

# building an investment portfolio

This factsheet aims to give an introduction to the principles underlying portfolio construction.

To the novice investor, the world of investments can seem a daunting place. Consulting a financial adviser prior to making long-term investment decisions is always a wise move.

Even with advice, it is important to have a broad understanding of how investment decisions are made before creating an investment portfolio. There are many factors that contribute to how

an investment portfolio is constructed; this fact sheet will help you understand the significance of these factors.

## things to consider

Each investor is different. They might have already retired and need to ensure that their investments are secure. On the other hand, they might be prepared to accept a higher exposure to risk in return for potentially larger returns.

Here are some key considerations:

### Age and investment duration

Age may dictate investment duration. For example a young professional investing in a pension may be more likely to

take higher levels of risk, due to the length of time available to recoup any short-term losses. Alternatively, an older couple may be far more cautious with any savings, as they will be keen to preserve capital to support their retirement.

## Investment objective

You may be looking for the value of your investment to increase in value over time, perhaps to purchase a second home or finance a child's education. Or you could be looking for investments to provide an income for retirement. An investment objective needs to be determined before deciding the 'make-up' of a portfolio.

## Existing financial commitments

It is important that a portfolio reflects any significant financial commitments, such as a mortgage to repay or a family to support. If you are reliant upon your investments to meet these commitments then a high-risk approach is unlikely to be entirely appropriate.

## Attitude to losses

Clearly defining how much of a loss you are prepared to accept as a percentage of your portfolio is vital. A financial

adviser may try to ascertain your risk profile by assessing your reaction to short-term losses upon being given a hypothetical investment scenario.

If a loss of less than 5% is accepted, you are definitely a risk-averse investor. But if you are prepared in the short term to lose more (for example 20-25%) in exchange for a higher chance of gaining additional profit, you might be considered a high-risk investor.

## defining a risk profile

Various tools exist to assist financial advisers when making these assessments. Filling in a 'risk questionnaire' with your adviser is one way of discussing the considerations mentioned above and will enable an adviser to decipher which risk profile best suits you.

### A low-risk profile

This means the investor places greater importance on preserving the capital value of their investment over increasing its value.

The low-risk investor may choose to invest in the lower end of the risk spectrum, with a long-term goal.

### A medium-risk profile

If the investor can tolerate some fluctuations and volatility, but tends to stay away from investments that may dramatically or frequently change in value, they might be considered to accept medium levels of risk.

The medium-risk investor may have a long-term goal for the investment.

### A high-risk profile

If the investor is willing to accept a greater possibility of a decline in the value of their investment in return for potentially higher returns, they are more than likely to be considered a high-risk investor.

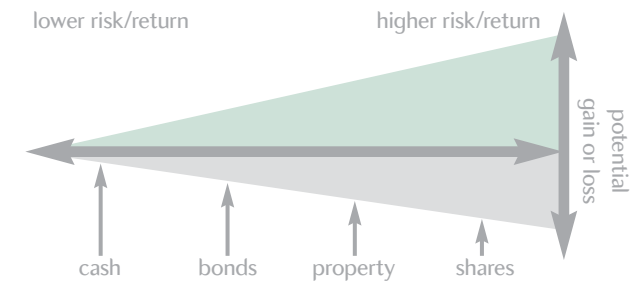
They will be prepared for the possibility of losing a large proportion or all of the money invested.

## Asset Allocation:

The process of dividing investments among different kinds of assets, such as shares, bonds, property and cash, to optimise the risk/reward trade-off based on an individual's specific situation and goals.

## get going!

Once you are aware of the major considerations to take into account when building a portfolio, and your financial adviser has helped you to identify which risk profile best suits you, it is time to decide where to invest.



Different asset classes have different risk/return characteristics, as illustrated in the diagram to the right.

A financial adviser will take into consideration all of the information gathered, including investment objectives and risk profile, to ascertain the most appropriate blend of asset classes.

Generally speaking, risk averse or **low-risk investors** tend to construct portfolios with a bias for cash and bonds, and less exposure to shares. Despite a low potential for significant capital growth, a portfolio with this structure is likely to be far less volatile than one with a high weighting in shares.

**Medium-risk** portfolios are likely to have a more balanced weighting between bonds and shares, with perhaps some exposure to property and cash also. This portfolio has the potential for capital growth from the share component and to derive an income stream from the bond segment.

A **high-risk** portfolio often apportions the majority of the investment to shares, with less exposure to bonds and cash. Whilst the value of the investment may rise significantly over the long term, the volatile nature of shares means that there is a risk of dramatic reductions in value.

# reviewing your investment portfolio

Having built a portfolio, it is important that both you and your adviser continually review its progress.

The financial markets are constantly changing, providing new possibilities for growth and opportunities to prosper.

Alternatively markets could decline, requiring a portfolio to be reviewed and perhaps adapted so that the asset allocations reflect the new conditions.

One important rule of thumb is to never 'fall in love' with any specific investment – the progress of a portfolio should always be objectively re-analysed and rebalanced accordingly.

## and finally...

There is no doubting that it is possible to build a comprehensive portfolio of investments to suit the risk profile and goals of each individual investor.

However, building a truly diverse and successful portfolio is a complex process. Even with the 'know-how' of a financial adviser, it is useful to gain a general understanding of how

portfolios can be tailored to suit specific needs and goals. Only then are you truly in control of your investments.

Investments held in Emerging Markets tend to be volatile and the fund prices can move sharply up or down. They are also usually considered to carry a greater degree of risk relating to dealing, settlement and custody practices than investment in established markets.

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This leaflet is designed to give a basic understanding of building an investment portfolio. It is not designed as investment advice. The value of shares may fall as well as rise. Past performance is not a guide to future performance.

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