by changes in the general level of interest rates. Bonds pay a fixed level of interest and in common with other fixed interest investments their capital values will fall if general interest rates increase, or are expected to increase. Capital values i.e. bond prices will also fall if inflation increases significantly or is expected to and/or if the default risk increases or is thought by the markets to have increased. Default risk is the risk that the issuer – the company – might not be able to fund interest payments on time or be able to afford to redeem the bonds, i.e. pay back investors the money they effectively loaned the company when they bought its bonds.

Bonds are often associated with low risk investments. Because they offer a stable income, bond funds tend to be seen as the territory of older investors or the more risk-averse. This is a common but serious error. It is true that some bond funds are safe but the degree of risk varies significantly – and some funds hold highly risky investments. The fundamental risk entailed with a bond is the possibility that the company an investor has lent money will fail and be unable to repay the loan: default.

The risk of the UK government defaulting is essentially nil therefore the risk is lowest with gilts. Not all sovereign debt is safe however. Over time many countries have defaulted on their bonds, usually for economic reason but sometimes for political reasons such as the Russian and Chinese revolutions. Corporate bonds can be almost as safe as gilts or they can be extremely high risk. Investors must look at companies on an individual basis.

Company ratings assigned by agencies provide a useful starting point. Firms such as Moody's and Standard & Poor's (S&P) grade companies based on their financial strength. Ratings of AAA+ to BBB- indicate a company is of investment grade while those from BB+ down to D are deemed sub-investment grade, also known as speculative grade, 'high yield' bonds. Regardless of how good a credit risk a company or government may be however, inflation is a risk for all bond investors.

Commercial Property Funds
The value of property is generally a matter of a valuer's opinion rather than a matter of fact. It is not possible to sell major commercial properties at short notice and therefore investments in Property Funds may be subject to restrictions on encashments, as it is necessary for the fund manager to protect the interests of all investors in the fund. This could mean that you are not able to withdraw your investment at the time you wish. Most property fund managers reserve the right to defer encashments for at least six months should such action be necessitated by market conditions as happened in 2016 after the Brexit referendum.

Product-Specific Risk – Income Drawdown
An alternative to buying an annuity is ***income drawdown*** or, to give it its proper name, unsecured pension. Drawdown potentially allows the pension planholder to benefit from an increase in the value of the plan's underlying investments but at the risk that the opposite may happen – i.e. the investment values may fall. If that happens then the fund may buy less of an annuity than would be the case if one had been bought immediately rather than putting the fund into drawdown. Other risks are that annuity rates may be lower in the future. A planholder going into 'deferred drawdown', i.e. taking the tax-free cash but not buying an annuity and leaving the fund invested, does not receive a payment each month as he or she otherwise would. Unless the pension fund grows by a commensurate amount and/or annuity rates increase, the planholder's total payments might never equal what could have been received had an immediate annuity been bought.

Money Purchase Annual Allowance (MPAA)
At the point any income is drawn from a drawdown arrangement over and above the tax-free amount, the Money Purchase Annual Allowance (MPAA) rules will be triggered. This means that any future contributions to a pension plan will be limited to £4000pa as opposed to the annual allowance of £40,000pa.

Critical Yield must be considered. This is the growth rate the fund needs to achieve to be sufficient to provide and maintain an income equal to that obtainable under the annuity that could have been bought. If this yield is not achieved then the planholder may end up with a lower pension than would otherwise have been the case.

Income Drawdown, or unsecured pension, can be a valuable retirement planning tool for the right people. Typically, it suits those who are not averse to investment risk, and who have larger pension funds. However, there are no guarantees that income will be greater than if the fund was used to purchase an annuity at retirement so the trade-off is the potential of more income long-term for accepting the risk of less. It is a more flexible alternative to the traditional annuity route, offering greater choice and control for many people. Drawdown enables the investor to put off buying an annuity and instead withdraw a regular income from the pension fund while the remainder of the fund stays invested. While the fund remains invested, the investor can benefit from potential growth in the market and from ongoing advice.

Mortality drag is another risk and refers to the absence in drawdown of any cross-subsidy as exists in a pool of annuitants. When calculating annuity rates, actuaries effectively assume an average life expectancy and those clients purchasing an annuity and fortunate enough to live beyond this are generally gaining at the expense of those dying younger, something commonly referred to as mortality cross-subsidy or ***mortality gain***. Mortality drag is the opposite effect and refers to the fact that those clients who go into drawdown pension and defer annuity purchase lose out on this cross-subsidy. The longer annuity purchase is deferred, the harder the drawdown pension fund has to work (or the more the fund has to grow) to compensate, as life expectancy reduces with age and has the effect of increasing the critical yield.

WARNING

Since 'pension freedom' became available a plethora of scammers have arrived on the scene. These people attempt to persuade investors to cash in their pensions to invest in high-risk schemes promising 'safe' returns that are way above those which might reasonably be expected from the average Unit Trusts/OEICs and Investment Trusts and conventional income products such as annuities. Many such schemes involve foreign property in places like Cape Verde. If such schemes are marketed to you, we urge you to exercise extreme caution and to contact us for advice before committing to anything.

West Riding Personal Financial Solutions Ltd has NO relationships with any professional introducers and nor do we encourage any client to take third-party advice, particularly if it involves foreign real estate, biofuels and the many other so-called 'investments' that typically turn out to be scams.

Miscellaneous Risks

Switch Costs and Risks

Reinvesting usually involves some cost. There is no guarantee that a switch will produce an increase in performance sufficient to offset the cost involved. Likewise, there is no guarantee that an investor would not be better off staying in his or her existing product and/or fund. We make recommendations in good faith, but we do not profess to be omniscient and we cannot predict the future.

When a product or fund is sold and another is bought there will usually be a point when the investment is 'out of the market', i.e. in cash. If the market rises in between these points, the investor will miss the growth he or she might otherwise have had. (Equally of course, if the market falls, he or she will avoid the effects of the fall.)

The following section headed ***'Different Types of Investment Risk'*** explains what types of risk affect all forms of investment. These include, for example, interest rate risk as covered in the section above on fixed-interest funds.

Different Types of Investment Risk

ACD/Trustee/Operational Risk (Fraud of any of the Third Parties)
The risk of fraud or mismanagement by third parties involved in an investment as happened with Keydata.

Basis/Spread Risk
The risk due to spread exposure as in spread betting, index gambling, writing options etc. It was 'spread risk' – coupled with the fraudulent concealing of losses by Nick Leeson – that caused the downfall of Barings.

Business Risk
The risk due to the poor management of a company as happened with Northern Rock and Bradford & Bingley, or the decline of a business sector in general as happened to Kodak and photographic developers with the advent of digital and the near-death of camera film.

Capital Risk
The risk that the investor will not receive return of all capital and that some/all of the individual capital invested may be lost. The possibility of this risk usually increases where investments provide the potential for higher real returns. This applies to most investments and certainly to investments in stocks-and-shares.

Company Specific Risk (Shares)
The risk of poor performance or even the total loss of investment into an individual company. We reduce this risk by diversifying investments via funds.

Concentration Risk
The risk of lack of diversification in a portfolio.

Counterparty Risk
The risk of any counterparties defaulting. (Also see Credit risk/Default risk.) We minimise this by generally avoiding investments that rely on counterparties, but it is nigh-on impossible to completely manage out this risk without greatly reducing the 'universe' of investable funds.

Country Risk
The risk that a country's government will suddenly change its policies in a way that is detrimental to the investment. An example of this would be the Swiss National Bank's decoupling of the Swiss Franc from the €uro.

Credit Risk (Corporate or Sovereign Default)
The risk that a company or other entity will be unable to pay the contractual interest or principal on its debt obligations, also known as counterparty or default risk. Greece is a recent example.

Exchange Rate Risk
The risk of movements in exchange rates affecting the investment values. Exchange rate risk occurs where investments are in overseas currencies or foreign assets; an appreciation of the pound can reduce the value of these investments to a UK investor.

Inflation Risk
The risk that rising prices erode the buying power of an investor's capital.

Insurance Risk
The risk that an insurer will be required to pay a claim.

Interest Rate Risk
The risk of a reduction in the value of a security, especially a bond, resulting from a rise in interest rates. A rise in rates could be good for variable rate savers, not good for borrowers. Likewise, a fall in rates will have the opposite effect. Fixed interest investments such as gilts and corporate bonds will usually fall in value if interest rates rise. Likewise, a loan such as a mortgage will cost more unless the borrowing has been arranged on a fixed rate basis.

Legal Risk
The risk that counterparties are not legally able to enter into a contract.

Liquidity Risk
The risk that an investment - e.g. unlisted company shares - might be difficult to sell. The risk of assets held in an investment not being realisable.

Longevity Risk
The risk with investments in second-hand life policies that the life expectancy of the lives assured is unpredictable.

Market Risk
The risk of a fall in an individual country's stockmarket.

Manager Risk
The risk of investment manager producing poor performance or even total loss.

Opportunity Risk
No investment will be free of any risk because some risk will be associated with capital loss, and some with the nature or level of returns.

Political / Socio-Political Risk
The risk that changes in a Government's policies can affect the assets within a portfolio to varying degrees. An extreme example would be a military coup, debt default or a nationalisation policy such as when Nasser nationalised the Suez Canal in 1956. A less extreme example would be the withdrawing of tax breaks making investments less profitable and/or less likely to succeed. Funds investing in ground rents are at political risk.

Premium Risk
The risk that with traded life policies, where regular premiums have to be paid, a lack of liquidity might lead to premiums not being paid causing the policies to lapse.

Profit Risk (Individual Equities)
The specific company risk whereby a company's income statement lacks income diversification and income variability, i.e. the company has all its eggs in one basket, over-relying on one area of business for its profits.

Refinancing Risk
The risk that a borrower cannot refinance by borrowing to repay existing debt. Refinancing risk that caused the near-insolvency of Northern Rock when the financial system 'froze' in the credit crunch. Northern Rock had borrowed money from other financial institutions to lend out to mortgage borrowers – borrowing short and lending long. When Northern Rock suddenly could not borrow new money to repay existing borrowings as their repayments fell due the UK government was forced to step in and nationalise the bank.

Reputational Risk
The risk of a reduction in a share price due to specific events occurring which damaged the reputation of a particular company or country, e.g. Gerald Ratner's infamous 'joke' that his company, Ratners, 'sold crap' and that its ear rings would not last as long as a Marks & Spencer's prawn sandwich. Fashion chain Ted Baker suffered from the 'forced hugs' scandal that forced out its founder Ray Kelvin, wiping a third off its market value in six months.

Sector Specific Risk (Specific Shares in Specific Sectors)
The risk of poor performance of a certain sector or geographical area.

Settlement/Counterparty/Herrstat Risk
The risk that one party will fail to deliver the terms of a contract with another party at the time of settlement.

Shortfall Risk
The risk that the desired returns from an investment over time fall short of their target. This was the risk suffered by holders of mortgage endowment policies. The policies matured for less than was needed to pay off the policyholders' mortgages. This risk has to be weighed in comparison to capital risk. If a low level of capital risk is insisted upon then shortfall risk will increase and the investor must accept that returns are likely to be relatively low in comparison to other available investments.

Solvency Risk
The risk of loss owing to the failure (bankruptcy) of an issuer of a financial asset.

Systemic Risk
This is the risk influencing a large number of differing assets in a portfolio. Systemic risk will affect the performance of most or all securities to a greater or lesser extent. Again, theorists suggest that this risk can be "managed" by consideration of the types of security to be held and how they are likely to react (e.g. less than, more than, in line) with the market as a whole.

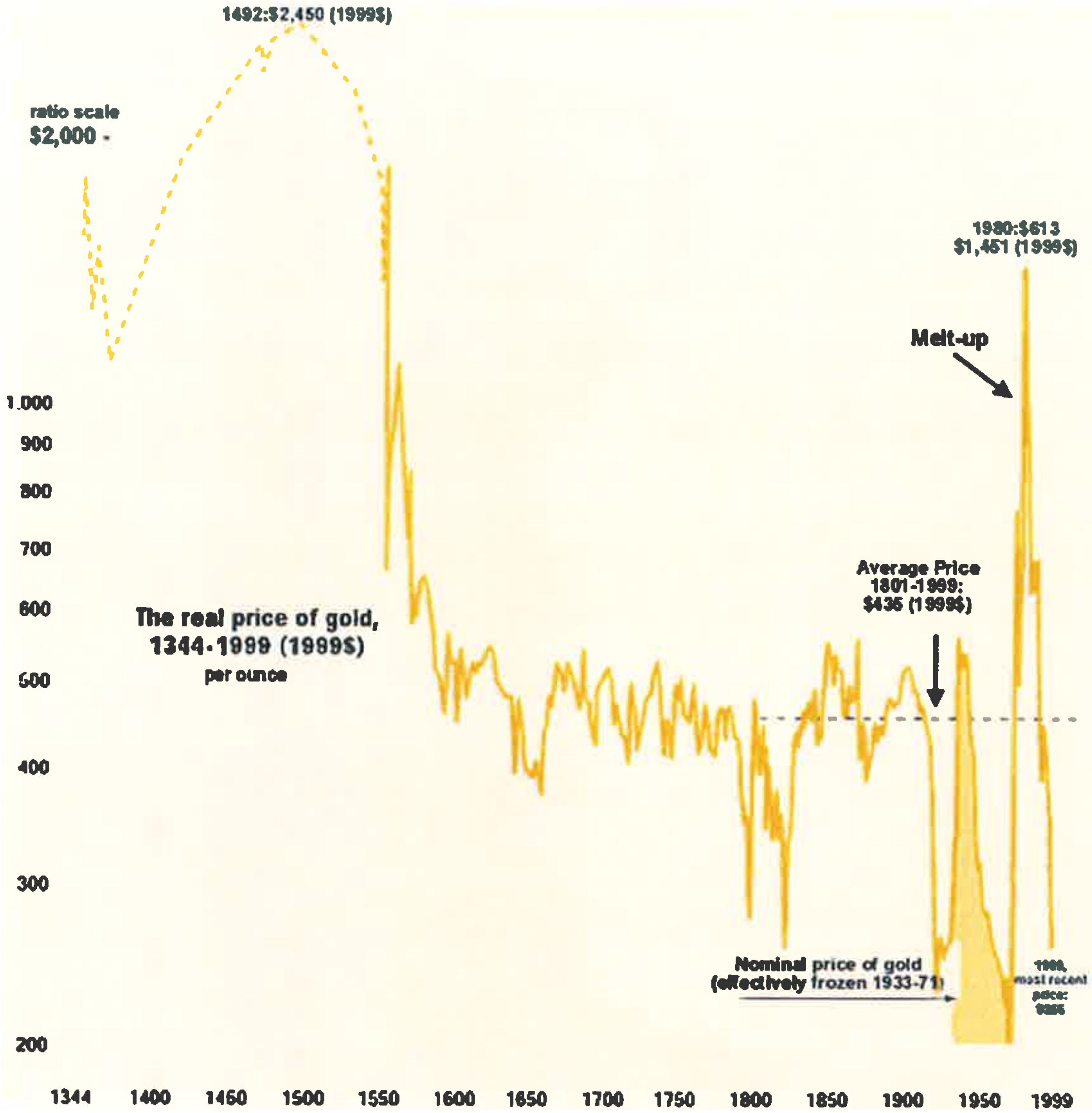
Term Structure/Yield Curve/Repricing risk
The risk due to changes in the fixed income term structure.

Unsystematic/Concentration/Specific Risk
The risk affecting specific assets within a portfolio, i.e. the risk of some internal or external event that can affect the performance of one company (and therefore value/earnings etc for the investor), but may not necessarily affect other institutions. A common policy to counteract this type of risk is to hold a number of different stocks, shares or even asset types within a portfolio (diversify).

Valuation Risk
The risk of assets held being incorrectly valued as experienced when a major oil company misinformed the market that it had more reserves than was actually the case. Similarly, Tesco's overstatement of profits in 2014 and a similar instance by DIY chain Wickes in 1996 which led to fraud charges against the directors concerned in 1999 and their subsequent acquittal in 2002.

Volatility Risk
The risk of a variation in values of investments and other assets.

The Myth Of 'Safe' Gold



West Riding Personal Financial Solutions Ltd

Risk in Reality

This was written on 25 October 2018 and should be read in the context of that time.

This compilation of case studies aims to get across what 'risk' means in reality. It is vitally important to us that, on the one hand, we only put you into the kind of investments with which you will be comfortable. It is equally, if not more important however, that you are realistic and reasonable in your expectations of what is likely to be achieved, given the parameters you ask us to work within. The best results and happiest outcomes are invariably achieved when a reasonable and realistic client works with an honest and competent adviser. Problems occur for clients if their adviser is incompetent and/or dishonest. Problems occur for advisers when clients are not reasonable or realistic.

Below are detailed some real-life examples of situations we have encountered, how we have dealt with them and what the results have been.

Mr V

Mr V came to us in May 2011 with a portfolio worth £456,000. He'd heard my BBC Radio Leeds broadcasts. He told us he was a cautious investor. When we analysed his portfolio however, we found it contained a great many high-risk and volatile funds investing in commodities, Russia, China, Latin America and frontier markets. Away from the managed funds portfolio we found he also had a significant number of single-share direct investments. We had to say to Mr V, *"Look, you've said you're cautious but the portfolio you've built yourself is anything but cautious. If you're asking us to take responsibility for managing your portfolio you have to do one of two things: Either you have to sell all the risky and concentrated holdings or you need to agree that you're not actually 'cautious' at all, that in reality you're quite adventurous and well-used to volatile investments. If neither of those options is acceptable then I'm sorry but we cannot take you on as a client."*

On reflection Mr V agreed that so far as his actual investments were concerned, he was thoroughly adventurous and happily accepted the ups and downs of the markets. What he'd *meant*, he told us on reflection, that he was cautious about letting other people manage his money. That was fair enough, obviously. We agreed with him that we'd make recommendations in keeping with the kind of investments he was well used to and that we wouldn't buy or sell anything without his agreement – which we do in any case as our service is advisory not discretionary.

Mr V was impressed that unlike so many advisors who just tell clients what they want to hear, we tell clients what they need to hear. He is still with us as a client today, we have a fantastic client-advisor relationship, and his portfolio which we manage is now worth in excess of £1.06m. We were honest with him and he in turn was reasonable and realistic. We get along great. He's the kind of investor an adviser can really work with.

Mr L

Mr L was a client of a firm I worked for 1985-1988 in Harrogate, NIMCo Ltd. Mr L came to us in July 1987. He'd sold his sub post office business and wanted to put a sum of money on the markets for two years. He'd lived in rented accommodation since selling up and told us that he intended to stay renting for another two years because he thought the housing market had risen too high and was bound to fall. My thoughts were exactly the opposite of his. I'd bought my first house aged 23 the previous December for £15,650 and in the intervening period it had made more in terms of increased value than I had earned in salary. I saw no prospect of the rise in prices coming to an end but thought the markets had probably peaked and we might well see a fall. I told him this. I told him he should forget investing and go buy himself his retirement home before he got left behind by the market. I told him that two years was far too short a term to invest money in the stockmarket; if he was going to invest it should be for at least five years, not two, but really, he'd be better off buying his house. My advice was not well received. His response was *"You're just a young lad. What do you know? I've been an investor all my life. If you won't take my money I'll go down to Analysis and see them."* Analysis was the other big firm in Harrogate, the one that later got into trouble due to its involvement with Barlow Clowes.

I checked with the boss who decreed we should invest Mr L's money on an 'insistent client' basis. Effectively that means saying *"We've told you to do 'A' but you've told us you want to do 'B' so on your head be it."* That was July. On October 14 1987 the Dow Jones Industrial Average dropped 95.46 points (3.8%) to 2,412.70, and fell another 58 points (2.4%) the next day, down over 12% from the August 25 all-time high. On Thursday, October 15, 1987 Iran hit the American-owned oil supertanker, the Sungari, with a Silkworm missile off Kuwait's main oil port. The next morning, Iran hit another ship, the US-flagged MV Sea Isle City.

Friday, October 16 1987. The Dow fell 108.35 points (4.6%) to close at 2,246.74 on record volume. US Treasury Secretary James Baker then voiced concerns about the falling prices. The trading day in London closed early though due to what is popularly remembered as 'Michael Fish's Hurricane' after the BBC weather forecaster who said we need not worry about one. Over the weekend the financial world held its breath waiting for the markets to open the following Monday morning. Monday 19 October 1987. 'Black Monday'. The crash started in Hong Kong which is 7 hours ahead of London, so London opened that Monday morning with the Far East down heavily. It picked up momentum when London opened, largely because London had closed early the previous Friday due to the storm. By 9.30am, the London FTSE100 had fallen over 136 points – 10.84%. By the end of October, stock markets had fallen in Hong Kong (45.5%), Australia (41.8%), Spain (31%), the United Kingdom (26.45%), the United States (22.68%) and Canada (22.5%). I was in the office until 11pm that night.

The next day I went in early, arriving at the office around 5am. Mr L's car was already in the car park. Before my wheels stopped turning Mr L was at my car door insisting that he wanted all his holdings sold. The markets weren't open at that time however, and London's telecoms were still severely disrupted from the previous Friday's storm. I explained that he should sit tight for the recovery. He'd come to us with a 2-year timescale but was now wanting to sell out after just three months. I'd told him not to invest at all, but he'd insisted on doing it. I'd told him if he did invest it should be for a minimum of five years not two but he'd ignored that as well. Now for the third time in three months he was ignoring my advice. Instead of sitting tight he cashed out, taking a loss of around 30% which he would never recover.

By September 1989 the FTSE had recovered completely as had the Dow. If Mr L had stayed invested for his own 2-year timescale, thanks to the compounding effect of reinvested dividends, he'd have made a handsome profit. But he could not take advice and panicked out.

Mr and Mrs G

These clients came to us in 2010. Both aged 60, his occupational pension wouldn't let him take benefits before age 65 without a severe penalty. She had worked for a trade union all her life, but had been forced to retire early due to ill health. All their lives they'd been savers, using the building societies, and had saved some £140,000. They'd never been investors. She wanted her husband to retire immediately and said she wanted us to invest their £140,000 to fill the income gap that would result until their state retirement pensions kicked in.

I was nervous about this. These were people who lived frugally, never went out and had never invested in the kind of assets that can go down as well as up. She (It was the lady who did all the talking) told us that she'd decided to become an investor now because returns on cash were so poor and would not make up the income shortfall. So, I talked her through each asset class, explaining how each worked and what the risks were. Equities (shares) I explained at length and in great detail. Too risky! She wasn't interested. Commercial property? The same. Bonds? The same. So, we were back to cash, which is where they were already. *"But that won't give us enough to live on!"* she exclaimed. *"A friend of ours retired ten years ago and he's been able to live on his interest, so why can't we?"*

I had to explain that interest rates between 2001 and 2008 had averaged around 5% and asked her *"How's he managed in the last couple of years?"* to which she replied *"Oh he's really struggled since rates came down."* I then went on to explain that there wasn't any 'secret account' anywhere paying 5% or 6%, and that if she wanted absolute safety and flexibility, she was stuck with deposits paying maybe 1%.

I then went on to explain that the best solution was for her husband to keep on working until his normal retirement age, which was what he wanted to do anyway – she was the one wanting him to retire. That way they wouldn't have an income gap, they wouldn't have to take risks with which she was uncomfortable and in due course he could retire on a full pension.

When I left, she was not very happy, but a couple of weeks later I did receive a very nice letter from her saying how grateful she was that we'd talked her through her options frankly and had led her to make what was the right decision for them. Her husband would work to normal retirement age. Had she invested then I'm pretty sure she would have sat at home watching the market minute by minute, would have made herself ill in the process, and would probably have panicked out the first time the market had a bad day, with the same disastrous results as Mr L suffered when he cashed out in 1987.

Mr B
Mr B came to us in 2011, dissatisfied with his previous adviser. When we looked back at the history of Mr B's dealings, we found that he'd consistently gone against his previous adviser's advice. He'd done precisely the opposite of what he really should have done. When the market went up, he wanted to pile more money in. After a fall he insisted on cashing out. We told him the truth that his previous adviser had actually given him good advice and done a good job, but that he himself had in effect undone the work his adviser had tried to do on his behalf. In reality, he'd been an un-advisable client. If we were to work successfully for him, he'd need to change his mind-set.

He took our comments on board and joined us anyway. Since then on a couple of occasions he's almost relapsed into his old ways (wanting to pile in more money after a rise, wanting to pull out after a drop) but we've managed to keep him on track by referring him back to our original discussions. He sees now that what we told him is true and the way we do it works. Unlike Mr L, Mr B has learned to take advice, and it's paid off for him.

Mr S
Mr S came to us with a number of other new clients in February 2013 after hearing me being interviewed by Paul Lewis on BBC Radio 4's Money Box programme. He said he'd been "Burned by Equitable Life and several other disasters, and only wanted cautious investments so as not to get 'burned' again.

Fine. Having been given a clear brief, we worked to it. A few months down the road his portfolio was nicely in profit making way more than it would have in the bank or building society, but he was not happy. He complained that "My portfolio isn't setting the world on fire." Our reply was "Correct – you said you didn't want to get burned. You told us you wanted a cautious portfolio and that's what we've built you." He had time on his hands so this conversation then repeated itself, usually at intervals of 6-8 weeks. We made it clear that Mr S could re-categorize himself should he wish to do so as a less cautious less risk-averse investor, and we would then change his portfolio accordingly. His response was that he wanted to stay on record as a cautious investor but wanted us to find him higher-return investments. If we'd done that and put him into investments that had a higher potential of return but carried commensurately more risk, then in essence we would have been taking the extra risk, not him. If they'd gone up in value then he'd have been happy and would have enjoyed the fruits of success. If they'd not done well, he would have complained that we'd put him in more risky investments, when he was down on record with us as a 'cautious' investor.

Essentially Mr S wanted a *"Heads I win tails you lose"* scenario where we were the only people taking any risk. After going around the mulberry bush numerous times with the same conversation, in October 2014 we told Mr S that we could no longer offer him our services and that he needed to find a new adviser. We had made him a significant amount of money and had kept all our promises, but he wanted something which, if we delivered it, would endanger the future of our business. We were honest with him, but he was not reasonable or realistic in return.

'Mr and Mrs Vast Majority'
We find that the vast majority of clients score a risk-rating in the range 4 to 6 on the 1-10 scale and are perfectly comfortable with portfolios built to meet those parameters.

Reasonable and intelligent clients understand that in a 1987 'Black Monday' scenario a £100,000 portfolio one day can be worth £70,000 the next day, and that if we have a repeat of 2008, they might see its value halved. They also understand that if a sudden crash happens then they need to stay put and not 'panic out' of the market. They understand this because we walk everyone through the 'Mr L' case study. It's real. All the above case studies are 100% as they happened, dates and amounts included; we've only changed the initials.

Throughout the whole 2008 financial crisis we only had one client withdraw funds and even she was ahead of the game profit-wise when she cashed out. The rest all sat it through and made money in the recovery that followed.

<u>This is the reality of risk as it applies to the way we manage money</u>. We never put any client into any investment where we can identify even the slightest chance of a total loss. All the investments we do are broadly-based and diversified to spread risk. Yes, market falls can occur. The average investor was down 30% after Black Monday 1987 compared with where he'd been pre-crash, and was 50% down or more in 2008. But diversified portfolios recover. Investors who panic out lose out. Investors who can grit their teeth and sit through a crash when the markets look horrendous are the ones who make money long term. After the 1987 crash I was on the phone to investors taking orders to buy in to blue-chip funds with new money from investors who could see that prices 30% lower were real bargains. After 2008 I was buying into bombed-out high-yield bond funds on double-digit yields that came rocketing back when the Bank of England started cutting interest rates.

This may sound like an extreme and dramatic analogy, but when we as a family use an airline, we drill our kids in how to act if we find ourselves in the middle of a terrorist attack; airports and tourist centres being major terrorist targets in today's world. Our children are drilled to stay calm, to know what cover looks like and to use it (concrete planters full of earth make great cover, whereas Coke machines offer *concealment* but won't stop bullets), to look for opportunities, and survive.

The same applies to investment. Those who panic are the most likely to become casualties. Those who stay calm and follow advice benefit from the recovery when it comes.

<u>Risk for Growth Investors v Risk for Income Drawdown Investors</u>
When we talk about 'drawdown' we're most often talking about using a pension fund to provide a regular income, rather than buying an annuity, but the term applies equally to non-pension investors who are using a portfolio of funds to provide themselves with a regular income and/or ad-hoc lump sums from time to time.

Risks apply differently to those investing for long term capital growth compared with those investing for income. Long term capital growth investors can afford to be more laid-back about periodic market corrections. For income drawdown investors however, a different approach is required. For this reason, we developed our Advised **D**ynamic **D**rawdown **S**olution.

The Advised Dynamic Drawdown Solution

It all *ADDS* up

The fact is that markets do fall from time to time, sometimes suddenly and heavily as in 1987, sometimes gradually but over a more protracted period. Sometimes markets can be highly volatile over a long period as happened in 2008, when we often saw 10% in-day swings. Some advisers, we know, try to hide this fact from their clients and/or they blandish them that somehow, "it'll all work out fine". Some pretend that they can somehow immunise their clients from market falls, lulling them into a false sense of security. The fact is they ***can't*** immunise clients from market falls, nobody truly can, and that includes us. The difference is *we* don't pretend.

We reduce risk by programming drawdown arrangements to take from the less-volatile funds, typically those in the absolute return, property and short duration bond sectors. We start by reserving 12-to-18 months' income in such funds. We call this the 'in-plan buffer', as distinct from the client's non-plan self-managed cash buffer fund. Then, every six months, we internally review the portfolio and advise the client on replenishing the in-plan buffer from the other funds in the portfolio. This is the part that requires skill and judgement and is the most time-consuming element. The aim is to replenish the in-plan buffer using money from the funds we would rather downsize whilst preserving the holdings we believe have greater potential. Where market falls are heavy and general, as happens from time to time, we can also advise clients to draw on their own self-managed 'non-plan' cash buffer funds, thereby avoiding the unnecessary depletion of their holdings. We always advise all clients, especially drawdown clients, to keep a good-sized self-managed cash buffer fund.

We cannot manufacture gains when markets are falling; nobody can. But by judiciously managing *how* your drawdown is provided, we can aim to minimise the impact of falls when they do happen and then aim to maximise recovery. That's our **A**dvised **D**ynamic **D**rawdown **S**olution: It all ***ADDS*** up - our tailored solution for drawdown clients.

When You Read a Risk Warning, We Really Mean It!

We hope this guide is informative and useful. Here at West Riding we give risk warnings for a purpose. We want our clients to be as fully informed as possible and to be able to make informed investment decisions in full possession of the facts.

Some people – other advisers certainly – think we over-do our risk warnings. We don't think so. We never 'talk-down' risks to inveigle clients into investing; investment is not right for everyone and that is a fact. Some people cannot cope with risk and if invested would worry themselves to death over normal market fluctuations. Such people are better off in peace-of-mind terms if they keep their money in cash in the bank or building society. Every year we meet a few clients with such a profile but it something that only becomes apparent as we go through our fact-finding process. We find that as well as helping us understand what a particular client wants and needs, the process of talking it through with an adviser also helps clients better understand themselves.

Some would say that by being so up-front about risk we talk ourselves out of business we could otherwise have. We merely look on it as doing the job properly.

We have had meetings with some clients where we have outlined investment risks in explicit and stark detail. At the end they've said *"I know you have to say that, to cover yourself, but it'll go up won't it?"* At this point we point out that we mean what we say: Risk is real. We are not in the business of misleading clients. When we say that investments and the income they produce can go down as well as up, we mean it. We do not say it to 'cover our backs' or to 'manage expectations'. It is a real warning of a fact that we want our clients to understand.

Fair enough?

Neil

Neil F Liversidge Dip PFS
MANAGING DIRECTOR

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Completely Personal, Confidential and Totally Independent Financial Solutions

Investments and Savings

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Asset Defence, Including Nursing Home Fee Protection Inheritance Tax Planning, Wills, Probate Services, Funeral Plans, Powers of Attorney and Trust Planning

*

Life Assurance, Critical Illness Cover and Income Protection Insurance to Protect You, Your Home and Your Family

West Riding's Clear and FAIR Service and FairFees charging structure have been specifically designed to guarantee clients totally unbiased advice with fair and transparent charging. West Riding was declared by the Financial Services Authority (now the Financial Conduct Authority) to be 'Treating Customers Fairly' following an in-depth interview in May 2010 as part of its 'TCF' programme.

Neil Liversidge, born 1963, started in financial services in 1980 at Hill Samuel and was previously Chief Investment Analyst at DBS, 'The advisor to the advisors.' Neil has written regular columns for the financial press and has had articles published in Investors Chronicle, the FT, Money Management and Financial Adviser, the Daily Telegraph, the Times and other respected journals. He appears regularly on the BBC and other networks and was named one of the *'Top 50 most influential people in UK finance'* by Professional Adviser magazine. A member of the governing council of PIMFA, the UK's Personal Investment Management & Financial Advice Association, Neil is married to Linda, his co-director in West Riding. They have three children and live in Great Preston just three miles from the office.

We are based in Castleford and are committed long-term to the town. All staff members live locally, and we aim to provide peace of mind and security of employment, something which is increasingly rare these days. It is our view that a happy, committed, stable and experienced workforce is of great benefit to our clients. Longer-serving staff members acquire a deeper understanding of clients' circumstances. The better we know our clients, the more we can help.