



Australian Financial Services Number: 322212
Lifetime Financial Pty Ltd ABN 33 119 161 438
Level 1, 32 Logan Rd, Woolloongabba, Brisbane, 4102
Ph: (07) 3891 6218 Fx: (07) 3891 5255
email: admin@life.com.au web: www.life.com.au

Investment Risk Profiling

How does an adviser determine the most appropriate investment portfolio for each client?

What are the best set of charts to show so you so you can understand market volatility and questions to ask to arrive at your most appropriate profile?

Research conducted in 2006 by the School of Finance and Economics, University of Technology, Sydney, into how the financial planning industry address's investment risk profiling showed that the financial planning industry only agreed with 4 out of 10 factors highlighted as relevant by academic studies. They were:

- Household size (number of dependants)
- Financial knowledge
- Entrepreneurship
- Independent thinking

Other factors highlighted as relevant by academic studies include:

- Gender
- Age
- Marital status
- Home ownership
- Wealth and income
- Occupation
- Level of Education

In our risk profiling process we have expanded our questionnaire to further address some factors proven to be important by academic studies, plus the agreed factors that all found to be important.

Ideally all investors would like to enjoy the highest return but the lowest risk, however we should all be aware enough to realise that we need to trade some increased risk or volatility for increased longer term returns. The best way to understand this is to look at some historic evidence so that you can be informed and therefore more likely to understand the meaning of the questions that you may be asked.

The aim is not to lead you into accepting a higher or lesser potential growth position, but to help you understand investment market volatility so you can determine the most appropriate profile given your personality.

The following table highlights the performance of the various asset classes from June 30, 1990 to June 30, 2008.

The returns shown below are from the indices we consider to be in the most representative of the particular class of investment. **These figures represent past returns only and may not be relied upon as an accurate indicator of future returns.** Returns are total therefore include both income paid and capital price movement.

Yearly to end June	Cash	Fixed Interest	Shares		Property	CPI
	90 day bank bills	10 year bonds	ASX Accum Index	International MSCI	ASX Index	Bureau of Stats
	%	%	%	%	%	%
1991	13.51	22.36	5.90	-1.71	7.70	3.40
1992	9.00	22.05	13.30	7.53	14.70	1.20
1993	5.91	13.93	9.90	32.59	17.10	1.90
1994	4.93	-1.13	18.50	0.70	9.80	1.70
1995	7.10	11.88	5.70	14.64	7.90	4.50
1996	7.75	9.45	15.80	7.17	3.60	3.10
1997	6.77	16.76	26.60	29.02	28.50	0.30
1998	5.11	10.88	1.60	42.10	10.00	0.03
1999	5.04	3.28	15.34	8.60	4.31	1.10
2000	5.58	6.17	13.70	24.06	12.05	2.40
2001	6.08	7.42	8.85	-5.63	14.51	6.00
2002	4.70	6.20	-4.50	-23.90	15.20	2.80
2003	4.97	9.78	-1.61	-18.15	12.15	2.70
2004	5.30	2.33	21.73	19.90	17.24	2.50
2005	5.56	7.79	26.03	0.53	18.10	2.50
2006	5.85	3.41	24.02	20.44	18.05	4.00
2007	6.42	3.99	29.21	8.27	25.87	2.10
2008	7.30	4.40	-13.70	-21.00	-36.30	4.50
Average return (% pa)	6.49	8.94	12.02	8.06	11.14	2.60
Std Deviation	2.09	6.52	11.72	18.38	13.52	1.52
Highest Return	13.51	22.36	29.21	42.10	28.50	0.03
Lowest return	4.70	-1.13	-13.70	-23.80	3.60	4.50
Average Real Return / Inflation	3.90	6.35	9.42	5.47	8.54	0.00
Rank	5	3	1	4	2	

Source: ABS/Lonsec/Morningstar/RBA/Commsec

Now let's view the outcome of investing \$10,000 over the same period into each of the above asset sectors.

Yearly to end June	Cash	Fixed Interest	Aust Shares	Int.Shares	Property	CPI
	90 day bank bills	10 year bonds	ASX Accum Index	International MSCI	ASX Index	Bureau of Stats
	\$	\$	\$	\$	\$	\$
	Cash	Fixed Interest	Aust Shares	Int.Shares	Property	CPI
1990	10,000	10,000	10,000	10,000	10,000	10,000
1991	11,351	12,236	10,590	9,829	10,770	10,340
1992	12,373	14,934	11,998	10,569	12,353	10,464
1993	13,104	17,014	13,186	14,014	14,466	10,663
1994	13,750	16,822	15,626	14,112	15,883	10,844
1995	14,726	18,821	16,516	16,178	17,138	11,332
1996	15,867	20,599	19,126	17,338	17,755	11,683
1997	16,942	24,052	24,214	22,369	22,815	11,719
1998	17,807	26,668	24,601	31,786	25,097	11,722
1999	18,705	27,543	28,375	34,520	26,178	11,851
2000	19,748	29,242	32,262	42,825	29,333	12,135
2001	20,949	31,412	35,117	40,414	33,589	12,864
2002	21,934	33,360	33,537	30,755	38,694	13,224
2003	23,024	36,622	32,997	25,173	43,396	13,581
2004	24,244	37,476	40,167	30,183	50,877	13,920
2005	25,592	40,395	50,623	30,343	60,086	14,268
2006	27,089	41,772	62,783	36,545	70,932	14,839
2007	28,828	43,439	81,121	39,567	89,282	15,151
2008	30,933	45,351	70,008	31,258	56,872	15,832
Rank	5	3	1	4	2	

As expected the least volatile sector (lowest risk) was the short term cash deposit sector. Prior to any tax liability it outperformed the CPI rate (cost of living increase) but fell well short of the end result from all other sectors. Next up was the International Share accumulation index that fell from a clear leader at the end of 2000 to be just ahead of cash. It was the most volatile of all markets over this period as measure by standard deviation. Next up was long term bonds that benefited from a falling interest rate period throughout the 1990's; however followed by consistently low long term rates. Next up was Property that was ahead till end of 2007. Property securities were adversely affected by the 2007/8 credit crunch and overvaluations that caused investors to dump shares in property trusts. Australian Shares finished ahead, (despite the credit crunch, declining commodity prices and economic slowdown worldwide in 2008) due to good economic fundamentals in Australia and a well capitalised banking sector.

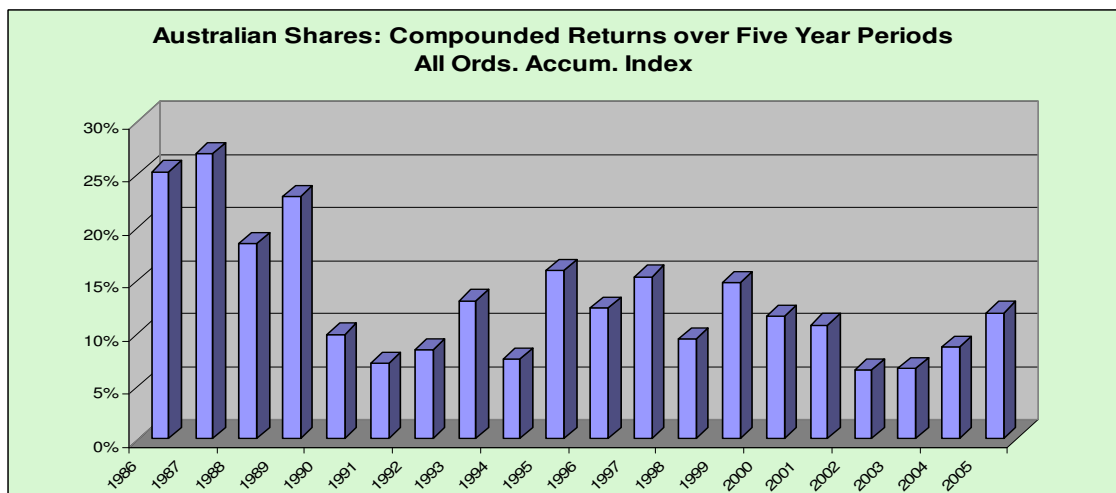
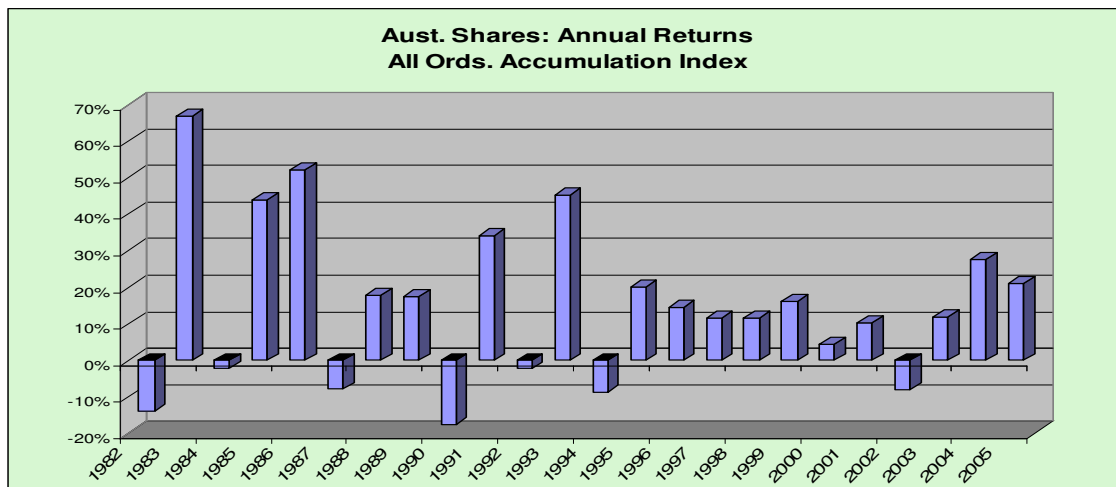
Sound fundamentals need to exist in any financial market. Each market competes for your investment dollar and must provide a return that is relatively attractive, compared to the other markets. Some markets, like property and industrial shares, show greater price gain when interest rates are falling as the rent and dividend income becomes more attractive against fixed interest investments. All markets but short term cash suffer when interest rates rise as the competition bar has risen. Interest rates are most likely to be driven by inflation outlook so that is why such an interest is taken in the CPI rate and the reserve bank meetings following that determine the cash rate in response.

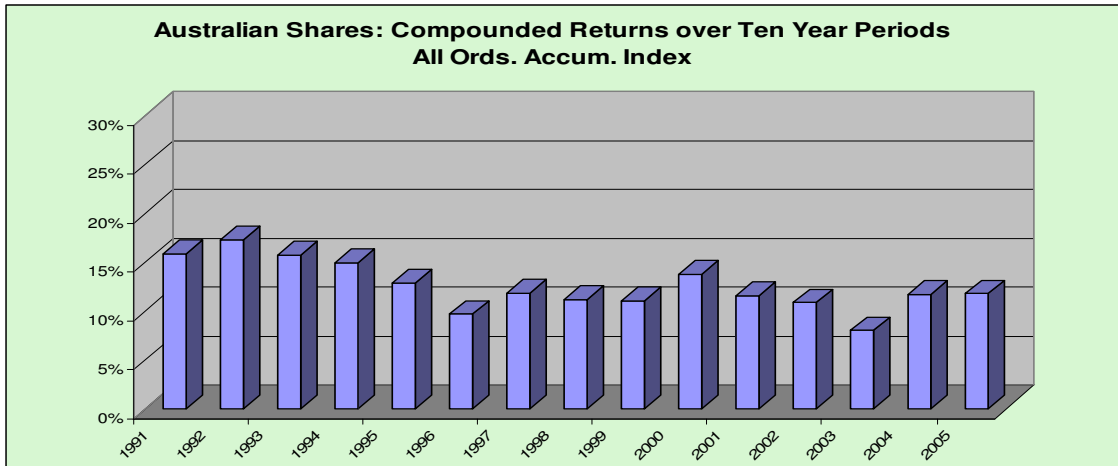
This leads us to the conclusion that spreading across sectors reduces risk and value volatility; but a tactical approach from time to time after considering market fundamentals can add long term value. It may also reduce downside investment risk.

The main aim of investor risk profiling is to determine the strategic position of your investments whilst you are in the investment market. (ie. the portion of the portfolio to be invested in the least volatile sectors (typically cash & fixed interest) and the more volatile growth sectors such as shares and property.)

We can all see over the last 18 years that investing across the Australian stock exchange resulted in the highest value accumulated, however that was achieved in close to ideal conditions, low inflation, low interest rates, improved workplace efficiency, competitive currency and strong world demand in the later years. What will the next 10 years bring?

One way to display return volatility in the short term versus the medium term and the longer term is to view the annual returns delivered from the Australian share market (All Ordinaries accumulation index), then the five year average compound result and then a 10 year rolling return result.





As you can see the volatility is remarkably reduced when viewed by average return over rolling 5 year terms and even further over rolling 10 year terms. Sure the return is variable however no incidence of negative 5 or 10 year results.

Understanding Investment Risk versus Volatility

There is a distinct difference between investment risk and investment volatility. Not all people react similar to risk. Some see danger and caution and others see opportunity and thrill. To risk ones money may see it die completely, gone forever; or it may participate in exceptional value growth. On the other hand there is volatility. Volatility is measured by standard deviation; the magnitude of fluctuation from a constant performance. It is possible for a low volatile investment to be risky and for a higher volatile investment to be less risky. Confused: read on please.

For example some specialist investments involve very high risk. Recent history has proven that investment in farming ventures (timber, ostrich etc) and mortgage funds (Westpoint, MFS etc) were risky, because many investors lost part or all their capital. This is called investment risk. If you make a loan to one individual and that person does not repay you, then you stand to lose all the capital. This is called credit risk. Some people think they are investing in low risk deposits due to some guarantee offered by a company but find out later the guarantee is only as good as the financial backing of the company offering it.

The more established public trading markets, such as the Australian Stock Exchange (ASX), are not likely to disappear, however individual listed companies may. Therefore if you invest across a wide range of companies, share trust or index fund managed by an experienced institution you are not likely to lose all your money unless the entire public market is valueless. However the investment valuation over certain periods may be highly volatile.

Most people that I have met would prefer to have an investment portfolio that had no risk, and if possible no downside volatility. On the other hand the low rate of return from this type of investment (or non investment) leads people to accept some volatility in order to increase the real value of their investment over time. Volatility on growth investments generally decreases when measured over longer periods of time as seen in the previous charts.

The fundamental law of investment states that, over the long term, shares will outperform property and property will outperform bonds and bonds will outperform short-term cash. Over the longer term, the "safe" investments, such as savings accounts, provide the lowest rate of return. While there will be some periods, even perhaps years, where this law does not seem to work, in the long term there is abundant evidence that it does.

Despite having all this knowledge behavioural research indicates that a negative return in the short term has three times the impact of a similar positive return. If you invest in the growth sectors or shares markets and property it is very important that you are prepared for the inevitable downturns that will occur in the investment markets. By knowing they will happen, and understanding that they are not permanent, you can better manage your anxiety at those times.

RISK PROFILE QUESTIONNAIRE

Client Name: _____ DATE: / /20_____

1) When you think of the word “Risk” which of the following comes to your mind first:

- (a) Danger – stay away!
- (b) Uncertainty – Caution!
- (c) Indifferent reaction – does not worry me
- (d) Opportunity!
- (e) Thrilling!

2) Keeping in mind your goals and total lifespan, over how many years would you expect your investment strategy to span?

- (a) Less than a year
- (b) 1 to 3 years
- (c) 4 to 7 years
- (d) 7 to 10 years
- (e) more than 10 years
- (f) Remaining lifespan – (Life expectancy factor years)

3) Cost of living increase has eroded the purchasing power of money over time? For example in Dec 1985 the national CPI factor was 72.7 and by Dec 2005 the factor grew to 150.6. This means that the cost of the CPI basket of goods rose by 107% over the last 20 years, equal to 3.7% per annum compound increase.

How important to you is it that your savings and investment values stay ahead of the rate of inflation?

- (a) Increases in cost of living are not a concern to me
- (b) Neutral, not sure
- (c) Concerned
- (d) Quite concerned
- (e) Very concerned

4) How driven are you by tax efficiency?

- (a) I do not or will not pay tax so this is not an issue
- (b) Some tax efficiency is appreciated
- (c) I am seeking to not pay additional tax
- (d) I want to be very tax efficient and legally reduce my taxable income through my investment strategy
- (e) My main aim is to achieve tax savings and/or tax advantaged income

5) Debt Powered Investment Strategies.

Investing borrowed funds means that you may make a profit or loss from money sourced from a loan however you will eventually be expected to repay the loan, regardless of what your investment is worth.

How familiar are you with investment gearing (using borrowed money to invest)

- (a) Is not part of my strategy (eg superannuation or post retirement strategy)
- (b) Never heard of it
- (c) Would like to learn more about the opportunity and risks
- (d) Have done it previously and are happy to do again
- (e) Very familiar and in favour of further geared investments
- (f) I never want to borrow any funds to invest.

6) How familiar are you with investment markets?

- (a) Very little understanding nor am I interested
- (b) Not familiar but I would like to learn some basic fundamentals
- (c) I am aware that some markets have the ability to rise and fall and that income levels are not guaranteed
- (d) I am an experienced investor and understand the factors which influence performance and create price and income fluctuations.

7) The level of formal education and occupation has some bearing on risk tolerance according to academic research. What is your formal education level?

- (a) Never finished high school
- (b) Completed high school certificate grade 10
- (c) Completed high school certificate grade 12
- (d) Have a tertiary trade qualification
- (e) Have a tertiary diploma qualification
- (f) Completed a degree at University
- (g) Completed a Masters or PHD

8) Hypothetically, if your investment portfolio declined by 20% (1/5th) over the next year, how would you react?

- (a) I invest for the long-term and I accept fluctuations are part of the process, including falls in value due to short-term market influences. I would retain my long-term focus.
- (b) I am willing to accept falls in my investment value over shorter terms in order to increase the chance of longer term returns.
- (c) I would retain my long-term focus but would be concerned with this decline. I would probably check my balance more often to track the progress and seek comfort and direction advice from my adviser.
- (d) It would upset me, but I may not withdraw funds. I may reconsider portfolio re-allocation once the value recovered, as I may not be suited to the unavoidable ups and downs of growth assets.
- (e) I can't accept any declines in the value of my investments of this level. I would be upset and would want to withdraw my investment immediately.
- (f) I would look to take legal action against my adviser, as I would have never given any impression that this would be acceptable.

9) Keeping in mind that investments with higher long term returns have short term risks and investments that are protected from negative returns generally give poor long term results, which of the following reflects your personality?

- (a) Any return as long as my investments are adequately protected.
- (b) The rate of inflation to maintain the real value of my investment over the medium to long term.
- (c) The rate of inflation plus a moderate margin over the medium to long term.
- (d) The rate of inflation plus a fair margin for genuine longer-term real value growth.
- (e) I want to make a serious long-term profit and I understand there will be volatility and I appreciate that there is no implied guarantee.

10) Which of the following statements best describe your attitude towards investing:

- (a) I would select investments that have a low degree of risk associated with them. (generally referred to as "Secure")
- (b) I prefer to diversify with a mix of investments, which have an emphasis on low risk. I am happy to have a small portion of the portfolio invested in assets, which have a higher degree of risk in order to achieve a slightly higher return. I would expect and accept a negative investment return is probable 1 in every 9 years. (generally referred to as "Capital Stable")
- (c) I prefer to have a spread of investments in a more balanced portfolio. I would expect and accept a negative return is probable 1 in every 7 years. (generally referred to as "Balanced")
- (d) I prefer to diversify my investments with an emphasis on more investments that may deliver higher long-term returns, but still having some low risk investments. I would expect and accept a negative return is probable 1 in every 5 years. (generally referred to as "Balanced Growth")
- (e) I would only select investments that have a higher degree of investment price fluctuation with historical evidence of higher long-term returns. I would expect and accept that market influences may result in a downturn at any stage of a reasonable magnitude. (generally referred to as "High Growth")

Risk Profile Result For

Date _____

Risk Profile Points			Risk Profile Points		
Question 1	a)	1	Question 2	a)	0
	b)	2		b)	1
	c)	3		c)	2
	d)	4		d)	4
	e)	5		e)	5
				f)	5
Question 3	a)	1	Question 4	a)	1
	b)	2		b)	2
	c)	3		c)	3
	d)	4		d)	4
	e)	5		e)	5
Question 5	a)	3	Question 6	a)	0
	b)	1		b)	2
	c)	2		c)	3
	d)	3		d)	5
	e)	4			
	f)	0			
Question 7	a)	1	Question 8	a)	6
	b)	2		b)	5
	c)	3		c)	4
	d)	4		d)	3
	e)	5		e)	2
	f)	6		f)	1
	g)	7		g) minus	(10)
Question 9	a)	1	Question 10	a)	2
	b)	2		b)	4
	c)	3		c)	6
	d)	4		d)	8
	e)	5		e)	10

TOTAL SCORE

RESULTS

Secure Deposits Only (Score -4 to 7)

You do not wish to accept any investment value downturns at any time. You require a very low risk portfolio. Low returns are acceptable to ensure capital is protected. Negative effects of tax and inflation are not a big issue, as long as capital is preserved.

Investments will typically be in “cash deposit” funds, “term deposits” and “Capital Guaranteed” managed accounts from large banking and major life insurance institutions.

Conservative (Score 8 to 20)

You would prefer quite low volatility with a large portion (app 75%) of investment in low risk defensive investments such as capital guaranteed, long term fixed interest bonds, term deposits and cash deposit funds. Remaining portion (app 25%) in growth investments such as property and share managed funds. You are seeking better than basic returns but risk must still be fairly low. You are an investor wanting to preserve capital.

Investments will typically be in “capital stable” funds or specific sector funds to arrive at a similar asset allocation.

Cautious (Score 21 to 25)

You are a judicious investor with some understanding of market behaviour. You do not wish to see all of your capital eaten away by tax and inflation and are prepared to take a lower short term risk in order to gain some longer term capital growth. The most appropriate investment strategy would be 60% defensive investments and 40% growth investments.

Investments will typically be in a combination of “capital stable” and “balanced” funds or specific sector funds to arrive at a similar asset allocation.

Balanced (Score 26 to 38)

You suit a balanced portfolio. A balanced portfolio typically holds app 60% in growth assets such as Australian and international shares and property and app 40% in defensive assets such as bonds, term deposits and some shorter-term cash deposits. You are looking for a balance between volatility and return and accept that a wide diversification will achieve this for you. Your investment strategy must cope with inflation and may be tax efficient to some degree. Your portfolio will include some international investments.

Investments will typically be in “balanced” funds or specific sector funds to arrive at a similar asset allocation.

Growth (Score 39 to 50)

You are prepared to accept growth asset market volatility and the risks that come with investing across a wide range of growth assets such as Australian and international shares and property. You understand and accept these market risks.

Your investment portfolio will be allocated app 85% to growth assets and app 15% to defensive assets. Typically you invest in “growth” funds or specific sector funds to arrive at a similar asset allocation. An assertive investor may gear (invest borrowed money) a portion of the overall portfolio.

High Growth (Score 51 and over)

You are prepared to risk your capital in order to achieve higher returns. Prefer high risk, high return assets. You may invest heavily in a particular sector or economy that you believe may outperform the wider market. You may also invest in individual stocks that you have researched.

Investments will typically be in “equity” or “specialist” funds. A typical aggressive investor will increase exposure by gearing (investing borrowed money) into assets.

Signed: / /

Print Name:..... **Version 032009**