Canaccord Genuity Wealth Management

Guide to risk and investment

Any investment involves a degree of risk and some investments are more risky than others. Whether this is the first time you have considered investing, or whether you have prior investment experience, this guide is designed to highlight the key aspects of investing for you to consider.

Whether you wish to be actively involved in managing your wealth, or want to have it managed for you, you have key decisions to make, such as the level of risk you are willing or indeed able to accept, your investment objectives, time horizon and saving and spending patterns.

This document is important. It has been produced by Canaccord Genuity Wealth Management (CGWM) to provide investors and potential investors with information on investment products, markets and risks to assist with understanding the implications of investing. It is not intended to be a comprehensive guide to risk and it should be read in conjunction with the agreements governing our relationship and our terms of business. The information contained in this guide is correct at the time of going to print and is included for illustrative purposes only and does not form the basis of an investment recommendation.

Prices can fall as well as rise and there is a risk that you may lose some or all of the money that you have invested. Past performance is no guarantee of future performance. The income which you receive from your investments can fluctuate and is not guaranteed.

There are many different financial products available, each carrying their own level of risk. Some of the most common instruments and the risks attached to them are outlined below.

What is investing?

Investing means purchasing an asset with the view that the asset will appreciate in value and/or generate an income in the future.

The types of assets that can be bought and sold vary significantly in nature and risk, which will affect both the chances of the asset appreciating in value or generating an income and the amount of that appreciation/income.

There are many different types of assets that can be used to invest. Some of the more common types of investments are outlined below.

In addition to the different types of assets, there are different means of investing. A direct investment in a specific asset can be made, such as in an equity or a bond. Typically, a portfolio made up of direct investments will contain multiple investments of different types that have different risk and return characteristics, used to diversify the portfolio risk and return. Alternatively, you can spread your risk (diversify) by investing via a 'collective investment scheme'. Collective investments, such as open ended collective investment companies (OEICs), unit trusts and investment trusts (collectively known as 'funds'), will pool your investment with that of other investors. This is then managed by a fund manager in a portfolio which may include several asset classes such as cash, shares (both domestic and overseas), property, precious metals and/or derivatives in order to achieve the fund's objectives. The number of asset classes and investments within an asset class held by the fund helps to spread risk. The investor also benefits from having the fund's investments constantly monitored by the fund manager, and economies of scale mean that a collective investment can be a cost efficient way to buy and sell shares or other asset classes. The downside, however, is that these portfolios will not be 'tailored' to your specific requirements.

Funds can be closed ended (of a fixed size) or open ended, where additional units can be created. An investor's opportunity to invest in or exit from a closed ended fund will depend on the number of buyers or sellers in the market (known as 'liquidity'). This is generally driven by the fund's size and underlying asset class. Open ended funds should not suffer from liquidity problems unless the underlying assets held become illiquid and a large number of holders wish to sell their holdings. In addition, you should also be aware that open ended funds have fixed dealing days, which can be daily, weekly, monthly or longer if it is a specialist fund. Depending on the frequency of dealing, both buying and selling may be delayed accordingly.

Some funds employ 'gearing', which is borrowing against the fund's assets to fund further investment. Gearing is the ratio of a fund's debt to its capital. A highly geared company is one where there is a high proportion of debt to equity. The risk profile of funds employing gearing is higher than those which do not employ gearing and will increase according to the level of gearing employed. You should be aware that where an investment employs gearing, it may be subject to sudden and large falls in value. In addition, movements in the price of the geared fund are magnified when compared with the movement in the price of the underlying investments and there is a risk that you may lose all the money you have invested.

What is risk?

Everybody takes risks every day. Crossing the road involves risk. The amount of risk you take will be a combination of your personality (i.e. your inherent level of risk aversion) and the amount of reward you think you will receive for taking the risk.

In an investment context, risk is a measure of the extent to which investment returns may deviate from expectations. That means the extent to which the actual return on an investment differs from the return the investor expected or hoped for. While all investors and advisors should aim to quantify that risk, this quantification can only be based on past events, which may not be a good indicator of future results. As it is impossible to predict future events with any certainty, all investment involves risk.

Importance of understanding your own risk appetite and capacity to take risk

It is important to decide what sort of investor you are. Generally, the greater the risk you are prepared to take, the greater the potential return you may make, but the greater the potential loss you could sustain. Risk is a natural part of investing. You must carefully consider the level of risk you are prepared to take to reach your objectives - this is a personal decision that you should feel comfortable with.

In the client questionnaire, you will see the graph replicated below (see figure 1).

It is important that you take the time to consider what each option (1 to 9) means, whether you are prepared to accept the risk that your investments might fall in exchange for the potential for increased return. The theoretical portfolios in the graph have increasing levels of risk and return, which are created by changing the proportion of the portfolio that is invested in more volatile assets. As you move along the scale from 1 to 9, more of the portfolio is invested in more volatile assets. Portfolios 7 to 9 are completely invested in equities.

While the graph is based on a statistical analysis of historic price movements, such an analysis is unlikely to capture all unforeseen events, particularly severe market shocks. The orange squares show what has happened during the most severe market shocks seen over the last 30 years.

It is important to note that if you do not need to sell your investments then you do not crystallise your losses, so the length of time for which you can leave your investments untouched is an important factor in deciding how much risk you can take. The table below shows the length of time it would have taken for a theoretical portfolio invested as above to recover from the relevant market shock (see figure 2).

Figure 1

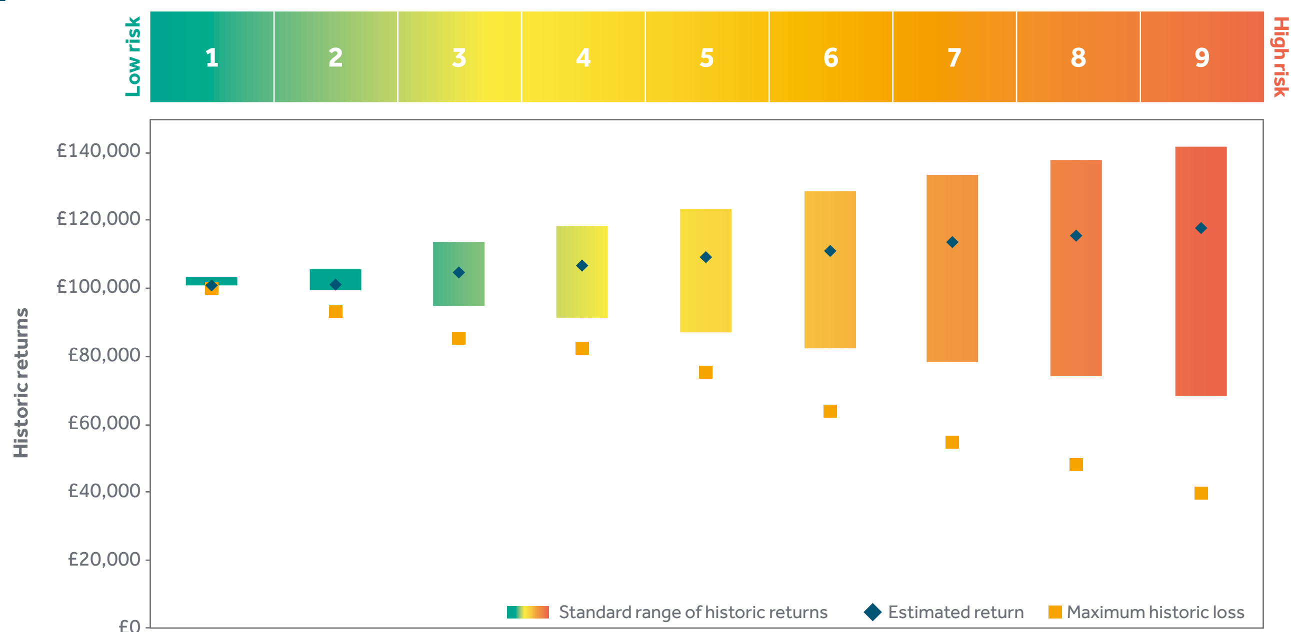

Figure 2

Low risk — High risk

	1	2	3	4	5	6	7	8	9
Estimated potential long-run return[1]	**2.5%**	**3.0%**	**4.5%**	**5.5%**	**6.5%**	**7.0%**	**7.5%**	**8.0%**	**8.5%**
£100 turns into over 10 years[2]	**£128.01**	**£134.39**	**£155.30**	**£170.81**	**£187.71**	**£196.72**	**£206.10**	**£215.89**	**£226.10**
Normal annual range of returns[3]	**+1% to +4%**	**0% to +6%**	**-5% to +14%**	**-8% to +19%**	**-13% to +24%**	**-17% to +29%**	**-22% to +34%**	**-26% to +38%**	**-32% to +42%**
Largest loss from peak[4]	**–**	**-6.56%**	**-14.83%**	**-17.38%**	**-24.51%**	**-36.05%**	**-45.40%**	**-51.71%**	**-60.43%**
Number of months to recover[5]	**Not recovered**	**Not recovered**	**7**	**7**	**32**	**34**	**38**	**35**	**55**

Performance is calculated excluding fees from December 1998 to December 2022.

Notes:

[1] This is CGWM's broad estimate of the kind of annualised returns you might expect from the relevant risk profile over ten years based on broad assumptions - it is not a benchmark and in no way does it represent a guarantee

[2] This shows what £100 invested at the beginning of year one would turn into over 10 years if the estimated potential long-run return is exactly realised annually over that period

[3] This shows the range of annual return outcomes that have occurred in each risk profile 68% of the time

[4] The risk profile's largest fall from peak to trough, which may cover a period longer than a year; individual risk profiles may have their largest falls at different times

[5] The longest length of time it has taken for the value of the risk profile to recover to its previous peak from its largest historic loss.

Risks of investing

Market risk

Market risk defines the extent to which returns from all investments change in the same way because they have been subject to the same underlying stimulus, such as a change in the interest rate outlook or prospective growth path. You cannot manage market risk by diversifying your portfolio.

Stock specific risk

Stock specific risk defines the extent to which the returns change for one specific asset such as a company (equity) or bond, as the result of new information or news flow. That is, the returns change in response to very specific information about that specific asset but which has no implications for other similar assets. This risk can be diversified away.

Credit risk

Credit risk defines the extent to which an issuer of a loan (typically a company or a government) is likely to repay that loan and/ or any interest accruing to it. Whenever an investor buys a bond, they are extending a loan to the issuer of the bond. There are a number of independent agencies that assess credit risk for companies and government entities that issue bonds (debt), and their measure of credit risk is usually referred to as a credit rating.

Liquidity risk

Liquidity risk measures the depth of a market for a particular asset. A liquid (or deep) market would be one where there is always a buyer and a seller for that asset. The FTSE 100 would represent such a market, and prices adjust quickly to capture new information. An illiquid market would be one where buyers and sellers trade infrequently. The market for real estate would be a good example, and one where prices remain 'sticky' because the last trade recorded may not have captured the latest relevant information. These markets are inefficient in incorporating new information into the asset price.

Currency risk

When buying assets from overseas, the transaction usually takes place in the currency of the domestic market. In this instance, there is risk in the underlying asset plus a currency risk overlaying that. So while we may describe the risk in a high quality government bond as being low relative to the equity of a company, the risk of a foreign currency government bond may not be equivalent because of the added currency risk.

Counterparty risk

Counterparty risk represents the possibility that the party on the other side of an investment transaction defaults or reneges on their obligation.

Return

Asset returns measure the extent to which the value of an asset changes over time. Some assets pay an income (dividend or coupon) while others do not. Clearly the total return of an asset should account for both the change in the asset value (the capital return) plus the income paid to the investor. Some assets that generate a high level of income may not generate much capital return, making the total return relatively predictable and lower risk. A government bond would be a good example of such an investment. Other low or no income producing assets generate their returns from capital appreciation, and these assets can contain more risk and have less predictable total returns. An equity investment in a technology company would be good examples of this type of investment.

The relationship between risk and return

Theoretically there exists a positive relationship between risk and return. The idea being that an investor should require a higher level of return from assets that are perceived to be more risky than from assets with less risk. While there also exists a good deal of empirical evidence to support this relationship over the long-term, there have been many periods in history where lower risk assets have provided higher returns than higher risk assets. Looking forward over a medium term investment horizon, however, investors should normally expect higher returns to come from higher risk assets.

Markets

(a) There are many differences between developed and emerging asset markets. Developed markets are typically subject to tight regulation, and information about assets is accurate and freely available. Developed markets are also usually liquid. Emerging markets are unlikely to match the liquidity of their developed counterparts, and information about emerging market assets is typically more opaque and harder to obtain and model. Emerging market geopolitical situations can be less stable, with consequent impacts on businesses and currencies. All these factors and others combine to make investment in emerging markets higher risk than investment in developed markets.

(b) While large and small cap stocks in the same market are typically subject to the same regulation, the small cap stocks tend to be less liquid and are less well understood/ researched. Both factors conspire to make small cap stocks relatively more risky investments.

Asset classes

Cash

Cash and cash equivalents are generally recognised as safe investments. The return on your investment is dependent on the prevailing level of interest rates. Usually, the more that you invest, the higher the interest rate you receive. The interest rate may also increase if you agree to deposit your cash over a longer period of time. However, penalties may apply if you withdraw the cash before the agreed period has expired.

Risks

- Real returns on cash deposits can be negatively impacted by the erosionary effects of inflation.
- Longer term deposit rates may be higher but may incur penalties if withdrawals are made early.
- Counterparty risk – you may not get all your money back, although this is a relatively low risk in the UK.

Advantages

- There is virtually no risk to your capital as long as your money is deposited with a sound financial institution.
- You have ready access to your money, except where you have arranged longer term deposit facilities.

Bonds – Government and Corporate

Bonds and Notes, also known as fixed-interest investments, are types of loans where a government or a company issues a bond to raise money. 'Gilt-edged' securities - known as 'gilts' - are borrowings made by the UK Government. Bonds are issued by most countries, and by companies (corporate bonds).

In return for its loan, the issuer of the bond pays an interest amount to the bond purchaser. This interest amount, which is usually a fixed rate, is typically paid semi-annually or annually to the purchaser, for as long as the purchaser continues to own the bond. Many different types of bonds are available, both simple and complex.

Most bonds have a pre-determined final payment date (the 'maturity' date) - at which time the company returns a set amount of money to investors that own the bond at that time. Consequently, when purchasing a bond, an investor can usually predict when the funds invested are likely to be repaid. This is important in making longer term investment decisions.

Bond prices tend to have an inverse relationship to interest rates. A bond paying a 7% interest rate is likely to be valued more highly when general interest rates are low than when interest rates are high. The length of time to maturity (repayment) of the bond also affects the price of the bond and how much it

may fluctuate (risk). The longer the maturity of the bond, the more risky its price tends to be. An increase or decrease in interest rates is likely to have a minor impact on the price of a bond maturing in less than a year. The price of a bond maturing in 30 years is likely to be significantly impacted by an interest rate change. Short term bonds are therefore considered to represent lower risk than longer term bonds.

Risks

Bonds are generally perceived to be lower risk than shares, although the risk depends on a variety of factors - and it is not the case that all bonds are low risk. Risk factors include:

- The ability of the lender to repay. If the lender is unable to repay the principal, the investor may sustain a loss of the entire investment. If the lender is unable to pay the interest, the purchaser will no longer receive the annual or semi-annual interest coupon. Generally, government issued bonds are lower risk than corporate bonds. Bonds are rated according to the ability of the issuer to pay. These ratings are assigned by third party agencies.
- The price of a bond may fluctuate during its life. If the purchaser sells the bond before the maturity date, the price at which it is sold may be lower than the purchase price, so the purchaser may lose money. The longer the time to maturity, the greater the risk that the price may fluctuate in this way.
- When a bond is redeemed, a purchaser receives cash. The purchaser may wish to find an alternative investment for the cash. If interest rates have fallen since the purchaser originally purchased the bond, the re-invested cash may earn a much lower rate of return. This is known as re-investment risk.
- Not all bonds are liquid - i.e. it is not always possible to find a buyer for a bond. Bonds are not traded on a market but 'over the counter' between one dealer and another. It is not always easy to determine the price of a bond or how easy it is to buy or sell. Generally, high quality bonds are more liquid and therefore easier to buy or sell.

Advantages

- Income - Bonds tend to pay a higher income than cash deposits.
- As many bonds pay a fixed level of income, a portfolio can be structured to pay a regular and predictable level of portfolio income.

Equities (shares)

Equities represent a part ownership in a company. As such, the owner of a share participates in the fortune of the company - for good or ill. If the company does well, the shares are likely to rise in price, but if the company does badly, the share price is likely to fall. Holders of ordinary shares are normally the last to be paid in the event of a company becoming insolvent. However, ordinary shareholders also have the potential for attractive returns provided the company does well and is perceived to be continuing to do well.

Some shares pay a dividend, either semi-annually or quarterly. A dividend is an amount of money, determined by the company's Board of Directors, which is a distribution of the company's profits. Established, profitable companies tend to pay dividends and have a good record of providing a steady stream of dividend payments. Periods of economic difficulty may, however, interrupt such dividend payment for even the most established equities. Younger, less established companies that are building a business tend to retain their profits for re-investment. These are called 'growth' companies as their business strategy is to grow their business rapidly.

Shares are available in companies of different sizes, industrial sectors, geographical locations, and on different stock markets. In order to manage the significant risks involved in investing in equities, it is advisable to spread (diversify) your holdings across a number of different companies and sectors.

Liquidity is an important risk factor when investing in individual equities and is generally driven by the market capitalisation (total value of issued shares) of the company and current market conditions. Liquidity levels can change rapidly and lack of liquidity often restricts trading in equities with smaller market capitalisations (known as mid cap and small cap).

Information on overseas investments is not as readily available to the UK public as for UK companies and the financial pages of the national press may give less coverage of the subject. Different time zones also mean that you will not always be able to get a real time price for overseas stocks during the UK trading day. Whether investing directly in overseas markets or through collective investment schemes, currency fluctuations need to be taken into account. A gain or loss made on the performance of a stock can easily be offset by a movement in the currency exchange rate. Alternatively, a gain or loss on a stock could be increased by exchange rate movements. Liquidity considerations are similar to UK shares. Dealing/administrative costs tend to be higher than UK shares.

Risks

Shares are usually perceived to represent greater risk than either cash or bonds. The price of individual shares can fluctuate considerably and can appreciate or decline rapidly. Shares can also remain in decline over long time periods.

- Share prices rise and fall according to the health of the company and general economic and market conditions.
- Individual share price rises and falls can be significant. Stock market investments tend to be more volatile than investments in most bonds.

Advantages

- Shares have greater potential for capital growth than many other asset classes. In the past, shares have typically produced higher returns than cash over longer time periods.
- Over the longer term, investment in shares tends to be a more effective protection against inflation than investment in bonds or cash deposits - although there is no guarantee that past performance will be repeated.
- Some shares tend to pay relatively high dividends and may provide scope for a sustainable income as well as the possibility of achieving capital growth.

Commodities

A commodity is a physical substance that investors buy or sell either on the cash market or on futures exchanges in the form of futures contracts. Examples include precious and base metals, soft commodities (e.g. grains) and oil. Commodity prices are driven by supply and demand. You can buy options on many commodity futures contracts to participate in the market for less than it might cost you to buy the underlying futures contracts. You can also invest through commodity funds or exchange traded funds, the price of which is designed to track the price of the underlying commodity. This relationship will, however, not be perfect due to declining costs or the intricacies of dealing in the futures market. Futures and options carry specific risks and are only suitable for experienced investors. Futures and options may only be traded once a separate derivative risk disclosure agreement has been entered into.

Guaranteed Products

There are various insurance-backed and institutionally-backed products on the market which offer 'guaranteed' returns of capital or part capital or capital and growth. These are only as safe as the company that has guaranteed them.

Alternatives including hedge funds

Alternative investments include non-traditional asset classes such as hedge funds, venture capital, private equity, commodities and property. Previously, such investments were the preserve of professional investors, but alternative investments may be suitable for some private investors when they are used to diversify the investor's portfolio.

Risks

Alternative investments can include both lower and higher risk investments. However, Alternative investments are considered to be a specialised investment class as information is not always readily available about such investments.

- Alternative investments are often not traded on any exchange - therefore it may not be possible to easily determine the price of such investments.
- It may be much more difficult to sell such investments quickly. Being unable to sell an investment quickly increases the risk of owning the investment (liquidity risk).
- Some alternative investments can be complex investment products and therefore require a higher level of investment sophistication in order to fully understand the risks of owning alternative investments.
- Unregulated collective investment schemes may not afford investors the same protections as with other regulated pooled investments.

Advantages

- Alternative investments may have a low correlation to equity and bond markets. This may provide diversification and reduce overall portfolio risk.
- Alternative investments are increasingly flexible and can be used to profit in declining markets or to reduce some of the risks associated with traditional investments.

Structured Products

A structured product is generally a pre-packaged investment strategy which offers exposure to an asset or group of assets such as a single security, a basket of securities, options, indices, commodities, debt issuances and/or foreign currencies. There is no single, uniform definition of a structured product but they often use derivatives and gearing to alter the exposure or its magnitude to the underlying asset. In general, an investor's return and the issuer's payment obligations are contingent on, or highly sensitive to, changes in the value of underlying assets, indices, interest rates or cash flows. A feature of some structured products is a 'principal guarantee' function which offers protection of the principal if held to maturity, but these are only as safe as the company that has guaranteed them.

Derivatives

Derivatives are complex investments that are generally suitable only for experienced investors. Derivatives are financial instruments whose value depends on the value of other underlying financial instruments, time to expiry, strike price, time to maturity and interest rates. The underlying instrument on which a derivative is based can be an asset (e.g. commodity, equity, property or bonds) or an index (e.g. interest rates, exchange rates or stock market indices). The main types of derivatives are forwards, futures, options and contracts for differences. Derivatives carry specific risks and may only be traded once a separate derivative risk disclosure agreement has been entered into.

Currency exposure

Where investment is made in currencies other than the investor's base currency, movements in exchange rates may have an independent effect, which may be favourable or unfavourable, on the gain or loss otherwise accruing to the value of the asset.

The impact of tax

The tax treatment of income and/or capital gains from your investments and the availability and value of tax reliefs will depend on the nature of the investments, the tax laws in your country of residence and your individual circumstances. CGWM are not tax advisors or tax experts and we therefore cannot provide advice on personal tax issues. Neither have we endeavoured to cover the subject of taxation in this guide. The eligibility of investments to taxation is outside the control of CGWM and may change during the period that you hold the investment. If you have any questions or doubts about your tax position, you should seek professional advice. It is your responsibility to obtain independent advice where appropriate and to correctly discharge your tax liabilities wherever they fall due.

Our approach to Capital Gains

Our investment style is an active one. We believe that once an asset appears fully valued, CGT considerations should not prohibit a sale taking place. While we will consider the CGT implications of transactions - and look to mitigate excess gains where possible - they should not be a constraint to investment management decisions. Therefore, bearing in mind the comparatively modest annual tax free allowance, it may prove both impractical and imprudent to keep gains within the nil rate band. If this is a view with which you disagree, please inform us.

Canaccord Genuity Wealth Management is a trading name of Canaccord Genuity Wealth (International) Limited (CGWIL) which is licensed and regulated by the Guernsey Financial Services Commission, the Isle of Man Financial Services Authority and the Jersey Financial Services Commission and is a member of the London Stock Exchange and The International Stock Exchange. CGWIL is registered in Guernsey no. 22761 and is a wholly owned subsidiary of Canaccord Genuity Group Inc. Registered office: Trafalgar Court, Admiral Park, St Peter Port, Guernsey, GY1 2JA.