

What is risk profiling and how does it work?

Your risk profile is a crucial factor when deciding where your money will be invested

Risk profiling is an important part of the financial planning process. When you meet with your financial planner to discuss your investment plans, he will assess your tolerance for risk and then use that information to help you make important investment decisions.

So what does risk profiling involve and what impact does it have on where you invest your money?

What is risk profiling?

Risk profiling is the process of calculating your attitude to risk. When you meet with your financial planner to receive investment advice, you'll need to answer a range of questions about your current financial situation, your investment goals and investment time frames – in other words, what are you hoping to achieve with your investments and over what time period? This assessment process commonly takes the form of a risk-profile questionnaire or quiz.

Your financial planner will use the information you provide in this questionnaire to determine your risk profile. Your risk profile takes into account a number of factors, including:

Your current financial situation

What are your debts and other ongoing expenses? How much income do you earn? How much money do you have to invest and how much financial risk can you afford to take?

Your investment goals

What are you hoping to achieve with your investments? Are you saving towards a particular goal, for example funding your retirement, or simply aiming to build wealth?

Your investment time frame

How long do you have to achieve your goals? Do you need to maximise returns in a short time frame or are you happy to play a longer game? What risk is required for you to reach your investment goals in the desired time frame?

Your general attitude to risk

Are you willing to adopt a riskier investment strategy in return for potentially higher rewards, or would you feel more comfortable if your portfolio was geared more towards guaranteed consistent returns?

The aim of risk profiling in financial planning is to not only determine the financial risk you have the capacity to take, but also the level of risk you are *willing* to take.

What are the different risk profiles?

Your risk profile outlines the level of investment risk you are willing to accept. Generally speaking, the greater the risk with an investment, the greater the potential returns. However, opting for riskier investments also means you need to accept the potential of losing money.

When you fill out a risk profile quiz – you can see some sample risk-profile quiz questions below – your answers will be graded with a score. Your total score at the end of the quiz will be tallied so that you can be classified into a particular investment style.

The names given to risk profiles vary, but profiles tend to fall into one of the following categories:

Conservative

You want stable, reliable growth and/or a high level of income. You are only willing to accept minimal losses and may have a short-term investment time frame.

Moderately conservative

You want reasonably stable growth and/or a moderate income and are willing to accept a moderate level of risk. Your investment term is a few years or more.

Balanced

You're looking for a diversified portfolio that contains a balance of security and the potential for growth. You're willing to accept a certain level of volatility and will typically be prepared to invest for five years or longer.

Moderately aggressive

You want to invest in a broad range of asset classes but with a greater focus on growth rather than income. You're willing to accept volatility in the value of your investments in return for potentially higher growth, and you could be looking to invest for up to 10 years.

Aggressive

Long-term capital growth is your main focus. You're willing to accept substantial fluctuations in value in the knowledge that you will be able to access the highest possible returns in 10 years or more.

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