Legal & Medical Investments Ltd

Legal & Medical Guide
to investment and understanding risk

Investing – as opposed to saving – means taking an **acceptable degree of risk** in return for the **potential** to make more money over the long term than you otherwise would make if you remained in non-risk assets such as cash, though this is not guaranteed.

The greater **risk** you take, the greater the **potential rewards**, but the greater the **potential loss**, especially in the short term

Investing should be for the **long term**. At least **5 years** and ideally **10 or more**.

The charts in the following pages use **real historic events and performance** and seek to act as an **illustrative*** guide to the relationship between **risk and reward** over the short and long term, and to emphasise the heightened risks of investment if you only take a short term view.

*** The portfolios illustrated are for conceptual purposes only, to illustrate the nature of risk vs reward. Actual portfolios will be discussed and recommended by your Legal & Medical adviser, after a full discussion on your attitude to risk and capacity for loss.**

Before we go there, let's look at 6 investment 'rules' that we believe in – and think you should too

1. **Identify and keep a contingency fund for short term emergencies and for planned spending within the next 5 years.** A typical emergency fund might be 6 months' worth of outgoings; but don't forget to factor in that car change or big holiday you've promised yourself!

2. **Only invest according to your risk tolerance (emotional views on risk) and your capacity for loss (whether you can actually afford to take risk, and to what degree).** Your adviser will have a thorough discussion with you to take account of these factors and help establish and agree your overall attitude to risk

3. **Only invest money surplus to what you require in your contingency fund.** If you keep enough in cash for emergencies and planned spending, then you don't have to worry about accessing your investments at the wrong time if they are affected by short-term fluctuations

4. **Beware of the risk of inflation.** Holding too much in cash is not totally 'risk-free' if the rate of inflation is higher than the rate you can earn in interest.

5. **Don't keep all your investment eggs in one basket** – spread you investment around different sectors and assets in order to benefit from diversification. This way if one investment falls, it could be counterbalanced by another.

6. **It's time in the markets that counts, not timing the market.** Trying to time when to buy or sell an investment can be a stressful business, and no-one can predict the future. It's far better to use time – not timing - to your advantage. The longer you can invest for, the more likely you are to have the potential for a healthy return, regardless of short-term blips or fluctuations.

Hopefully this guide will make this clear but please remember unlike cash, investments carry additional risks and can fall as well as rise, so you could get back less than you invest. If you are unsure of the suitability of an investment for your circumstances seek advice. Whilst we use examples of past performance to help illustrate the relationship between risk and reward we would also point out that this is not necessarily indicative of future performance.

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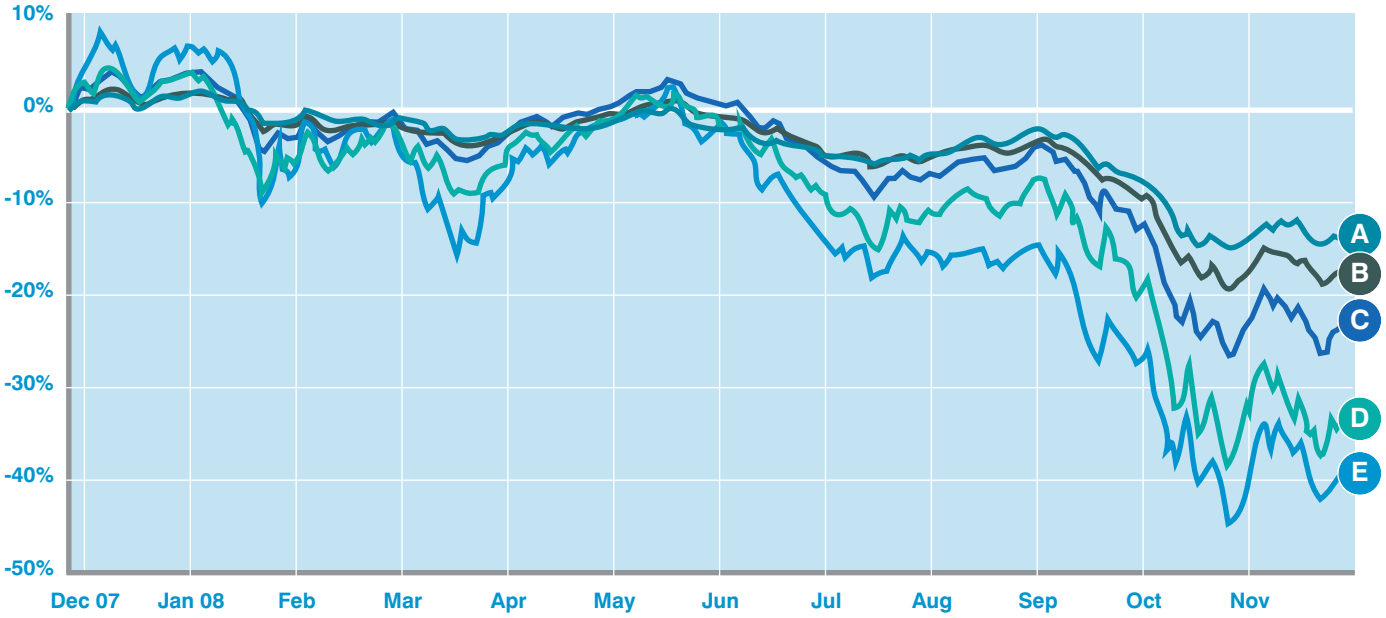
Concept 1

Greater risk means greater potential falls in value, especially in the short term.

This chart shows: A difficult 12 months during the financial crisis



28/11/2007 – 27/11/2008 Data from FE 2017

- **A** IA Mixed Investment 0 - 35% Shares TR in GB (-13.70%)
- **B** IA Mixed Investment 20 - 60% Shares TR in GB (-17.54%)
- **C** IA Mixed Investment 40 - 85% Shares TR in GB (-23.73%)
- **D** IA UK All Companies TR in GB (-33.29%)
- **E** IA Asia Pacific Excluding Japan TR in GB (-39.31%)

Commentary – In the space of 12 months, the Speculative Portfolio (Asia Pacific Sector) fell the most - nearly 40%, whereas the Defensive Portfolio (Mixed Inv 0-35% Shares Sector) fell the least - just 13.7% - in what was historically an exceptionally difficult economic situation. The 5 sectors fell by increasing amounts largely in line with their risk profile. The higher the risk in the portfolio, the greater the fall over that 12 month period.

This illustrates that holding investments can involve short-term volatility, where the value of capital can rise or fall quickly, especially with higher risk investments. This historic example shows what can happen in the case of a sharp downturn. It shows that, the greater the amount of risk, the greater these fluctuations tend to be. Investments should therefore be held for the long term to allow the opportunity for short-term fluctuations to be ironed out, and to give the best potential for real long term growth.

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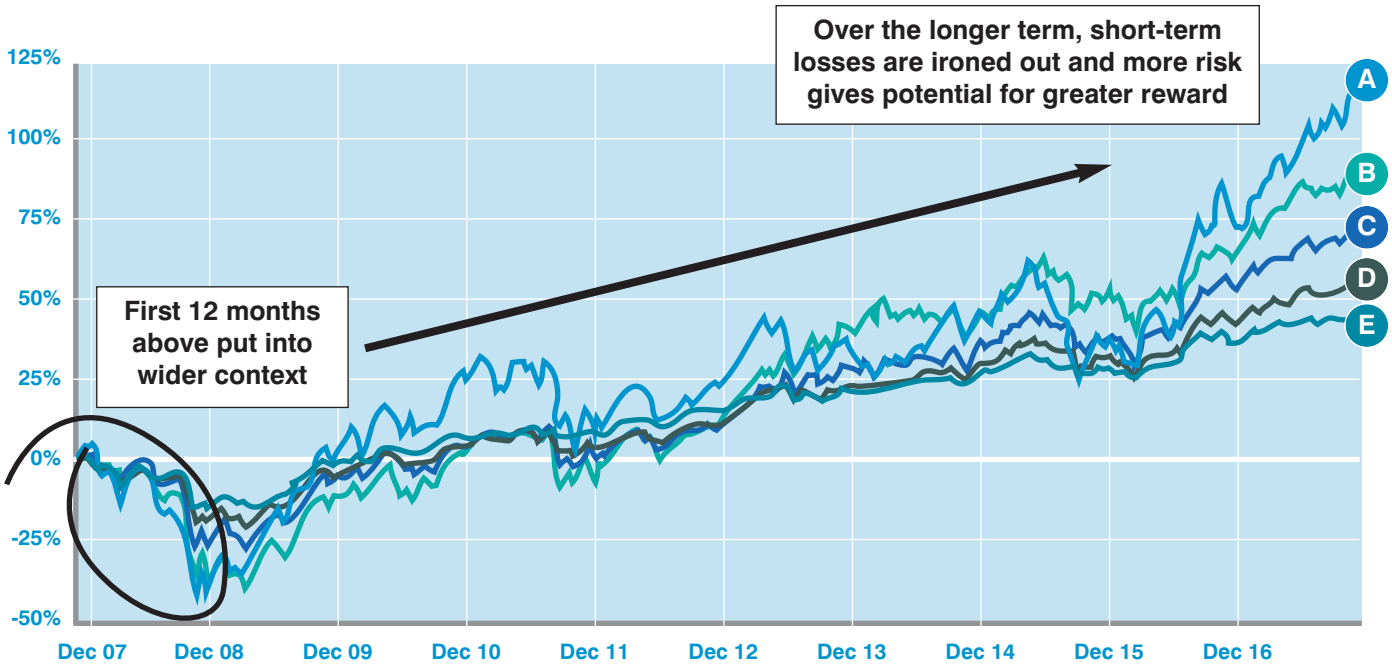
Concept 2

To show how greater risk typically** translates to greater rewards over the long term, despite short-term volatility.

** Accepting greater risk is not a guarantee of greater reward

This chart shows: The same 5 sectors over the last 10 years



28/11/2007 – 28/11/2017 Data from FE 2017

- **A** IA Asia Pacific Excluding Japan TR in GB (119.27%)
- **B** IA UK All Companies TR in GB (88.95%)
- **C** IA Mixed Investment 40 - 85% Shares TR in GB (72.35%)
- **D** IA Mixed Investment 20 - 60% Shares TR in GB (55.27%)
- **E** IA Mixed Investment 0 - 35% Shares TR in GB (45.75%)

Commentary – This puts the previous chart into some perspective when extended and viewed over the longer term. Over a 10-year period the Speculative Portfolio (Asia Pacific) rose by nearly 120%, whereas the Defensive Portfolio (Mixed Inv 0-35% Shares) rose by just over 45%. The short-term 12-month fall from the previous chart (circled here in black) is put into perspective when considered over the longer term. The 5 sectors rose by increasing amounts, largely in line with their risk profile. The higher the risk in the portfolio, the greater has been the rise in value over the 10 years.

This illustrates that while holding investments can involve short-term volatility, over the long term the potential for reward is generally linked to the level of risk taken. The higher the amount of risk, the greater the potential reward – but the greater the potential for fluctuations in value. Investments should therefore be held for the long term to give the chance for short-term fluctuations to be ironed out, and to give the best potential for real long term growth.

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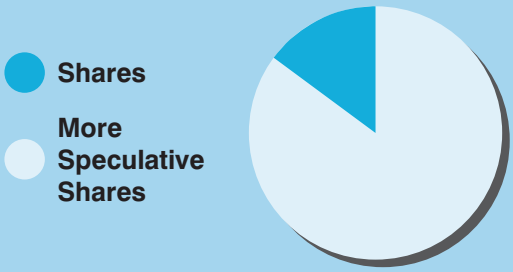
Example Portfolios

used in Charts Intended only for the purposes of illustrating degrees of volatility and risk – real portfolios will vary



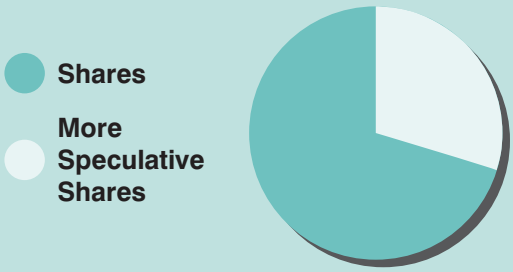
Speculative

Typical / target volatility 20+

For example:

100% Shares often overseas, emerging, specialist areas

In the chart example, the representation is Asia Pacific Ex Japan



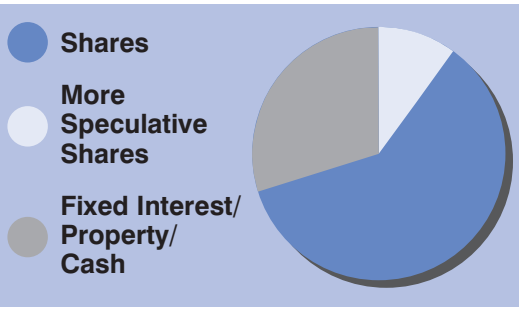
Adventurous

Typical / target volatility 15 – 20

For example:

100% Shares. Mainly UK but some overseas

In the chart example, the representation is UK All Companies



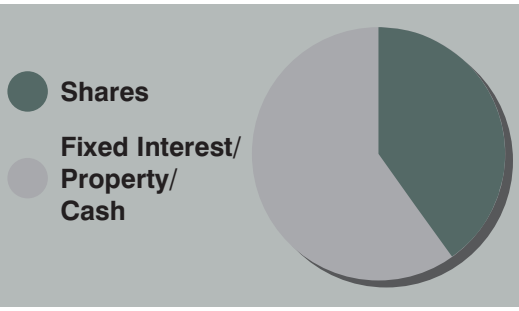
Moderately Adventurous

Typical / target volatility 10 – 15

For example:

Between 40-85% in Shares. Balance typically in non-equity assets

In the chart example, the representation is IA Mixed Investment 40-85% Shares



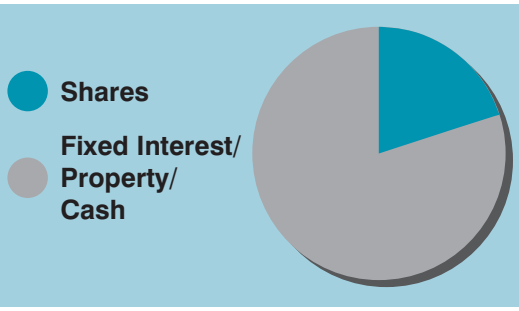
Cautious

Typical / target volatility 5 – 10

For example:

Between 20-60% in Shares. Balance typically in non-equity assets

In the chart example, the representation is IA Mixed Investment 20-60% Shares



Defensive

Typical / target volatility < 5

For example:

Between 0-35% in Shares. Balance typically in non-equity assets

In the chart example, the representation is IA Mixed Investment 0-35% Shares

The volatility bandings referred to above are a measure of historic risk as measured by fluctuation/deviation over the previous 3 years. You should never have a higher volatility score recommended than the range indicated for your attitude to risk.

Once in force, the ongoing volatility score for a portfolio may fluctuate outside of the agreed ranges, however, this will be subject to regular review for our Wealth Management clients. If we advise that this approach remains appropriate then the rationale for this will be explained according to your circumstances.

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